



## Henry Mayo Newhall Hospital

Financial Statements  
Years Ended September 30, 2017 and 2016

# **Henry Mayo Newhall Hospital**

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**Financial Statements**  
Years Ended September 30, 2017 and 2016

# Henry Mayo Newhall Hospital

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## Independent Auditor's Report

Board of Directors  
Henry Mayo Newhall Hospital  
Valencia, California

We have audited the accompanying financial statements of Henry Mayo Newhall Hospital, which comprise the statements of financial position as of September 30, 2017 and 2016, and the related statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

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

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

### *Auditor's Responsibility*

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

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

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

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Henry Mayo Newhall Hospital as of September 30, 2017 and 2016, and the results of its operations and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

BDO USA, LLP

December 22, 2017

## Financial Statements

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# Henry Mayo Newhall Hospital

## Statements of Financial Position

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<i>September 30,</i>	<b>2017</b>	<b>2016</b>
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 34,087,066	\$ 42,152,465
Investments	98,949,891	73,750,620
Assets limited as to use	46,511,785	2,198,635
Patient accounts receivable, less bad debt allowances of \$10,773,489 and \$11,251,548, respectively	53,335,450	51,873,513
Receivable from affiliate	8,609,705	5,558,262
Inventories	5,944,383	5,968,258
Prepaid expenses and other current assets	3,219,582	3,337,259
Quality assurance fee receivable	2,550,480	3,784,421
California Hospital Foundation grant receivable	-	1,509,872
Total current assets	253,208,342	190,133,305
Property, plant and equipment, net	229,632,334	189,702,815
Pledged lease	2,387,587	2,429,433
Other assets	1,936,535	1,621,947
Total assets	<u>\$ 487,164,798</u>	<u>\$ 383,887,500</u>

**Henry Mayo Newhall Hospital**  
**Statements of Financial Position (Continued)**

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<i>September 30,</i>	<b>2017</b>	<b>2016</b>
<b>Liabilities and Net Assets</b>		
<b>Current liabilities</b>		
Accounts payable and accrued expenses	\$ 39,262,427	\$ 31,438,040
Accrued payroll and benefits	17,709,746	17,788,876
Accrued interest	5,477,962	3,369,869
Current portion of long-term debt	4,900,000	4,715,000
Current portion of obligations under capitalized leases	1,789,766	1,567,089
Quality assurance fee payable	-	4,612,636
Quality assurance fee deferred revenue	<u>1,323,700</u>	<u>-</u>
Total current liabilities	<u>70,463,601</u>	<u>63,491,510</u>
<b>Long-term debt, less current portion, net of debt issuance costs</b>	<b>225,219,412</b>	<b>143,288,753</b>
Obligations under capitalized leases, less current portion	3,150,526	4,940,292
Deferred rent liability	947,169	703,719
Deferred contribution revenue	2,387,587	2,429,433
Accrued malpractice liability	<u>4,668,156</u>	<u>3,420,992</u>
Total liabilities	<u>306,836,451</u>	<u>218,274,699</u>
<b>Net assets</b>		
Temporarily restricted	8,659,000	5,539,677
Unrestricted	<u>171,669,347</u>	<u>160,073,124</u>
Total net assets	<u>180,328,347</u>	<u>165,612,801</u>
Total liabilities and net assets	<u>\$ 487,164,798</u>	<u>\$ 383,887,500</u>

*See accompanying notes to financial statements.*

# Henry Mayo Newhall Hospital

## Statements of Operations

Years ended September 30,	2017	2016
<b>Operating revenues</b>		
Patient service revenue, net of contractual discounts and allowances	\$ 323,742,549	\$ 321,808,237
Provision for bad debts	<u>(9,093,471)</u>	<u>(9,790,521)</u>
Net patient service revenue less provision for bad debts	314,649,078	312,017,716
Nonpatient revenue	5,164,546	3,680,360
California Hospital Foundation grant revenue	-	5,538,731
Net assets released from restrictions used for operations	<u>213,931</u>	<u>353,601</u>
Total operating revenues	<u>320,027,555</u>	<u>321,590,408</u>
<b>Operating expenses</b>		
Salaries and wages	120,869,015	112,192,528
Employee benefits	35,279,397	36,343,863
Registry	12,024,787	9,638,418
Supplies	48,212,794	46,609,930
Purchased services	32,776,845	30,129,558
Repairs and maintenance	6,441,805	5,914,673
Interest	5,726,131	6,207,105
Depreciation and amortization	15,051,115	14,519,150
Insurance, net	3,604,347	1,807,870
Facility costs	8,317,124	7,857,026
Quality assurance fee hospital tax	15,047,062	17,869,417
Other operating costs	<u>15,616,204</u>	<u>15,776,555</u>
Total operating expenses	<u>318,966,626</u>	<u>304,866,093</u>
<b>Operating income</b>	1,060,929	16,724,315
<b>Non-operating income (loss)</b>		
Contributions	41,865	7,727
Interest income	2,138,161	1,003,118
Other non-operating income, net	316,060	1,758,141
Equity in income of Joint Venture	732,681	753,463
Loss on bond defeasance	<u>(1,359,163)</u>	<u>-</u>
Excess of revenues over expenses	2,930,533	20,246,764
Unrealized gain on investments, net	8,100,391	4,729,416
Contributions to the Foundation	(800,400)	(784,272)
Net assets released from restrictions used for purchases of property, plant and equipment	<u>1,365,699</u>	<u>2,533,281</u>
Net increase in unrestricted net assets	<u>\$ 11,596,223</u>	<u>\$ 26,725,189</u>

*See accompanying notes to financial statements.*

**Henry Mayo Newhall Hospital**  
**Statements of Changes in Net Assets**

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<i>Years ended September 30,</i>	<b>2017</b>	<b>2016</b>
<b>Unrestricted net assets</b>		
Excess of revenues over expenses	\$ 2,930,533	\$ 20,246,764
Unrealized gain on investments, net	8,100,391	4,729,416
Contributions to the Foundation	(800,400)	(784,272)
Net assets released from restrictions used for purchases of property, plant and equipment	<u>1,365,699</u>	<u>2,533,281</u>
Net increase in unrestricted net assets	<u>11,596,223</u>	<u>26,725,189</u>
<b>Temporarily restricted net assets</b>		
Contributions	4,698,953	5,293,192
Net assets released from restrictions	<u>(1,579,630)</u>	<u>(2,886,882)</u>
Net increase in temporarily restricted net assets	<u>3,119,323</u>	<u>2,406,310</u>
Increase in net assets	14,715,546	29,131,499
Net assets, beginning of year	<u>165,612,801</u>	<u>136,481,302</u>
Net assets, end of year	<u>\$ 180,328,347</u>	<u>\$ 165,612,801</u>

# Henry Mayo Newhall Hospital

## Statements of Cash Flows

Years ended September 30,	2017	2016
<b>Cash flows from operating activities</b>		
Increase in net assets	\$ 14,715,546	\$ 29,131,499
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	15,051,115	14,519,150
Provision for bad debts	9,093,471	9,790,521
Amortization of deferred financing costs and bond premiums, net	409,367	188,178
Capitalization of financing interest	(4,642,251)	(1,587,398)
Capitalization of labor costs for internal use software	(302,026)	(1,313,277)
Equity in income of Joint Venture	(732,681)	(753,463)
Unrealized gain on investments, net	(8,100,391)	(4,729,416)
Changes in assets and liabilities:		
Patient accounts receivable	(10,555,408)	(13,619,119)
Receivable from affiliate	(3,051,443)	(2,615,835)
Inventories	23,875	(797,152)
Prepaid expenses and other current assets	117,677	1,307,531
Quality assurance fee receivable	1,233,941	(1,004,727)
California Hospital Foundation grant receivable	1,509,872	339,799
Other assets	(71,906)	192,297
Accounts payable and accrued expenses	7,824,387	8,022,722
Accrued payroll and benefits	(79,130)	(1,710,840)
Accrued interest	2,108,093	(85,691)
Deferred rent	243,450	703,719
Quality assurance fee payable	(4,612,636)	472,203
Quality assurance fee deferred revenue	1,323,700	(1,453,462)
Accrued malpractice liability	1,247,164	27,652
	<b>22,753,786</b>	<b>35,024,891</b>
<b>Net cash and cash equivalents provided by operating activities</b>		
<b>Cash flows from investing activities</b>		
Acquisition of property, plant and equipment	(50,036,357)	(48,477,111)
Proceeds from sale of short-term investments	-	68,950,620
Purchases of short-term investments	(17,098,880)	(68,950,899)
Decrease in assets limited as to use	-	6,526,470
Increase in assets limited as to use	(44,313,150)	-
Distribution from Joint Venture	490,000	814,000
	<b>(110,958,387)</b>	<b>(41,136,920)</b>
<b>Net cash and cash equivalents used in investing activities</b>		

**Henry Mayo Newhall Hospital**  
**Statements of Cash Flows (Continued)**

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<i>Years ended September 30,</i>	<b>2017</b>	<b>2016</b>
<b>Cash flows from financing activities</b>		
Proceeds from bond issuance, net of issuance cost	\$ 113,621,292	\$ -
Payments on long-term debt	(31,915,000)	(4,540,000)
Payments on capital lease obligations	<u>(1,567,090)</u>	<u>(1,367,013)</u>
Net cash and cash equivalents provided by (used in) financing activities	<u>80,139,202</u>	<u>(5,907,013)</u>
<b>Net decrease in cash and cash equivalents</b>	<b>(8,065,399)</b>	<b>(12,019,042)</b>
Cash and cash equivalents, beginning of year	<u>42,152,465</u>	<u>54,171,507</u>
Cash and cash equivalents, end of year	<u>\$ 34,087,066</u>	<u>\$ 42,152,465</u>
<b>Supplemental disclosure of cash flow information</b>		
Cash paid for interest during the year	<u>\$ 7,850,922</u>	<u>\$ 7,692,016</u>

*See accompanying notes to financial statements.*

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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### 1. Organization

Henry Mayo Newhall Hospital (the “Company” or “Hospital”) is a California not-for-profit public service benefit acute care hospital providing patient services to individuals in Santa Clarita, California and the surrounding communities.

The Hospital is affiliated with Santa Clarita Health Care Association, Inc. and its affiliates through common management. Santa Clarita Health Care Association and one of its subsidiaries, Santa Clarita Health Care Management Group, Inc., had no activity during the years ended September 30, 2017 and 2016. In addition, the Hospital is also affiliated with Henry Mayo Newhall Health Foundation (the “Foundation”). The Foundation shares some members of management with the Hospital, however, the Hospital has no control over the Foundation. The Hospital has an ongoing economic interest in the Foundation.

### 2. Summary of Significant Accounting Policies

#### *Basis of Presentation*

The Company prepares its financial statements in accordance with the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 954, *Health Care Entities*. The Company’s accounting policies used in the preparation of the accompanying financial statements are in conformity with accounting principles generally accepted in the United States of America and have been consistently applied.

#### *Management’s Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The significant estimates made in the preparation of the Company’s financial statements relate to the assessment of the carrying value of patient accounts receivable including contractual and bad debt allowances, accruals for malpractice liability and other similar risks, amounts payable or receivable under self-insured health insurance plans and amounts payable or receivable from the government. While management believes that these estimates are reasonable, actual results could be materially different from those estimates.

#### *Cash and Cash Equivalents*

Cash and cash equivalents include certain highly liquid investments with original maturities of three months or less when purchased, that are not held as collateral.

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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### ***Investments***

Investments are accounted for in accordance with FASB ASC 954-320, *Healthcare Entities – Investments – Debt and Equity Securities*. Under FASB ASC 954-320, equity securities with readily determinable fair values and all investments in debt securities designated as trading are reported at fair value with realized and unrealized gains and losses included in other non-operating income (loss) in the accompanying statements of operations.

Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts in the statements of financial position.

### ***Patient Accounts Receivable***

Patient accounts receivable are stated at the amounts billed to patients or third-party payors and others, less contractual allowances. The carrying amount of patient accounts receivable is also reduced by bad debt allowances that reflect management's best estimate of the amounts that will not be collected. Bad debt allowances are based on management's review of the historical collection experience of all balances.

The Company provides for an allowance against patient accounts receivable for an amount that could become uncollectible, whereby such receivables are reduced to their estimated net realizable value. The Company estimates this allowance based on the aging of their accounts receivable, historical collection experience from the payors, and other relevant factors. There are various factors that can impact the collection trends, such as changes in the economy, which in turn have an impact on unemployment rates and the number of uninsured and underinsured patients, volume of patients through the emergency department, the increased burden of co-payments to be made by patients with insurance and business practices related to collection efforts. These factors continuously change and can have an impact on collection trends and the Company's estimation process. These impacts may be material.

The Company's policy is to attempt to collect amounts due from patients, including co-payments and deductibles due from patients with insurance, at the time of service while complying with all federal and state laws and regulations, including, but not limited to, the Emergency Medical Treatment and Labor Act ("EMTALA").

Certain classes of patient accounts receivable are charged off against allowances after a designated period of collection efforts. Subsequent cash recoveries are recognized as income in the period when they occur.

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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The Company provides outpatient and emergency trauma services (“AB99”) for Medi-Cal and other beneficiaries. The Hospital has been designated as a Private Trauma Hospital, as defined by the Centers for Medicare and Medicaid Services (“CMS”), in the County of Los Angeles, and receives supplemental reimbursements for such trauma services that it provides during its fiscal year. Based on agreements entered into and related reimbursements received to date, the Company determined that no reserves were necessary for its receivables relating to the California AB99 payor category as of September 30, 2017 and 2016. There are various factors that can impact the supplemental reimbursements and the changes in these factors can have a material impact on future collection of these amounts. At September 30, 2017 and 2016, the Hospital recorded AB99 receivable balances of approximately \$1,686,000 and \$2,241,000, respectively.

### *Inventories*

Inventories consist primarily of pharmaceuticals and medical supplies and are stated at the lower of cost, which is determined using the weighted-average method, or market.

### *Assets Limited as to Use*

Assets limited as to use include assets set aside by trustees under indenture agreements. These investments, consisting primarily of cash, money market accounts, and debt securities, are stated at fair value. Assets limited as to use are classified according to their underlying obligation.

### *Property, Plant and Equipment*

Property, plant and equipment are stated at cost less depreciation and amortization. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements. The estimated useful lives of the related assets are as follows:

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	Years
Building and improvements	10 to 40
Equipment and furniture	<u>2 to 15</u>

Maintenance, repairs and investments in minor equipment are charged to operations. Expenditures which materially increase the value of properties or extend the useful lives are capitalized.

In accordance with ASC 835-20, *Capitalization of Interest - Qualifying Assets*, the Hospital capitalizes interest costs on assets that meet the criteria described in that accounting literature.

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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In accordance with ASC 350-40, *Internal-Use Software*, the Hospital capitalizes certain external direct costs of materials and services consumed in developing or obtaining internal-use computer software. Additionally, the Hospital capitalizes certain payroll costs for employees who are directly associated with and who devote time to the internal-use computer software project, to the extent of the time spent directly on the project during the application development stage.

### ***Deferred Financing Costs***

In connection with the issuance of the 2013 Bond Series A, B, C, 2014 Bonds and 2017 Bonds (see Note 6), the Company capitalized \$5,168,095 of issuance costs, which are being amortized over the term of the bonds using the effective interest method. Amortization expenses of approximately \$223,000 and \$227,000 were recorded for the years ended September 30, 2017 and 2016, respectively, and are included in interest expense in the accompanying statements of operations.

Deferred financing costs, net totaled \$4,116,835 and \$3,159,116 as of September 30, 2017 and 2016, respectively.

### ***Fair Value Measurements***

FASB ASC 820, *Fair Value Measurements and Disclosures* ("ASC 820"), provides a framework for measuring fair value and requires enhanced disclosures about fair value measurements. These guidelines clarify that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

ASC 820 requires disclosure about how fair value is determined for assets and liabilities and establishes a hierarchy for which these assets and liabilities must be grouped, based on significant levels of inputs as follows: Level 1 quoted prices in active markets for identical assets or liabilities; Level 2 quoted prices in active markets for similar assets and liabilities and inputs that are observable for the asset or liability; or Level 3 unobservable inputs for the asset or liability, such as discounted cash flow models or valuations. The determination of where assets and liabilities fall within this hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The Company's Level 1 assets as of September 30, 2017 and 2016 include part of the Company's cash equivalents, investments which consist of fixed income mutual funds and equity mutual funds, and assets limited as to use which consists of cash and debt securities. The Company's Level 2 assets as of September 30, 2017 consists of money market funds and debt securities.

The Company does not have any Level 3 assets as of September 30, 2017 or 2016.

### ***Fixed Income Mutual Funds***

The fixed income mutual funds are registered with the Securities and Exchange Commission as mutual funds under the Investment Company Act of 1940 and are valued based on quoted prices from the applicable exchange, and to the extent valuation adjustments are not applied to these securities, are categorized as Level 1.

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

### *Equity Mutual Funds (Domestic and International)*

The equity mutual funds are registered with the Securities and Exchange Commission as mutual funds under the Investment Company Act of 1940 and are valued based on quoted prices from the applicable exchange, and to the extent valuation adjustments are not applied to these securities, are categorized as Level 1.

The following table presents the financial instruments carried at fair value as of September 30, 2017 (as described above):

	Level 1	Level 2	Level 3	Total
<b>Investments:</b>				
Mutual fund - fixed income	\$ 33,757,168	\$ -	\$ -	\$ 33,757,168
Mutual fund - equity securities	65,192,723	-	-	65,192,723
<b>Assets limited as to use:</b>				
Cash	6,972,358	-	-	6,972,358
Money market funds	-	12,018,109	-	12,018,109
<b>Debt securities:</b>				
US treasuries	8,987,580	-	-	8,987,580
Agency securities	-	13,545,438	-	13,545,438
Corporate bonds	-	4,988,300	-	4,988,300
<b>Total assets at fair value</b>	<b>\$ 114,909,829</b>	<b>\$ 30,551,847</b>	<b>-</b>	<b>\$ 145,461,676</b>

The following table presents the financial instruments carried at fair value as of September 30, 2016 (as described above):

	Level 1	Level 2	Level 3	Total
<b>Investments:</b>				
Mutual fund - fixed income	\$ 25,432,406	\$ -	\$ -	\$ 25,432,406
Mutual fund - equity securities	48,318,214	-	-	48,318,214
<b>Assets limited as to use:</b>				
Cash	2,198,635	-	-	2,198,635
<b>Total assets at fair value</b>	<b>\$ 75,949,255</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 75,949,255</b>

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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### ***Excess of Revenues Over Expenses***

The statements of operations include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction are to be used for the purposes of acquiring such assets).

### ***Temporarily and Permanently Restricted Net Assets***

Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time period or purpose. Permanently restricted net assets are those that must be maintained by the Hospital in perpetuity.

At September 30, 2017 and 2016, the Hospital had \$8,659,000 and \$5,539,000 of temporarily restricted net assets, respectively. The Hospital did not have any permanently restricted net assets at September 30, 2017 and 2016.

### ***California Quality Assurance Fee Program***

The California Quality Assurance Fee Program (the "Program") is comprised of certain laws enacted by the state of California to provide supplemental payments to certain medical facilities that serve a disproportionate share of indigent and low-income patients. The Program and all of its statutory provisions were made permanent through the passage of Proposition 52 in November 2016. The program is administered in three year cycles with the terms of each cycle requiring approval from the California Legislature and CMS. The current program being administered covers the periods from January 1, 2014 through December 31, 2016 (the "Thirty-Six Month Program").

The Program requires a Quality Assurance Fee ("QA Fee") to be paid by certain hospitals to a State fund established to accumulate the assessed QA Fees and receive matching federal funds. QA Fees and corresponding matching federal funds are then paid to participating hospitals in two supplemental payment methodologies: a fee-for-service methodology and a managed care plan methodology. CMS has approved California's State Plan Amendment and Waivers as of December 5, 2014, allowing the State to implement the QA Fee and the fee-for-service Supplement Payment methodology of the legislation for the Thirty-Six Month program. During the year ended September 30, 2017, the managed care plan methodology for the Thirty-six Month Program was approved by CMS through June 30, 2015. The fee for service payment methodology was approved through December 31, 2016.

Based on estimates provided to the Hospital, revenues earned by the Hospital under the program for the three year cycle ended December 31, 2016 are expected to approximate the costs the Hospital pays into the program. Due to the fact that CMS approves portions of the program at different times, the Company's results of operations and cash flows associated with the program are subject to material variability from year to year.

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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Based on formulas contained in the legislation as well as modeling done by the California Hospital Association, the Hospital recognized approximately \$9,304,000 and \$13,630,000 in net patient service revenue and \$15,047,000 and \$17,869,000 in quality assurance fee hospital tax in the accompanying statements of operations for the years ended September 30, 2017 and 2016, respectively. The Hospital recognized approximately \$0 and \$5,539,000 in California Hospital Foundation and Trust (“CHFT”) grant revenue in the statement of operations. As of September 30, 2017 and 2016, respectively the Hospital recognized approximately \$2,550,000 and \$5,294,000 in receivables related to the Program. As of September 30, 2017 and 2016, respectively, quality assurance fees payable of approximately \$0 and \$4,613,000 was accrued in current liabilities, and approximately \$1,324,000 and \$0, respectively, was recognized as quality assurance fee deferred revenue pending full CMS approval of the managed care portion of the current program period.

In March 2017, the California Hospital Association submitted the Quality Assurance Fee Program package covering the periods from January 1, 2017 through December 31, 2019 (“2017-19 Program”) to CMS for approval. The 2017-19 Program was approved by CMS effective December 14, 2017. The Company will recognize revenue for the 2017-19 Program during the year ended September 30, 2018. Management is currently evaluating the impact on the Company’s financial statements and related disclosures.

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

The Hospital recognizes net patient service revenue in the period in which services are performed. The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established charges. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors (including the Medicare and Medi-Cal programs). Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. These retroactive adjustments may be material.

Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), from these major payor sources, are as follows:

<i>Years ended September 30,</i>	<b>2017</b>	<b>2016</b>
Medicare	\$ 96,700,204	\$ 100,447,034
Medi-Cal	32,752,514	25,846,534
HMO/PPO	183,839,440	190,614,450
Self-Pay and others	<u>10,450,391</u>	<u>4,900,219</u>
	<b><u>\$ 323,742,549</u></b>	<b><u>\$ 321,808,237</u></b>

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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### ***Charity Care and Community Benefit (unaudited)***

The Hospital provides care without charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. The Hospital's charity care policy includes criteria such as patients with a prior history of bad debt without payments, patients who have expired, homeless patients, incarcerated patients whose services were provided prior to arrest, and patients with a history of unemployment, or a history of ongoing major illness causing multiple hospitalizations. Other types of exceptions to the above categories require management approval on a specific case by case basis. Net patient service revenue is reflected net of the charity care reserves. The actual costs for charity care in accordance with the Hospital's charity care policy aggregated approximately \$4,663,000 and \$4,027,000 for the years ended September 30, 2017 and 2016, respectively. The Hospital has estimated the cost of charity care based on a ratio of cost to charges of operating expenses.

In furtherance of their charitable purpose, the Hospital provides a wide variety of benefits to the community. A large number of prevention and wellness programs are provided by the Hospital including low cost immunizations, wellness fairs, health screening, health education classes and the donation of space for use by community groups. The amount of community benefit provided by the Hospital during the year ended September 30, 2016 was \$6,060,389. The amount of community benefit provided during the year ended September 30, 2017 has not been determined as of the report date.

### ***Donated Services***

Volunteers perform various services. The services donated are not reflected in the accompanying financial statements as expense and income from donations, as these services do not meet the criteria for recognition.

### ***Interest Expense***

Interest expense, which includes amortization of deferred financing costs, during the years ended September 30, 2017 and 2016 was approximately \$5,726,000 and \$6,207,000, respectively. The Company capitalized approximately \$4,642,000 and \$1,587,000 of interest expense related to assets under construction during the years ended September 30, 2017 and 2016, respectively.

### ***Income Taxes***

The Hospital is a not-for-profit corporation and has been recognized as tax-exempt pursuant to Section 501 (c)(3) of the Internal Revenue Code ("IRC"). Under FASB ASC 740, *Uncertainty in Income Taxes*, interest and penalties, if any, are recorded to interest expense and other operating costs, respectively. There were no interest or penalties recorded for the years ended September 30, 2017 and 2016. The tax years subject to examination by major tax jurisdictions include the years 2013 and forward by the U.S. Internal Revenue Service ("IRS"). For California, the tax years subject to examination include the years 2012 and forward.

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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### ***Impairment of Long-Lived Assets***

The Company periodically reviews the carrying values of its long-lived assets for possible impairment. Whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable, the Company records an adjustment to reduce the related assets to their net realizable value. The Company believes that no material impairment of its long-lived assets exists at September 30, 2017 and 2016, respectively.

### ***Accrual for General and Professional Liability Risks***

The Company records reserves for claims when they are probable and reasonably estimable. The Company maintains reserves, which are based on actuarial estimates by an independent third party, for the portion of their professional liability risks, including incurred but not reported claims. The Company estimates reserves for losses and related expenses using expected loss-reporting patterns. Reserves are not discounted. There can be no assurance that the ultimate liability will not exceed the Company's estimates. Adjustments to the estimated reserves are recorded in the Company's statements of operations in the periods when such amounts are determined. These adjustments may be material.

### ***New Accounting Pronouncements***

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09), as amended by ASU 2015-14. The core principle of ASU 2014-09 is built on the contract between a vendor and a customer for the provision of goods and services, and attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, (v) recognize revenue when (or as) the entity satisfies a performance obligation. Nonpublic entities will apply the new standard for annual periods beginning after December 15, 2018, including interim periods therein. Three basic transition methods are available – full retrospective, retrospective with certain practical expedients, and a modified retrospective approach. Under the third alternative, an entity would apply the new revenue standard only to contracts that are incomplete under legacy U.S. GAAP at the date of initial application (e.g. January 1, 2019) and recognize the cumulative effect of the new standard as an adjustment to the opening balance of retained earnings. That is, prior years would not be restated and additional disclosures would be required to enable users of the financial statements to understand the impact of adopting the new standard in the current year compared to prior years that are presented under legacy U.S. GAAP. Early adoption is permitted for fiscal years beginning after December 15, 2016. The Company is currently evaluating the effect of this guidance on its financial statements.

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements - Going Concern: Disclosures of Uncertainties about an Entity's Ability to Continue as a Going Concern*. This ASU provides guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Specifically, this ASU provides a definition of the term substantial doubt and requires an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). It also requires certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans and requires an express statement and other disclosures when substantial doubt is not alleviated. The new standard will be effective for reporting periods ending after December 15, 2016, with early adoption permitted. The Company's adoption of ASU No. 2014-15 effective October 1, 2016 did not have a material impact on the Company's financial statements or footnote disclosures.

In April 2015, the FASB issued ASU No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. This ASU amends existing guidance to require the presentation of debt issuance cost on the statement of financial position as a deduction from the carrying amount of the related debt, instead of an asset. This ASU is effective for reporting periods beginning after December 15, 2015 and early adoption is permitted. The Company's adoption of ASU No. 2015-03 did not have a material impact on its financial statements and footnote disclosures.

In February 2016, the FASB issued ASU No. 2016-02, *Leases* (ASU 2016-02). The core principle of ASU 2016-02 is that a lessee should recognize the assets and liabilities that arise from leases, including operating leases. Under the new requirements, a lessee will recognize in the statement of financial position a liability to make lease payments (the lease liability) and the right-of-use asset representing the right to the underlying asset for the lease term. For leases with a term of 12 months or less, the lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. The standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application of the amendment is permitted. The Company is currently evaluating the standard and the impact on its financial statements and footnote disclosures.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958) and Health Care Entities (Topic 954) - Presentation of Financial Statements of Not-for-Profit Entities*. This ASU is aimed to improve the presentation of financial statements of not-for-profit entities. ASU No. 2016-14 replaces the current presentation of three classes of net assets (unrestricted, temporarily restricted, and permanently restricted) with two classes of net assets - net assets with donor restrictions and net assets without donor restrictions. In addition, the ASU requires investment return to be presented net of all related external and direct internal expenses and introduces a requirement to present expenses by nature and function, as well as an analysis of these expenses in a single location. ASU No. 2016-14 also requires additional disclosures regarding qualitative information on how a nonprofit entity manages its liquid available resources to meet cash needs for general expenditures within one year of the balance sheet date and quantitative information that communicates the availability of a nonprofit's financial assets to meet cash needs for general expenditures within one year of the balance sheet date. ASU 2016-14 is effective for fiscal years beginning after December 15, 2017. The Company is currently evaluating this standard and the impact on its financial statements and footnote disclosures.

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230)*, which requires the statement of cash flows to explain the change during the period in the total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. This update is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company is currently evaluating the impact of the provisions of ASU No. 2016-18 on the financial statements.

In January 2017, the FASB issued ASU No. 2017-02, *Not-for-Profit Entities-Consolidation (Topic 958)*, to clarify when a not-for-profit entity that is a general partner or a limited partner should consolidate a for profit limited partnership or similar legal entity. This update is effective for fiscal years beginning after December 15, 2016, with early adoption permitted. The Company is currently evaluating the impact of the provisions of ASU No. 2017-02 on its financial statements and footnote disclosures.

### ***Reclassification***

Certain amounts for 2016 have been reclassified to conform to the 2017 financial statement presentation with no impact on the previously reported net assets.

### ***Subsequent Events***

Management has evaluated events that have occurred subsequent to September 30, 2017 through December 22, 2017, the date on which the financial statements were available to be issued.

## **3. Net Patient Service Revenue**

Gross patient service revenue is recorded on the basis of the Company's usual and customary charges. The Company has agreements with third-party payors that provide for payments to the Company at amounts different from its established rates. The difference between charges generated from agreements with third-party payors and the related payment amounts are reflected as contractual discounts as shown below:

<i>Years ended September 30,</i>	<b>2017</b>	<b>2016</b>
Gross patient service revenue	\$ 1,538,094,355	\$ 1,413,844,375
Contractual discounts	<u>(1,214,351,806)</u>	<u>(1,092,036,138)</u>
Net patient service revenue	<u>\$ 323,742,549</u>	<u>\$ 321,808,237</u>

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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A summary of the payment arrangements with major third party payors is as follows:

### ***Medicare***

Inpatient acute services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge (“DRGs”). These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Outpatient services related to Medicare beneficiaries are paid at prospectively determined rates according to Ambulatory Payment Classifications (“APCs”). Other payments, including disproportionate share and Medicare bad debt expense reimbursement, are based on the Hospital’s cost reports, and are estimated using historical trends and current factors. The Hospital is reimbursed at a tentative rate for these other payments, with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The Hospital’s Medicare Cost reports have been audited and final settled by the Medicare fiscal intermediary through 2013. The 2014 through 2016 cost reports have been filed and tentatively settled as of the date of the financial statements. The 2017 cost report has not been filed as of the date of the financial statements. Annual cost reports are generally due five months after the financial year end.

Laws and regulations governing the Medicare program are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term.

### ***HMO/PPO***

The Company also has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations (“HMOs”), and preferred provider organizations (“PPOs”). The basis for payment to the Company under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

### ***Self-Pay and Other***

The Hospital offers managed care-style discounts to most uninsured patients, which enables the Hospital to offer lower rates to those patients who historically have been charged standard gross charges. Under this method, the discount offered to uninsured patients is recognized as a contractual allowance instead of provision for bad debts, which reduces net patient revenues at the time the uninsured patient accounts are recorded. The uninsured patient accounts, net of contractual allowances recorded, are further reduced to their net realizable value through provision for bad debts or as charity care based on historical collection trends and other factors that affect the estimation process. For the years ended September 30, 2017 and 2016, provisions for bad debts were approximately \$9,093,000 and \$9,790,000, respectively. See Charity Care under Note 2 for further information.

The other payor category is comprised primarily of indemnity, workers’ compensation, and other commercial payors. Payment usually occurs on a negotiated settlement basis at some discount to the Hospital’s gross charges.

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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### **Medi-Cal**

Inpatient services rendered to Medi-Cal program beneficiaries are reimbursed at prospectively determined rates based on diagnosis related groups. Outpatient services are paid based on prospectively determined rates per procedure provided. For the years ended September 30, 2017 and 2016, the AB99 program provided approximately \$1,761,000 and \$3,219,000, respectively, in additional revenue for this class of net patient service revenues.

### **4. Assets Limited as to Use and Investments**

The composition of assets limited as to use at September 30, 2017 and 2016, is set forth in the following table. Assets limited as to use are held at fair value (see Note 2).

	2017	2016
Under indenture agreement, held by trustees:		
Money market account	\$ 12,018,109	\$ -
Cash	6,972,358	2,198,635
Debt securities:		
US treasuries	8,987,580	-
Agency securities	13,545,438	-
Corporate bonds	4,988,300	-
Total assets limited as to use	46,511,785	2,198,635
Less current portion	(46,511,785)	(2,198,635)
Noncurrent portion	\$ -	\$ -

The Hospital is required to maintain certain funds held by trustees in connection with the master trust indentures and loan agreements (see Note 6). As of September 30, 2017, these funds are limited to financing the construction and equipping of a new hospital tower. As of September 30, 2016, these funds were limited to payment of bond principle and interest.

The composition of investments at September 30, 2017 and 2016, is set forth in the following table. Investments are held at fair value (see Note 2).

	2017	2016
<b>Investments - current</b>		
Mutual funds - equities (international and domestic)	\$ 65,192,723	\$ 48,318,214
Mutual fund - fixed income	33,757,168	25,432,406
Total	\$ 98,949,891	\$ 73,750,620

For the year ended September 30, 2017, net unrealized gains were approximately \$8,100,000 and net realized gains were approximately \$316,000. For the year ended September 30, 2016, net unrealized gains were approximately \$4,729,000 and net realized losses were approximately \$867,000. Realized gains and losses and investment income were included in other non-operating income (loss), net in the accompanying statements of operations.

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

### 5. Property, Plant and Equipment

A summary of property, plant and equipment at September 30, 2017 and 2016, is as follows:

	2017	2016
Building and improvements	\$ 199,430,503	\$ 179,976,932
Equipment and furniture	123,671,478	110,293,407
Building, improvements and equipment under capital leases	<u>13,379,607</u>	<u>13,379,607</u>
	336,481,588	303,649,946
Less accumulated depreciation and amortization	<u>(200,693,601)</u>	<u>(186,262,756)</u>
	135,787,987	117,387,190
Construction-in-progress	90,617,588	69,088,865
Land	<u>3,226,759</u>	<u>3,226,760</u>
Property, plant and equipment, net	<u>\$ 229,632,334</u>	<u>\$ 189,702,815</u>

Depreciation expense for the years ended September 30, 2017 and 2016 amounted to approximately \$15,051,000 and \$14,519,000, respectively. At September 30, 2017 and 2016, assets held under capital lease obligations, amounted to \$13,380,000 for both years, and related accumulated amortization amounted to approximately \$12,283,000 and \$11,816,000, respectively.

Construction-in-progress consists primarily of the costs associated with construction of the Patient Tower as well as other construction projects on campus. The new Patient Tower is expected to be placed in service by spring 2019.

### 6. Long-Term Debt

Long-term debt at September 30, 2017 and 2016 consists of the following:

	2017	2016
2013 Series A Revenue Bonds (1)	\$ 20,800,000	\$ 22,175,000
2013 Series B Revenue Bonds (2)	28,025,000	30,300,000
2013 Series C Revenue Bonds (3)	625,000	28,450,000
2014 Insured Revenue Bonds (4)	69,120,000	69,560,000
2017 California Public Finance Authority Revenue Bonds (5)	<u>109,625,000</u>	-
	228,195,000	150,485,000
Deferred financing costs, net of accumulated amortization	(4,117,000)	(3,159,000)
Unamortized bond premium	<u>6,041,000</u>	<u>678,000</u>
	230,119,000	148,004,000
Less current maturities	<u>(4,900,000)</u>	<u>(4,715,000)</u>
	<u>\$ 225,219,000</u>	<u>\$ 143,289,000</u>

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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- (1) California Statewide Communities Development Authority Series 2013 A Revenue Bonds in the original amount of \$25,000,000 dated December 1, 2013, which bear interest at an annual rate of 4.19%, payable semi-annually (the "2013 Bonds Series A"). The 2013 Bonds Series A requires annual principal payments ranging from \$1,075,000 to \$4,500,000 beginning in 2014 through 2028. The 2013 Bonds Series A are secured by a deed of trust on substantially all of the Hospital's property.
- (2) California Statewide Communities Development Authority Series 2013 B Revenue Bonds in the original amount of \$35,000,000 dated December 1, 2013, which bear interest at an annual rate of 3.82%, payable semi-annually (the "2013 Bonds Series B"). The 2013 Bonds Series B requires annual principal payments ranging from \$1,750,000 to \$3,500,000 beginning in 2014 through 2027. The 2013 Bonds Series B are secured by a deed of trust on substantially all of the Hospital's property.
- (3) California Statewide Communities Development Authority Series 2013 C Revenue Bonds in the original amount of \$29,550,000 dated December 1, 2013, which bear interest at an annual rate of 3.93%, payable semi-annually (the "2013 Bonds Series C"). The 2013 Bonds Series C requires annual principal payments ranging from \$550,000 to \$4,125,000 beginning in 2014 through 2038. The 2013 Bonds Series C are secured by a deed of trust on substantially all of the Hospital's property. During the year ended September 30, 2017, the 2013 Bonds Series C was redeemed with the proceeds from the 2017 Bonds.
- (4) California Statewide Communities Development Authority Series 2014 Insured Revenue Bonds in the original amount of \$70,000,000 dated January 22, 2014, which bear interest at annual rates ranging from 2.00% to 5.25%, payable semi-annually (the "2014 Bonds"). The 2014 Bonds require annual principal payments ranging from \$295,000 to \$5,715,000 beginning in 2016 through 2043. The 2014 Bonds are insured by Assured Guarantee Municipal Corp ("AGM") and are secured by a grant of security interest in the gross revenues of the Hospital as well as a deed of trust on substantially all of the Hospital's property. The 2014 Bonds were secured on parity with the 2013 Bonds Series A, B, and C.
- (5) California Public Finance Authority Revenue Bonds (Henry Mayo Newhall Hospital), Series 2017 in the original amount of \$109,625,000 dated January 30, 2017, which bear interest at annual rates ranging from 1.25% to 5.00%, payable semi-annually (the "2017 Bonds"). Net proceeds from the issuance of approximately \$28,618,000 were used to redeem the outstanding principal balance of the 2013 Bonds Series C. Net proceeds in the amount of \$85,000,000 are restricted to finance the construction and equipping of a new patient tower. The 2017 Bonds require annual principal payments ranging from \$780,000 to \$12,360,000 beginning in 2021 through 2048. The 2017 Bonds are secured by a grant of security interest in the gross revenues of the Hospital as well as a deed of trust on substantially all of the Hospital's property.

The master trust indentures and loan agreements require that certain funds be established with the trustee as defined. Accordingly, these funds are recorded as assets limited as to use in the statements of financial position (see Note 4). The master trust indentures also require the Hospital to comply with certain restrictive covenants including maintaining an annual debt service coverage ratio of at least 1.25 to 1, days cash on hand of not less than 60 days, a ratio of funded debt to capitalization as defined of no greater than 0.7 to 1 and restrictions on incurrence of additional debt among other covenants. The Hospital was in compliance with the covenants included in the new master trust indenture at September 30, 2017 and 2016.

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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Maturities of long-term debt at September 30, 2017 above are as follows:

<i>Years ending September 30,</i>	<i>Principal Maturities</i>
2018	\$ 4,900,000
2019	4,395,000
2020	4,595,000
2021	5,490,000
2022	5,730,000
Thereafter	<u>203,085,000</u>
	228,195,000
Deferred financing costs, net of accumulated amortization	(4,117,000)
Unamortized net bond premium and discounts, net	<u>6,041,000</u>
	<u>\$ 230,119,000</u>

### 7. Pension Plan

The Hospital maintains a deferred compensation annuity plan (defined as an IRC Section 403(b) plan), which covers employees who elect to participate.

The Hospital provides matching contributions equal to 5% of participants' eligible annual compensation up to the amount allowed by the Internal Revenue Service for the calendar year. Employer matching contributions are funded annually based on the calendar year. For the years ended September 30, 2017 and 2016, the Company's matching contributions were approximately \$3,100,000 and \$2,800,000, respectively.

### 8. Receivable from Affiliate

ASC 958-20-15, *Transfers of Assets to a Not-For-Profit Organization or Charitable Remainder Trust That Raises or Holds Contributions for Others*, requires organizations similar to the Hospital and the Foundation to recognize on the designated organization's financial statements as a temporarily restricted asset, those funds raised by the Foundation for the benefit of the Hospital.

The amounts raised on behalf of the Hospital by the Foundation are recorded as a receivable from affiliate as follows:

<i>September 30,</i>	<i>2017</i>	<i>2016</i>
Program receivables	\$ 8,560,632	\$ 5,477,877
Other receivables (payables), net	<u>49,073</u>	<u>80,385</u>
	<u>\$ 8,609,705</u>	<u>\$ 5,558,262</u>

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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### 9. Related Party Transactions

The Foundation received contributions of approximately \$4,448,000 and \$4,951,000 for the benefit of Hospital programs such as the new patient tower, the ICU, the cath-lab, the palliative care unit and the NICU for the years ended September 30, 2017 and 2016, respectively (see Note 10). At September 30, 2017 and 2016, the Hospital had a net receivable from the Foundation in the amount of \$8,610,000 and \$5,558,000, respectively (see Note 8). During the years ended September 30, 2017 and 2016, funds in the amount of approximately \$1,366,000 and \$2,533,000, respectively, were received from the Foundation and spent by the hospital on these programs. The Hospital contributed \$800,000 and \$784,000 to the Foundation for general operations for the years ended September 30, 2017 and 2016, respectively, which is included as a change in unrestricted assets in the accompanying statement of changes in net assets.

### 10. Temporarily Restricted Net Assets

Funds received from the Foundation for the benefit of Hospital programs such as the ICU, NICU and Emergency Room are recorded as temporarily restricted contributions.

Contributions and grants that were recorded as temporarily restricted contributions and funds relating to these temporarily restricted net assets were transferred to unrestricted net assets when the temporary restriction had lapsed and when used or incurred for the program.

Temporarily restricted net assets are available for the following purposes at September 30, 2017 and 2016:

<i>September 30,</i>	<b>2017</b>	<b>2016</b>
Foundation funds:		
Emergency room	\$ 2,057,842	\$ 1,701,747
New patient tower	4,983,167	2,789,133
Other equipment	883,878	398,097
ICU/NICU	50,649	48,745
Infusion center	79,107	79,056
Other	<u>505,910</u>	<u>461,021</u>
	<b>8,560,553</b>	<b>5,477,799</b>
Bio terrorism	<u>98,447</u>	<u>61,878</u>
Total	<u>\$ 8,659,000</u>	<u>\$ 5,539,677</u>

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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### 11. Tower Imaging Joint Venture

The Company has a 50% joint venture agreement with Tower Imaging Medical Group, Inc., a California professional corporation (“TIMG”), whereby the Company and TIMG (together the “Partners”) own Tower Imaging Valencia, LLC, a California limited liability company (the “Joint Venture”). The Tower Imaging Joint Venture, which provides radiology services outside of the Hospital, is a for-profit enterprise. The Company accounts for the investment in the Joint Venture under the equity method of accounting. Under the equity method, the Company recognizes its share of the earnings or losses in the Joint Venture.

The Partners share the profits and losses of the Joint Venture in a pre-determined ratio of 50% and 50%, in accordance with the Joint Venture agreement. Allocation of cash distributions to the LLC members is to be made in proportion to the respective percentage interests of the Company and TIMG. During the year ended September 30, 2017, the Joint Venture distributed a total of \$980,000 or \$490,000 for each partner from the Joint Venture. During the year ended September 30, 2016, the Joint Venture distributed a total of \$1,628,000 or \$814,000 for each partner from the Joint Venture. The original term of the Joint Venture agreement was ten years, and during 2016 it was extended another five years, until 2021.

As members of the Joint Venture, TIMG and the Company have the obligation to guarantee, in the form of credit support, to a third-party credit lender pro rata amounts based on that member’s percentage interest. In return, each member making such guarantee is to receive an annual credit enhancement fee equal to a fair market value percentage rate of the amount of the liability guaranteed by each member, and the credit enhancement fee is to be paid prior to any distributions to the members. In the event there is a default of the guaranteed obligation, then such member has all of the rights against the Joint Venture including, without limitation, to receive the credit enhancement fee until such member is exonerated from the underlying liability. At September 30, 2017, the Company and TIMG have not guaranteed any debt relating to the Joint Venture.

The carrying value of the investment in the Joint Venture at September 30, 2017 and 2016 was approximately \$1,026,000 and \$788,000, respectively, and is recorded as part of other assets in the statements of financial position.

The unaudited condensed financial statement information for the Joint Venture as of and for the years ended September 30, 2017 and 2016, respectively, was:

	2017	2016
Condensed financial statement information (unaudited):		
Total assets	\$ 3,087,979	\$ 3,290,512
Total liabilities	932,808	1,173,570
Net income	<u>1,469,077</u>	<u>1,546,245</u>

### 12. Commitments and Contingencies

#### *Leases*

The Hospital leases various facilities and equipment under operating and capital leases.

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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The Hospital's most significant capital lease obligation is for the ambulatory care facility and office, which was amended on December 1, 2007. The lease requires monthly minimum payments of approximately \$150,000, subject to an annual consumer price index adjustment with a minimum/maximum range through to April 2020. The lease agreement does not have an option for renewal however, negotiations to extend the lease have begun. The facility houses an outpatient surgery program and certain other functions that support the Hospital. Portions of the facility are sublet to third parties.

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. Operating leases consist primarily of medical office space and equipment leases. Total rental expense, including month-to-month rentals, for the years ended September 30, 2017 and 2016, was approximately \$5,175,000 and \$5,055,000, respectively.

The Hospital has entered into various sublease agreements. The lease termination dates range through to 2072. Rental sublease income generated from these leases totaled approximately \$1,153,000 and \$1,133,000 for the years ended September 30, 2017 and 2016, respectively.

The future minimum lease payments required under capital leases and non-cancelable operating lease agreements with terms of one year or more are as follows:

<i>Years ending September 30,</i>	Capital Leases	Operating Leases
2018	\$ 2,209,114	\$ 3,447,888
2019	2,264,342	3,312,086
2020	1,146,148	3,132,381
2021	-	2,996,963
2022	-	2,595,063
Thereafter	-	21,397,020
Total lease obligation	5,619,604	\$ 36,881,401
Less amount representing interest at 10.1% per annum	<u>(679,312)</u>	
Present value of future minimum lease payments	4,940,292	
Less current portion	<u>(1,789,766)</u>	
Noncurrent portion	<u>\$ 3,150,526</u>	

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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The future minimum expected sublease income for these agreements is as follows:

<i>Years ending December 31,</i>	Sublease Income
2018	\$ 303,069
2019	312,161
2020	321,526
2021	331,172
2022	341,107
Thereafter	<u>39,630,107</u>
Total	<u>\$ 41,239,142</u>

In November 2012, the Hospital (as landlord) entered into a ground lease with an independent third-party (as tenant) to lease approximately 53,870 square feet of the Hospital's land for the construction of a Medical Office Building ("MOB") that the Hospital will occupy and lease upon completion of the MOB. The ground lease term is for 60 years with annual base rent in the amount of \$124,575 payable to the Hospital in equal monthly installments. The annual rent increase is 3% for the first twenty years followed by increases using the CPI Index with a floor of 2% and ceiling of 4% compounded as recalculated from the initial base rent assuming the first twenty year period used the CPI Index method.

In connection with the ground lease, the Hospital (as tenant) entered into a lease agreement to occupy approximately 38,378 square feet of the MOB. The initial lease term is 20 years with a lessee option to renew for 4 additional 10 year periods with the base rent of \$75,886 per month with annual rent increases of 3%. After the initial lease term, assuming options to renew are exercised, the base rent increases using the CPI Index with a floor of 2% and a ceiling of 4%. The lease commenced in March 2014. The Company determined this to be an operating lease and lease rentals were straight-lined over the initial term of the lease.

### ***Litigation***

The Hospital is a defendant in various legal actions alleging malpractice and other matters. Further, the Hospital is a named defendant in employment-related matters, such as alleged discrimination complaints and certain wage-related claims. It is the management's opinion that these actions are covered by insurance, existing accruals, or otherwise will be resolved without a material adverse effect on the financial position or results of operations of the Hospital.

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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### ***Golden Valley Pledged Lease Asset***

On September 10, 2008, the Hospital entered into a lease Agreement with GMS Golden Valley Ranch, LLC for 50 years at a minimum annual rent of \$1.00 plus common area costs, taxes and insurance (the "Golden Valley Lease") for 2,000 sq. ft. of space in a new shopping center nearby to the Hospital, for the purpose of operating a physical therapy facility. The lease of the space is contingent on the continued use by the Hospital for public benefit. Accordingly, the Golden Valley Lease was recorded as a conditional pledge for the present value of the fair value of lease payments and an underlying pledged lease asset was recorded in the amount of \$2,742,543. Due to the contingent nature of the lease, a liability for \$2,742,543 was recorded as deferred contribution revenue on the statements of financial position. As of September 30, 2017 and 2016, the pledged lease asset and deferred contribution revenue was \$2,387,587 and \$2,429,433, respectively. The pledged asset and corresponding liability are being amortized using the straight-line method over the life of the lease.

### ***Construction Commitment***

At September 30, 2017 and 2016, the Hospital has outstanding construction commitments of approximately \$48,809,000 and \$80,408,000, respectively, related to the new patient tower under construction.

### ***Management Incentive Plan***

The Hospital has a Management Incentive Plan which provides incentive compensation when certain performance goals are met. For the years ended September 30, 2017 and 2016, the Hospital incurred incentive compensation of \$1,819,363 and \$1,553,210, respectively.

### ***Legislation***

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medi-Cal fraud and abuse. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. The Company believes that it is in compliance with fraud and abuse as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

### ***Malpractice Insurance***

The Hospital maintains medical malpractice insurance under a claims-made policy. A claims-made policy covers only claims net of the Hospital's self-insured retention ("SIR") of \$500,000 per claim that occurs and are filed in the period during which the policy is in force. As of September 30, 2017 and 2016, the Hospital has made provisions for estimated medical malpractice claims including estimates of the ultimate costs for both reported claims and claims incurred but not reported. Management believes that its estimates are sufficient and will not result in any materially adverse adjustments.

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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In June and November 2005, the Company invested a total of \$217,840 for the purchase of 27,230 shares (1.36% ownership in December 31, 2011) of capital stock in California Healthcare Insurance Company, Inc. ("CHI"), a risk retention group domiciled in Hawaii. CHI insures its owners and their affiliated entities for general and professional liability risks. The Company accounts for its investment in CHI under the cost method of accounting. During the years ended September 30, 2017 and 2016, the Company paid approximately \$748,000 and \$757,000, respectively, in premiums to CHI.

CHI covers claims through a combination of risk layers that include, assuming the risk, reinsurance treaties with four A+ rated reinsurers and conventional type insurance with an A+ rated commercial carrier. CHI adjusts risk layers periodically in response to market conditions. The Company believes that CHI will provide the Company with efficient and cost effective management of its medical malpractice and other risks. As of September 30, 2017 and 2016, AM Best, the worldwide insurance rating and information agency, reported CHI's rating at A-. There is no guarantee that CHI will remain a viable insurance company. Excessive claims could have a material adverse effect on CHI's ability to pay claims.

### ***Self-Insurance Program for Employee Healthcare***

The Hospital has a self-insured program for employee healthcare for the years ended September 30, 2017 and 2016. An accrual has been made for the estimated liabilities arising from outstanding healthcare claims incurred but not yet reported, as of September 30, 2017 and 2016. Management believes that its estimates are sufficient, however, actual amounts may materially differ from those estimates. For the years ended September 30, 2017 and 2016, these liabilities were approximately \$1,954,000 and \$1,945,000, respectively, and are recorded in accrued payroll and benefits in the accompanying statements of financial position. The Hospital also maintains a stop-loss reinsurance policy for its self-insured healthcare program. The stop-loss policy reimburses the Hospital 100% of the costs incurred for a patient incident that exceeds certain thresholds of \$200,000 if it occurred prior to May 2016 and \$250,000 if it occurred subsequent to May 2016.

### ***Worker's Compensation***

The Hospital has a guaranteed cost premium policy. An accrual has been made for the liability arising from an audit of the policy for the plan year ended September 30, 2017 and 2016 for approximately \$165,000 and \$87,000, respectively, and is included in accrued payroll and benefits in the accompanying statements of financial position. An estimated accrual has been made for the liability arising from the previous policy for the plan years ended September 30, 2016 and prior for approximately \$2,565,000 and \$2,396,000 which is included in accrued payroll and benefits in the accompanying statements of financial position for the years ended September 30, 2017 and 2016, respectively. Actual amounts may materially differ from those estimates.

### ***Union Contract***

The Hospital has contracts with the California Nurses Association and the United Electrical, Radio & Machine Workers of America for the period January 2012 through January 2019 and February 2017 through January 2020, respectively. Employee benefits provided by the contracts include paid time off and health and retirement benefits. The contracts also specify compensation rates and hours of work and overtime. These compensation rates and benefits could change materially subject to the outcome of collective bargaining agreements.

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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### 13. Fair Value of Financial Instruments

The following methods and assumptions were used by the Hospital in estimating the fair value of its financial instruments:

*Cash and cash equivalents:* The carrying amount reported on the statements of financial position for cash approximates its fair value.

*Investments:* The carrying amount reported on the statements of financial position for short term investments approximates its fair value.

*Assets limited as to use:* The carrying amount reported on the statements of financial position for assets limited as to use approximates its fair value.

*Long-term debt:* Fair values of the Hospital's 2014 and 2017 Bonds are based on current traded value. The fair value of the 2013 Bonds is based on the discounted present value of cash flows.

The carrying amounts and estimated fair values of the Hospital's financial instruments at September 30, 2017 and 2016, are as follows (in thousands):

	2017		2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 34,087	\$ 34,087	\$ 42,152	\$ 42,152
Investments	98,950	98,950	73,751	73,751
Asset limited as to use	46,512	46,512	2,199	2,199
Long-term debt	<u>\$ 234,236</u>	<u>246,259*</u>	<u>151,163</u>	<u>160,328*</u>

\* Level 1 measurement was used to determine the fair value of the 2014 Bonds and 2017 Bonds. Level 2 measurement was used to determine the fair value of the 2013 Series A, B, and C Bonds.

### 14. Functional Expenses

The Hospital provides general healthcare services to residents within its geographic location. Expenses related to providing these services for the years ended September 30, 2017 and 2016, were as follows:

	2017	2016
Health care services	\$ 278,968,829	\$ 266,555,413
General and administrative	<u>39,997,797</u>	<u>38,310,680</u>
	<u>\$ 318,966,626</u>	<u>\$ 304,866,093</u>

# Henry Mayo Newhall Hospital

## Notes to Financial Statements

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### 15. Concentration of Credit Risk

The Hospital maintains cash deposits in financial institutions that exceed the amount insured by the United States government. Nonperformance by these institutions could expose the Hospital to losses for amounts in excess of the insured balances. The Hospital has not experienced, nor does it anticipate, nonperformance by these institutions.

Investments are managed by a board-approved investment policy within guidelines established by the Board of Directors, which, as a matter of policy, limit the amounts that may be invested in any one issuer. Concentration of credit risk with respect to patient accounts receivable, other than from government programs, is limited due to the large numbers of payors comprising the Hospital's patient base.

The Company is highly dependent upon various third-party payors and government programs for payment.

The Company grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of net patient revenues and patient accounts receivable as of and for the years ended September 30, 2017 and 2016, was as follows:

	2017	2016
Net patient revenues:		
Medicare	30%	31%
Medi-Cal	10	8
Self-Pay and Other	3	2
HMO/PPO	<u>57</u>	<u>59</u>
	<u>100%</u>	<u>100%</u>
	2017	2016
Patient accounts receivable:		
Medicare	33%	32%
Medi-Cal	12	10
Self-Pay and Other	14	15
HMO/PPO	<u>41</u>	<u>43</u>
	<u>100%</u>	<u>100%</u>