
SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2019



Postlethwaite & Netterville

A Professional Accounting Corporation

www.pncpa.com

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

CONSOLIDATED FINANCIAL STATEMENTS

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INDEPENDENT AUDITORS' REPORT

The Board of Trustees
Southwest Louisiana Health Care System, Inc.

We have audited the accompanying consolidated financial statements of Southwest Louisiana Health Care System, Inc. and its affiliates (the System), which comprise the consolidated balance sheets as of December 31, 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 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 consolidated financial position of Southwest Louisiana Health Care System, Inc. and its affiliates as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Emphasis of Matters

As discussed in Note 1 to the financial statements, the System adopted Accounting Standards Update No. 2016-02, "Leases" and Accounting Standards Update No. 2016-18, "Statement of Cash Flows" during the current fiscal year. Additionally, as described in Note 16 to the consolidated financial statements, the System is being impacted by disruptions in the economy and business interruptions associated with the coronavirus (COVID-19) pandemic. The System expects this matter to negatively impact its operating results and cash flows in the near future. Our opinion is not modified with respect to this matter.

Postlethwaite & Netterville

Baton Rouge, Louisiana
April 27, 2020

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2019 AND 2018

ASSETS

<i>(in thousands)</i>	<u>2019</u>	<u>2018</u>
<u>CURRENT ASSETS</u>		
Cash and cash equivalents	\$ 48,390	\$ 35,646
Cash and cash equivalents - restricted	11,965	11,234
Patient accounts receivable	38,601	35,383
Assets limited as to use - current portion	7,484	4,773
Inventory	7,320	6,810
Short-term investments	376	59
Other current assets	9,581	8,998
Total current assets	<u>123,717</u>	<u>102,903</u>
 <u>ASSETS LIMITED AS TO USE</u>		
Held by trustee in accordance with bond indentures	23,031	11,399
Internally designated for malpractice claims	1,868	1,719
Internally designated for the Foundation	1,931	1,479
Total assets whose use is limited	<u>26,830</u>	<u>14,597</u>
Less: amounts required to meet current liabilities	<u>(7,484)</u>	<u>(4,773)</u>
Noncurrent assets limited as to use	<u>19,346</u>	<u>9,824</u>
 <u>PROPERTY AND EQUIPMENT, net</u>		
Total property and equipment, net	<u>147,483</u>	<u>134,778</u>
 <u>RIGHT OF USE ASSETS</u>		
Total right of use assets	<u>24,397</u>	<u>-</u>
 <u>OTHER ASSETS</u>		
Other	<u>1,682</u>	<u>5,375</u>
Total other assets	<u>1,682</u>	<u>5,375</u>
 TOTAL ASSETS		
	<u>\$ 316,625</u>	<u>\$ 252,880</u>

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

LIABILITIES AND NET ASSETS

(in thousands)

	<u>2019</u>	<u>2018</u>
<u>CURRENT LIABILITIES</u>		
Current portion of long-term debt	\$ 4,166	\$ 7,807
Current portion of lease liability	3,390	-
Accrued interest payable	424	449
Accounts payable	23,644	19,710
Accrued compensation and benefits	27,304	19,508
Estimated third-party payor settlements	9,818	6,775
Other accrued expenses	22,357	25,886
Credit balances in patient accounts receivable	823	828
Total current liabilities	<u>91,926</u>	<u>80,963</u>
<u>LONG-TERM LIABILITIES</u>		
Long-term debt, net of current portion	118,177	92,580
Lease liability, net of current portion	17,254	-
Other long-term liabilities	3,753	3,220
Total long-term liabilities	<u>139,184</u>	<u>95,800</u>
Total liabilities	<u>231,110</u>	<u>176,763</u>
<u>TOTAL NET ASSETS</u>		
Noncontrolling interest	446	858
Controlling interest - without donor restrictions	84,785	75,116
Controlling interest - with donor restrictions	284	143
Total net assets	<u>85,515</u>	<u>76,117</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 316,625</u>	<u>\$ 252,880</u>

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2019 AND 2018

(in thousands)

	2019	2018
<u>CHANGES IN NET ASSETS WITHOUT DONOR RESTRICTIONS</u>		
<u>OPERATING REVENUES</u>		
Net patient service revenue	\$ 385,180	\$ 364,846
Other operating revenues	23,413	16,052
Total operating revenues	408,593	380,898
<u>OPERATING EXPENSES</u>		
Salaries and wages	177,224	163,087
Employee benefits	29,094	29,084
Contract labor	11,020	8,996
Supplies	92,522	86,025
Professional fees	6,079	7,124
Service contracts	7,894	7,503
Purchased services	33,194	31,177
Management fees	1,607	1,493
Depreciation	14,083	13,912
Interest expense	5,648	5,251
Insurance	4,999	4,713
Other	15,651	14,065
Total operating expenses	399,015	372,430
INCOME FROM OPERATIONS	9,578	8,468
<u>NONOPERATING REVENUES</u>		
Contributions	79	84
Other revenues - net	2,068	630
	2,147	714
REVENUES OVER EXPENSES	11,725	9,182
Change in fair value of investments	83	9
Gain (loss) on disposal of property and equipment	(16)	41
Loss on bond refunding	(2,300)	-
Net assets released from restriction	387	262
	387	262
CHANGE IN NET ASSETS WITHOUT DONOR RESTRICTIONS	9,879	9,494
<u>CHANGES IN NET ASSETS WITH DONOR RESTRICTIONS</u>		
Contributions	528	183
Net assets released from restriction	(387)	(262)
Total changes in net assets with donor restrictions	141	(79)
CHANGE IN NET ASSETS	10,020	9,415
Increase in net assets - noncontrolling interest	210	740
Increase in net assets - controlling interest	\$ 9,810	\$ 8,675

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

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2019 AND 2018

<i>(in thousands)</i>	Controlling Interest		Noncontrolling Interest	Total Net Assets
	Net Assets Without Donor Restrictions	Net Assets With Donor Restrictions		
<u>Balance at December 31, 2017</u>	\$ 66,362	\$ 222	\$ 717	\$ 67,301
Cash paid to minority shareholders	-	-	(599)	(599)
Increase (decrease) in net assets for the year ended December 31, 2018	<u>8,754</u>	<u>(79)</u>	<u>740</u>	<u>9,415</u>
<u>Balance at December 31, 2018</u>	75,116	143	858	76,117
Cash paid to minority shareholders	-	-	(622)	(622)
Increase (decrease) in net assets for the year ended December 31, 2019	<u>9,669</u>	<u>141</u>	<u>210</u>	<u>10,020</u>
<u>Balance at December 31, 2019</u>	<u>\$ 84,785</u>	<u>\$ 284</u>	<u>\$ 446</u>	<u>\$ 85,515</u>

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

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2019 AND 2018

<i>(in thousands)</i>	<u>2019</u>	<u>2018</u>
<u>CASH FLOWS FROM OPERATING ACTIVITIES</u>		
Change in net assets	\$ 10,020	\$ 9,415
Adjustments to reconcile the changes in net assets to net cash provided by operating activities:		
Depreciation	14,083	13,912
Amortization of bond (premium) discount	(138)	210
Net unrealized gains on investments	(83)	(9)
(Gain) loss on disposal of property and equipment	16	(41)
Loss on bond refinance	2,300	-
Changes in operating assets and liabilities:		
Patient accounts receivable	(3,223)	(2,521)
Inventories and other current assets	(1,093)	(897)
Other assets	(60)	(169)
Accounts payable and accrued expenses	6,705	4,766
Third party payor settlements	3,043	720
Other liabilities	533	(250)
Net cash provided by operating activities	<u>32,103</u>	<u>25,136</u>
<u>CASH FLOWS FROM INVESTING ACTIVITIES</u>		
Acquisitions of property and equipment	(25,333)	(16,531)
Proceeds from sale of property and equipment	-	425
Sale of investments	8,886	1,417
Purchase of investments	(2,742)	(1,451)
Change in assets whose use is limited	(18,611)	4,366
Net cash used in investing activities	<u>(37,800)</u>	<u>(11,774)</u>
<u>CASH FLOWS FROM FINANCING ACTIVITIES</u>		
Principal payments on revenue bonds and notes	(13,943)	(9,297)
Proceeds from issuance of revenue bonds	34,597	-
Cash paid to minority shareholders	(622)	(599)
Deferred financing costs paid	(860)	-
Net cash provided by (used in) financing activities	<u>19,172</u>	<u>(9,896)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	13,475	3,466
Cash and cash equivalents at beginning of year	<u>46,880</u>	<u>43,414</u>
Cash and cash equivalents at end of year	<u>\$ 60,355</u>	<u>\$ 46,880</u>
<u>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</u>		
Cash paid during the year for interest, net of capitalized interest	<u>\$ 6,091</u>	<u>\$ 5,725</u>
Accounts payable for property and equipment	<u>\$ 1,471</u>	<u>\$ 1,384</u>
Revenue bond proceeds used to refund prior bonds and underwriter's discount	<u>\$ 86,673</u>	<u>\$ -</u>
<u>RECONCILIATION OF CASH, CASH EQUIVALENTS, AND RESTRICTED CASH REPORTED:</u>		
Cash and cash equivalents	\$ 48,390	\$ 35,646
Cash and cash equivalents - restricted	11,965	11,234
Total cash, cash equivalents, and restricted cash reported	<u>\$ 60,355</u>	<u>\$ 46,880</u>

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

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of significant accounting policies

Southwest Louisiana Health Care System, Inc. (the System) was organized as a Louisiana non-profit corporation for the purpose of conducting charitable, scientific, and educational activities. The System or the Hospital is designated as the “sole member” of its affiliates with the exception of several joint ventures, and, through the actions of its Board of Trustees, has the power to change or elect the Board of Trustees, approve certain corporate actions, and amend the articles of incorporation of its affiliates, thereby functioning in the capacity of the sole shareholder.

The accounting and reporting policies of the System conform to accounting principles generally accepted in the United States of America and the prevailing practices within the healthcare industry. The significant accounting policies used by the System in preparing and presenting its consolidated financial statements are summarized as follows:

Principles of consolidation

The consolidated financial statements include the Southwest Louisiana Hospital Association, d/b/a Lake Charles Memorial Hospital (the Hospital), the major operating unit in the System. The Hospital provides a wide range of inpatient and outpatient services through a 313-bed acute care facility, a 52-bed hospital for women, a 42-bed behavioral health hospital (opened in July 2018), and satellite locations. Also, included in the consolidated financial statements is Memorial Medical Group, LLC, a wholly-owned corporation formed for the purpose of entering into for-profit healthcare ventures, and the Southwest Louisiana Hospital Association Foundation, Inc. Through these entities, the System provides integrated healthcare services in southwest Louisiana. All significant intercompany transactions and balances have been eliminated upon consolidation.

The System owns greater than 50% in Lake Charles Health Plan, which was formed in 1997. The System is also a 51% owner in an MRI joint venture, which began operations in January of 2006, and a 51% owner in a toxicology testing joint venture with Lab Trust, L.L.C., which began operations in February 2018. The joint ventures are consolidated in the accompanying financial statements due to the System’s ownership percentage exceeding 50%.

The System established the Southwest Louisiana Hospital Association Foundation, Inc. in 2009. The Foundation is organized as a non-profit corporation established to operate exclusively for the charitable, benevolent, educational and scientific purposes of Lake Charles Memorial Hospital. The Foundation has received exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code.

During 2013, the System entered into discussions with the LSU System and the State of Louisiana to lease the assets and be responsible for the operations of W.O. Moss Regional Hospital (Moss). A memorandum of understanding (MOU) was approved by the LSU Board of Supervisors, and a cooperative endeavor agreement (CEA) outlining the terms of the agreement was signed on June 24, 2013. W.O. Moss Regional ceased inpatient operations in June 2013 subject to legislative action and the System began operating ambulatory/outpatient clinics at the site effective June 24, 2013. The CEA was amended and restated in October of 2014. MOUs have been signed in 2016, 2017, 2018, and 2019 that modify some of the terms of the CEA. The Moss campus activities are included in the accompanying consolidated financial statements.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of significant accounting policies (continued)

New accounting pronouncements adopted

As of January 1, 2019, the System adopted Financial Accounting Standards Board Accounting Standards Update No. 2016-02, "Leases (Topic 842)" using the modified retrospective method of adoption. The System elected to use the transition option that allows an organization to apply the new lease standard at the adoption date and recognize a cumulative-effect adjustment (if any) to the opening balance of net assets in the year of adoption. Comparable periods continue to be presented under the guidance of the previous standard. Topic 842 requires lessees to recognize a lease liability and right-of-use asset on the balance sheet for operating leases. For lessors, the new accounting model remains largely the same, although some changes have been made to align it with the new lessee model and the new revenue recognition guidance, Accounting Standard Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606). The System's adoption of Topic 842 did not result in any adjustments to net assets or changes in the timing or amounts of lease costs.

Upon adoption of Topic 842, the System recorded approximately \$22,231,000 of right-of-use assets, associated with operating and financing leases in the System's consolidated balance sheets. The System also recorded approximately \$3,426,000 of current liabilities associated with operating and financing leases in other current liabilities in the System's consolidated balance sheets and \$18,805,000 of long-term liabilities associated with operating and financing leases in other long-term liabilities in the System's consolidated balance sheets.

FASB also issued ASU No. 2016-18, "Statement of Cash Flows (Topic 230), Restricted Cash." The ASU requires presentation of the total change in cash, cash equivalents, restricted cash, and restricted cash equivalents for the period in the statements of cash flows. The ASU has been applied retrospectively to all periods presented. The adoption of this ASU had no impact to net assets of the System.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Cash and cash equivalents

Cash and cash equivalents include all unrestricted checking accounts and certain investments in highly liquid debt instruments which had maturities of three months or less at the time of purchase. Cash and cash equivalents does not include cash that has been restricted.

Restricted cash includes state and local taxes paid as "payments under protest" since April 2011 as it relates to Medicare and Medicaid recipients of medical devices. Medical devices are defined as instrument, apparatus, implants, or pharmaceuticals used to diagnose, prevent, or treat the body. Escrow accounts for both local and state governments which total approximately \$11,965,000 and \$11,234,000 as of December 31, 2019 and December 31, 2018, respectively, have been established. These escrow accounts were set up as holding accounts awaiting the outcome of a pending lawsuit with the Calcasieu Parish School Board regarding the decision on whether certain medical devices and pharmaceuticals that are provided to Medicare and Medicaid patients are taxable at the local level.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of significant accounting policies (continued)

Short-term investments

Short-term investments include stock and a certificate of deposit (See Note 5).

Investments and investment income

The System follows the provisions of the accounting guidance contained in the Accounting Standards Codification (ASC) for investments in equity securities with readily determinable fair values and all investments in debt securities which requires them to be measured at fair value in the balance sheets.

Investment income or loss (including realized gains and losses on investments, interest, and dividends) is recorded as an increase in net assets without donor restrictions, unless the use is restricted by the donor or law. Investment income on proceeds of borrowings that are held by a trustee, to the extent not capitalized, are reported as other operating revenues. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses unless the investments are trading securities.

Donated investments are recorded at their market value at the date of receipt, which is then treated as cost. Realized gains and losses on dispositions are based on the net proceeds and the adjusted cost basis of the securities sold, using the specific identification method. These realized gains and losses flow through the System's yearly activities.

Assets limited as to use

Assets limited as to use primarily include assets held by trustees under indenture agreements and designated assets set aside by the Board of Trustees, over which the Board retains control and may at its discretion subsequently use for other purposes. Amounts required to meet current liabilities of the System have been reclassified in the consolidated balance sheets.

Patient accounts receivable

The System provides credit in the normal course of operations to patients located primarily in Southwestern Louisiana and to third-party payors conducting operations in these areas. Due to the Hospital's geographic location, the System participates in multiple states' Medicaid programs to cover patients who are admitted from states in close proximity to Louisiana.

Patient accounts receivable are recorded at net realizable value based on certain assumptions determined for each payor. For third-party payors including Medicare, Medicaid, and Managed Care, the net realizable value is based on the estimated contractual reimbursement percentage, which is based on current contract prices or historical paid claims data by payor. For self-pay accounts receivable, which includes patients who are uninsured and the patient responsibility portion for patients with insurance, the net realizable value is determined using estimates of historical collection experience. These estimates are adjusted for estimated conversions of patient responsibility portions, expected recoveries, and any anticipated changes in trends.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of significant accounting policies (continued)

Patient accounts receivable (continued)

Patient accounts receivable can be impacted by the effectiveness of the System's collection efforts. Additionally, significant changes in payor mix, business office operations, economic conditions or trends in federal and state governmental healthcare coverage could affect the net realizable value of accounts receivable. The System also continually reviews the net realizable value of accounts receivable by monitoring historical cash collections, as well as by analyzing current period net revenue and admissions by payor classification, aged accounts receivable by payor, days revenue outstanding, and the composition of self-pay receivables between pure self-pay patients and the patient responsibility portion of third-party insured receivables.

The System determines if patient accounts receivable are past-due based on the discharge date; however, the System does not charge interest on past-due accounts but has entered into an agreement with a third party vendor who charges a monthly fee to the patient on extended payment plans. The System charges off patient accounts receivable if management considers the collection of the outstanding balances to be doubtful.

Contract assets consist of services provided to patients who are still receiving inpatient care at the System's facilities at December 31, 2019 and 2018. This represents patient charges that have not been billed and which do not meet the conditions of unconditional right to payment at the consolidated balance sheet dates.

Inventories

Inventories consist primarily of drugs, medical supplies, and general supplies and are stated at the lower of cost (using the first-in, first-out method) or net realizable value.

Property and equipment

Property and equipment are stated at historical cost. Donated property is recorded at its estimated fair value on the date of receipt, which is then treated as cost. Additions, renewals, and betterments that extend the lives or increase the value of assets are capitalized. Maintenance and repair expenditures are expensed as incurred.

Depreciation has been provided using the straight-line method over the estimated useful lives of the related assets, which range from 2 to 40 years. For the year ended December 31, 2018, equipment under lease obligations was amortized using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment.

When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts, and any resulting gains and losses are recognized in the System's yearly operations.

Other assets

Other assets consist primarily of investments in affiliated entities, including Louisiana Pet Imaging of Lake Charles, LLC (33% ownership), Shareport, LLC, (18.6% ownership), and CHG Hospital Sulphur, LLC, specialty hospital (49% ownership). The System accounts for investments in affiliated entities of which it owns more than 20% but not more than 50%, using the equity method.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of significant accounting policies (continued)

Leases

ASU 2016-02 was issued to increase transparency and comparability among financial statements by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about lease agreements. The System adopted ASU 2016-02 and its improvements, as described previously, using a modified retrospective approach, and the accounting policies related to leases were revised at the adoption date of January 1, 2019.

The System determines if an arrangement is a lease at inception of the contract. For leases with terms greater than twelve months, right of use assets and lease liabilities are recognized at contract commencement date based on the present value of lease payments over the lease term. Right of use assets represent the System's right to use the underlying assets for the lease term. Lease liabilities represent the System's obligation to make lease payments arising from these contracts. The System uses the risk-free rate, which is derived from information available at the lease commencement date, in determining the present value of lease payments.

Lease agreements may include rental escalation clauses or renewal options that are factored into management's determination of lease payments, when appropriate. The estimated useful life of assets is limited by the expected lease term, unless there is a transfer of title or purchase option reasonably certain of exercise.

The System's lease agreements may include payments based on usage while others include rental payments adjusted periodically for inflation. These variable lease payments are recognized in operating expenses, but are not included in the right of use asset or lease liability balances. The System's lease agreements do not contain any material residual value guarantees, restrictions, or covenants.

The System has elected the practical expedient that allows lessees to choose to not separate lease and non-lease components by class of underlying asset and are applying this expedient to all relevant asset classes. Additionally, the System elected the package of transition provisions available which allowed the carryforward of the System's historical assessments of whether contracts are or contain leases, the lease classification, and the treatment of initial direct costs.

Costs of borrowing

Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Financing costs are amortized to interest expense on a straight-line basis over the period that the related obligation is outstanding.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of significant accounting policies (continued)

Net Assets

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

Net Assets Without Donor Restrictions – Net assets available for use for any purpose in performing the primary objectives and general operations of the System and not subject to donor (or certain grantor) restrictions.

Net Assets With Donor Restrictions – Net assets subject to donor-imposed or grantor restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. The System did not have any net assets with perpetual donor restrictions at December 31, 2019 or 2018.

Donor-restricted contributions are reported as increases in net assets with donor restrictions. When a restriction expires, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the consolidated statements of operations as net assets released from restrictions.

Income from operations

The consolidated statements of operations include the line item entitled “income from operations.” Income from operations includes, but is not limited to, patient revenues, investment income from unrestricted assets, cafeteria revenues, insurance proceeds, medical office rental revenues, and other government subsidies. Changes in net assets without donor restrictions which are excluded from income from operations include contributions, unrealized gains, and other non-operating activities.

Patient service revenue and third-party settlements

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

Performance obligations are determined based on the nature of the services provided by the System. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. The System believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the hospital receiving inpatient acute care services or patients receiving services in the outpatient clinics or in their homes (home care). The System measures the performance obligation from admission into the hospital, or the commencement of an outpatient service, to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or completion of the outpatient services. Revenue for performance obligations satisfied at a point in time is generally recognized when goods are provided to patients and customers in a retail setting (for example, pharmaceuticals and medical equipment) and the System does not believe it is required to provide additional goods or services related to that sale.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of significant accounting policies (continued)

Patient service revenue and third-party settlements (continued)

Because all of its performance obligations relate to contracts with a duration of less than one year, the System has elected to apply the optional exemption provided in FASB ASC 606-10-50-14a and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to previously 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.

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

The System has agreements with third-party payors that provide for payments to the System at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period that the related services are rendered and adjusted in future periods as final settlements are determined or as years are no longer subject to examination. The System has recorded these third-party estimates based on the most likely amount to be realized. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Consequently, there is at least a reasonable possibility that recorded estimates could change by a material amount. The System applied the principles surrounding balance sheet offsetting during the years ended December 31, 2019 and 2018. Therefore, the third-party receivables and payables are presented separately on the accompanying consolidated balance sheets.

Consistent with the System's mission, care is provided to patients regardless of their ability to pay. Therefore, the System has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances (for example, copays and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts the System expects to collect based on its collection history with those patients. Patients who meet the System's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue.

The laws and regulations governing the System's operations, along with the terms of participation in various government programs, regulate how the System does business, the services offered and its interactions with patients and the public. These laws and regulations, and their interpretations, are subject to frequent change. Changes in existing laws or regulations, or their interpretations, or the enactment of new laws or regulations could materially and adversely affect the System's operations and financial condition.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of significant accounting policies (continued)

Patient service revenue and third-party settlements (continued)

The System is subject to various routine and non-routine governmental reviews, audits and investigations. In recent years, federal and state civil and criminal enforcement agencies have heightened and coordinated their oversight efforts related to the health care industry, including referral practices, cost reporting, billing practices, joint ventures and other financial relationships among health care providers. Violation of the laws governing the System's operations, or changes in the interpretation of those laws, could result in the imposition of fines, civil or criminal penalties, and/or termination of the System's rights to participate in federal and state-sponsored programs and suspension or revocation of the System's licenses. The System believes that it is in material compliance with all applicable laws and regulations.

Donor-restricted gifts

Unconditional promises to give cash and other assets to the System are reported at their fair values at the date the promises are received. Conditional promises to give and indications of intentions to give are reported at their fair values at the date the gifts are 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.

Employee health benefit claims

The provision for accrued and unpaid medical claims includes estimates of claims related to its employees who participate in the group health care benefit plan. Such provisions are estimated by management and include amounts for claims filed and not paid and an estimate of claims incurred but not filed at year end.

Professional liability claims

The provision for estimated malpractice claims includes estimates of the ultimate cost for both reported claims, including costs to defend claims, and claims incurred but not reported. The System has not experienced material losses from professional liability claims in the past.

Functional Allocation of Expenses

The consolidated financial statements report certain expense categories that are attributable to more than one healthcare service or support function. Therefore, these expenses require an allocation on a reasonable basis that is consistently applied. Costs not directly attributable to a function, including depreciation, amortization, interest, and other occupancy costs, are allocated to a function based on a square-footage basis. See Note 12.

Income taxes

The Hospital and certain affiliates are non-profit organizations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal and state income taxes on related income pursuant to Section 501(a) of the Internal Revenue Code. Certain other affiliates are for-profit taxpaying entities. Federal income tax liabilities generated by the System's taxable activities, if any, are insignificant. Accordingly, no provision for income taxes on related income has been included in the consolidated financial statements.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of significant accounting policies (continued)

Income taxes (continued)

The System applies the accounting guidance related to accounting for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions. The System recognizes the effect of income tax positions only if the positions are more likely than not of being sustained. Recognized income tax positions are recorded at the largest amount that is greater than 50% likely of being realized. Changes in the recognition or measurement are reflected in the period in which the change in judgment occurs. The System has evaluated its position regarding the accounting for uncertain income tax positions and does not believe that it has any material uncertain tax positions.

Reclassifications

Certain reclassifications of amounts previously reported have been made to the accompanying consolidated financial statements to maintain consistency between periods presented. The reclassification had no impact on previously reported net assets.

2. Current operating environment

The Affordable Care Act provides for significant reductions in the growth of Medicare spending and reductions in Medicare and Medicaid disproportionate share hospital payments. Any shortfalls, now or in the future, whether as a result of the economic downturn, the expansion of Medicaid coverage under the Affordable Care Act, or otherwise, could result in additional reductions to Medicare or Medicaid payments.

As described in Note 1, the CEA related to the Moss campus provides for reimbursement for indigent patient care and effectively mitigates reductions in Medicaid reimbursements. As a result of the CEA signed in June 2013 and last amended September 2014 and further clarified by MOU's in 2016, 2017 and 2018, the Hospital received approximately \$33,360,115 and \$39,983,000 in CEA related payments during 2019 and 2018, respectively. The System recognized \$34,791,000 and \$39,774,000 as uncompensated care revenue related to performance obligations satisfied under that CEA during 2019 and 2018, respectively. Approximately \$3,753,000 in 2019 and 2018, respectively, is rent paid in advance to LSU (see Note 11) and is unearned income paid to the Hospital under the CEA that is attributable to future periods.

The System is a member of the Gulf South Quality Network (GSQN), aimed at providing a physician network engaged in the process of clinical integration. The System has signed a clinical integration agreement through GSQN.

The System recognized \$2,549,000 in Upper Payment Limit revenue related to its clinic operations in 2019. This amount is included in net patient service revenue in the consolidated statement of operations.

The System received \$2,812,000 and \$447,000 in 2019 and 2018, respectively, from claims relating to the 2010 Deepwater Horizon oil spill in the Gulf of Mexico. These funds do not have any restrictions associated with their expenditure.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

3. Liquidity and Availability

As of December 31, 2019, the System has working capital of \$31,791,000 and average days (based on normal operating expenditures) cash on hand of 46 days.

Financial assets at December 31 are as follows (in thousands):

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents - unrestricted	\$ 48,390	\$ 35,646
Patient accounts receivable	38,601	35,383
Short-term investments	376	59
Assets limited to use:		
Internally designated	3,799	3,198
Funds held by trustee	<u>23,031</u>	<u>11,399</u>
 Total financial assets	 <u>114,197</u>	 <u>85,685</u>
 Less amounts not available to be used within one year:		
Internally designated	(3,799)	(3,198)
Funds held by trustee	<u>(23,031)</u>	<u>(11,399)</u>
 Financial assets not available to be used within one year	 <u>(26,830)</u>	 <u>(14,597)</u>
 Financial assets available to meet general expenditures within one year	 <u>\$ 87,367</u>	 <u>\$ 71,088</u>

The System has other assets limited as to use for donor-restricted purposes, debt service, and for malpractice claims. These assets limited as to use, which are more fully described in Note 5 are not available for general expenditure within the next year. However, the internally-designated amounts could be made available, if necessary.

Additionally, the System maintains a \$3,000,000 line of credit, as discussed in more detail in Note 7. The amount of unused line of credit was \$3,000,000 at December 31, 2019.

4. Patient service revenue

The System's revenues generally relate to contracts with patients in which the performance obligations are to provide health care services to patients and the System records revenues as performance obligations are satisfied. The performance obligations for inpatient services are generally satisfied over periods that average approximately four days, and revenues are recognized based on charges incurred in relation to total expected charges. The performance obligations for outpatient services are generally satisfied over a period of less than one day. The contractual relationships with patients, in most cases, also involve a third-party payor (Medicare, Medicaid, managed care health plans, and commercial insurance companies, including plans offered through the health insurance exchanges).

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

4. Patient service revenue (continued)

The estimates for implicit price concessions are based upon management's assessment of historical writeoffs and expected net collections, business and economic conditions, trends in federal, state and private employer health care coverage and other collection indicators. Management relies on the results of detailed reviews of historical writeoffs and collections (the "hindsight analysis") as a primary source of information in estimating the collectability of accounts receivable.

Agreements with third-party payors typically provide for payments at amounts less than established charges. A summary of the payment arrangements with major third-party payors follows:

- Medicare - Certain inpatient acute care services are paid at prospectively determined rates per discharge based on clinical, diagnostic, and other factors. Certain services are paid based on cost-reimbursement methodologies subject to certain limits. Physician services are paid based upon established fee schedules. Outpatient services are paid using prospectively determined rates.
- Medicaid - Reimbursements for Medicaid services are generally paid at prospectively determined rates per day, or per occasion of service.
- Other - Payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations provide for payment using prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Management continually reviews the contractual estimation process to consider and incorporate updates to laws and regulations and the frequent changes in managed care contractual terms resulting from contract renegotiations and renewals.

For the years ended December 31, 2019 and 2018, the System recorded approximately \$953,283,000 and \$847,112,000 of implicit and explicit price concessions as a direct reduction of net operating revenues.

Additionally, the System reports contract assets of approximately \$3,590,000 and \$3,664,000, which are included in patient accounts receivable in the consolidated balance sheets at December 31, 2019 and 2018, respectively.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Estimated reimbursement amounts are adjusted in subsequent periods as cost reports are prepared and filed and as final settlements are determined (in relation to certain government programs, primarily Medicare, this is generally referred to as the "cost report" filing and settlement process). 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 System's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available), or as years are settled or are no longer subject to such audits, reviews, and investigations. Adjustments arising from a change in the transaction prices were \$9,818,000 and \$6,775,000 for the years ended December 31, 2019 and 2018, respectively. There were no recorded settlements receivable at December 31, 2019 or 2018. Net patient service revenue decreased approximately \$1,276,000 in 2019 and \$14,000 in 2018 due to prior-year retroactive adjustments in excess of amounts previously estimated.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

4. Patient service revenue (continued)

The Emergency Medical Treatment and Labor Act (“EMTALA”) requires any hospital participating in the Medicare program to conduct an appropriate medical screening examination of every person who presents to the hospital’s emergency room for treatment and, if the individual is suffering from an emergency medical condition, to either stabilize the condition or make an appropriate transfer of the individual to a facility able to handle the condition. The obligation to screen and stabilize emergency medical conditions exists regardless of an individual’s ability to pay for treatment. Federal and state laws and regulations require, and the System’s commitment to providing quality patient care encourages, the System to provide services to patients who are financially unable to pay for the health care services they receive. The System has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances (for example, copays and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts the System expects to collect based on its collection history with those patients.

The System has determined that the nature, amount, timing, and uncertainty of revenue and cash flows are affected by the following factors: payors, geography, service lines, method of reimbursement, and timing of when revenue is recognized. For the year ended December 31, the System’s patient revenue was comprised of:

	Years Ended December 31,	
	2019	2018
Inpatient	31.57%	35.29%
Outpatient	66.92%	63.74%
Other	1.51%	0.97%
Total	<u>100.00%</u>	<u>100.00%</u>

The composition of patient care service revenue by primary payor for the years ended December 31 is as follows:

	Years Ended December 31,			
	2019	Ratio	2018	Ratio
Medicare	\$ 146,730	38%	\$ 140,832	39%
Medicaid	83,018	22%	76,719	21%
Managed care	145,779	38%	140,038	38%
Self-pay patients	9,653	2%	7,257	2%
Total Revenues	<u>\$ 385,180</u>	<u>100%</u>	<u>\$ 364,846</u>	<u>100%</u>

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

5. Investments/Assets limited as to use

The composition of assets limited as to use at December 31, 2019 and 2018 is set forth in the following tables. Investments are stated at fair value (in thousands).

	<u>2019</u>	<u>2018</u>
Assets held by the trustee in accordance with bond indenture agreements:		
Cash and cash equivalents	\$ 23,031	\$ 4,734
Investment agreements	-	6,665
	<u>23,031</u>	<u>11,399</u>
Less: amount classified as current	(7,484)	(4,773)
	<u>\$ 15,547</u>	<u>\$ 6,626</u>
Assets internally designated by the Board of Trustees for professional liability claims and the Foundation:		
Cash and cash equivalents	\$ 2,181	\$ 1,701
Equity mutual funds	287	347
U.S. Government agencies	1,331	1,150
	<u>\$ 3,799</u>	<u>\$ 3,198</u>
Total non-current assets limited as to use	<u>\$ 19,346</u>	<u>\$ 9,824</u>

Use of the above funds is limited by trust indentures as well as internal designations. Bond trust funds of \$8,751,000 and \$11,399,000 in 2019 and 2018, respectively, are generally limited to payment of debt service, maintenance of reserve funds, and security for bondholders. Additionally, bond trust funds of \$14,280,000 at December 31, 2019 are limited for use on future capital expenditures. Use of the professional liability funds of \$1,868,000 and \$1,719,000 in 2019 and 2018, respectively, is limited by the Board of Trustees for the payment of professional liability claims and related expenses. Funds totaling \$1,931,000 and \$1,479,000, in 2019 and 2018, respectively are designated for the Hospital's foundation. The trust indenture authorizes the deposit of certain funds into investment agreements maintained with financial institutions. The funds deposited into these agreements are generally unsecured and redemption of the investments depends solely on the financial condition of the financial institutions, which hold the investments, and their ability to pay their obligations. The System had approximately \$6,665,000 of these types of investments at December 31, 2018, and no such investments at December 31, 2019.

Included in short-term investments is a certificate of deposit of \$300,000 at December 31, 2019, and an investment in stock which totaled approximately \$76,000 and \$59,000 as of December 31, 2019 and 2018, respectively.

The System recognized investment revenues of approximately \$1,030,000 and \$497,000 during the years ended December 31, 2019 and 2018, respectively. These amounts are classified as other operating revenues in the consolidated statements of operations.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

6. Property and equipment

Property and equipment at December 31, 2019 and 2018 consisted of the following (in thousands):

	<u>2019</u>	<u>2018</u>
Land and land improvements	\$ 19,108	\$ 18,867
Buildings and improvements	213,521	201,280
Equipment, furniture, and fixtures	<u>189,509</u>	<u>174,140</u>
	422,138	394,287
Less: accumulated depreciation	<u>(279,693)</u>	<u>(265,996)</u>
	142,445	128,291
Construction-in-progress	<u>5,038</u>	<u>6,487</u>
Property and equipment, net	<u>\$ 147,483</u>	<u>\$ 134,778</u>

Depreciation expense amounted to approximately \$14,083,000 and \$13,912,000 during the years ended December 31, 2019 and 2018, respectively.

The Board has approved a series of construction and renovation projects throughout the Hospital. Several of those projects were in progress in 2018 and 2019 and will continue into future years. See Note 15 regarding these construction commitments outstanding at December 31, 2019.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

7. Long-term liabilities

A summary of long-term liabilities at December 31 is as follows (in thousands):

	<u>2019</u>	<u>2018</u>
Hospital Revenue Bonds (Series 2007); term bonds due annually on December 1st through December 1, 2034, at rates ranging from 6.25% to 6.375%.	\$ -	\$ 62,170
Hospital Revenue Bonds (Series 2014); term bonds due annually on January 1st through January 1, 2024, at a rates ranging from 2.62% to 3.70%.	-	5,510
Hospital Revenue Bonds (Series 2015); term bonds due at various dates through January 1, 2025, at rates ranging from 2.00% to 2.85%.	-	8,913
Hospital Revenue Bonds (Series 2015A); term bonds due at various dates through October 1, 2025, at rates ranging from 2.309% to 2.914%.	-	9,506
Promissory note of up to \$6,000,000, due in monthly installments through June of 2020 at 3.69% (secured by Nelson Rd property).	906	2,668
Promissory note of up to \$3,600,000, due in monthly installments through December 5, 2024 at the WSJ Prime rate, 4.75% and 5.5% at December 31, 2019 and 2018, respectively (secured by Oak Park Blvd property, Floors 2 & 3).	2,250	2,700
Hospital Revenue Bonds (Series 2017); term bonds due at various dates through October 1, 2027, at rates ranging from 2.45% to 3.30%.	-	9,730
Promissory note of \$1,700,000, due in monthly installments through January 2019 at 4% (secured by Linear Accelerator).	-	444
Hospital Revenue Bonds (Series 2019); term bonds due at various dates through December 1, 2039, at rates ranging from 4% to 5%.	<u>104,935</u>	<u>-</u>
	108,091	101,641
Less: current portion of long-term liabilities	(4,166)	(7,807)
Less: unamortized debt issuance costs	(1,809)	(1,254)
Add: unamortized bond premium	16,061	-
Long-term liabilities, net	<u>\$ 118,177</u>	<u>\$ 92,580</u>

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

7. Long-term liabilities (continued)

The System has a \$3,000,000 line of credit, secured by medical equipment. The line of credit has a fixed interest rate of 5.5% at December 31, 2019 and matures on May 30, 2020. As amounts are drawn on the line, they convert to promissory notes and are included in the above notes payable summary. The amount of unused line of credit was \$3,000,000 and \$2,556,032 at December 31, 2019 and 2018, respectively.

The System capitalized interest expense of \$418,000 and \$504,000 in 2019 and 2018, respectively, in connection with its construction-in-progress projects.

The System is required to maintain certain deposits in accordance with bond agreements, and such deposits are included with assets limited as to use. The revenue bond indentures also place limits on the incurrence of additional borrowings, place limits on the amount of assets that can be disposed of outside the normal course of business, and require the restricted group to satisfy measures of financial performance as long as the bonds are outstanding. The System was in compliance with these covenants at December 31, 2019.

The long-term debt obligations are scheduled to mature as follows (in thousands):

<u>Year ending December 31st,</u>	<u>Bonds & Notes Payable</u>
2020	\$ 3,441
2021	3,545
2022	3,705
2023	3,855
2024	3,890
Thereafter	<u>89,655</u>
	108,091
Plus: unamortized bond premium	16,061
Less: unamortized debt issuance costs	<u>(1,809)</u>
Total long-term debt	\$ <u>122,343</u>

Hospital Revenue Bonds (Series 2007):

During November of 2007, the Hospital completed an offering of \$69,775,000 of hospital revenue and refunding bonds. The Series 2007 bonds are fixed rate term bonds with rates ranging from 6.250% to 6.375% and are scheduled to mature at various times through December 1, 2034. The bonds are collateralized by the Hospital's gross receipts and a collateral mortgage on System property. The proceeds of the Series 2007 bonds were used, along with other available funds, to advance refund previous bond issues and to provide funds for new capital improvements. The Series 2007 bonds were refunded in September 2019 and paid off in December 2019.

Hospital Revenue Bonds (Series 2014):

During January of 2014, the Hospital completed an offering of \$10,000,000 of hospital revenue and refunding bonds. The Series 2014 bonds are fixed rate term bonds with rates ranging from 2.62% to 3.70% and are scheduled to mature at January 1, 2024. The bonds are collateralized by the Hospital's gross receipts, the mortgage over facilities, and the UCC fixture filing. The proceeds of the Series 2014 bonds were used, along with other available funds, to fund construction projects. The Series 2014 bonds were refunded in September 2019.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

7. Long-term liabilities (continued)

Hospital Revenue Bonds (Series 2015)

During February of 2015, the Hospital completed an offering of \$10,000,000 of hospital revenue bonds for the purpose of providing funds for acquisition, construction, renovation and equipping of hospital facilities and paying costs of issuing the bonds. The Series 2015 bonds are fixed rate term bonds with rates ranging from 2.00% to 2.85% and are scheduled to mature at January 1, 2025. The bonds are collateralized by the Hospital's gross receipts, the mortgage over facilities, and the UCC fixture filing. The proceeds of the Series 2015 bonds were used, along with other available funds, to fund construction projects. The Series 2015 bonds were refunded in September 2019.

Hospital Revenue Bonds (Series 2015A):

During October of 2015, the Hospital completed an offering of \$10,000,000 of hospital revenue bonds for the purpose of providing funds for the renovation of the kitchen and loading dock adjacent to the back area of the kitchen at the hospital's main campus, construction of a free-standing inpatient and outpatient psychiatric facility at the Gauthier Road campus, and paying costs of issuing the bonds. The Series 2015A bonds are fixed rate term bonds with rates ranging from 2.309% to 2.914% and are scheduled to mature at October 1, 2025. The bonds are collateralized by the Hospital's gross receipts, the mortgage over facilities, and the UCC fixture filing. The proceeds of the Series 2015 bonds were used, along with other available funds, to fund construction projects. The Series 2015A bonds were refunded in September 2019.

Hospital Revenue Bonds (Series 2017):

During December 2017, the Hospital completed an offering of \$10,000,000 of hospital revenue bonds for the purpose of providing funds for the completion of existing hospital capital projects at the hospital's main campus, Gauthier Road campus, and paying costs of issuing the bonds. The Series 2017 bonds are fixed rate term bonds with rates ranging from 2.45% to 3.30% and are scheduled to mature at October 1, 2027. The bonds are collateralized by the Hospital's gross receipts, the mortgage over facilities, and the UCC fixture filing. The proceeds of the Series 2017 bonds are being used, along with other available funds, to fund construction projects. The Series 2017 bonds were refunded in September 2019.

Hospital Revenue Bonds (Series 2019):

During September of 2019, the Hospital completed an offering of \$104,935,000 of hospital revenue and refunding bonds. The Series 2019 bonds include \$38,270,000 in serial bonds with rates ranging from 4.0% to 5.0%, and \$66,665,000 in fixed rate term bonds with a 5.0% interest rate. The bonds are scheduled to mature at various times through December 1, 2039. The bonds are collateralized by the Hospital's gross receipts and a collateral mortgage on System property. The proceeds of the Series 2019 bonds were used, along with other available funds, to advance refund previous bond issues and to provide funds for new capital improvements.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

8. Insurance programs

Any exposure under \$100,000 per claim for professional liability is covered by the System. Additional professional liability coverage is provided by the Louisiana Patient's Compensation Fund up to the present statutory maximum of \$500,000 per claim (exclusive of additional amounts for future medical expense provided by law). The preceding policies are on an occurrence basis. The System has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims.

The System is self-insured for group health insurance and pays all claims up to \$225,000 per person. A stop loss policy pays claims in excess of this amount. The System is also self-insured for workers' compensation liability up to the deductible of its excess workers' compensation policy of \$750,000 per claim.

The System also maintains various other insurance programs typical of the industry.

The System has reflected its estimate of the ultimate liability for known and incurred, but not reported, claims in the accompanying consolidated financial statements.

9. Retirement plans

The Hospital has a defined contribution plan under IRS Code Section 401(a) that covers substantially all full-time employees who are over the age of twenty-one and who have met eligibility requirements. Discretionary contributions by the Hospital include matching contributions to the employee 401(a) plan up to certain limits of compensation. Total contributions were approximately \$2,471,000 and \$2,345,000 for the years ended December 31, 2019 and 2018, respectively.

The Hospital also maintains a pretax retirement plan under code Section 403(b) in which substantially all of the employees of the System can participate. All contributions to the 403(b) are made by employees through tax deferred contributions and the employees are 100% vested in these amounts from the inception of their participation.

10. Business and credit concentrations

Financial instruments which potentially subject the System to concentrations of credit risk consist principally of unsecured accounts receivable and temporary cash investments.

The System maintains its cash investments with several financial institutions operating primarily in southern Louisiana. The balances, at times, may exceed federally insured limits. Management believes the credit risk associated with these deposits is minimal.

The System grants credit to patients, substantially all of whom are regional residents. The System generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, and commercial insurance policies).

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

10. Business and credit concentrations (continued)

The mix of receivables from patients and third-party payors at December 31, 2019 and 2018 was as follows:

	<u>2019</u>	<u>2018</u>
Medicare	25.51%	27.80%
Medicaid	19.68%	21.96%
Commercial insurance and managed care organizations	37.15%	32.86%
Self-pay patients and other	17.66%	17.38%
	<u>100.00%</u>	<u>100.00%</u>

11. Leases

As described in Note 1, effective January 1, 2019, the System adopted Accounting Standards Update (“ASU”) No. 2016-02, “Leases (Topic 842)” and the series of related ASUs that followed (collectively referred to as “Topic 842”). The System elected the practical expedient available under ASU 2018-11 “Leases: Targeted Improvements” which allowed the System to apply the transition provision for Topic 842 at the adoption date instead of at the earliest comparative period presented in consolidated financial statements. Therefore, the System recognized and measured leases existing at January 1, 2019 but without retrospective application.

The following table presents the components of our right-of-use assets and liabilities related to leases in the System’s consolidated balance sheets at December 31, 2019 (in thousands):

<u>Assets:</u>	
Operating lease assets	\$ 24,378
Finance lease asset	19
Total leased assets	<u>\$ 24,397</u>
 <u>Liabilities:</u>	
Operating lease liabilities:	
Current	\$ 3,371
Long-term	17,254
Total operating lease liabilities	<u>20,625</u>
Finance lease liabilities:	
Current	19
Total finance lease liabilities	<u>19</u>
Total lease liabilities	<u>\$ 20,644</u>

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

11. Leases (continued)

Right-of-use assets and lease liabilities are recognized at commencement date based on the present value of lease payments over the lease term. The right of use assets and lease liabilities were recognized based on the present value of lease payments over the lease term at commencement date. The System's operating lease in effect prior to January 1, 2019 was recognized at the present value of the remaining payments on the remaining lease term as of January 1, 2019. The lease provided for specific rent increases over the life of the lease. The System used the risk-free interest rate.

Lease costs included in the 2019 consolidated statement of operations were approximately \$4,452,000, including short-term lease expense related to equipment rentals, finance lease rent, and the operating lease rent as described below.

The System's operating leases are primarily for real estate, including off-campus outpatient facilities, medical office buildings, and corporate and other administrative offices, as well as medical and office equipment. The finance lease is for medical office space. Other information related to operating leases is as follows (in thousands, except lease term and discount rate) as of December 31, 2019 (in thousands):

Weighted-average remaining lease term (years)		
Operating leases		8.55
Finance Leases		0.50
Weighted average discount rate		
Operating leases		2.49%
Finance Leases		2.50%
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash outflows from operating leases	\$	4,024
Operating cash outflows from finance leases	\$	40
Financing cash outflows from finance leases	\$	1
Right-of-use assets obtained in exchange for lease obligations:		
Operating leases	\$	1,941

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

11. Leases (continued)

As lessee, operating lease liabilities under non-cancellable leases (excluding short-term leases) are as follows (in thousands):

<u>Year ending December 31st,</u>	<u>Operating Lease Liabilities</u>
2020	\$ 3,877
2021	3,614
2022	3,379
2023	2,947
2024	2,746
Thereafter	6,356
Total lease payments(a)	<u>22,919</u>
Less: Interest	(2,294)
Present value of lease liabilities	<u>\$ 20,625</u>

Lease costs included in the 2018 consolidated statement of operations were approximately \$2,863,000.

12. Functional Allocation of Expenses

The following table approximates the functional allocation of operating expenses incurred during the year ended December 31, 2019 (in thousands):

	<u>Health Care Services</u>				<u>Support Services</u>		<u>Total</u>
	<u>Acute</u>	<u>Ambulatory</u>	<u>Physician</u>	<u>Post-Acute</u>	<u>MG&A</u>	<u>Fundraising</u>	
Salaries and wages	\$ 51,794	\$ 12,390	\$ 72,025	\$ 10,815	\$ 29,981	\$ 219	\$ 177,224
Employee benefits	11,379	2,730	5,974	2,376	6,580	55	29,094
Contract labor	5,460	484	1,091	160	3,825	-	11,020
Supplies	68,314	12,888	3,980	568	6,748	24	92,522
Professional fees	3,487	795	1,257	209	331	-	6,079
Service contracts	2,560	943	242	61	4,088	-	7,894
Purchased services	10,516	3,594	3,329	692	15,023	40	33,194
Management fees	689	22	346	20	530	-	1,607
Depreciation	5,788	2,018	304	428	5,545	-	14,083
Interest expense	2,356	739	124	172	2,257	-	5,648
Insurance	-	-	1,719	-	3,280	-	4,999
Other	4,515	1,572	2,407	366	6,304	487	15,651
	<u>\$166,858</u>	<u>\$ 38,175</u>	<u>\$ 92,798</u>	<u>\$ 15,867</u>	<u>\$ 84,492</u>	<u>\$ 825</u>	<u>\$ 399,015</u>

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

12. Functional Allocation of Expenses (continued)

The following table approximates the functional allocation of operating expenses incurred during the year ended December 31, 2018 (in thousands):

	Health Care Services				Support Services		Total
	Acute	Ambulatory	Physician	Post-Acute	MG&A	Fundraising	
Salaries and wages	\$ 50,765	\$ 10,463	\$ 62,284	\$ 11,794	\$ 27,581	\$ 200	\$ 163,087
Employee benefits	12,099	2,497	5,352	2,843	6,243	50	29,084
Contract labor	4,294	599	257	406	3,440	-	8,996
Supplies	66,378	9,275	3,969	837	5,316	250	86,025
Professional fees	3,011	1,805	1,367	583	358	-	7,124
Service contracts	2,500	1,123	289	16	3,575	-	7,503
Purchased services	10,520	2,334	3,564	2,010	12,699	50	31,177
Management fees	770	-	177	13	533	-	1,493
Depreciation	5,695	2,000	299	462	5,456	-	13,912
Interest expense	2,190	687	115	160	2,099	-	5,251
Insurance	-	-	1,572	49	3,092	-	4,713
Other	4,309	1,531	1,631	664	5,760	170	14,065
	<u>\$162,531</u>	<u>\$ 32,314</u>	<u>\$ 80,876</u>	<u>\$ 19,837</u>	<u>\$ 76,152</u>	<u>\$ 720</u>	<u>\$ 372,430</u>

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

13. Disclosures about the fair value of financial instruments

In Accordance with the *Fair Value Measurements and Disclosure* topic of the FASB ASC, disclosure of fair value information about financial instruments, whether or not recognized in the consolidated balance sheets is required. Fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. Fair value is best determined based upon quoted market prices. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instruments. Therefore, the aggregate fair value amounts presented do not represent the underlying value of the System.

The fair value guidance provides a consistent definition of fair value. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

Fair Value Hierarchy

In accordance with this guidance, the System groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 – Valuation is based on quoted prices in active markets for identical assets or liabilities that the System has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 - Valuation is based on inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 - Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

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

The following methods and assumptions were used by the System in estimating its fair value disclosures for financial instruments:

Cash and cash equivalents - the carrying amounts approximate fair values because of the short maturity of these instruments.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

13. Disclosures about the fair value of financial instruments (continued)

Assets limited as to use and short-term investments - the carrying amounts reported on the consolidated balance sheets for assets limited as to use and stocks included in short-term investments are fair values based on quoted market prices. The guaranteed investment contracts are deposits in an entity with guaranteed interest rates over the life of the respective bond issues and have no secondary market. Therefore, cash flow projections are used to measure fair value and are substantially the same as cost. The carrying amounts reported on the consolidated balance sheets for certificates of deposit included in short-term investments is cost, which is deemed to approximate fair value because these assets are highly liquid.

Mortgage backed securities – the carrying amounts reported are estimated based on quoted market prices for securities with similar characteristics.

Long-term liabilities - the fair value of the Hospital's revenue bonds are estimated based on current traded value. The fair value of the Hospital's remaining long term debt is estimated using discounted cash flow analyses, based on the hospital's current incremental borrowing rates for similar types of borrowing arrangements.

The System's financial instruments whose estimated fair value differs from its carrying amount are summarized as follows at December 31st:

	2019		2018	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Long-term liabilities				
(in thousands)	\$ 108,091	\$ 127,317	\$ 101,641	\$ 104,110

Limitations - fair value estimates are made at a specific point in time, based on relevant market information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The following table presents for each fair-value hierarchy level the System's financial assets that are measured at fair value on a recurring basis as of (in thousands).

	Level 1		Level 2		Level 3	
<u>December 31, 2019</u>						
Cash and Cash Equivalents	\$	25,212	\$	-	\$	-
Fixed Income		1,331		-		-
Equities		363		-		-
Certificate of Deposit		-		300		-
Total	\$	<u>26,906</u>	\$	<u>300</u>	\$	<u>-</u>
<u>December 31, 2018</u>						
Guaranteed Investment Contract	\$	-	\$	-	\$	6,665
Cash and Cash Equivalents		6,435		-		-
Fixed Income		1,150		-		-
Equities		406		-		-
Total	\$	<u>7,991</u>	\$	<u>-</u>	\$	<u>6,665</u>

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

13. Disclosures about the fair value of financial instruments (continued)

The following table presents the changes in fair value (in thousands) for the years ended December 31, 2019 and 2018, in Level 3 instruments that are measured at fair value on a recurring basis.

Balance, December 31, 2017	\$	6,665
Purchases		139
Sales		<u>(139)</u>
Balance, December 31, 2018		6,665
Purchases		-
Sales		<u>(6,665)</u>
Balance, December 31, 2019	\$	<u><u>-</u></u>

14. Related party transactions

The System has transactions with related parties for which the System believes the terms and conditions are comparable to terms that would have been available from a third party that was unaffiliated with the System.

15. Commitments and contingencies

The provision of health care services entails an inherent risk of liability. Participants in the health care industry are subject to lawsuits alleging malpractice, violations of false claims acts, product liability, or related legal theories, many of which involve large claims and significant defense costs. Like many other companies engaged in the health care industry in the United States, the System has the potential for liability claims, disputes and legal actions for professional liability and other related issues. It is expected that the System will continue to be subject to such suits as a result of the nature of the services provided. Further, as with all health care providers, the System is periodically subject to regulatory actions seeking fines and penalties for alleged violations of health care laws and are potentially subject to the increased scrutiny of regulators for issues related to compliance with health care fraud and abuse laws and with respect to the quality of care provided to patients.

Like other health care providers, in the ordinary course of business, the System is also subject to claims made by employees and other disputes and litigation arising from the conduct of business.

The ultimate resolution of these matters is not ascertainable at this time; however, management is of the opinion that any liability or loss in excess of insurance coverage resulting from such litigation will not have a material effect upon the financial position of the System.

As referred to in Note 6, the Hospital has begun a series of construction and renovation projects. Contracts related to these projects totaled approximately \$5,699,000 at December 31, 2019. Approximately \$3,296,000 has been paid on these contracts as of December 31, 2019, with approximately \$2,403,000 to be completed in future years.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

16. Subsequent events

A novel strain of coronavirus surfaced in another country and has spread around the world, resulting in business and social disruption. In March 2020, the novel coronavirus (COVID-19) global pandemic began affecting the System's employees, patients, communities, and business operations, as well as the United States economy and financial markets. The Centers for Medicare and Medicaid Services and the Louisiana Department of Health have requested the postponement of elective surgeries and other non-essential procedures and medical services. While the disruption is expected to be temporary, much of its impact remains unknown and difficult to predict. There is a likelihood that this pandemic will affect the System's financial performance in fiscal year 2020 and potentially beyond. The related financial impact and duration cannot be reasonably estimated at this time.

Management has evaluated events through the date that the consolidated financial statements were available to be issued, April 27, 2020, and determined that no additional disclosures are necessary other than the item noted above.

17. Community service (unaudited)

As a non-profit, community based health system, the Hospital provides significant programs and health-related services for the indigent and medically underserved in southwest Louisiana, which represents the Hospital's financial commitment to those in the community with inadequate resources or who are uninsured or underinsured. In addition, the Hospital operates an emergency room which is open to the public, 24 hours a day and seven days a week.

Charity Care represents the cost of free or discounted health related services for those who cannot afford to pay for those services and who meet the Hospital's criteria for financial assistance. Under the Hospital's criteria for determining assistance, the Hospital provides full charity care for those whose income levels are at or below 200.99% of the Federal Poverty Guidelines (FPG). Discounted services are available to those people whose income is above 201% of the FPG and up and including to 500% of the FPG. Charity Care services provided to these people are reported as income in the consolidated statements of operations to the extent of the estimated cost recovery allowed under the Moss Cooperative Endeavor Agreement (Moss CEA). The Hospital also provides some services at a reduced rate that does not cover the costs. For example, the Hospital provides free or significantly discounted vaccinations for children and elderly patients. The unreimbursed Medicaid Costs reported below have been reduced by funds received that approximate the difference between Medicaid payments and the costs allowed under the Moss CEA.

Additionally, the Hospital provides the clinical and financial resources for the Memorial/LSUHSC Family Practice Residency Program, through an affiliation agreement with the Louisiana State University Health Sciences Center – New Orleans, with 8 full-time and 3 part-time faculty members to train 20 family practice residents. The Hospital also provides the clinical and financial resources for a Radiology Technology and Medical Technology program in affiliation with other state universities. The Hospital is also involved in providing services to the community at large by supplementing professional medical staffing at community clinics and through the provision of support groups, community health education classes, staffing support at McNeese State University School of Nursing, and cash donations to local non-profit organizations.

The Hospital continues to fulfill its obligations under Internal Revenue Service guidelines to participate in Community Health Needs Assessment (CHNA) and has updated its CHNA in 2016. The Hospital has provided a CHNA update in 2017. This report is available on its website at www.lcmh.com. The next report will not be available until 2020.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

17. Community service (unaudited) (continued)

The following is a summary of the Hospital's estimated costs of community benefits (in thousands):

Programs for the Poor and Underserved:	2019	2018
Charity Care, at cost	\$ 13,479	\$ 15,006
Direct Offsetting Revenue	(11,626)	(11,780)
Charity Care	<u>1,853</u>	<u>3,226</u>
Medicaid Patient Care, at cost	73,772	75,623
Direct Offsetting Revenue	(69,382)	(67,957)
Unreimbursed Medicaid	<u>4,390</u>	<u>7,666</u>
Community services for the community at large		
Education and research	4,332	3,699
Other	745	294
Total	<u>\$ 11,320</u>	<u>\$ 14,885</u>