

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES
Valencia, California

CONSOLIDATED FINANCIAL STATEMENTS

Including Independent Auditors' Report

As of and for the Years Ended September 30, 2019 and 2018

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Henry Mayo Newhall Hospital and Subsidiaries

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Henry Mayo Newhall Hospital and Subsidiaries (the "Organization"), which comprise the consolidated statements of financial position as of September 30, 2019 and 2018, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Organization as of September 30, 2019 and 2018, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Report on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit 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, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Baker Tilly Virchow Krause, LLP

Minneapolis, Minnesota
February 21, 2020

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION As of September 30, 2019 and 2018

ASSETS		
	2019	2018
CURRENT ASSETS		
Cash and cash equivalents	\$ 53,317,376	\$ 46,011,172
Investments	76,914,826	95,371,751
Pledges receivable	16,876	7,500
Patient accounts receivable	63,147,652	55,549,815
Inventories	5,911,973	5,990,170
Prepaid expense and other current assets	7,806,222	5,676,229
Quality assurance program receivable	<u>9,686,455</u>	-
Total current assets	216,801,380	208,606,637
PLEDGES RECEIVABLE, NET	1,710,105	1,925,132
PROPERTY, PLANT AND EQUIPMENT, NET	334,450,660	311,611,613
PLEDGED LEASE	2,301,991	2,345,110
RECEIVABLES UNDER TRUST AGREEMENTS	3,000,126	3,126,463
OTHER ASSETS	<u>285,607</u>	<u>520,429</u>
TOTAL ASSETS	<u>\$ 558,549,869</u>	<u>\$ 528,135,384</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current portion of long-term debt	\$ 4,994,704	\$ 4,759,168
Accounts payable and accrued liabilities	43,921,835	43,314,411
Accrued payroll and benefits	19,287,992	18,396,630
Accrued interest	5,298,090	5,382,986
Quality assurance fee payable	12,919,793	-
Quality assurance fee deferred revenue	218,610	8,980,966
Estimated third party liabilities	<u>3,985,867</u>	<u>1,180,783</u>
Total current liabilities	90,626,891	82,014,944
LONG-TERM DEBT, NET	238,177,953	243,232,433
DEFERRED RENT LIABILITY	1,383,439	1,161,279
DEFERRED CONTRIBUTION REVENUE	2,301,991	2,345,110
ACCRUED MALPRACTICE LIABILITY	<u>4,798,029</u>	<u>4,904,029</u>
Total Liabilities	337,288,303	333,657,795
NET ASSETS		
Without donor restrictions	212,047,982	185,335,557
With donor restrictions	<u>9,213,584</u>	<u>9,142,032</u>
Total net assets	<u>221,261,566</u>	<u>194,477,589</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 558,549,869</u>	<u>\$ 528,135,384</u>

See accompanying notes to consolidated financial statements.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS For the Years Ended September 30, 2019 and 2018

	2019	2018
OPERATING REVENUES		
Net patient service revenue	\$ 347,177,607	\$ 334,281,500
Other revenue	8,440,408	6,165,848
California Hospital Foundation and Trust grant revenue	3,811,985	6,430,096
Net assets released from restrictions used for operations	377,236	788,146
Total operating revenues	359,807,236	347,665,590
OPERATING EXPENSES		
Salaries and wages	122,225,145	121,863,319
Employee benefits	43,628,535	43,670,879
Registry	1,931,629	2,333,100
Supplies	51,039,371	49,652,998
Purchased services	44,112,572	44,086,036
Repairs and maintenance	8,629,201	6,657,341
Interest	5,383,800	4,227,725
Depreciation	18,104,642	17,374,685
Insurance	2,278,931	2,747,157
Rent	5,442,790	5,755,117
Utilities	3,343,589	2,574,773
Quality assurance fee hospital tax	19,901,311	23,343,608
Other operating expenses	14,744,623	16,403,095
Software development costs write-off	-	5,850,830
Total operating expenses	340,766,139	346,540,663
OPERATING INCOME	19,041,097	1,124,927
NON-OPERATING INCOME (LOSS)		
Contributions	202,491	801,723
Interest and dividends	2,561,126	2,673,422
Realized gain on investments, net	6,111,609	3,022,033
Unrealized (loss) gain on investments, net	(6,999,348)	981,876
Other non-operating (loss) income, net	(70,347)	2,495,256
Equity in income of joint venture	579,238	926,276
REVENUES IN EXCESS OF EXPENSES	21,425,866	12,025,513
NET ASSETS RELEASED FROM RESTRICTED USED FOR PURCHASES OF PROPERTY, PLANT AND EQUIPMENT	1,500,000	1,623,568
INCREASE IN NET ASSETS WITHOUT DONOR RESTRICTIONS	\$ 22,925,866	\$ 13,649,081

See accompanying notes to consolidated financial statements.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS For the Years Ended September 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
CHANGE IN NET ASSETS WITHOUT DONOR RESTRICTIONS		
Revenues in excess of expenses	\$ 21,425,866	\$ 12,025,513
Net assets released from restricted used for purchases of property, plant and equipment	<u>1,500,000</u>	<u>1,623,568</u>
Increase in net assets without donor restrictions	<u>22,925,866</u>	<u>13,649,081</u>
CHANGE IN NET ASSETS WITH DONOR RESTRICTIONS		
Contributions	2,075,125	2,148,993
Change in value of receivables under trust agreements	(126,337)	324,534
Net assets released from restrictions	<u>(1,877,236)</u>	<u>(2,411,714)</u>
Increase in net assets with donor restrictions	<u>71,552</u>	<u>61,813</u>
INCREASE IN NET ASSETS	<u>22,997,418</u>	<u>13,710,894</u>
NET ASSETS - BEGINNING OF YEAR	194,477,589	180,766,695
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPAL - NET ASSETS WITHOUT DONOR RESTRICTIONS (NOTE 2)	<u>3,786,559</u>	<u>-</u>
NET ASSETS - BEGINNING OF YEAR, AS ADJUSTED	<u>198,264,148</u>	<u>180,766,695</u>
NET ASSETS - END OF YEAR	<u>\$ 221,261,566</u>	<u>\$ 194,477,589</u>

See accompanying notes to consolidated financial statements.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS For the Years Ended September 30, 2019 and 2018

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase in net assets	\$ 22,997,418	\$ 13,710,894
Adjustments to reconcile increase in net assets to net cash and cash equivalents provided by operating activities		
Depreciation	18,104,642	17,374,685
Amortization of deferred financing costs and bond premiums, net	(59,669)	(380,000)
Net loss on disposal of assets	118,516	3,356,177
Equity in income of joint venture	(579,238)	(926,276)
Realized gain on investments, net	(6,111,609)	(3,022,033)
Unrealized loss (gain) on investments, net	6,999,348	(981,876)
Change in value of receivables under trust agreements	126,337	(324,534)
Change in provision for uncollectible pledges	86,464	70,715
Contributions restricted for capital	(1,387,570)	(813,696)
Changes in assets and liabilities		
Patient accounts receivable	(7,597,837)	1,028,024
Pledges receivable	54,567	229,276
Inventories	78,197	(45,787)
Prepaid expenses and other current assets	4,143,453	(478,149)
Quality assurance program receivable	(9,686,455)	2,550,480
Other assets	234,822	(169,790)
Accounts payable and accrued liabilities	(5,583,193)	(10,134,618)
Accrued payroll and benefits	1,051,362	470,429
Accrued interest	(84,896)	(94,976)
Quality assurance fee payable	12,919,793	-
Quality assurance fee deferred revenue	211,690	7,657,266
Deferred rent liability	222,160	214,110
Estimated third party settlement	2,805,084	(12,740)
Accrued malpractice liability	(106,000)	235,873
Net Cash and Cash Equivalents Provided by Operating Activities	38,957,386	29,513,454
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of property, plant and equipment	(39,803,564)	(74,367,372)
Proceeds from sale of short-term investments	71,822,271	24,245,225
Purchases of short-term investments	(54,253,085)	(16,663,176)
Decrease in assets limited as to use	-	46,511,785
Capitalization of financing interest	(6,709,719)	(6,926,531)
Distribution from joint venture	600,000	707,000
Net Cash and Cash Equivalents Used in Investing Activities	(28,344,097)	(26,493,069)

See accompanying notes to consolidated financial statements.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS For the Years Ended September 30, 2019 and 2018 (cont.)

	2019	2018
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from debt, net of issuance cost	\$ -	\$ 10,395,889
Payments on long-term debt	(4,759,275)	(4,480,817)
Payments on capital lease obligations	-	(1,621,320)
Cash received restricted for capital	<u>1,452,190</u>	<u>1,508,002</u>
Net Cash and Cash Equivalents (Used in) Provided by Financing Activities	<u>(3,307,085)</u>	<u>5,801,754</u>
 Net Increase in Cash and Cash Equivalents	 7,306,204	 8,822,139
 CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	 <u>46,011,172</u>	 <u>37,189,033</u>
 CASH AND CASH EQUIVALENTS - END OF YEAR	 <u>\$ 53,317,376</u>	 <u>\$ 46,011,172</u>
 Supplemental cash flow disclosures		
Cash paid for interest	\$ 5,409,027	\$ 4,812,579
 Noncash investing and financing activities		
Acquisition of property and equipment financed through accounts payable	\$ 6,947,015	\$ 12,398,093
Cancellation of capital lease	-	3,318,972
Loan assumed	-	12,337,117

See accompanying notes to consolidated financial statements.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 1 - Organization

Henry Mayo Newhall Hospital (the "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.

Henry Mayo Newhall Hospital Foundation, Inc. (the "Foundation") is a California not-for-profit public benefit corporation formed to support and assist the Hospital so long as the Hospital remains tax exempt. Effective May 30, 2018, the Hospital became the sole member of the Foundation.

Henry Mayo Newhall Care Network, LLC (the "Network") is a California limited liability company formed during 2018. The Hospital is the sole member of the Network. The Hospital and Network work jointly to develop processes necessary to facilitate the evolution to a value based care delivery and contracting model. Furthermore, the Hospital and Network intend to develop a regional physician driven provider network that will enhance patient care by developing, implementing and operating programs designed to create a partnership for the mutual benefit of patients and a network of independent providers based on the principles of clinical interaction. There was no activity in this entity during fiscal year 2018.

In 2019, the Hospital, as its sole corporate member, formed Henry Mayo Newhall Clinics, LLC (the "Clinic"). The Clinic is a California limited liability company that operates ambulatory clinics within the greater Santa Clarita area. There was no activity in this entity during fiscal year 2019.

The Hospital established the Henry Mayo Management Service Organization ("MSO") for the purposes of offering administrative services for local health care facilities and the Clinic. The MSO is a not-for-profit mutual benefit company and the Hospital is the sole member.

NOTE 2 - Summary of Significant Accounting Policies

Principles of Consolidation

The net assets and results of operations of the Hospital, the Foundation, the Network, the Clinic, and the MSO (collectively, the "Organization") are included in the consolidated financial statements. All significant intercompany transactions have been eliminated.

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 disclosures of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Cash and Cash Equivalents

The Organization considers all liquid investments with original maturities of three months or less when purchased, that are not held as collateral to be cash equivalents. The Organization's cash balances exceed amounts insured by the Federal Deposits Insurance Corporation.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 2 - Summary of Significant Accounting Policies (cont.)

Charitable Remainder Trusts

The Foundation is the beneficiary under two irrevocable charitable remainder trusts (the "trusts"). The charitable remainder trusts are managed by an independent trustee, who was appointed by the donor, and the investment portfolio is comprised of money market mutual funds, fixed income, equity securities, alternative investments and a real asset fund as of September 30, 2019 and 2018.

Changes in value of the receivable under the charitable remainder trust agreements are excluded from revenues in excess of expenses. For the years ended September 30, 2019 and 2018, the changes in value of the receivables under charitable remainder trust agreements were approximately (\$126,000) and \$325,000, respectively.

Investments and Investment Return

Investments in equity securities having a readily determinable fair value and all debt securities are carried at fair value; these fair values are estimates and are subject to change. Investment return includes dividend, interest and other investment income; realized and unrealized gains and losses on investments. Investment return that is initially restricted by donor stipulation and for which the restriction will be satisfied in the same year is included in net assets without donor restrictions. Investment returns are reflected in the consolidated statements of operations and consolidated statements of changes in net assets without donor restrictions or net assets with donor restrictions, based on the existence and nature of any donor or legally imposed restrictions. Investments that are available for the operations of the Hospital and can be converted to cash within one year are classified as current.

Donor Restricted Gifts

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

Patients Accounts Receivable

Patient accounts receivable are recorded at net realizable value at the transaction price based on standard charges for services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured or underinsured patients in accordance with the Hospital's policies, and/or implicit price concessions provided to uninsured or underinsured patients, and do not bear interest. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient revenue in the period of the change.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 2 - Summary of Significant Accounting Policies (cont.)

Pledges Receivable

Pledges that are expected to be collected within one year are recorded as current assets at net realizable value unless restricted for long-lived assets. Pledges that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using risk-free interest rates applicable to the years in which the pledged amounts are to be received. Amortization of the discounts is included in the contribution, in the accompanying consolidated statements of operations.

At September 30, 2019 and 2018, certain pledges not restricted for long-lived assets were to be received in future periods greater than a year. At September 30, 2019 and 2018, the discounts on such pledges were immaterial. Further, as of September 30, 2019 and 2018, allowances for uncollectible amounts were \$124,000 and \$40,000, respectively.

Inventories

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

Property, Plant and Equipment

Property, plant and equipment are recorded at cost when purchased or at fair value when received by donation. The provision for depreciation is calculated using the straight-line method, which allocates the cost equally over their estimated useful lives.

The Organization uses depreciable lives recommended by the American Hospital Association. Equipment and facilities under capital lease obligations are amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment or facilities. Such amortization is included in depreciation and amortization in the consolidated statements of operations. The estimated useful lives of the related assets are as follows:

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

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.

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

The Organization capitalizes interest costs as a component of construction in progress, based on interest costs of borrowing specifically for the period, net of interest earned on investments acquired with the proceeds of the borrowings. Total capitalized interest in construction in progress as of September 30, 2019 and 2018 was approximately \$19,866,000 and \$13,156,000, respectively.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 2 - Summary of Significant Accounting Policies (cont.)

In accordance with the Accounting Standards Codification ("ASC") 350-40, Internal-Use Software, the Organization capitalizes certain external direct costs of materials and services consumed in developing or obtaining internal-use computer software. Additionally, the Organization 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.

Impairment of Property, Plant and Equipment

Property, plant and equipment are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. If expected cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of the assets. There were no impairment costs recognized for the year ended September 30, 2019. Impairment losses for writeoff of software development costs of approximately \$5,851,000 was recognized for the year ended September 30, 2018.

Deferred Financing Costs

In connection with the issuance of the 2013 Bond Series A, B, 2014 Bonds, 2017 Bonds, and 2018 Bonds, as well as an assumption of a loan in connection with the organization of a property adjacent to the Hospital's main campus in Valencia, California, (see Note 6), the Organization capitalized \$5,568,000 of issuance costs, which are being amortized over the term of the bonds and loan using the effective interest method. Amortization expenses of approximately \$334,000 and \$265,000 were recorded for the years ended September 30, 2019 and 2018, respectively, and are included in interest in the accompanying consolidated statements of operations.

Revenues in Excess of Expenses

The consolidated statements of operations in net assets include excess if revenues over expenses. Changes in net assets without donor restrictions which are excluded from revenues in excess of expenses, consistent with industry practice, include 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).

Net Assets

Net assets, revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Organization and changes therein are classified as follows:

Net Assets Without Donor Restrictions - net assets available for use in general operations and not subject to donor restrictions. All revenue not restricted by donors and donor restricted contributions whose restrictions are met in the same period in which they are received are accounted for in net assets without donor restrictions.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 2 - Summary of Significant Accounting Policies (cont.)

Net Assets With Donor Restrictions - net assets subject to donor-imposed restrictions that are temporary in nature, such as those that may be met either by the passage of time or other events specified by the donor. All revenues restricted by donors as to either timing or purpose of the related expenditures are accounted for in net assets with donor restrictions. When a donor restriction expires, that is when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions.

Measure of Operations

For purposes of presentation, transactions deemed by management to be ongoing, major or central to the provision of healthcare services are reported as operating revenues and expenses. Investment and other income, loss on refunding and pension settlement and periodic pension cost are considered non-operating activities.

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 cycles not to exceed three years with the terms of each cycle requiring approval from the CMS. The program covering the period from January 1, 2014 through December 31, 2016 (the "2016 Program"), was complete as of December 2018. The next program covers the period from January 1, 2017 through June 30, 2019 (the "2019 Program") for which final payments and receipts are still being collected and paid. The program currently being administered covers the period from July 1, 2019 through December 31, 2021 (the "2021 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. During the year ended September 30, 2018, the fee for service payment methodology for the 2019 Program was approved by CMS. During the year ended September 30, 2019, the managed care payment methodology for the 2016 Program was approved by CMS. Over the last six Program cycles, there have been no subsequent adjustments to either the fee-for-service or the managed care portions of the model as a result of CMS review and approval.

Based on estimates provided to the Organization, revenues earned by the Organization under the 2019 Program and 2021 Program are expected to approximate the costs the Organization pays into the Program. Due to the fact that CMS approves portions of the program at different times, the Organization's cash flows associated with the program are subject to material variability from year to year.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 2 - Summary of Significant Accounting Policies (cont.)

Based on formulas contained in the legislation as well as modeling done by the California Hospital Association, the Organization recorded amounts related to the program as follows as of September 30 on the consolidated statements of financial position:

	2019	2018
Quality assurance program receivable	\$ 9,686,000	\$ -
Quality assurance fee payable	(12,919,793)	-
Quality assurance fee deferred revenue	(219,000)	(8,981,000)
Net	\$ (3,452,793)	\$ (8,981,000)

The Organization recognizes amounts related to the program as follows for the years ended September 30 on the consolidated statements of operations:

	2019	2018
California Hospital Foundation and Trust grant revenue	\$ 3,812,000	\$ 6,430,000
Quality assurance program revenue	16,089,000	16,930,000
Quality assurance hospital tax expense	(19,901,000)	(23,344,000)
Net	\$ -	\$ 16,000

Revenue Recognition

Revenue is recognized in the period services are performed and performance obligations are satisfied and consists primarily of net patient service revenue (Note 4). Net patient service revenue relates to amounts due from patients, third-party payors, and others for services rendered and include estimated retroactive revenue adjustments due to future audits, reviews, and investigations (including the Medicare and Medi-Cal programs). Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to audits, reviews and investigations.

Charity Care and Community Benefit (unaudited)

The Organization provides care without charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. The Organization'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 Organization's charity care policy aggregated approximately \$614,000 and \$576,000 for the years ended September 30, 2019 and 2018, respectively. The Organization has estimated the cost of charity care using its cost accounting system.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 2 - Summary of Significant Accounting Policies (cont.)

In furtherance of their charitable purpose, the Organization provides a wide variety of benefits to the community. A large number of prevention and wellness programs are provided by the Organization 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 Organization during the year ended September 30, 2018 was \$5,320,000. The amount of community benefit provided during the year ended September 30, 2019 has not been determined as of the report date.

Donated Services

Volunteers perform various services. The services donated are not reflected in the accompanying consolidated 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, 2019 and 2018 was approximately \$5,384,000 and \$4,228,000, respectively. The Organization capitalized approximately \$6,710,000 and \$6,927,000 of interest expense related to assets under construction during the years ended September 30, 2019 and 2018, respectively.

Income Taxes

The Hospital and the Foundation are exempt from income taxes pursuant to Section 501 (c)(3) of the Internal Revenue Code ("IRC") and a similar provision of state law. Accordingly, no provisions for income taxes for these entities has been made in the accompanying consolidated financial statements. The MSO does not qualify for and has not applied for 501(c)(3) exemption; as such, the MSO is a taxable corporation under provisions of the Internal Revenue Code and a similar section of the state income tax law. The Network and the Clinic are limited liability companies and are considered disregarded entities for tax purposes. The Organization is subject to federal income tax on any unrelated business taxable income. The Organization, with the exclusion of the MSO, has no uncertain tax positions at September 30, 2019 and 2018.

Accrual for General and Professional Liability Risks

The Organization records reserves for claims when they are probable and reasonably estimable. The Organization 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 Organization estimates reserves for losses and related expenses using expected loss-reporting patterns. Reserves are discounted at 2.0% and 3.0% as of September 30, 2019 and 2018, respectively. There can be no assurance that the ultimate liability will not exceed the Organization's estimates. Anticipated insurance recoveries associated with reported claims are reported in the Organization's consolidated statements of financial position at net realizable value, and are included in other assets. Adjustments to the estimated reserves are recorded in the Organization's consolidated statements of operations in the periods when such amounts are determined. These adjustments may be material.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 2 - Summary of Significant Accounting Policies (cont.)

Reclassification

For comparability, certain amounts for 2018 have been reclassified to conform with classifications adopted in 2019. These reclassifications have no effect on the reported amounts of total net assets, revenues in excess of expenses, or change in total net assets.

Recently Adopted Accounting Pronouncements

Revenue Recognition

In 2019, the Organization adopted the Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* using the modified retrospective approach. ASU No. 2014-09 supersedes the revenue recognition requirements in Topic 605, *Revenue Recognition*, and most industry specific guidance. The core principle under ASU No. 2014-09 is that revenues are recognized to depict the transfer of promised goods or services to customers (patients) in an amount that reflects the consideration at which the entity expects to be entitled in exchange for those goods or services. Additionally, ASU No. 2014-09 requires enhanced disclosures of revenue arrangements.

Under the modified retrospective approach, the guidance is applied to the most current period presented, recognizing a cumulative effect of the adoption change as an adjustment to beginning net assets without donor restrictions. The Organization has determined that there was a change to the valuation for the Quality Assurance Fee Program under ASU No. 2014-09. As a result, there was a net change to quality assurance program receivable, quality assurance fee payable, and quality assurance fee deferred revenue of \$3,787,000 and net assets without donor restrictions as of October 1, 2019.

The most significant impact of adopting the new standard is within the consolidated statements of operations. Certain patient activity where collection was uncertain, previously included as net patient service revenue and separately reported as the provision for bad debts, no longer meets the criteria for revenue recognition. Accordingly, net patient service revenue has been reduced by the amounts previously reported as the provision for bad debts and accordingly the provision for bad debts has been eliminated. Such patient activity, previously reported as the provision for bad debts (representing approximately \$38.4 million and \$21.6 million for the years ended September 30, 2019 and 2018, respectively) is now classified as an implicit price concession. In addition, the Organization eliminated the related presentation of the allowance for doubtful accounts (representing approximately \$17.3 million and \$15.3 million for the years ended September 30, 2019 and 2018, respectively) on the consolidated statements of financial position as a result of the adoption of the new standard.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 2 - Summary of Significant Accounting Policies (cont.)

Financial Assets and Liabilities

In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Liabilities (Subtopic 825-10)*. The new guidance requires equity investments (except equity method investments or those that result in consolidation) to be measured at fair value with changes in fair value recognized in net income. Finally, ASU 2016-01 requires other specific investment presentation and disclosures in the financial statements for certain financial instruments. In 2019, the Organization early adopted ASU No. 2016-01 in its consolidated financial statements. In addition to the adoption of ASU No. 2016-01, the Organization changed its accounting policy for its debt securities from available for sale to trading securities, whereby, equity and debt securities are combined in unrealized gains and losses in the consolidated statements of operations. As part of the adoption of ASU No. 2016-01 and the change in accounting policy, the Organization reclassified its changes in unrealized gains and (losses) on investments in the amounts of (\$6,999,348) and \$981,876 to be included in non-operating income (loss) within revenues in excess of expenses for the years ended September 30, 2019 and 2018, respectively. The Organization removed certain unrealized loss disclosures, which had been required for investments classified as available for sale securities. The Organization also eliminated the requirement to disclose the fair value of financial instruments measured at amortized costs and reconciliation of Level 3 investments.

Presentation of Financial Statements of Not-for-Profit Entities

In August 2016, FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities and Liquidity and Availability of Resources*. The new guidance is intended to improve and simplify the current net asset classification requirements and information presented in financial statements and notes that is useful in assessing a not-for-profit's liquidity, financial performance and cash flows. In 2019, the Organization adopted ASU No. 2016-14 on its consolidated financial statements. The Organization has adjusted the presentation of these consolidated financial statements accordingly. ASU No. 2016-14 has been applied retrospectively to all periods presented, except for the disclosures around liquidity and availability of resources and analysis of expenses by nature and function. These disclosures have been presented for 2019 only, as allowed by ASU No. 2016-14.

- > The unrestricted net asset class has been renamed net assets without donor restrictions
- > The temporarily restricted net asset class have been renamed net assets with donor restrictions
- > The consolidated financial statements include disclosures about liquidity and availability of resources (Note 3)
- > The functional expense disclosure for 2019 includes expense reported both by nature and function (Note 16)

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 2 - Summary of Significant Accounting Policies (cont.)

Clarifying the Scope and the Accounting Guidance for Contributions Received and Made

In June 2018, FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The guidance is intended to clarify and improve accounting guidance for contributions received and contributions made. The amendments in this ASU assist entities in: (1) evaluating whether transactions should be accounted for as a contribution (nonreciprocal transaction) or as an exchange (reciprocal transaction) subject to other guidance, and (2) determining whether a contribution is conditional. The guidance is only applied to agreements that were not completed at the date of adoption (September 1, 2018) and those entered into after that date. The guidance cannot be applied retrospectively. The Organization determined there were no significant changes to its consolidated financial statements from applying the new guidance as compared to prior guidance.

New Accounting Pronouncements Not Yet Adopted

In February 2016, the FASB issued Accounting Standards Update ASU No. 2016-02, *Leases (Topic 842)*. ASU No. 2016-02 was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the consolidated statements of financial position and disclosing key information about leasing arrangements. Under the provisions of ASU No. 2016-02, a lessee is required to recognize a right-to-use asset and lease liability, initially measured at the present value of the lease payments, in the balance sheet. In addition, lessees are required to provide qualitative and quantitative disclosures that enable users to understand more about the nature of the Organization's leasing activities. The Organization will be required to retrospectively adopt the guidance in ASU No. 2016-02 for years beginning after December 15, 2018. The Organization is currently evaluating the standard and the impact on its consolidated financial statements and footnote disclosures.

In August 2016, the FASB issued ASU 2016-15, *Classification of Certain Cash Receipts and Cash Payments*. The standard addresses the classification of certain transactions within the statement of cash flows, including cash payments for debt prepayment or debt extinguishment costs, contingent consideration payments made after a business combination, and distributions received from equity method investments. The ASU is effective for the Organization in fiscal year 2020. The Organization is assessing the impact this standard will have on its consolidated financial statements.

In August 2018, FASB issued ASU 2018-13, *Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*. ASU 2018-13 modifies the disclosure requirements for fair value measurements and is effective for the Organization in fiscal 2021. Early adoption is permitted. The Organization is assessing the impact this standard will have on its consolidated financial statements.

In March 2019, FASB issued ASU 2019-03, *Not-for-Profit-Entities (Topic 958) - Updating the Definition of Collections*. ASU 2019-03 modifies the definition of the term 'collections' and require that a collection-holding entity disclose its policy for the use of proceeds from when collection items are deaccessioned. ASU 2019-03, expands the definition of 'collections' and now allows Not-for-Profit Entities that have collections to use funds from deaccessioned collection pieces to support the direct care of existing collections in addition to the current requirement that proceeds from sales of collection items be used to acquire other items for collection. ASU 2019-03 is effective for the Organization in fiscal 2021. Early adoption is permitted and ASU 2019-03 is to be applied on a prospective basis. The Organization is assessing the impact this standard will have on its consolidated financial statements.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 3 - Liquidity and Availability of Financial Assets

As of September 30, 2019, financial assets available for general expenditure within one year of the consolidated statement of financial position date, consists of the following:

Cash and cash equivalents	\$ 53,317,376
Investments	76,914,826
Patient accounts receivable, net	63,147,652
Other	5,072,079
Less: Net assets with donor restrictions included in cash	<u>(4,460,276)</u>
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 193,991,657</u>

As part of the Organization's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due.

NOTE 4 - Net Patient Service Revenue

Net patient service revenues are recognized at the amount that reflects the consideration to which the Hospital expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including commercial and governmental programs), and others and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations. Generally, the Hospital bills the patients and third-party payors shortly after the services are performed and/or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by the Hospital. Revenue for performance obligations satisfied over time is recognized based on actual services incurred in relation to total expected (or actual) payments. The Hospital believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the Hospital receiving inpatient acute care services. The Hospital measures the performance obligation from admission into the facility to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time are recognized when services are provided and the Hospital does not believe it is required to provide additional services to the patient.

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

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 4 - Net Patient Service Revenue (cont.)

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

The composition of the Hospital's net patient care services revenue by major payor sources, are as follows for the years ended September 30 (approximate):

	2019	2018
Medicare	\$ 89,547,000	\$ 97,690,000
Medi-Cal	32,825,000	19,627,000
HMO/PPO	198,211,000	189,951,000
Self-Pay and others	10,506,000	10,084,000
Subtotal	331,089,000	317,352,000
Quality assurance program revenue	16,089,000	16,930,000
Total	\$ 347,178,000	\$ 334,282,000

The composition of patient care service revenue based on the Hospital's lines of business for years ended September 30 (approximate):

	2019	2018
Inpatient	\$ 161,695,000	\$ 161,792,000
Outpatient	80,100,000	70,286,000
Emergency	89,294,000	85,274,000
Subtotal	331,089,000	317,352,000
Quality assurance program revenue	16,089,000	16,930,000
Total	\$ 347,178,000	\$ 334,282,000

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended September 30, 2019 and 2018

NOTE 4 - Net Patient Service Revenue (cont.)

The Organization has agreements with third-party payors that provide for payments and amounts less than established charges. A summary of the payment arrangements with major third party payors is as follows:

Medicare

Revenue from the Medicare program accounted for approximately 26% and 28% of the Organization's net patient service revenue for the years ended September 30, 2019 and 2018, respectively. Inpatient acute services rendered to Medicare program beneficiaries are paid at prospectively determined diagnosis related groups ("DRGs") and case mix groups ("CMGs") and prospective per diem rates, depending on the services they receive. 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 Organization's cost reports, and are estimated using historical trends and current factors. The Organization is reimbursed for certain services at tentative rates for these other payments, with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The Organization's Medicare cost reports have been audited and final settled by the Medicare fiscal intermediary through 2014. The 2015 through 2018 cost reports have been filed and tentatively settled as of the date of the financial statements. The 2019 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.

Medi-Cal

Revenue from the Medi-Cal program accounted for approximately 10% and 5% of the Organization's net patient service revenue for the years ended September 30, 2019 and 2018, respectively. 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, 2019 and 2018, the AB99 program provided approximately \$4,604,000 and \$3,563,000, respectively, in additional revenue for this class of net patient service revenues on the consolidated statement of operations.

HMO/PPO

The Organization 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 Organization under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Other

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 Organization's gross charges.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 4 - Net Patient Service Revenue (cont.)

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various health care organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge the Hospital'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 Hospital. In addition, the contracts the Hospital has with commercial payors also provide for retroactive audit and review of claims.

Settlements with third-party payors for retroactive adjustments due to audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor and the Hospital'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. Revenue received under third-party arrangements is subject to audit and retroactive adjustments.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The Organization also provides services to uninsured patients, and offers those uninsured or underinsured patients a discount, either by policy or law, from standard charges. The Organization 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 charges, by any contractual adjustment, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustment to net patient service revenues in the period of the change. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

Consistent with the Hospital's mission, care is provided to patients regardless of their ability to pay. Therefore, the Hospital has determined it has provided implicit price concessions to uninsured patients and other patient 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 Hospital expects to collect based on its collection history with those patients.

The Hospital disaggregates revenue from contracts with customers by type of service and payor source as this depicts the nature, amount, timing and uncertainty of its revenue and cash flows as affected by economic factors. Tables providing details of these factors are presented in Note 4.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 5 - Property, Plant and Equipment

Property, plant and equipment consist of the following as of September 30 (approximate):

	2019	2018
Building and improvements	\$ 221,072,000	\$ 221,653,000
Equipment and furniture	<u>123,158,000</u>	<u>119,132,000</u>
	344,230,000	340,785,000
Less accumulated depreciation and amortization	<u>(208,022,000)</u>	<u>(190,079,000)</u>
	136,208,000	150,706,000
Construction-in-progress	187,517,000	150,180,000
Land and land improvements	<u>10,726,000</u>	<u>10,726,000</u>
Property, plant and equipment, net	<u>\$ 334,451,000</u>	<u>\$ 311,612,000</u>

Depreciation expense for the years ended September 30, 2019 and 2018 amounted to approximately \$18,105,000 and \$17,375,000, 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 was placed into service in October 2019, which reduced construction-in-progress by approximately \$176,000,000.

NOTE 6 - Long-Term Debt

Long-term debt at consists of the following as of September 30 (approximate):

	2019	2018
2013 Series A Revenue Bonds (1)	\$ 17,850,000	\$ 19,350,000
2013 Series B Revenue Bonds (2)	23,200,000	25,650,000
2014 Insured Revenue Bonds (3)	68,225,000	68,670,000
2017 California Public Finance Authority Revenue Bonds (4)	109,625,000	109,625,000
2018 Series Taxable Bond (5)	10,479,000	10,500,000
Mortgage Loan Payable (6)	<u>12,146,000</u>	<u>12,490,000</u>
	241,525,000	246,285,000
Deferred financing costs, net of accumulated amortization	(3,857,000)	(4,066,000)
Unamortized bond premium	<u>5,505,000</u>	<u>5,773,000</u>
	243,173,000	247,992,000
Less current maturities	<u>(4,995,000)</u>	<u>(4,759,000)</u>
	<u>\$ 238,178,000</u>	<u>\$ 243,233,000</u>

(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.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 6 - Long-Term Debt (cont.)

- (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 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 and B.
- (4) 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"). The 2017 Bonds require annual principal payments ranging from \$780,000 to \$12,360,000 beginning in 2021 through 2047. 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.
- (5) Henry Mayo Newhall Hospital Taxable Bond, Series 2018 in the original amount of \$10,500,000, which bears interest at an annual rate of 4.75%, payable monthly (the "2018 Bonds"). Interest only payments are required from October 2018 through August 2020 and principal and interest payments are required thereafter through August 2028. Annual payments range from \$503,000 to \$750,000, with a balloon payment of \$8,063,011 due in August 2028. The 2018 Bonds are held by a bank. The 2018 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.
- (6) Mortgage Loan Payable assumed in August 2018 in the amount of \$12,519,000 which bears interest at an annual rate of 3.94%, payable monthly (the "Loan Payable"). The Loan Payable requires annual principal and interest payments of \$850,000, with a balloon payment of \$9,683,000 due in September 2025. The Loan Payable is secured by lease payments under a master lease for the acquired property whereby the Foundation is the lessor and the Hospital is the lessee. The Hospital is the guarantor of the Loan Payable, for which the Foundation is the primary obligor.

The master trust indentures 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 financial covenants included in the master trust indenture at September 30, 2019 and 2018.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 6 - Long-Term Debt (cont.)

Maturities of long-term debt at September 30, 2019 above are as follows:

	<u>Principal Maturities</u>
2020	\$ 4,995,000
2021	6,141,000
2022	6,410,000
2023	6,704,000
2024	7,005,000
Thereafter	<u>210,270,000</u>
	241,525,000
Deferred financing costs, net of accumulated amortization	(3,857,000)
Unamortized net bond premium and discounts, net	<u>5,505,000</u>
	<u>\$ 243,173,000</u>

NOTE 7 - Pension Plan

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

The Organization 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, 2019 and 2018, the Organization's matching contributions were approximately \$3,587,000 and \$3,439,000, respectively, in employee benefits on the consolidated statements of operations.

NOTE 8 - Pledges Receivable

Pledges receivable consist of the following as of September 30 (approximate):

	<u>2019</u>	<u>2018</u>
Less than one year	\$ 602,000	\$ 724,000
One to five years	1,249,000	1,249,000
Less: Allowance for uncollectible pledges	<u>(124,000)</u>	<u>(40,000)</u>
Net pledges receivable	<u>\$ 1,727,000</u>	<u>\$ 1,933,000</u>

Pledges receivable are not discounted.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 9 - Charitable Remainder Trusts

The Foundation is the beneficiary under two irrevocable charitable remainder trusts (the "trusts"). These trusts pay a stipulated annuity to the donor and provide the donor with a life income interest in the assets contributed. At a stipulated time (upon death of the donor or donor's designee), the remaining assets are generally available for the Foundation's use. The present value of the estimated future distributions expected to be received by the Foundation over the term of the arrangements of \$3,000,000 and \$3,126,000 as of September 30, 2019 and 2018, respectively were recorded as receivables under trust agreements. As of September 30, 2019 and 2018, the fair market values of the assets were estimated at \$6,919,000 and \$7,028,000, respectively. Annually, the amounts payable to annuitants and the contributions receivable are revised based on an actuarial calculation using discount rates, mortality factors, and current fair values of trust assets. The changes in contributions receivable from remainder trusts are reported as changes in value of receivables under trust agreements on the consolidated statements of changes in net assets.

NOTE 10 - Net Assets With Donor Restrictions

Contributions received that are restricted for specific Organization programs or capital projects are recorded as net assets with donor restrictions.

Contributions and grants that were recorded as net assets with donor restrictions and funds relating to these net assets were transferred to net assets without donor restrictions when the restriction had lapsed and when used or incurred for their intended purpose.

Net assets with donor restrictions are available for the following purposes at September 30 (approximate):

	<u>2019</u>	<u>2018</u>
New patient tower	\$ 2,583,000	\$ 2,367,000
Emergency room	2,306,000	2,052,000
Other equipment	251,000	454,000
Diabetes program	399,000	399,000
Breast imaging program	352,000	284,000
Bio terrorism	-	121,000
Charitable remainder trust	3,000,000	3,126,000
Other	<u>323,000</u>	<u>339,000</u>
Total	<u>\$ 9,214,000</u>	<u>\$ 9,142,000</u>

NOTE 11 - Tower Imaging Joint Venture

The Organization has a 50% joint venture agreement with Tower Imaging Medical Group, Inc., a California professional corporation ("TIMG"), whereby the Organization 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 Organization, is a for-profit enterprise. The Organization accounts for the investment in the Joint Venture under the equity method of accounting. Under the equity method, the Organization recognizes its share of the earnings or losses in the Joint Venture.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 11 - Tower Imaging Joint Venture (cont.)

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 Organization and TIMG. During the year ended September 30, 2019, the Joint Venture distributed a total of \$1,200,000 or \$600,000 for each partner from the Joint Venture. During the year ended September 30, 2018, the Joint Venture distributed a total of \$1,414,000 or \$707,000 for each partner from the Joint Venture. The term of the Joint Venture agreement is until 2021.

As members of the Joint Venture, TIMG and the Organization 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, 2019, the Organization 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, 2019 and 2018 was approximately \$1,069,000 and \$1,090,000, respectively, and is recorded as part of other assets in the consolidated statements of financial position.

The unaudited condensed financial statement information for the Joint Venture as of and for the years ended September 30, 2019 and 2018, respectively, was approximately:

	<u>2019</u>	<u>2018</u>
Condensed financial statement information (unaudited):		
Program receivables	\$ 282,000	\$ 339,000
Other receivables (payables), net	319,000	275,000
Net income	1,162,000	1,314,000

NOTE 12 - Capital Lease Obligations

The Organization had capital lease obligation for the ambulatory care facility and office, which was amended on December 1, 2007. The lease required 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 facility houses an outpatient surgery program and certain other functions that support the Organization. Portions of the facility are sublet to third parties. In August 2018 the Organization terminated the ambulatory care facility capital lease in connection with acquiring the property.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 13 - Operating Leases

In November 2012, the Organization (as landlord) entered into a ground lease with an independent third party (as tenant) to lease approximately 53,870 square feet of the Organization's land for the construction of a Medical Office Building ("MOB") that the Organization occupied and leased upon completion of the MOB. The ground lease term is for 60 years with annual base rent in the amount of \$125,000 payable to the Organization 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 Organization (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 \$76,000 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 Organization determined this to be an operating lease and lease rentals were straightlined over the initial term of the lease.

Operating leases consist primarily of medical and office space, as well as equipment leases. Total facilities rental expense, including month-to-month rentals, for the years ended September 30, 2019 and 2018, respectively, was approximately \$4,558,536 and \$5,267,000, respectively.

The Organization (as landlord) has entered into various operating lease agreements. The lease termination dates range through 2072. Rental income generated from these leases totaled approximately \$1,179,000 and \$1,180,000 for the years ended September 30, 2019 and 2018, respectively.

Future minimum annual rental commitments under noncancelable operating leases, principally for medical and office space, are as follows (approximate):

2020	\$ 3,596,000
2021	3,199,000
2022	2,756,000
2023	2,671,000
2024	2,720,000
Thereafter	<u>16,876,000</u>
Total	<u>\$ 31,818,000</u>

Future minimum expected annual rental income under noncancelable operating leases, principally for office space, are as follows (approximate):

2020	\$ 663,000
2021	337,000
2022	346,000
2023	355,000
2024	365,000
Thereafter	<u>37,385,000</u>
Total	<u>\$ 39,451,000</u>

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 14 - Commitments and Contingencies

Golden Valley Pledged Lease Asset

On September 10, 2008, the Organization 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 Organization, for the purpose of operating a physical therapy facility. The lease of the space is contingent on the continued use by the Organization 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 \$2,743,000. Due to the contingent nature of the lease, a liability for \$2,743,000 was recorded as deferred contribution revenue on the consolidated statements of financial position. As of September 30, 2019 and 2018, the pledged lease asset and deferred contribution revenue were \$2,302,000 and \$2,345,000, 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, 2019 and 2018, the Organization had outstanding construction commitments of approximately \$4,559,723 and \$24,524,000, respectively, related to the construction of the new Patient Tower as well as other construction projects in progress on campus.

Management Incentive Plan

The Organization has a Management Incentive Plan which provides incentive compensation when certain performance goals are met. For the years ended September 30, 2019 and 2018, the Organization incurred incentive compensation of \$1,432,000 and \$1,270,000, respectively, in salaries and wages on the consolidated statements of operations.

Malpractice Insurance

The Organization maintains medical malpractice insurance under a claims-made policy. A claims-made policy covers only claims net of the Organization'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. The primary policy provides coverage with an annual aggregate of \$15,000,000 with \$5,000,000 limited per claim and an additional umbrella policy with a \$25,000,000 aggregate. The Organization also purchases excess umbrella liability coverage, which provided additional coverage above the basic policy limits up to the specified in umbrella policy. The Organization has obtained coverage through July 1, 2020.

Based on the Organization's claim experience, an accrual has been made for the Organization's estimated medical malpractice costs, including costs associated with litigating or settling claims, under its malpractice insurance policy, in the amounts of approximately \$4,798,000 and \$4,904,000, as of September 30, 2019 and 2018, respectively. It is reasonably possible that this estimate could change materially in the near term.

In June and November 2005, the Organization invested a total of \$218,000 for the purchase of 27,230 shares (1.7% ownership as of September 30, 2019 and 2018) 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 Organization accounts for its investment in CHI under the cost method of accounting. During the years ended September 30, 2019 and 2018, the Organization paid approximately \$825,000 and \$762,000, respectively, in premiums to CHI.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 14 - Commitments and Contingencies (cont.)

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 Organization believes that CHI will provide the Organization with efficient and cost effective management of its medical malpractice and other risks. As of September 30, 2019 and 2018, 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 Organization has a self-insured program for employee healthcare for the years ended September 30, 2019 and 2018. An accrual has been made for the estimated liabilities arising from outstanding healthcare claims incurred but not yet reported, as of September 30, 2019 and 2018. Management believes that its estimates are sufficient, however, actual amounts may materially differ from those estimates. For the years ended September 30, 2019 and 2018, these liabilities were approximately \$1,942,000 and \$1,791,000, respectively, and are recorded in accrued payroll and benefits in the accompanying consolidated statements of financial position. The Organization also maintains a stop-loss reinsurance policy for its self-insured healthcare program. The stop-loss policy reimburses the Organization 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 Organization has a guaranteed cost premium policy. Accruals have been made for the liabilities arising from audits of the policy for the plan years ended September 30, 2019 and 2018 for approximately \$665,000 and \$786,000, respectively, and are included in accrued payroll and benefits in the accompanying consolidated statements of financial position. An estimated accrual has been made for the liabilities arising from the previous policies for the plan years ended September 30, 2018 and prior for approximately \$1,633,000 which is included in accrued payroll and benefits in the accompanying consolidated statements of financial position for the years ended September 30, 2019 and 2018. Actual amounts may materially differ from those estimates.

Union Contract

The Organization has contracts with the California Nurses Association and the United Electrical, Radio & Machine Workers of America for the period January 2019 through January 2022 and February 2020 through January 2023, 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. As of September 30, 2019 and 2018, respectively, 76.5% and 77.4% of the Organization's employees were covered by union contracts. The renewal contract with the United Electrical, Radio & Machine Workers of America was ratified on February 6, 2020 by union vote.

Litigation

The Organization is involved in litigation arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, these matters are expected to be resolved without a material adverse effect on the Organization's consolidated statement of financial position. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 14 - Commitments and Contingencies (cont.)

Regulatory Environment

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations are not limited to matters such as licensure, accreditation, government healthcare program participating requirements, reimbursements for patient services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. 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. 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.

In November 2018, the Organization submitted a request to be entered into the Centers for Medicare and Medicaid Services voluntary self-disclosure protocol, which is a process for self-disclosing actual or potential violations of the federal physician self-referral statute. The potential violations disclosed involve multiple physician arrangements, and primarily concern possible overpayments by the Organization. At this time the Organization cannot estimate the amount of any repayment, if any, that may result from the voluntary self-disclosure.

NOTE 15 - Investments and Fair Value Measurements

Fair value is defined in the accounting guidance as the exchange price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the assets or liability in an orderly transaction between market participants at the measurement date. Under this guidance a three level hierarchy is used for fair value measurements which are based on the transparency of information, such as the pricing source used in the valuation of an asset or liability as of the measurement date.

Financial instruments measured and reported at fair value are classified and disclosed in one of the following three categories:

Level 1 - Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities, that the reporting entity can access at the measurement date.

Level 2 - Inputs other than quoted prices included in Level 1 that are observable for the assets or liability, either directly or indirectly. This includes quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or market corroborated inputs.

Level 3 - Inputs are unobservable for the asset or liability. Unobservable inputs reflect the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk) using the best information available in the circumstances, which may include using the reporting entity's own data.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended September 30, 2019 and 2018

NOTE 15 - Fair Value Measurements (cont.)

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the techniques and inputs used as of September 30, 2019 and 2018.

Fixed income mutual funds, domestic equity mutual funds, international equity mutual funds and balanced funds are valued based on quoted market prices.

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

While the Organization believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial statements could result in a different estimate of fair value at the reporting date.

The following table presents the fair value measurements of assets recognized in the accompanying consolidated statements of financial position measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurement falls at September 30, 2019 and 2018 (approximate):

	2019			
	Level 1	Level 2	Level 3	Total
<u>Investments:</u>				
Mutual funds - fixed income	\$ 30,959,000	\$ -	\$ -	\$ 30,959,000
Mutual funds - domestic equity	19,070,000	-	-	19,070,000
Mutual funds - international equity	15,339,000	-	-	15,339,000
Balanced funds	<u>11,547,000</u>	-	-	<u>11,547,000</u>
Total investments	<u>\$ 76,915,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 76,915,000</u>
 <u>Assets disclosed at fair value:</u>				
Receivable under charitable remainder trust agreements	-	-	3,000,000	3,000,000
	2018			
	Level 1	Level 2	Level 3	Total
<u>Investments:</u>				
Mutual funds - fixed income	33,234,000	\$ -	\$ -	\$ 33,234,000
Mutual funds - domestic equity	43,345,000	-	-	43,345,000
Mutual funds - international equity	<u>18,793,000</u>	-	-	<u>18,793,000</u>
Total investments	<u>\$ 95,372,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 95,372,000</u>
 <u>Assets disclosed at fair value:</u>				
Receivable under charitable remainder trust agreements	-	-	3,126,000	3,126,000

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 15 - Fair Value Measurements (cont.)

Significant Unobservable Inputs for Level 3 Investments

The following table provides quantitative information related to the significant unobservable inputs for Level 3 investments, which are carried at fair value as of September 30, 2019 (approximate):

Fair Value of Level 3 investments	Valuation Technique	Unobservable Input	Rate
\$ 3,000,000	Present value approach	Discount Rate	1.67 %
		Mortality Factor (Number of Years)	14.1

The following table provides quantitative information related to the significant unobservable inputs for Level 3 investments which are carried at fair value as of September 30, 2018 (approximate):

Fair Value of Level 3 investments	Valuation Technique	Unobservable Input	Rate
\$ 3,126,000	Present value approach	Discount Rate	3.09 %
		Mortality Factor (Number of Years)	14.7

Under the present value approach, the significant unobservable inputs used in the fair value measurement of the Foundation's receivables under charitable remainder trust agreements are the discount rate and the mortality factor (number of years). Significant increases or decreases in the discount rate in isolation may result in a significantly higher or lower fair value measurement, respectively. Significant increases or decreases in the mortality factor (number of years) may result in a significantly lower or higher fair value measurement, respectively.

NOTE 16 - Functional Expenses

The consolidated financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the Organization. These expenses include depreciation, interest and amortization, administration, communications, media production, information technology, and facilities operations and maintenance. Employee benefits are allocated based on the respective proportion of salaries and wages. Depreciation and interest are allocated based on square footage. Costs of other categories were allocated on estimates of time and effort.

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 16 - Functional Expenses (cont.)

Functional expenses for the year ended September 30, 2019 (approximate):

	Healthcare Services	General and Administrative	Fundraising	Total
Salaries and wages	\$ 108,514,000	\$ 13,252,000	\$ 459,000	\$ 122,225,000
Employee benefits	38,832,000	4,657,000	140,000	43,629,000
Registry	1,828,000	104,000	-	1,932,000
Supplies	50,300,000	739,000	-	51,039,000
Purchased Services	35,841,000	8,269,000	3,000	44,113,000
Repairs and maintenance	7,046,000	1,583,000	-	8,629,000
Interest	3,911,000	1,473,000	-	5,384,000
Depreciation and amortization	15,188,000	2,917,000	-	18,105,000
Insurance	2,208,000	66,000	5,000	2,279,000
Rent	3,734,000	1,663,000	46,000	5,443,000
Utilities	2,821,000	523,000	-	3,344,000
Quality assurance fee hospital tax	19,901,000	-	-	19,901,000
Other operating expenses	10,320,000	4,229,000	195,000	14,744,000
	\$ 300,444,000	\$ 39,475,000	\$ 848,000	\$ 340,767,000

Functional expenses for the year ended September 30, 2018:

Health care services	\$ 302,665,000
General and administrative	42,710,000
Fundraising	1,166,000
	\$ 346,541,000

NOTE 17 - Concentration of Credit Risk

The Organization grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The composition of net patient accounts receivable and third-party payors was as follows as of September 30:

	2019	2018
Patient accounts receivable:		
Medicare	32 %	30 %
Medi-Cal	14	13
Self-Pay and Other	20	18
HMO/PPO	34	39
	100 %	100 %

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended September 30, 2019 and 2018

NOTE 17 - Concentration of Credit Risk (cont.)

The composition of net patient services revenue recognized in the years ended September 30, was as follows:

	<u>2019</u>	<u>2018</u>
Net patient revenues:		
Medicare	26 %	28 %
Medi-Cal	10	5
Self-Pay and other	5	9
HMO/PPO	54	53
Quality assurance program	5	5
	<u>100 %</u>	<u>100 %</u>

NOTE 18 - Subsequent Events

Subsequent events have been evaluated through February 21, 2020, which is the date of the consolidated financial statements were issued.

SUPPLEMENTAL INFORMATION

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

STATEMENT OF FINANCIAL POSITION - CONSOLIDATING INFORMATION

As of September 30, 2019

ASSETS							
	Hospital	Foundation	MSO	Network	Total Before Eliminations	Eliminations	Consolidated
CURRENT ASSETS							
Cash and cash equivalents	\$ 48,140,985	\$ 5,040,923	\$ 26,854	\$ 108,614	\$ 53,317,376	\$ -	\$ 53,317,376
Investments	76,914,826	-	-	-	76,914,826	-	76,914,826
Pledges receivable, net	-	16,876	-	-	16,876	-	16,876
Patient accounts receivable	63,147,652	-	-	-	63,147,652	-	63,147,652
Receivables from affiliates	10,310,543	-	-	1,238,300	11,548,843	(11,548,843)	-
Inventories	5,911,973	-	-	-	5,911,973	-	5,911,973
Prepaid expenses and other current assets	7,096,313	320,204	379,267	10,438	7,806,222	-	7,806,222
Quality assurance program receivable	<u>9,686,455</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>9,686,455</u>	<u>-</u>	<u>9,686,455</u>
 Total current assets	 221,208,747	 5,378,003	 406,121	 1,357,352	 228,350,223	 (11,548,843)	 216,801,380
 PLEDGES RECEIVABLE, NET	 -	 1,710,105	 -	 -	 1,710,105	 -	 1,710,105
 PROPERTY, PLANT AND EQUIPMENT, NET	 307,355,501	 27,095,159	 -	 -	 334,450,660	 -	 334,450,660
 PLEDGED LEASE	 2,301,991	 -	 -	 -	 2,301,991	 -	 2,301,991
 RECEIVABLE UNDER TRUST AGREEMENT	 -	 3,000,126	 -	 -	 3,000,126	 -	 3,000,126
 OTHER ASSETS	 <u>-</u>	 <u>285,607</u>	 <u>-</u>	 <u>-</u>	 <u>285,607</u>	 <u>-</u>	 <u>285,607</u>
 TOTAL ASSETS	 <u>\$ 530,866,239</u>	 <u>\$ 37,469,000</u>	 <u>\$ 406,121</u>	 <u>\$ 1,357,352</u>	 <u>\$ 570,098,712</u>	 <u>\$ (11,548,843)</u>	 <u>\$ 558,549,869</u>

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

STATEMENT OF FINANCIAL POSITION - CONSOLIDATING INFORMATION

As of September 30, 2019 (continued)

LIABILITIES AND NET ASSETS							
	<u>Hospital</u>	<u>Foundation</u>	<u>MSO</u>	<u>Network</u>	<u>Total Before Eliminations</u>	<u>Eliminations</u>	<u>Consolidated</u>
CURRENT LIABILITIES							
Current portion of long-term debt	\$ 4,615,916	\$ 378,788	\$ -	\$ -	\$ 4,994,704	\$ -	\$ 4,994,704
Accounts payable and accrued liabilities	43,943,100	50,558	-	1,166,477	45,160,135	(1,238,300)	43,921,835
Accrued payroll and benefits	19,233,163	54,533	296	-	19,287,992	-	19,287,992
Accrued interest	5,298,090	-	-	-	5,298,090	-	5,298,090
Quality assurance fee payable	12,919,793	-	-	-	12,919,793	-	12,919,793
Quality assurance fee deferred revenue	218,610	-	-	-	218,610	-	218,610
Estimated third party liabilities	3,985,867	-	-	-	3,985,867	-	3,985,867
Payable to affiliate, net	-	9,260,188	924,619	125,736	10,310,543	(10,310,543)	-
Total current liabilities	90,214,539	9,744,067	924,915	1,292,213	102,175,734	(11,548,843)	64,787,305
LONG-TERM DEBT, NET	226,431,314	11,746,639	-	-	238,177,953	-	238,177,953
DEFERRED RENT LIABILITY	1,383,439	-	-	-	1,383,439	-	1,383,439
DEFERRED CONTRIBUTION REVENUE	2,301,991	-	-	-	2,301,991	-	2,301,991
ACCRUED MALPRACTICE LIABILITY	4,798,029	-	-	-	4,798,029	-	4,798,029
Total liabilities	<u>325,129,312</u>	<u>21,490,706</u>	<u>924,915</u>	<u>1,292,213</u>	<u>348,837,146</u>	<u>(11,548,843)</u>	<u>337,288,303</u>
NET ASSETS							
Without donor restrictions	196,523,343	15,978,294	(518,794)	65,139	212,047,982	-	212,047,982
With donor restrictions	9,213,584	-	-	-	9,213,584	-	9,213,584
Total net assets	<u>205,736,927</u>	<u>15,978,294</u>	<u>(518,794)</u>	<u>65,139</u>	<u>221,261,566</u>	<u>-</u>	<u>221,261,566</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 530,866,239</u>	<u>\$ 37,469,000</u>	<u>\$ 406,121</u>	<u>\$ 1,357,352</u>	<u>\$ 570,098,712</u>	<u>\$ (11,548,843)</u>	<u>\$ 558,549,869</u>

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

STATEMENT OF OPERATIONS - CONSOLIDATING INFORMATION

For the Year Ended September 30, 2019

	Hospital	Foundation	MSO	Network	Total Before Eliminations	Eliminations	Consolidated
OPERATING REVENUES							
Net patient service revenue	\$ 347,177,607	\$ -	\$ -	\$ -	\$ 347,177,607	\$ -	\$ 347,177,607
Other revenue	8,438,388	2,028,483	-	3,812,049	14,278,920	(5,838,512)	8,440,408
California Hospital Foundation grant revenue	3,811,985	-	-	-	3,811,985	-	3,811,985
Net assets released from restrictions used for operations	377,236	-	-	-	377,236	-	377,236
	<u>359,805,216</u>	<u>2,028,483</u>	<u>-</u>	<u>3,812,049</u>	<u>365,645,748</u>	<u>(5,838,512)</u>	<u>359,807,236</u>
Total operating revenues							
	<u>359,805,216</u>	<u>2,028,483</u>	<u>-</u>	<u>3,812,049</u>	<u>365,645,748</u>	<u>(5,838,512)</u>	<u>359,807,236</u>
OPERATING EXPENSES							
Salaries and wages	121,633,975	577,011	14,159	-	122,225,145	-	122,225,145
Employee benefits	43,454,370	172,547	1,618	-	43,628,535	-	43,628,535
Registry	1,931,629	-	-	-	1,931,629	-	1,931,629
Supplies	51,038,951	420	-	-	51,039,371	-	51,039,371
Purchased services	44,211,069	1,500	-	3,712,051	47,924,620	(3,812,048)	44,112,572
Repairs and maintenance	8,629,201	-	-	-	8,629,201	-	8,629,201
Interest	4,845,631	538,169	-	-	5,383,800	-	5,383,800
Depreciation and amortization	17,102,823	1,001,819	-	-	18,104,642	-	18,104,642
Insurance	2,273,435	5,496	-	-	2,278,931	-	2,278,931
Rent	7,295,224	46,160	127,870	-	7,469,254	(2,026,464)	5,442,790
Utilities	3,343,589	-	-	-	3,343,589	-	3,343,589
Quality assurance fee hospital tax	19,901,311	-	-	-	19,901,311	-	19,901,311
Other operating costs	14,476,245	233,519	-	34,859	14,744,623	-	14,744,623
	<u>340,137,453</u>	<u>2,576,641</u>	<u>143,647</u>	<u>3,746,910</u>	<u>346,604,651</u>	<u>(5,838,512)</u>	<u>340,766,139</u>
Total operating expenses							
	<u>340,137,453</u>	<u>2,576,641</u>	<u>143,647</u>	<u>3,746,910</u>	<u>346,604,651</u>	<u>(5,838,512)</u>	<u>340,766,139</u>
OPERATING INCOME (LOSS)	<u>\$ 19,667,763</u>	<u>\$ (548,158)</u>	<u>\$ (143,647)</u>	<u>\$ 65,139</u>	<u>\$ 19,041,097</u>	<u>\$ -</u>	<u>\$ 19,041,097</u>

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

STATEMENT OF OPERATIONS - CONSOLIDATING INFORMATION For the Year Ended September 30, 2019 (continued)

	Hospital	Foundation	MSO	Network	Total Before Eliminations	Eliminations	Consolidated
NON-OPERATING INCOME (LOSS)							
Contributions	\$ 38,147	\$ 164,344	\$ -	\$ -	\$ 202,491	\$ -	\$ 202,491
Interest and dividends	2,531,258	29,868	-	-	2,561,126	-	2,561,126
Realized gain on investments, net	6,111,609	-	-	-	6,111,609	-	6,111,609
Unrealized loss on investments, net	(6,999,348)	-	-	-	(6,999,348)	-	(6,999,348)
Other non-operating (loss) income, net	(113,892)	-	43,545	-	(70,347)	-	(70,347)
Equity in income of joint venture	579,238	-	-	-	579,238	-	579,238
REVENUES IN EXCESS (DEFICIENCY) OF EXPENSES	21,814,775	(353,946)	(100,102)	65,139	21,425,866	-	21,425,866
Contributions from subsidiary	-	58,935	-	-	58,935	(58,935)	-
Contributions to subsidiary	(58,935)	-	-	-	(58,935)	58,935	-
NET ASSETS RELEASED FROM RESTRICTED USED FOR PURCHASES OF PROPERTY, PLANT AND EQUIPMENT	1,500,000	-	-	-	1,500,000	-	1,500,000
INCREASE IN NET ASSETS WITHOUT DONOR RESTRICTIONS	<u>\$ 23,255,840</u>	<u>\$ (295,011)</u>	<u>\$ (100,102)</u>	<u>\$ 65,139</u>	<u>\$ 22,925,866</u>	<u>\$ -</u>	<u>\$ 22,925,866</u>

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

STATEMENT OF CHANGES IN NET ASSETS - CONSOLIDATING INFORMATION

For the Year Ended September 30, 2019

	Hospital	Foundation	MSO	Network	Total Before Eliminations	Eliminations	Consolidated
CHANGES IN NET ASSETS WITHOUT DONOR RESTRICTIONS							
Revenues in excess (deficiency) of expense	\$ 21,814,775	\$ (353,946)	\$ (100,102)	\$ 65,139	\$ 21,425,866	\$ -	\$ 21,425,866
Contributions from subsidiary	-	58,935	-	-	58,935	(58,935)	-
Contributions to subsidiary	(58,935)	-	-	-	(58,935)	58,935	-
Net assets released from restrictions used for purchase of property, plant and equipment	<u>1,500,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,500,000</u>	<u>-</u>	<u>1,500,000</u>
Net increase (decrease) in net assets without donor restrictions	<u>23,255,840</u>	<u>(295,011)</u>	<u>(100,102)</u>	<u>65,139</u>	<u>22,925,866</u>	<u>-</u>	<u>22,925,866</u>
CHANGE IN NET ASSETS WITH DONOR RESTRICTIONS							
Contributions	2,075,125	-	-	-	2,075,125	-	2,075,125
Change in value of receivables under trust agreements	-	(126,337)	-	-	(126,337)	-	(126,337)
Net assets released from restrictions	<u>(1,877,236)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,877,236)</u>	<u>-</u>	<u>(1,877,236)</u>
Net Increase (decrease) in net assets with donor restrictions	<u>197,889</u>	<u>(126,337)</u>	<u>-</u>	<u>-</u>	<u>71,552</u>	<u>-</u>	<u>71,552</u>
INCREASE (DECREASE) IN NET ASSETS	<u>23,453,729</u>	<u>(421,348)</u>	<u>(100,102)</u>	<u>65,139</u>	<u>22,997,418</u>	<u>-</u>	<u>22,997,418</u>
NET ASSETS - BEGINNING OF YEAR	178,496,639	16,399,642	(418,692)	-	194,477,589	-	194,477,589
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE (NOTE 2)	<u>3,786,559</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,786,559</u>	<u>-</u>	<u>3,786,559</u>
NET ASSETS - BEGINNING OF YEAR, AS ADJUSTED	<u>182,283,198</u>	<u>16,399,642</u>	<u>(418,692)</u>	<u>-</u>	<u>198,264,148</u>	<u>-</u>	<u>198,264,148</u>
NET ASSETS - END OF YEAR	<u>\$ 205,736,927</u>	<u>\$ 15,978,294</u>	<u>\$ (518,794)</u>	<u>\$ 65,139</u>	<u>\$ 221,261,566</u>	<u>\$ -</u>	<u>\$ 221,261,566</u>

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

STATEMENT OF FINANCIAL POSITION - OBLIGATED GROUP INFORMATION As of September 30, 2019

ASSETS		<u>Hospital</u>
CURRENT ASSETS		
Cash and cash equivalents	\$	48,140,985
Investments		76,914,826
Patient accounts receivable		63,147,652
Receivables from affiliates		10,310,543
Inventories		5,911,973
Prepaid expenses and other current assets		7,096,313
Quality assurance fee receivable		<u>9,686,455</u>
Total current assets		221,208,747
PROPERTY, PLANT, AND EQUIPMENTS, NET		307,355,501
PLEDGED LEASE		<u>2,301,991</u>
TOTAL ASSETS		<u>\$ 530,866,239</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current portion of long-term debt	\$	4,615,916
Accounts payable and accrued liabilities		43,943,100
Accrued payroll and benefits		19,233,163
Accrued interest		5,298,090
Quality assurance fee payable		12,919,793
Quality assurance fee deferred revenue		218,610
Estimated third party liabilities		<u>3,985,867</u>
Total current liabilities		90,214,539
LONG-TERM DEBT, NET		226,431,314
DEFERRED RENT LIABILITY		1,383,439
DEFERRED CONTRIBUTION REVENUE		2,301,991
ACCRUED MALPRACTICE LIABILITY		<u>4,798,029</u>
Total liabilities		<u>325,129,312</u>
NET ASSETS		
Without donor restrictions		196,523,343
With donor restrictions		<u>9,213,584</u>
Total net assets		<u>205,736,927</u>
TOTAL LIABILITIES AND NET ASSETS		<u>\$ 530,866,239</u>

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

STATEMENT OF OPERATIONS - OBLIGATED GROUP INFORMATION For the Year Ended September 30, 2019

	<u>Hospital</u>
OPERATING REVENUES	
Net patient service revenue	\$ 347,177,607
Other revenue	8,438,388
California Hospital Foundation grant revenue	3,811,985
Net assets released from restrictions used for operations	<u>377,236</u>
Total operating revenues	<u>359,805,216</u>
OPERATING EXPENSES	
Salaries and wages	121,633,975
Employee benefits	43,454,370
Registry	1,931,629
Supplies	51,038,951
Purchased services	44,211,069
Repairs and maintenance	8,629,201
Interest	4,845,631
Depreciation and amortization	17,102,823
Insurance, net	2,273,435
Rent	7,295,224
Utilities	3,343,589
Quality assurance fee hospital tax	19,901,311
Other operating costs	<u>14,476,245</u>
Total operating expenses	<u>363,393,293</u>
OPERATING INCOME	(3,588,077)
NON-OPERATING INCOME (LOSS)	
Contributions	38,147
Interest and dividends	2,531,258
Realized gain on investments, net	6,111,609
Unrealized loss on investments, net	(6,999,348)
Other non-operating income, net	(113,892)
Equity in income of joint venture	<u>579,238</u>
REVENUES IN EXCESS OF EXPENSES	21,814,775
Contributions to subsidiaries, net	(58,935)
Net assets released from restrictions used for purchases of property, plant and equipment	<u>1,500,000</u>
INCREASE IN NET ASSETS WITHOUT DONOR RESTRICTIONS	<u>23,255,840</u>

HENRY MAYO NEWHALL HOSPITAL AND SUBSIDIARIES

STATEMENT OF CHANGES IN NET ASSETS - OBLIGATED GROUP INFORMATION For the Years Ended September 30, 2019

	<u>Hospital</u>
CHANGE IN NET ASSETS WITHOUT DONOR RESTRICTIONS	
Revenues in excess of expenses	\$ 21,814,775
Contributions to subsidiaries	(58,935)
Net assets released from restrictions used for purchases of property, plant and equipment	<u>1,500,000</u>
Increase in net assets without donor restrictions	<u>23,255,840</u>
CHANGE IN NET ASSETS WITH DONOR RESTRICTIONS	
Contributions	2,075,125
Net assets released from restrictions	<u>(1,877,236)</u>
Increase in net assets with donor restrictions	<u>197,889</u>
INCREASE IN NET ASSETS	<u>23,453,729</u>
NET ASSETS - BEGINNING OF YEAR	178,496,639
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE (NOTE 2)	<u>3,786,559</u>
NET ASSETS - BEGINNING OF YEAR, AS ADJUSTED	<u>182,283,198</u>
NET ASSETS - END OF YEAR	<u>\$ 205,736,927</u>