



TOWER HEALTH AND SUBSIDIARIES

Consolidated Financial Statements and
Supplementary Consolidating Information

June 30, 2019 and 2018

(With Independent Auditors' Report Thereon)

TOWER HEALTH AND SUBSIDIARIES

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KPMG LLP
1601 Market Street
Philadelphia, PA 19103-2499

Independent Auditors' Report

The Board of Directors
Tower Health (formerly Reading Health System):

We have audited the accompanying consolidated financial statements of Tower Health (formerly Reading Health System) and Subsidiaries, which comprise the consolidated balance sheets as of June 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 U.S. generally accepted accounting principles; 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on 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 Tower Health (formerly Reading Health System) and Subsidiaries as of June 30, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.



Emphasis of Matter

As discussed in note 2(w) to the consolidated financial statements, Tower Health and Subsidiaries adopted Accounting Standards Update (ASU) No. 2016-14 *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, and ASU No. 2014-09, *Revenue from Contracts with Customers* during the year ended June 30, 2019. Our opinion is not modified with respect to these matters.

Other Matter

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The Supplementary Consolidating Information in Schedules I – IV 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.

KPMG LLP

Philadelphia, Pennsylvania

October 2, 2019

TOWER HEALTH AND SUBSIDIARIES

Consolidated Balance Sheets

June 30, 2019 and 2018

(Dollars in thousands)

Assets	2019	2018
Current assets:		
Cash and cash equivalents	\$ 3,818	67,502
Patient accounts receivable , less allowance for uncollectible accounts of \$84,771 in 2018	314,630	314,232
Other receivables	10,757	5,339
Receivables from affiliates	312	142
Inventories	48,392	37,133
Estimated third-party payor receivables	21,461	14,087
Prepaid expenses and other current assets	32,515	27,763
Assets held for sale	19,875	19,875
Assets whose use is limited – required for current liabilities:		
Self-insurance funding arrangements	7,483	7,482
Total current assets	459,243	493,555
Assets whose use is limited:		
Self-insurance funding arrangements	19,902	11,988
Under regulatory requirements	2,000	2,000
By board for capital improvements	698,438	850,868
Investments with donor restrictions	40,998	33,601
Total assets whose use is limited, net of current portion	761,338	898,457
Property, plant and equipment, net	1,131,464	1,054,776
Goodwill	155,191	128,127
Investments in joint ventures	17,350	19,940
Other assets	1,580	4,348
Total assets	\$ 2,526,166	2,599,203

TOWER HEALTH AND SUBSIDIARIES

Consolidated Balance Sheets

June 30, 2019 and 2018

(Dollars in thousands)

Liabilities and Net Assets	2019	2018
Current liabilities:		
Current installments of long-term debt	\$ 6,312	5,600
Line of credit	17,802	—
Capital leases	2,215	2,120
Accounts payable	136,622	77,589
Estimated third-party payor settlements	4,277	8,965
Current portion of estimated self-insurance costs	9,430	13,669
Accrued expenses	51,742	56,445
Accrued vacation	50,515	40,997
Other current liabilities	24,372	13,202
Total current liabilities	303,287	218,587
Long-term debt, net of current portion and unamortized discount/premium and deferred financing costs	1,117,656	1,126,194
Capital leases, net of current portion	18,887	19,651
Accrued pension liabilities	226,031	201,974
Other liabilities	9,114	7,352
Estimated self-insurance costs, net of current portion	25,099	28,536
Swap contracts	31,387	26,776
Total liabilities	1,731,461	1,629,070
Net assets:		
Without donor restrictions	754,955	935,296
With donor restrictions	39,750	34,837
Total net assets	794,705	970,133
Total liabilities and net assets	\$ 2,526,166	2,599,203

See accompanying notes to consolidated financial statements.

TOWER HEALTH AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended June 30, 2019 and 2018

(Dollars in thousands)

	<u>2019</u>	<u>2018</u>
Revenues and other support:		
Net patient service revenue	\$ 1,688,264	1,674,401
Provision for uncollectible accounts	<u>—</u>	<u>(107,871)</u>
Net patient service revenue less provision for uncollectible accounts	1,688,264	1,566,530
Other revenue	<u>65,464</u>	<u>54,418</u>
Total revenues and other support	<u>1,753,728</u>	<u>1,620,948</u>
Expenses:		
Salaries and benefits	1,038,286	870,916
Supplies	291,284	260,541
Interest	42,010	36,580
Depreciation	94,412	90,491
Purchased services	258,189	198,647
Repairs and maintenance	64,676	52,834
Other	122,015	103,144
Transaction related expenses	<u>21,637</u>	<u>18,567</u>
Total expenses	<u>1,932,509</u>	<u>1,631,720</u>
Loss from operations	<u>(178,781)</u>	<u>(10,772)</u>
Nonoperating gains:		
Investment income	49,592	119,667
Change in fair value of swap contracts, net of settlement payments	(9,072)	7,307
Loss on early extinguishment of debt	—	(4,314)
Other losses	<u>(3,605)</u>	<u>(3,204)</u>
Nonoperating gains, net	<u>36,915</u>	<u>119,456</u>
(Deficiency) excess of revenues, gains and other support over expenses	<u>\$ (141,866)</u>	<u>108,684</u>

See accompanying notes to consolidated financial statements.

TOWER HEALTH AND SUBSIDIARIES

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2019 and 2018

(Dollars in thousands)

	Without donor restrictions	With donor restrictions	Total net assets
Net assets at June 30, 2017	\$ 862,951	30,118	893,069
Changes in net assets:			
Excess of revenues, gains, and other support over expenses	108,684	—	108,684
Net in unrealized (losses) gains on investments	(70,878)	361	(70,517)
Change in pension liability	34,887	—	34,887
Donor restricted contributions	—	3,328	3,328
Net assets released from restrictions	—	(348)	(348)
Change in beneficial interest in trusts	—	1,378	1,378
Other	(348)	—	(348)
Change in net assets	72,345	4,719	77,064
Net assets at June 30, 2018	935,296	34,837	970,133
Changes in net assets:			
Deficiency of revenues, gains, and other support over expenses	(141,866)	—	(141,866)
Net in unrealized gains on investments	341	127	468
Net in realized gains on investments	—	855	855
Change in pension liability	(39,841)	—	(39,841)
Donor restricted contributions	—	5,310	5,310
Net assets released from restrictions	—	(2,493)	(2,493)
Change in beneficial interest in trusts	—	133	133
Other	1,025	981	2,006
Change in net assets	(180,341)	4,913	(175,428)
Net assets at June 30, 2019	\$ 754,955	39,750	794,705

See accompanying notes to consolidated financial statements.

TOWER HEALTH AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended June 30, 2019 and 2018

(Dollars in thousands)

	2019	2018
Cash flows from operating activities:		
Change in net assets	\$ (175,428)	77,064
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Unrealized losses (gains) on investments and beneficial interest in trusts	(18,120)	73,658
Change in fair value of swap contracts	4,611	(14,014)
Amortization of bond discount	60	65
Amortization of bond premium	(2,378)	(1,923)
Amortization of deferred financing costs	525	448
Change in pension liability, net	24,057	(50,282)
Depreciation	94,412	90,491
Amortization of entrance fees	—	(1,236)
Proceeds from entrance fees and deposits	—	937
Gain on disposal of fixed assets	—	(1,115)
Provision for uncollectible accounts	—	107,871
Investment income	(31,336)	(124,186)
Equity in earnings of affiliates	(7,213)	(8,875)
Contributions and investment income donor restricted for long-term investment and capital	(5,310)	(3,328)
Loss on early extinguishment of debt	—	4,314
Loss on divestiture of affiliate	—	6,390
Gain on acquisition of affiliate	(3,550)	—
Change in cash due to changes in operating assets and liabilities:		
Receivable from patients and others	(5,038)	(301,669)
Inventories	(11,259)	(3,469)
Prepaid expenses and other assets	(1,829)	(7,416)
Accounts payable and other liabilities	61,065	60,323
Estimated self-insurance costs	(7,676)	(6,179)
Third-party payor settlements	(12,062)	(1,972)
Net cash used in operating activities	<u>(96,469)</u>	<u>(104,103)</u>
Cash flows from investing activities:		
Acquisition of property, plant and equipment	(157,118)	(87,102)
Proceeds from the sale of property, plant and equipment	—	3,773
Divestiture of affiliate	—	69,133
Acquisition of businesses, net of cash received	(23,510)	(423,365)
Investment in equity investees	(430)	—
Distribution from equity investees	6,589	4,770
Sales of investments and assets whose use is limited, net	309,045	779,290
Purchases of investments and assets whose use is limited, net	(118,082)	(786,617)
Net cash provided by (used in) investing activities	<u>16,494</u>	<u>(440,118)</u>
Cash flows from financing activities:		
Contributions and investment income donor restricted for long-term investment and capital	5,310	3,328
Payments to escrow for debt extinguishment	—	(48,561)
Proceeds from long-term debt issuance	—	646,651
Payment of deferred financing costs	—	(4,171)
Repayments of long-term debt	(6,033)	(39,548)
Proceeds from bridge loan	—	(491,018)
Repayment of bridge loan	—	491,018
Proceeds from line of credit	31,531	—
Repayments on line of credit	(13,729)	—
Payments on capital leases	(788)	(1,457)
Refunds of entrance fees and deposits	—	(54)
Net cash provided by financing activities	<u>16,291</u>	<u>556,188</u>
Net (decrease) increase in cash and cash equivalents	<u>(63,684)</u>	<u>11,967</u>
Cash and cash equivalents:		
Beginning of year	67,502	55,535
End of year	<u>\$ 3,818</u>	<u>67,502</u>
Supplemental cash flow information:		
Cash paid during the year for interest, net of capitalized interest of \$2,638 and \$382 for 2019 and 2018	\$ 42,045	32,354
Fixed asset additions included in accounts payable and accrued expenses at June 30	14,696	5,138
Noncash consideration of affiliate	3,466	—

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(Dollars in thousands)

(1) Organizational Structure and Nature of Operations

Tower Health (formerly Reading Health System) (Parent) is a tax-exempt not-for-profit corporation under Section 501(c)(3) of the Internal Revenue Code. The Parent is located in West Reading, Pennsylvania, and provides inpatient, outpatient and emergency care for residents of the greater Berks, Montgomery, and Chester County areas through its subsidiaries (collectively, the System).

(a) *Subsidiaries of the Parent Include*

Reading Hospital (Hospital), a tax-exempt not-for-profit corporation providing acute and post-acute care.

Chester/Montgomery/Philadelphia hospitals acquired on October 1, 2017 from Community Health Systems (CHS), are tax-exempt not-for-profit corporations providing acute and post acute care. The five hospitals include: Brandywine Hospital in Coatesville; Chestnut Hill Hospital in Philadelphia; Jennersville Regional Hospital in West Grove; Phoenixville Hospital in Phoenixville and Pottstown Memorial Medical Center in Pottstown (collectively, Chester/Montgomery/Philadelphia Hospitals (CMP)).

Tower Health Medical Group (THMG), formerly Reading Health Physician Network (RHPN), a tax-exempt entity established to assure access to high quality primary care physicians and specialty physicians in sufficient numbers to meet the community needs for charitable, educational, and scientific purposes. THMG also recruits physicians and provides administrative services for the Hospital, including supervision and instruction for medical students completing their residency training. The Chester/Montgomery/Philadelphia clinics and practices are part of THMG.

The Highlands at Wyomissing (The Highlands), a not-for-profit corporation, was a fully controlled entity of the Parent through September 30, 2017. The purpose of The Highlands was to operate a continuing care retirement community including residential, recreational and health care facilities and services specially designed to meet the physical, social and psychological needs of elderly persons. The Highlands facility is located in Wyomissing, Pennsylvania, and its residents are principally from the Wyomissing and Reading, Pennsylvania, area. The facility contains 285 residential living units, an 80-bed skilled nursing unit, and 66 personal care units. Certain members of the Board of Directors from the Hospital are also members of the Board of Directors of The Highlands. The Highlands affiliation with the Parent was divested on September 30, 2017. The Parent recorded a loss of \$6,390 in the year ended June 30, 2018 in connection with the divestiture, which is included in transaction related expenses in the accompanying 2018 consolidated statement of operations.

Tower Health Partners (THP), formerly Reading Health Partners (RHP), a Pennsylvania limited liability company, was formed to develop a physician network working in conjunction with the Parent to implement a clinical integration program. Clinical integration is the implementation of an active and ongoing program to evaluate and modify practice patterns by the network's physician participants and create a high degree of interdependence and cooperation among the physicians to control costs and improve the quality and efficiency of health care in the community.

TOWER HEALTH AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(Dollars in thousands)

Reading Hospital Foundation (RHF), formerly Reading Health System Foundation, a not-for-profit corporation to support research, education, innovation and fund raising in support of the Parent and its subsidiaries, and the community. The Parent is the sole member of RHF.

Tower Health Enterprises (THE), a Pennsylvania limited liability company, was initially formed to hold the interest in joint ventures acquired as part of the acquisition of CMP on October 1, 2017. These joint ventures are recorded under the equity method of accounting and are included in investments in joint ventures on the accompanying consolidated balance sheets, totaling \$4,098 and \$3,685 at June 30, 2019 and 2018, respectively. Also included is Tower Health Urgent Care, acquired on December 1, 2018 from Premier Immediate Medical Care, LLC (Premier), and Tower Health at Home, acquired on January 1, 2019.

(b) Other Noncontrolled Entities Include

The Reading Hospital Surgicenter at Springridge, LLC (Springridge, LLC), a limited liability company, was established to provide ambulatory surgery services to the surrounding community. The Hospital maintains a 50% ownership and during the years ended June 30, 2019 and 2018, the Hospital received distributions of \$2,716 and \$3,445, respectively. This investment is recorded under the equity method of accounting and is included in investments in joint ventures on the accompanying consolidated balance sheets, totaling \$199 and \$605 at June 30, 2019 and 2018, respectively.

The Parent, along with several other acute care service hospitals throughout the central Pennsylvania area, contributed capital to form Central Pennsylvania Alliance Laboratories (CPAL), a joint venture to combine laboratory operations. The Parent maintains a 20% ownership interest in CPAL. This investment is recorded under the equity method of accounting and is included in investments in joint ventures on the accompanying consolidated balance sheets, totaling \$350 at both June 30, 2019 and 2018.

The Parent's ownership of Central Pennsylvania Homecare, Inc. (d.b.a. Affilia Home Health, AHH) is 44.1%. AHH provides visiting home nursing services to outpatients of the Hospital and other healthcare providers in the surrounding community. This investment is recorded under the equity method of accounting and is included in investments in joint ventures on the accompanying consolidated balance sheets, totaling \$0 and \$6,361 at June 30, 2019 and 2018, respectively. In the year ended June 30, 2019, the joint venture was dissolved and the Parent received a distribution of \$2,500. On January 1, 2019 the Parent acquired Berks Visiting Nurse Association (VNA), Pottstown VNA and Advantage Home Care, Inc (BHC), see note 3(b). These transactions resulted in a net gain of \$3,550 in the year ended June 30, 2019.

The Parent is a 20% owner of Quest Behavioral Health, Inc. (Quest). Quest is a not-for-profit corporation providing full service managed behavioral healthcare. This investment is recorded under the equity method of accounting and is included in investments in joint ventures on the accompanying consolidated balance sheets, totaling \$164 and \$90 at June 30, 2019 and 2018, respectively.

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Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(Dollars in thousands)

Horizon is a for-profit limited liability partnership of which the Parent is a 25% owner. The investment is recorded under the equity method of accounting and is included in investments in joint ventures on the accompanying consolidated balance sheets, totaling \$2,222 and \$1,292 at June 30, 2019 and 2018, respectively.

AllSpire Health Partners, LLC is an alliance of five systems in New Jersey and Pennsylvania of which the Parent is a 20% owner. The consortium will carry out joint activities in traditional areas of patient care services, research and education to enhance the value of health care that communities receive. This investment is recorded under the equity method of accounting and is included in investments in joint ventures on the accompanying consolidated balance sheets, totaling \$406 and \$602 at June 30, 2019 and 2018, respectively.

AllSpire Health GPO, LLC formed May 31, 2016 is an alliance of the five system's that are part of AllSpire Health Partners, LLC of which the Parent is a 20% owner. The alliance was created to help manage expenses by group establishing purchasing volumes, streamlining suppliers and implementing efficiencies across all partners. The goal is to identify clinical optimization and revenue opportunities to provide access to quality products to providers and patients. In the year ended June 30, 2019 and 2018, the Parent received a distribution of \$1,373 and \$1,324, respectively. This investment is recorded under the equity method of accounting and is included in investments in joint ventures on the accompanying consolidated balance sheets, totaling \$2,510 and \$2,863 at June 30, 2019 and 2018, respectively.

UPMC (University of Pittsburgh Medical Center) Health Plan and the Parent created a joint venture on January 1, 2017, of which each member is a 50% equity owner. UPMC Health Plan provides third party administration and flexible spending account administration services for the System. Additional benefits result in enhanced cost savings, value based healthcare to residents and companies in the greater Berks County area and access to the System as an in-network provider. This investment is recorded under the equity method of accounting and is included in investments in joint ventures on the accompanying consolidated balance sheets, totaling \$7,401 and \$4,092 at June 30, 2019 and 2018, respectively.

(2) Summary of Significant Accounting Policies

Basis of Accounting

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles (GAAP). The significant accounting policies followed by the System are as follows:

(a) Principles of Consolidation

The consolidated financial statements of the System include the accounts of the Parent, the Hospital, CMP, THMG, The Highlands (divested on September 30, 2017), THP, RHF, and THE. All entities where the Parent, Hospital, or THE exercises significant influence but for which it does not have control are accounted for under the equity method. All significant intercompany balances and transactions have been eliminated.

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Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(Dollars in thousands)

(b) Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP 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 those estimates.

(c) (Deficiency) Excess of Revenues, Gains and Other Support over Expenses

The consolidated statements of operations include the (deficiency) excess of revenues, gains and other support over expenses. Changes in net assets without donor restrictions that are excluded from this performance indicator, consistent with industry practice, include changes in unrealized gains (losses) on marketable securities classified as other than trading securities, adjustments for defined benefit and other postretirement benefits, and contributions of long-lived assets (including assets acquired using contributions, which by donor-restriction were to be used for the purposes of acquiring such assets).

(d) Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less. At June 30, 2019 and 2018, the System had cash balances in financial institutions that exceeded federal depository insurance limits. Management believes that the credit risk related to these deposits is minimal.

(e) Net Patient Service Revenue

The System's net patient 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, and others and include an estimate of 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 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 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 reasonable representation 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 inpatient services. The System measures the performance obligation from admission into the hospital 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 is recognized when goods or services are provided and the System does not believe it is required to provide additional goods or services to the patient.

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Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(Dollars in thousands)

The majority of the System's services are rendered to patients with third party coverage. Reimbursement under these programs for all payors is based on a combination of prospectively determined rates, discounted charges and historical costs. Amounts received under Medicare and Medicaid programs are subject to review and final determination by program intermediaries or their agents the contracts the System has with commercial payors also provide for retroactive audit and review of claims. Agreements with third-party payors typically provide for payments at amounts less than established charges. Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The System also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. The System estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Implicit price concessions are determined based on historical collection experience. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Consistent with the System's mission, care is provided to patients regardless of their ability to pay. The System has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances (e.g. 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. The System has determined that it has provided sufficient implicit price concessions for these accounts. Price concessions, consisting of charity care are not reported as revenue.

The Company's estimate of the transaction price includes estimates of price concessions for such items as contractual allowances, charity care, potential adjustments that may arise from payment and other reviews, and uncollectible amounts, which are determined using a portfolio approach as a practical expedient to account for patient contracts as collective groups rather than individually. Estimates for uncollectible amounts are based on the aging of the accounts receivable, historical collection experience for similar payors and patients, current market conditions, and other relevant factors.

Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to net patient service revenue in the period of the change. Subsequent changes that are determined to be the result of an adverse change in the payor's or patient's ability to pay are recorded as bad debt expense. Bad debt expense for the year ended June 30, 2019 was not significant to the consolidated financial statements.

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Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(Dollars in thousands)

The percentages of net patient service revenue from patients and third-party payors for the years ended June 30, 2019 and 2018 were as follows:

	2019	2018
Medicare	19 %	22 %
Medicare Advantage	11	13
Medicaid	3	2
Managed Medicaid	9	9
Blue Cross	33	30
Commercial	19	20
Self-pay and other	6	4
	100 %	100 %

(f) Accounts Receivable

The System has agreements with third-party payors that provide for payment at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Management regularly reviews accounts and contracts and provides appropriate contractual allowances and discounts that are netted against patient accounts receivable in the consolidated balance sheets. The System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor arrangements. The percentages of net patient accounts receivable from patients and third-party payors as of June 30, 2019 and 2018 were as follows:

	2019	2018
Medicare	14 %	12 %
Medicare Advantage	13	12
Medicaid	7	6
Managed Medicaid	12	13
Blue Cross	16	16
Commercial	18	20
Self-pay and other	20	21
	100 %	100 %

(g) Inventories

Inventories are stated at lower of cost (determined by the first-in, first-out method) or market.

(h) Assets Whose Use is Limited

Assets whose use is limited includes designated assets set aside by the Board of Directors for future capital improvements, assets held by trustees under indenture agreements and self-insurance trust

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Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(Dollars in thousands)

arrangements. The Board of Directors retains control over Board-designated assets and may at its discretion subsequently use these assets for other purposes.

Assets whose use is limited includes cash and cash equivalents, marketable securities (including U.S. government and government agencies, corporate, state and local government), marketable equity securities (including common, preferred, and foreign stock), exchange traded/listed mutual funds (including fixed income funds), hedge funds, private equity funds, and limited partnerships.

(i) Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are recorded at fair value in the consolidated balance sheets. In the year ended June 30, 2018, the System restructured its unrestricted Long-Term Capital (LTC) investment portfolio by eliminating redundant investment advisors and redeploying investments. As a part of this restructuring, the LTC portfolio was designated as a trading portfolio.

Investment income earned on securities (interest and dividends) is reported in the nonoperating gains (losses) section of the consolidated statements of operations within investment income. Realized gains or losses related to the sale of investments, impairment losses on other than trading investments, and unrealized gains or losses on alternative investments and LTC investments, are included in the nonoperating gains (losses) section of the consolidated statements of operations in investment income unless the income or loss is restricted by donor or law.

Restricted investments and assets held for self-funding arrangements are classified as other than trading, and changes in unrealized gains on these instruments are included in the consolidated statements of changes in net assets. Impairment losses are included in the consolidated statements of operations within nonoperating gains (losses) as other than temporary impairment on other than trading investments. Prior to the restructuring of the LTC portfolio in the year ended June 30, 2018, unrestricted investments held in the LTC were also classified as other than trading.

The fair value option for financial assets and liabilities permits the System to elect to measure eligible items at fair value on an instrument by instrument basis. If elected, this option requires the System to report the unrealized gains and losses on these instruments as part of the performance indicator. Once elected, the fair value option is irrevocable for that instrument. Alternative investments include investments in managed funds, which include hedge funds, private equities, limited partnerships, and other investments that do not have readily determinable fair values and may be subject to withdrawal restrictions. Investments in hedge funds, private equities, limited partnerships, and other investments in managed funds (collectively Alternative Investments) are accounted for using the fair value option. The unrealized gains or losses from these Alternative Investments are included in the consolidated statements of operations as part of nonoperating gains (losses) within investment income.

(j) Fair Value Measurements

The System follows the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurement* (ASC 820), which defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. ASC 820 also establishes a

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framework for measuring fair value using valuation techniques such as the market approach, cost approach, and income approach, and making disclosures about fair value measurements.

ASC 820 emphasizes that fair value is a market-based measurement, not an entity specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing an asset or liability. As a basis for considering market participant assumptions in fair value measurements, ASC 820 defines a three-level fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity and the reporting entity's own assumptions about market participants. The fair value hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 – Inputs utilized quoted market prices in active markets for identical assets or liabilities that the System has the ability to access.

Level 2 – Inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset and liability (other than quoted prices) such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals.

Level 3 – Inputs are unobservable inputs for the asset or liability, which is typically based on an entity's own assumptions, as there is little, if any, related market activity.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the Level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest Level input that is significant to the fair value measurement in its entirety. The System's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

Where quoted prices are available in an active market, investments are classified in Level 1 of the valuation hierarchy. Investments in Level 1 include cash, exchange-traded equity securities, and mutual funds with a published daily net asset value or its equivalent (NAV). Investments in Level 2 include financial instruments valued based on quoted market prices for identical securities in markets that are not active, quoted prices for similar securities in markets that are active, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. If quoted prices are not available, other accepted valuation methodologies, such as interest rates, observable yield curves and spreads may be used to determine fair value. Level 2 includes state and municipal government securities, corporate and foreign bonds, U.S. Government securities, and certain mutual and fixed income funds that permit daily redemptions but whose NAV is not published. Auction rate securities are estimated using the income approach. This approach uses estimation techniques to determine the estimated future cash flows of the respective asset or liability expected by a market participant and discounts those cash flows back to present value.

The fair values of Alternative Investments have been estimated by management based on all available data, including information provided by third-party pricing vendors, fund managers and general partners. Alternative Investments are recorded at fair value based on the NAV as a practical expedient, as provided by the respective general partner or fund administrator of the individual Alternative

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Investment funds. The System believes the fair value of Alternative Investments in the consolidated balance sheets is a reasonable estimate of its ownership interest in the Alternative Investment funds. As part of the System's overall valuation process, management evaluates these third-party methodologies to ensure that they are representative of exit prices in the security's principal markets.

These valuation methods may produce a fair value estimate that may not be reflective of future fair values. Furthermore, while the System believes that its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine fair value could result in a materially different estimate of fair value at the reporting date.

(k) Property, Plant and Equipment

Property, plant and equipment are carried at cost, less accumulated depreciation. Expenditures that substantially increase the useful lives of existing assets are capitalized. Routine maintenance and repairs are expensed as incurred. Depreciation is computed using the straight-line method over the estimated useful lives of each class of depreciable asset. Useful lives range as follows:

Land improvements	5–25 years
Buildings and building improvements	10–50 years
Fixed equipment	5–15 years
Movable equipment (including software and hardware)	3–15 years

During the year ended June 30, 2018, the System changed the estimated useful lives of certain capital assets at the Hospital, primarily impacting buildings and building improvements from 10-40 years to 10-50 years. The effect was a decrease in depreciation expense of approximately \$15,000 for the year ended June 30, 2018.

Gains and losses resulting from the retirement or sale of property, plant and equipment are included in the consolidated statements of operations. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Gifts of long-lived operating assets such as land, buildings or equipment are reported as contributions without donor restrictions and are excluded from the performance indicator unless explicit donor stipulations specify how the donated asset must be used. Gifts of long-lived assets with explicit donor restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as support with donor restrictions. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

The System reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Management has reviewed the carrying amount of these assets and has determined that they are not currently impaired.

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(l) Goodwill and Intangible Assets

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination. The System evaluates goodwill for impairment annually and whenever events or changes in circumstances indicate that the value of the asset may be impaired. Impairment testing consists of performing internal qualitative and/or quantitative assessments and considers other publicly available market information. If the carrying amount of the goodwill exceeds the estimated fair value, an impairment charge to current operations is recorded to reduce the carrying value to the estimated fair value. All of the System's goodwill was acquired as a result of the transactions with CHS and Premier. As of June 30, 2019 and 2018 there was no indication of impairment of goodwill.

(m) Deferred Financing Costs

Deferred financing costs are amortized over the period the debt is outstanding using the straight-line method, which approximates the effective interest method. Amortization of deferred financing costs totaled \$525 and \$448 for the years ended June 30, 2019 and 2018, respectively. Accumulated amortization totaled \$2,127 and \$1,602 as of June 30, 2019 and 2018, respectively.

(n) Estimated Self-Insurance Costs

The provision for estimated self-insured claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. The System self-insures its medical malpractice, general liability, and workers' compensation risks. Reserve estimates are subject to the impact of changes in claim trends as well as prevailing social, economic, and legal conditions. The ultimate net cost of settling these liabilities may vary from the estimated amounts. Accordingly, reserve estimates are continually reviewed and updated, and any resulting adjustments are reflected in the performance indicator.

(o) Accrued Vacation

The System records a liability for amounts due to employees for future paid leave, which are attributable to services performed in the current and prior periods.

(p) Bond Premiums and Discounts

Bond premiums and discounts are amortized to interest and expensed as direct additions or reductions of the carrying values of the related debt instruments from which the discounts or premiums arose. Bond premiums and discounts are amortized to interest expense over the period during which the debt is outstanding using the straight-line method, which approximates the effective interest method.

(q) Derivative Instruments

The System follows accounting guidance on derivative financial instruments that is based on whether the derivative instrument meets the criteria for designation as an effective cash flow hedge. The process for designating a derivative as an effective hedge includes an assessment of the instrument's effectiveness in risk reduction, matching the derivative instrument to its underlying transactions and an assessment of the probability that the underlying transaction will occur. All of the System's derivative financial instruments are interest rate swap agreements without hedge accounting designation.

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Entering into interest rate swap agreements involves, to varying degrees, elements of credit, default, prepayments, and market risk in excess of the amounts recognized on the consolidated balance sheets. Such risks include the possibility that there will be no liquid market for these arrangements, the counterparty to these arrangements may default on its obligations to perform, and there may be unfavorable changes in interest rates. The System does not hold derivative instruments for the purpose of managing credit risk and enters into derivative transactions with high quality counterparties.

The interest rate swap agreements entered into by the System are adjusted to market value based upon quotations from the counterparties and a credit valuation adjustment is applied to the valuations of the swaps which takes into consideration counterparty risk of default. The change in market value is recorded in the consolidated statements of operations within the performance indicator.

(r) Net Assets with Donor Restrictions

Net assets with donor restrictions are those whose use by the System have been limited by donors to a specific time period or purpose and net assets that have been restricted by donors to be maintained by the System in perpetuity.

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires the System to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature are to be reported in net assets with donor restrictions as of year-end. These deficiencies can result from unfavorable market fluctuations that occur shortly after the investment of new donor restricted contributions and continued appropriation for certain programs that was deemed prudent by the Board of Trustees. No material deficiencies existed at June 30, 2019 and 2018.

(s) Other Revenue

Significant components of other revenue include rental income on leased properties, residential revenue, tuition revenue for The Reading Hospital School of Health Sciences, and cafeteria revenues.

Additionally, pharmacy sales and other contracts related to health care services are included in other revenue and consist of contracts which vary in duration and in performance. Revenue is recognized when the performance obligations identified within the individual contracts are satisfied and collections can be reasonably assured.

(t) 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 donor restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends and/or purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported in the consolidated statements of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as contributions without donor restrictions in the accompanying consolidated statements of operations.

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(u) Income Taxes

The System is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. On such a basis, the exempt entities do not incur liability for federal income taxes, except in the case of unrelated business income.

The System evaluates uncertain tax positions using a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in an unrelated business activity tax return and disclosures regarding uncertainties in tax positions. No adjustments to the consolidated financial statements were required as a result of this evaluation.

On December 22, 2017, the President signed into law H.R. 1, originally known as the Tax Cuts and Jobs Act. The new law includes several provisions that result in substantial changes to the tax treatment of tax-exempt organizations and their donors. The System has reviewed these provisions and the potential impact and concluded the enactment of H.R. 1 did not have a material impact on the operations of the System.

(v) Uncompensated Care and Community Service

The System provides services to patients who meet the criteria of its charity service policy without charge or at amounts less than the established rates. Criteria for charity care consider the patient's family income, family size, and ability to pay. Individuals who qualify for charity care do not have insurance or other coverage.

The System maintains records to identify and monitor the level of charity care and community service it provides. These records include the amount of charges foregone based on established rates for services, and supplies furnished under its charity care and community service policies, and the estimated cost of those services.

Charges foregone for uncompensated care as determined in accordance with the System's policies were approximately \$23,187 and \$16,621 in the years ended June 30, 2019 and 2018, respectively. Direct and indirect costs to provide these services were approximately \$6,912 and \$4,955 for the years ended June 30, 2019 and 2018, respectively. The estimated costs were based on a calculation, which multiplied the cost to charge ratio by the gross charges associated with providing uncompensated care to patients. The cost to charge ratio was obtained from the System's most recently filed Medicare cost report.

Additionally, the System sponsors certain other service programs and charity services, which provide substantial benefit to the broader community. Such programs include services to needy populations requiring special services and support, community service programs and charity services, as well as health promotion and education.

The System's community service includes the Medical Assistance program, which makes payment for services provided to families with dependent children, the aged, the blind, and the permanently and totally disabled, whose income and resources are insufficient to meet the costs of necessary medical

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services. Payments from the Medical Assistance program are generally less than the System's cost of providing the service.

In addition, community service represents the cost to deliver services to the community, net of any payment received for those services. Included in these services are the System's subsidies of outpatient clinics, education of medical professionals who work with various health care providers in the community upon graduation and community mental health programs. The System also sponsors health fairs and other wellness programs throughout the community.

(w) Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*, (ASU 2014-09) which changes the requirements for recognizing revenue when entities enter into contracts with customers. Under ASU 2014-09, an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. It also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. In December 2016, the FASB issued ASU No. 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*, (ASU 2016-20) which serves to narrow aspects of the guidance issued in ASU 2014-09. The adoption of ASU 2014-09 is effective for annual and interim periods beginning after December 15, 2017 and early adoption is not permitted. The System adopted ASU 2014-09 and ASU 2016-20, effective July 1, 2018 using the modified retrospective method.

In January 2016, the FASB issued ASU No 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities* (ASU 2016-01), which changes the income statement impact of equity investments held by an entity, and the recognition of changes in fair value of financial liabilities when the fair value option is elected. The adoption of ASU 2016-01 is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted for fiscal years beginning after December 15, 2017. The System is currently assessing the impact of the adoption of ASU 2016-01 and the impact it will have on the System's consolidated financial condition and results of operations.

In February 2016, the FASB issued ASU No. 2016-02, *Leases* (ASU 2016-02), which will require lessees to recognize most leases on-balance sheet, increasing their reported assets and liabilities – sometimes very significantly. This update was developed to provide financial statement users with more information about an entity's leasing activities, and will require changes in processes and internal controls. The adoption of ASU 2016-02 is effective for annual and interim periods beginning after December 15, 2018, and will require application of the new guidance at the beginning of the earliest comparable period presented. Early adoption is permitted. The System adopted the standard on July 1, 2019 and is finalizing the accounting for ASU No. 2016-02, which is expected to have a material impact on the System's consolidated financial position and results of operations.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements for Not-for-Profit Entities*. This update is intended to improve financial statement requirements by not-for-profit organizations. There are changes to qualitative and quantitative

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requirements in a number of areas; including net asset classification, liquidity and availability of resources, disclosing expenses by both their natural and functional classification, financial performance and cash flows. The main provision of this guidance reduces the number of net asset classes presented on the balance sheet from three to two: *with donor restrictions* and *without donor restrictions*. The System adopted ASU 2016-14 effective July 1, 2018 using the retrospective method of transition. As a result of adopting this standard certain prior year amounts were reclassified to conform to the presentation requirements of the standard.

(3) Acquisitions

(a) Tower Health Urgent Care

On December 1, 2018, the System acquired Tower Health Urgent Care, LLC from Premier. Total cash consideration paid was \$24,345. The total consideration paid was allocated to net tangible assets acquired and liabilities assumed based upon the estimated fair values. The excess of the consideration paid over the estimated fair value of the net tangible assets acquired and liabilities assumed was recorded as goodwill. Goodwill recognized from the acquisition is the result of the expected savings to be realized from achieving certain efficiencies and economies of scale with increased quality and access at a lower cost of care.

The consideration price and related fair value allocation of the assets acquired and liabilities assumed in the acquisition, which resulted in goodwill totaling \$27,064, are summarized as follows:

Property, plant and equipment	\$	2,346
Goodwill		27,064
Accrued expenses		(2,719)
Accrued vacation		(416)
Other current liabilities		(1,863)
Capital lease obligations		(67)
		<hr/>
Net assets acquired	\$	<u>24,345</u>

(b) Tower Health at Home

The System acquired Tower Health at Home on January 1, 2019. No cash consideration was paid as a result of the acquisition. The Parent treated the business combination as a nonreciprocal transfer of assets, resulting in the contribution of the fair value of the acquiree's net assets to the acquirer. The excess of the fair value of net assets acquired over the consideration transferred was recorded as a

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contribution related to the acquisition totaling \$7,194. The related fair value allocation of the assets acquired and liabilities assumed in the acquisition is summarized as follows:

Cash and cash equivalents	\$	835
Account receivables		948
Prepaid expenses and other current assets		109
Property, plant and equipment		2,078
Investments		4,389
Other assets		46
Accounts payable		(570)
Accrued expenses		(589)
Capital lease obligations		<u>(52)</u>
Net assets acquired	\$	<u><u>7,194</u></u>

(c) Chester/Montgomery/Philadelphia Hospitals

On October 1, 2017, the Chester/Montgomery/Philadelphia Hospitals and related physician clinics and practices were acquired from CHS. The total consideration paid was \$423,377. The total consideration paid was allocated to net tangible assets acquired and liabilities assumed based upon the estimated fair values. The excess of the consideration paid over the estimated fair value of the net tangible assets acquired and liabilities assumed was recorded as goodwill. The allocation of the consideration paid to property, plant and equipment was based upon valuation data and estimates. Goodwill recognized from the acquisition is the result of (i) the expected savings to be realized from achieving certain efficiencies and economies of scale with increased quality and access at a lower cost of care and (ii) anticipated long-term improvements in core businesses of the Chester/Montgomery/Philadelphia Hospitals and related physician clinics and practices.

The acquisition purchase price of \$423,377 was financed with proceeds from a bridge loan borrowing of \$491,018 with the remaining proceeds used for the general working capital needs of the System. The bridge loan was repaid in connection with the issuance of Berks County Municipal Authority Hospital Revenue Bond Series of 2017 on October 31, 2017 (note 9).

For the year ended June 30, 2018, the System incurred acquisition costs of \$6,856, consisting of investment banking, legal, accounting and other costs associated with the transaction, which is included in transaction related expenses on the accompanying consolidated statements of operations. The System also incurred \$4,171 of deferred financing costs associated with the debt financings in the year ended June 30, 2018, which has been capitalized and treated as a reduction in long-term debt on the accompanying consolidated balance sheets.

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The consideration paid and related fair value allocation of the assets acquired and liabilities assumed in the acquisition, which resulted in goodwill totaling \$128,127, are summarized as follows:

Cash and cash equivalents	\$	12
Inventories		18,831
Prepaid expenses and other current assets		5,230
Property, plant and equipment		298,045
Goodwill		128,127
Investments in joint ventures		3,518
Accrued vacation		(7,145)
Other current liabilities		(13)
Capital lease obligations		<u>(23,228)</u>
Net assets acquired	\$	<u>423,377</u>

The 2018 consolidated statement of operations includes the results of operations of the Chester/Montgomery/Philadelphia Hospitals and related physician clinics and practices from October 1, 2017. Total revenues and other support attributable to the Chester/Montgomery/Philadelphia Hospitals in the accompanying 2019 and 2018 consolidated statement of operations was \$533,669 and \$471,865, respectively.

The pro forma combined results as though the acquisition date occurred at the beginning of the fiscal year 2018 are summarized as follows:

		<u>June 30, 2018</u>
		(Unaudited)
Total revenues and other support	\$	1,800,425
Loss from operations		(26,465)

(4) Pending Transactions

On November 12, 2018, the System announced an agreement to sell an undeveloped 80 acre parcel of land in Spring Township, Pennsylvania. The System's overall ownership of the parcel is approximately 103 acres and it will retain approximately 23 acres following the transaction. The land has been reclassified to assets held for sale at June 30, 2019 and 2018 on the accompanying consolidated balance sheets.

In February 2019, the System and Drexel University (Drexel) signed a 20 year academic agreement. In connection with this affiliation, a new four-year regional campus of Drexel University College of Medicine will be constructed in West Reading. The campus is expected to be operational for the 2021-2022 academic year. In August 2019, the System entered into a joint venture arrangement and the construction of the campus will be funded by capital commitments from the joint venture partners and lender financing.

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The System contributed \$6,145 to the joint venture in August 2019 and future committed contributions are not to exceed \$4,855.

In September 2019, the System and Drexel entered into an agreement to acquire St. Christopher's Hospital for Children for \$50,000. After the closing, the System and Drexel will each own 50% of St. Christopher's Hospital for Children. The sale was approved by the U.S. Bankruptcy Court for the District of Delaware as part of the process to resolve the Chapter 11 bankruptcy filed by the former owner and operator of St. Christopher's Hospital for Children. The transaction is expected to close in the quarter ended December 31, 2019.

(5) Net Patient Service Revenue

The System has agreements with third-party payors that provide for payments at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows.

(a) Medicare and Medicare Advantage

Inpatient acute care and rehabilitation services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient services are reimbursed by Medicare under the Ambulatory Payment Classification System. The System is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare fiscal intermediary. The System's classification of patients under the Medicare program and the appropriateness of their admission are subject to medical necessity reviews by independent organizations under contract with the Center for Medicare and Medicaid Services (CMS). The System has received settlements on Medicare cost reports through June 30, 2016.

(b) Medicaid and Managed Medicaid

On December 29, 2010, the Pennsylvania Department of Human Services (DHS) received approval from the Centers for Medicare & Medicaid Services for the state plan amendments pursuant to Act 49 of 2010, passed by the Pennsylvania General Assembly on July 3, 2010, which established a new inpatient hospital fee for service payment system, new supplemental payments and the waiver to establish the statewide Quality Care Assessment. DHS also received approval on final language for the DHS contracts with managed care organizations. The estimated net impact on the System for the years ended June 30, 2019 and 2018, was \$20,864 and \$17,494, respectively, (based on total payment increases of \$50,723 and \$43,087, offset by assessments of \$29,944 and \$25,593, respectively).

(c) Nongovernmental Payors

Inpatient services rendered by nongovernmental payors are reimbursed at negotiated rates. The System continues to be reimbursed for outpatient services at a negotiated percentage of covered charges.

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(d) *Workers' Compensation*

The payment method by which all employers and/or insurers of workers' compensation policies will pay for the services provided by health care providers to employees covered by workers' compensation is a percentage of the Medicare payment for these services.

(e) *Other Contractual Arrangements*

The System has various payment agreements with preferred provider organizations and health maintenance organizations. The basis for payment under these agreements includes discounts from established charges.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at the time. Recently, government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of fraud and abuse statutes and regulations, which could result in the imposition of significant fines and penalties as well as significant repayments for patient services previously billed.

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(6) Assets Whose Use is Limited and Investments

Assets whose use is limited and that are required for obligations classified as current liabilities are reported as current assets. The composition of assets whose use is limited at June 30, is set forth in the following tables.

	2019	2018
Self-insurance funding arrangements:		
Cash and cash equivalents	\$ 2,169	351
Certificates of deposit	7,723	—
U.S. government securities	11,693	10,717
Corporate bonds	5,230	7,887
Equity mutual funds	570	515
Total assets whose use is limited under self-insurance funding arrangements	\$ 27,385	19,470
By board for capital improvements and under regulatory requirements:		
Cash and cash equivalents	\$ 6,613	14,858
Common, foreign, and preferred stock	13,041	16,416
Equity mutual funds	196,963	351,505
Fixed income mutual funds	268,611	328,914
Hedge, private equity, common collective trust funds	215,210	141,175
Total assets whose use is limited by the board for capital improvements and under regulatory requirements	\$ 700,438	852,868
Investments with donor restrictions:		
Cash and cash equivalents	\$ 6,661	699
Equity mutual funds	12,423	12,081
Fixed income mutual funds	3,885	3,834
Beneficial interest in trusts	18,029	16,987
Total investments with donor restrictions	\$ 40,998	33,601

The System's investments include a variety of financial instruments; the related values as presented in the consolidated financial statements are subject to various market fluctuations, which include changes in the equity markets, interest rate environment and general economic conditions.

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In the year ended June 30, 2018, the System restructured its unrestricted Long-Term Capital (LTC) investment portfolio by eliminating redundant investment advisors and redeploying investments. This redeployment created approximately \$85,000 of one-time realized gains for the year ended June 30, 2018.

The following table presents cost and fair value of assets whose use is limited and investments as of June 30, 2019:

	Fair value	Cost
Cash and cash equivalents	\$ 15,446	15,446
Certificates of deposit	7,723	7,723
Corporate and foreign bonds	5,230	5,193
Common, foreign, and preferred stock	13,041	13,236
U.S. government securities	11,691	11,562
Equity mutual funds	209,955	206,421
Fixed income mutual funds	272,496	259,796
Hedge funds and private equity	215,210	191,935
Beneficial interest in trusts	18,029	15,301
Total	\$ 768,821	726,613

The following table presents cost and fair value of assets whose use is limited and investments as of June 30, 2018:

	Fair value	Cost
Cash and cash equivalents	\$ 15,908	15,908
Corporate and foreign bonds	7,887	7,956
Common, foreign, and preferred stock	16,416	16,244
U.S. government securities	10,717	10,818
Equity mutual funds	364,101	357,890
Fixed income mutual funds	332,748	340,408
Hedge funds and private equity	141,175	120,366
Beneficial interest in trusts	16,987	14,528
Total	\$ 905,939	884,118

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The following table represents the fair value measurement levels for all assets and liabilities, which the System has recorded at fair value on a recurring basis:

	Fair value June 30, 2019	2019		
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Assets:				
Cash and cash equivalents	\$ 15,446	15,446	—	—
Certificates of deposit	7,723	7,723	—	—
Corporate and foreign bonds	5,230	—	5,230	—
Common, foreign and preferred stock	13,041	13,041	—	—
U.S. government securities	11,691	—	11,691	—
Equity mutual funds	209,955	209,955	—	—
Fixed income funds	272,496	272,496	—	—
Hedge funds and private equity (1)	215,210	—	—	—
Beneficial interest in trusts	18,029	—	—	18,029
Total investments	<u>\$ 768,821</u>	<u>518,661</u>	<u>16,921</u>	<u>18,029</u>
Liabilities:				
Swap contracts	\$ 31,387	—	31,387	—
2018				
	Fair value June 30, 2018	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Assets:				
Cash and cash equivalents	\$ 15,908	15,908	—	—
Corporate and foreign bonds	7,887	—	7,887	—
Common, foreign and preferred stock	16,416	16,416	—	—
U.S. government securities	10,717	—	10,717	—
Equity mutual funds	364,101	364,101	—	—
Fixed income funds	332,748	332,748	—	—
Hedge funds and private equity (1)	141,175	—	—	—
Beneficial interest in trusts	16,987	—	—	16,987
Total investments	<u>\$ 905,939</u>	<u>729,173</u>	<u>18,604</u>	<u>16,987</u>
Liabilities:				
Swap contracts	\$ 26,776	—	26,776	—

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- (1) Certain investments that are measured at net asset value per share (or its equivalent) as a practical expedient to fair value have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

Following is the summary of the inputs and valuation techniques as of and for the years ended June 30, 2019 and 2018 for valuing Level 2 financial instruments:

<u>Financial instrument</u>	<u>Input</u>	<u>Valuation technique</u>
State, municipal government, and auction rate securities	Broker/dealer	Income
Corporate and foreign bonds	Broker/dealer	Market
U.S. government securities	Broker/dealer	Market
Swap contracts	Broker/dealer	Market

The following table represents the change in fair value for which fair value was measured under Level 3:

	Beneficial interests in trust
Fair value at June 30, 2017	\$ 15,609
Net unrealized gains	<u>1,378</u>
Fair value at June 30, 2018	16,987
Net unrealized gains and additions	<u>1,042</u>
Fair value at June 30, 2019	<u><u>\$ 18,029</u></u>

Transfers between levels occur when there is a change in the observability of significant inputs. A transfer between Level 1 and Level 2 generally occurs when the availability of quoted prices changes or when market activity of an investment significantly changes to active or inactive. A transfer between Level 2 and Level 3 generally occurs when the underlying inputs become, or can no longer be, corroborated with market observable data. Transfers between levels are recognized on the date they occur. For the years ended June 30, 2019 and 2018, no transfers were made between any Levels.

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The System holds instruments recorded at net asset value per share (or its equivalent) as a practical expedient to fair value and that do not have a readily determinable fair value as follows as of June 30:

<u>2019</u>	<u>Fair value</u>	<u>Unfunded commitments</u>	<u>Redemption frequency (if eligible)</u>	<u>Redemption notice period</u>
	(In millions)			
b – Multi-strategy hedge funds	\$ 62.9	—	Quarterly, annually	60 days
c – Real assets	8.5	0.7	Annually, up to 3 years	90 days
d – Real estate funds	99.1	7.6	N/A	N/A
e – Private equity funds	44.7	24.8	N/A	N/A
Total	<u>\$ 215.2</u>	<u>33.1</u>		

<u>2018</u>	<u>Fair value</u>	<u>Unfunded commitments</u>	<u>Redemption frequency (if eligible)</u>	<u>Redemption notice period</u>
	(In millions)			
a – Event driven hedge funds	\$ 0.1	—	Quarterly	65–70 days
b – Multi-strategy hedge funds	62.0	1.4	Quarterly, annually	60 days
c – Real assets	7.0	0.8	Annually	90 days
d – Real estate funds	29.8	18.2	N/A	N/A
e – Private equity funds	42.3	19.4	N/A	N/A
Total	<u>\$ 141.2</u>	<u>39.8</u>		

- a. **Event Driven:** This class includes investments in hedge funds that invest in equities and bonds to profit from economic, political and government driven events. A majority of the investments are targeted at economic policy decisions. The fair values of the investments in this class have been estimated using the net asset value per share of the investments as a practical expedient.
- b. **Multi-Strategy Hedge Funds:** This class invests in hedge funds that pursue multiple strategies to diversify risks and reduce volatility. The fair values of the investments in this class have been estimated using the net asset value per share of the investments as a practical expedient. The remaining restriction period for these investments ranges from quarterly to annually.
- c. **Real Assets:** This class includes funds with direct investments in global and energy infrastructure as well as in base and precious metals and investment securities of miners and associated mining equipment. The fair values of the investments in this class have been estimated using the net asset value per share of the investments as a practical expedient.

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- d. Real Estate: This class includes real estate funds that invest in U.S. and non-U.S. residential and commercial properties as well as distressed real estate. The fair values of the investments in this class have been estimated using the net asset value of the System's ownership interest in partners' capital as a practical expedient. It is estimated that the underlying assets of these funds will be liquidated over the next 7 to 10 years, although these funds may liquidate early in the event of purchase by a third party or initial public offering. The fair values of the investments in this class have been estimated using the net asset value of the System's ownership interest in partners' capital as a practical expedient.
- e. Private Equity: This class includes private equity funds. These investments cannot be redeemed with the funds. Instead, the nature of the investments in this class is that distributions are received through the liquidation of the underlying assets of the fund. These funds are managed by one of the System's advisors with particular private equity experience in secondary market dealing. These funds could be subject to redemption to a third party buyer, but at June 30, 2019 and 2018, no funds were currently being evaluated this way. The fair values of the investments in this class have been estimated using the net asset value of the System's ownership interest in partners' capital as a practical expedient.

(7) Liquidity and Availability of Resources

Financial assets available within one year of the balance sheet date for general expenditures such as operating expenses and construction costs not financed with debt at June 30 are as follows:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 3,818	67,502
Patient accounts receivable	314,630	314,232
Other receivables	10,757	5,339
Estimated third-party payor receivables	<u>21,461</u>	<u>14,087</u>
	<u>\$ 350,666</u>	<u>401,160</u>

Current financial assets not available for general use because of contractual or donor-imposed restrictions was \$7,483 for June 30, 2019. Amounts not available for general use include amounts set aside for self-insurance funds and perpetual, time and purpose restricted assets.

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(8) Property, Plant and Equipment

Property, plant and equipment and related accumulated depreciation at June 30 consists of the following:

	2019	2018
Land and land improvements	\$ 101,947	100,223
Buildings and improvements	913,694	893,959
Fixed equipment	415,413	406,847
Movable equipment (includes software and hardware)	640,439	598,485
Construction in progress	174,069	58,557
Property, plant and equipment before depreciation	2,245,562	2,058,071
Less accumulated depreciation	(1,114,098)	(1,003,295)
Property, plant and equipment, net	\$ 1,131,464	1,054,776

As of June 30, 2019 and 2018, assets under capital leases consist of medical buildings with an acquired fair value of \$20,261 and \$20,227 and accumulated amortization of \$1,493 and \$1,192, respectively. Assets under capital leases are included in property, plant and equipment on the accompanying consolidated balance sheets.

Depreciation expense relating to property, plant and equipment was \$94,412 and \$90,491 for the years ended June 30, 2019 and 2018, respectively.

(9) Long-Term Debt

Long-term debt at June 30, 2019 consists of the following:

	Carrying value	Fair value (Level 2)
Berks County Municipal Authority Hospital Revenue Bond Series of 2017, net of unamortized discount and premium	\$ 692,773	713,000
Berks County Municipal Authority Hospital Revenue Bond Series of 2012, net of unamortized discount and premium	265,197	262,167
Berks County Municipal Authority Hospital Revenue Bond Series of 2009, net of unamortized discount	49,011	50,302
Term loans	125,165	125,165
Total long-term debt	1,132,146	\$ 1,150,634
Less amounts due within one year	(6,312)	
Less deferred financing costs, net	(8,178)	
Long-term debt, net of current portion	\$ 1,117,656	

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Long-term debt at June 30, 2018 consists of the following:

	Carrying value	Fair value (Level 2)
Berks County Municipal Authority Hospital Revenue Bond Series of 2017, net of unamortized discount and premium	\$ 694,940	686,633
Berks County Municipal Authority Hospital Revenue Bond Series of 2012, net of unamortized discount and premium	266,757	259,720
Berks County Municipal Authority Hospital Revenue Bond Series of 2009, net of unamortized discount	53,635	56,478
Term loans	125,165	125,165
Total long-term debt	1,140,497	\$ 1,127,996
Less amounts due within one year	(5,600)	
Less deferred financing costs, net	(8,703)	
Long-term debt, net of current portion	\$ 1,126,194	

Under the terms of the various debt agreements, the System is required to maintain certain deposits with a trustee. Such deposits are included in assets whose use is limited in the accompanying consolidated balance sheets.

Scheduled principal repayments on long-term debt are as follows for the years ending June 30:

2020	\$	6,312
2021		3,997
2022		6,025
2023		13,756
2024		16,821
Thereafter		1,028,752
Total long-term debt – Par		1,075,663
Plus unamortized net premium/discounts		56,483
Less deferred financing costs, net		(8,178)
Long term-debt, net of unamortized premiums/discount and deferred financing costs	\$	1,123,968

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The Parent, the Hospital, and the Chester/Montgomery/Philadelphia Hospitals (collectively, the Obligated Group) have borrowed funds through revenue bonds issued by the Berks County Municipal Authority and the Berks County Industrial Development Authority (Authority). The proceeds originally were used in part to finance certain facilities of the Obligated Group. The revenue bonds are secured by a pledge of revenue of the Obligated Group. For accounting purposes, the revenue bonds are treated as though they are the debt of the entity which received the proceeds.

(a) Berks County Industrial Development Authority Hospital Revenue Bond Series of 2017

On October 31, 2017, the Authority issued \$590,500 of Revenue Bonds (2017) for the purpose of repaying the bridge loan (note 3) and refunding the 2009 A-3 bonds. The net original issuance premium associated with the issuance was \$56,151.

The Series 2017 bonds are comprised of \$161,400 of serial bonds and \$429,100 of term bonds. The serial bonds are due in annual installments payable on November 1, 2021 through November 1, 2039 with payments ranging from \$1,770 to \$13,715. The term bonds are due on November 1, 2042, 2047 and 2050 with total payments of \$43,185, \$196,320, and \$189,595, respectively. The effective interest rate ranges from 4% to 5% on the serial bonds and 3.75% to 5% on the term bonds.

On December 27, 2017, Berks County Municipal Authority issued \$50,000 of Variable Rate Serial Revenue bonds (2017 A) for the purpose of refunding the Authority Series 2016B. Mandatory annual principal redemptions by the System for the Series 2017 A bonds due November 1, 2022 through November 1, 2035, range from \$2,475 to \$5,025 with final maturity on November 1, 2035. Interest on these bonds is calculated on a SIFMA Municipal Index rate plus a fixed spread of 0.75%. The SIFMA Municipal Index Rate at June 30, 2019 and 2018 was 1.90% and 1.51%, respectively.

(b) Berks County Municipal Authority Hospital Revenue Bond Series of 2012

On June 28, 2012, the Authority issued \$473,275 of Revenue Bonds in four series, 2012 A, B, C, and D.

The Authority issued \$160,065 of Fixed Rate Serial Revenue Bonds (2012 A) for the purpose of refunding the then-existing Dauphin County General Authority Hospital Revenue Bond Series 1994A, and Berks County Bond Series 1998 and 2008. Mandatory annual principal redemptions by the System for the 2012 A bonds due November 1, 2039 through November 1, 2044, range from \$7,590 to \$33,555 with final maturity on November 1, 2044. Effective interest rate of the bonds range from 4.23% to 4.50%.

The Authority issued \$91,775 of Variable Rate Serial Revenue bonds (2012 B) for the purpose of refunding the Series 2009 A-5 bonds. Mandatory annual principal redemptions by the System for the 2012 B bonds due November 1, 2035 through November 1, 2039, range from \$3,225 to \$24,955 with final maturity on November 1, 2039. Interest on these bonds is calculated on a SIFMA Municipal Index rate plus a fixed spread of 1.50%. The SIFMA Municipal Index rate at June 30, 2019 and 2018, was 1.90% and 1.51%, respectively.

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The Authority issued a \$47,235 Floating Rate Bond (2012 C) used to refund the then-existing Series 2009 A-4 bonds and a \$174,000 Floating Rate Bond (2012 D) used to refund the then-existing Series 2009 A-1 and A-2 bonds. Both Series 2012 C and 2012 D bonds were privately placed with commercial banks. Mandatory monthly principal redemptions by the System for the Series 2012 C bonds commenced on August 1, 2012 through July 1, 2022, and range from \$39 to \$129 with final maturity date on July 1, 2022. Interest on these bonds is calculated using a one-month London Interbank Offered Rate Index rate (LIBOR) plus a fixed spread of 1.20% with the sum multiplied by a factor of 70.0%. The one-month LIBOR rate at June 30, 2019 and 2018, was 2.40% and 2.09%, respectively.

(c) Berks County Municipal Authority Hospital Revenue Bond Series of 2009

The Series 2009 A-3 bonds were issued on July 15, 2009. The Authority issued \$133,665 of Fixed Rate Revenue Bonds, Series 2009 A-3 for the primary purpose of redeeming \$115,520 of the then-existing Series 2001 bonds and \$14,965 for major renovation projects.

The Series 2009 A-3 bonds are comprised of \$44,285 of serial bonds and \$89,380 of term bonds. The serial bonds are due in installments payable November 1, 2009, through 2019, with payments ranging from \$120 to \$4,895. The term bonds are due on November 1 of 2024, 2031, and 2039, with payments ranging from \$820 to \$9,380. The effective interest rate ranges from 3% to 5% on the serial bonds and 5.25% to 5.75% on the term bonds.

During the fiscal year ended June 30, 2018, in connection with the issuance of the Series 2017 bonds, the System advance refunded a portion of the Series 2009 A-3 bonds by in-substance defeasance. The System funded an escrow account of \$48,561 and in connection with this transaction, the System recognized \$4,314 as a loss on early extinguishment of debt in the consolidated statements of operations. As of June 30, 2019 and 2018, \$44,675 of the original debt remained outstanding, but was considered to be extinguished by the System. Such debt will be paid to bondholders from escrow accounts funded at the transaction date.

(d) Term Loans

Effective May 16, 2016, the System refinanced the Series 2012 D bonds by the securing term bank loans in four series, 2016 A, B, C, and D with a notional amount of \$175,165. All 2016 series nonsyndicate bank loans are direct bank loans with a maturity of seven years.

Series 2016A with a notional amount of \$50,165 has an interest rate calculated at 67% of 1-month LIBOR plus a fixed spread of 0.58%. Principal installments of \$2,485 begin in November 1, 2022 followed by a full redemption of the balances in May 2023.

Series 2016B with a notional amount of \$50,000 were refunded in December 2017 by the issuance of the Series 2017A Variable Rate Serial Revenue Bonds.

Series 2016C with a notional amount of \$25,000 has an interest rate calculated at 70% of 1-month LIBOR plus a fixed spread of 0.84%. Principal installments of \$1,240 begin November 1, 2022 followed by a full redemption of the balance in May 2023.

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Series 2016D with a notional amount of \$50,000 has an interest rate calculated at 67% of 1-month LIBOR plus a fixed spread of 0.675%. Principal installments of \$2,475 begin in November 1, 2022 followed by a full redemption of the balance in May 2023.

(e) Lines of Credit

At June 30, 2019 and 2018, the Hospital has an unused line of credit with a regional bank in the amount of \$10,000. Letter of credit draws or direct borrowings from this facility are charged an interest rate of 1-month LIBOR plus 1.50%. Total combined open and undrawn letters of credit at June 30, 2019 and 2018 amounted to \$2,269 and \$3,095 respectively.

During 2019, an additional short-term 1-year uncommitted bank line of credit facility was opened in the amount of \$25,000. This line is used for liquidity purposes. Borrowings from this facility are charged an interest rate of 1-month LIBOR plus 1.20%. Drawn amounts on the bank line at June 30, 2019 were \$17,802.

Subsequent to June 30, 2019, The System opened new or modified existing lines of credit with several banks. The aggregate capacity opened subsequent to June 30, 2019 was \$75,000 with an average interest rate of 2.87%.

(f) Covenants

The various agreements place limits on the incurrence of additional borrowings and require that the System satisfy certain measures of financial performance as long as the debt is outstanding. These covenants apply to the Obligated Group and include, but are not limited to: a long-term debt service coverage ratio of 1.1 (measured quarterly) and 80 days cash on hand (measured annually at June 30).

(10) Interest Rate Swaps

The System utilizes derivative instruments, such as interest rate swaps, to manage certain interest rate exposures. Derivative instruments are viewed as risk management tools by the System and are not used for trading and speculative purposes.

When quoted market prices are not available, the valuation of derivative instruments is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each leg of the derivative. This analysis reflects the contractual terms of the derivatives, including interest rate curves and implied volatilities. The estimates of fair value valuation are made by swap counterparties using a standardized methodology based on observable market inputs. As part of the System's overall valuation process, management evaluates this counterparty valuation methodology to ensure that it is representative of exit prices in the principal markets. These future net cash flows, however, are susceptible to change primarily due to fluctuations in interest rates. As a result, the estimated values of these derivatives will change over time as cash is received and paid and as interest rates change. As these changes occur, they may have a positive or negative impact on estimated valuations.

The System has classified its interest rate swaps in Level 2 of the fair value hierarchy, as the significant inputs to the overall valuations are based on market-observable data or information derived from or corroborated by market-observable data. For over-the-counter derivatives that trade in liquid markets such

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as interest rate swaps, model inputs (i.e., contractual terms, market prices, yield curves, credit curves, and measures of volatility) can generally be verified, and model selection does not involve significant management judgment.

The fair value of the swap contracts was as follows as of June 30:

Classification of derivatives included in liabilities in the consolidated balance sheets	Fair value	
	2019	2018
Derivatives not designated as hedging instruments:		
2008 bond issuance	\$ (3,344)	(3,730)
2005 bond issuance	1,724	1,588
2002 bond issuance	15,311	13,256
2001 bond issuance	17,076	15,166
1992 bond issuance	620	496
Total swap contracts	<u>\$ 31,387</u>	<u>26,776</u>

Changes in fair value of swap contracts in the consolidated balance sheets totaled a loss of \$4,611 and a gain of \$14,014 for the years ended June 30, 2019 and 2018, respectively. The net amount paid or received under the swap contracts is recorded in the consolidated statements of operations as net cash settlement payments. Net payments totaled \$4,461 and \$6,707 for the years ended June 30, 2019 and 2018, respectively.

No new swaps were initiated in the fiscal years ending June 30, 2019 and 2018.

In connection with the 2008 bond issuance, the System entered into two interest rate basis swap agreements with a third party by which the System pays SIFMA and receives an average of 0.85% of three-month LIBOR with a third party. Notional amounts of these basis swaps are \$146,835 and \$152,210, respectively, and the three-month LIBOR rate at June 30, 2019 and 2018, was 2.320% and 2.337%, respectively. The SIFMA Municipal Index Rate at June 30, 2019 and 2018 was 1.900% and 1.510%, respectively.

In connection with the 2005 bond issuance, the System entered into an interest rate swap agreement with a third party. The swap economically converts the variable rate obligation of the 2005 bonds to a fixed rate of 3.584%. Notional amount of the swap is \$21,000.

In connection with the 2001 and 2002 bonds issuances, the System entered into two interest rate swap agreements with a third party. The swaps economically convert the variable rate obligations of the 2001 and 2002 bonds to a fixed rate of 4.30% and 4.69%, respectively. Notional amounts of the 2001 and 2002 bond issuance swaps are \$100,015 and \$59,530, respectively.

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In connection with the 2002 bond issuance, the System entered into two interest rate swap agreements with a third party. One of these swaps expired in FY2018. The remaining swap effectively converts the variable rate obligation of the Series A bonds to a fixed rate of 4.69%. Notional amounts of the swap is \$3,635.

In connection with the 1992 bond issuance, the System entered into an interest rate swap agreement with a third party, which was effective as of May 26, 2005. The swap effectively converts the variable rate obligation of the bonds to a fixed rate of 3.607%. Notional amount of the swap is \$5,500.

The change in the fair value of the interest rate swap agreements and the net settlement payments associated with these swaps are recorded in nonoperating gains (losses) on the consolidated statements of operations.

(11) Retirement Plans

Prior to June 30, 2016, substantially all employees of the System were covered under a qualified noncontributory defined benefit pension plan (the Plan). Pension costs are funded as accrued except when not permitted by regulations, such as full funding limitations. Unfunded prior service costs are amortized over an initial term of thirty years.

The System has effectively transitioned the Plan into a defined contribution plan as of June 30, 2016. Employees hired on or after July 1, 2013 have been enrolled in the defined contribution plan. Previous defined benefit participants hired on or before June 30, 2013, continued to accrue benefits in the existing defined benefit plan until June 30, 2016. As of July 1, 2016, all vested participant defined benefits remain accrued, but all current employees have now converted to and began to accumulate funds under the defined contribution plan. This action has effectively frozen the defined benefit plan as of June 30, 2016.

In the year ended June 30, 2019, the System completed a small balance pension plan annuitization initiative with a national insurance company in which a number of retirees who were previously paid monthly benefits by the pension plan, with an accrued pension liability of \$24,100, were transferred out of the plan for a one-time payment from plan assets of \$23,957. Impact to the plan funding status was negligible. The initiative had the effect of transferring administrative costs and future monthly pension payments of 44% of existing plan retirees to the insurance company. Further savings were also realized by reducing System future payments to the PBGC – Pension Benefit Guaranty Corporation.

Obligations and funded status at June 30 for the Plan:

	2019	2018
Change in projected benefit obligation:		
Benefit obligation at beginning of year	\$ 626,203	672,408
Interest cost	26,214	26,037
Actuarial gain	42,822	(34,420)
Benefits paid	(46,025)	(37,822)
Benefit obligation at end of year	\$ 649,214	626,203

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	2019	2018
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 424,228	420,152
Actual return on assets	31,660	27,628
Employer contributions	13,320	14,270
Benefits paid	(46,025)	(37,822)
Fair value of plan assets at end of year	\$ 423,183	424,228

Amounts recognized in the consolidated balance sheets at June 30 consist of:

	2019	2018
Accrued pension	\$ 226,031	201,974
Total accrued liability	\$ 226,031	201,974

Amounts recognized in net assets consist of:

Net actuarial loss	\$ 269,294	229,453
Pension cost charged to net assets	\$ 269,294	229,453

Net periodic pension benefit components at June 30 include the following:

	2019	2018
Interest cost on projected benefit obligation	\$ 26,214	26,037
Expected return on plan assets	(33,900)	(33,256)
Amortization of net loss	5,222	6,094
Net periodic pension benefit	\$ (2,464)	(1,125)

Other changes in plan assets and benefit obligations recognized in net assets without donor restrictions as of June 30:

	2019	2018
Net gain/(loss)	\$ 45,063	(28,793)
Amortization of net loss	(5,222)	(6,094)
Total recognized in net assets without donor restrictions	\$ 39,841	(34,887)

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The amount expected to be amortized from net assets without donor restrictions to net periodic pension cost in nonoperating gains (losses) during fiscal year 2020 is \$6,176.

Weighted average assumptions used to determine benefit obligations at June 30:

	<u>2019</u>	<u>2018</u>
Discount rate	3.78 %	4.29 %
Rate of compensation increase	N/A	N/A
Measurement date	6/30/2019	6/30/2018

Weighted average assumptions used to determine net periodic benefit cost for years ended June 30:

	<u>2019</u>	<u>2018</u>
Discount rate	4.29 %	3.94 %
Expected long-term return on plan assets	8.00	8.00
Rate of compensation increase	N/A	N/A

To develop the expected long-term rate of return on assets assumption, the System considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio.

(a) Plan Assets

The Plan's weighted average actual asset allocations and target allocations as of June 30 by asset category are as follows:

	<u>2019</u>	
	<u>Target</u>	<u>Actual</u>
Asset category:		
Cash and cash equivalents	— %	1.2 %
Equities, including mutual funds	45.0	39.5
Fixed income, including mutual funds, state, municipal government, and auction rate securities	20.0	23.6
Alternative investments (1)	35.0	35.7
	<u>100.0 %</u>	<u>100.0 %</u>

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	2018	
	Target	Actual
Asset category:		
Cash and cash equivalents	— %	2.1 %
Equities, including mutual funds	45.0	22.2
Fixed income, including mutual funds, state, municipal government, and auction rate securities	20.0	23.7
Alternative investments (1)	35.0	52.0
	<u>100.0 %</u>	<u>100.0 %</u>

(1) Note: Long/Short Equity and Private Equity are classified as Alternative Investments.

The overall investment objective of the Plan is to provide a return on investment consistent with the Plan's spending needs and to prevent erosion of purchasing power by inflation. Achievement of the return will be sought from an investment strategy that provides an opportunity for superior returns within acceptable levels of risk and volatility of returns. The following tables represent the fair value measurement levels for the Plan's investments:

	Fair value	2019		
		June 30, 2019	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)
Cash and cash equivalents	\$ 5,088	5,088	—	—
Equity mutual funds	158,125	158,125	—	—
Equities	8,935	8,935	—	—
Fixed income mutual funds	99,779	99,779	—	—
Hedge funds and private equity (1)	151,256	—	—	—
Total investments	<u>\$ 423,183</u>	<u>271,927</u>	<u>—</u>	<u>—</u>

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	Fair value June 30, 2018	2018		
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Cash and cash equivalents	\$ 9,113	9,113	—	—
State, municipal government, and auction rate securities	4,525	—	4,525	—
Equity mutual funds	54,094	54,094	—	—
Equities	40,059	40,059	—	—
Fixed income mutual funds	95,995	95,995	—	—
Hedge funds and private equity (1)	220,442	—	—	—
Total investments	\$ 424,228	199,261	4,525	—

(1) Certain investments that are measured at net asset value per share (or its equivalent) as a practical expedient to fair value have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

Transfers between levels occur when there is a change in the observability of significant inputs. A transfer between Level 1 and Level 2 generally occurs when the availability of quoted prices changes or when market activity of an investment significantly changes to active or inactive. A transfer between Level 2 and Level 3 generally occurs when the underlying inputs become, or can no longer be, corroborated with market observable data. Transfers between levels are recognized on the date they occur. For the years ended June 30, 2019 and 2018, no transfers were made between Levels.

TOWER HEALTH AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(Dollars in thousands)

The Plan holds investments that calculate net asset value per share (or its equivalent) and do not have a readily determinable value are as follows as of June 30:

<u>2019</u>	<u>Fair value</u>	<u>Unfunded commitments</u>	<u>Redemption frequency (if eligible)</u>	<u>Redemption notice period</u>
	(In millions)			
a – Multi-strategy hedge funds	\$ 108.3	3.3	Monthly, quarterly, annually, biannually, biennially	30–90 days
b – Real assets	11.0	4.5	Weekly, Monthly	5–30 days
c – Real estate funds	6.9	1.9	N/A	N/A
d – Private equity funds	25.1	13.7	N/A	N/A
Total	<u>\$ 151.3</u>	<u>23.4</u>		

<u>2018</u>	<u>Fair value</u>	<u>Unfunded commitments</u>	<u>Redemption frequency (if eligible)</u>	<u>Redemption notice period</u>
	(In millions)			
a – Multi-strategy hedge funds	\$ 169.6	0.2	Monthly, quarterly, annually, biannually, biennially	30–90 days
b – Real assets	15.4	6.3	Weekly, Monthly	5–30 days
c – Real estate funds	9.0	7.7	N/A	N/A
d – Private equity funds	26.4	16.3	N/A	N/A
Total	<u>\$ 220.4</u>	<u>30.5</u>		

- a. Multi-Strategy: This class invests in hedge funds that pursue multiple strategies to diversify risks and reduce volatility. The fair values of the investments in this class have been estimated using the net asset value per share of the investments as a practical expedient. The remaining restriction period for these investments ranges from monthly to biennially.
- b. Real Assets: This class includes funds with direct investments in commodities and energy master limited partnerships. The fair values of the investments in this class have been estimated using the net asset value per share of the investments as a practical expedient.
- c. Real Estate: This class includes real estate funds that invest in U.S. and non-U.S. residential and commercial properties as well as distressed real estate. The fair values of the investments in this class have been estimated using the net asset value of the System's ownership interest in partners' capital as a practical expedient. It is estimated that the underlying assets of these funds will be liquidated over the next 7 to 10 years, although these funds may liquidate early in the event of purchase by a third party or initial public offering.

TOWER HEALTH AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(Dollars in thousands)

- d. Private Equity: This class includes private equity funds. These investments cannot be redeemed with the funds. Instead, the nature of the investments in this class is that distributions are received through the liquidation of the underlying assets of the fund. These funds could be subject to redemption to a third-party buyer, but at June 30, 2019 and 2018, no funds were currently being evaluated this way. The fair values of the investments in this class have been estimated using the net asset value of the System's ownership interest in partners' capital as a practical expedient.

(b) Contributions

The System expects to contribute the minimum required contribution during the fiscal year 2020 to the Plan, which is estimated to be \$12,806. For the years ended June 30, 2019 and 2018, the System contributed \$13,320 and \$14,270, respectively to the Plan. For the years ended June 30, 2019 and 2018, the System contributed \$41,229 and \$41,001, respectively to the defined contribution plan and \$2,390 and \$1,763, respectively to the nonqualified deferred compensation plan.

(c) Estimated Future Benefit Payments

The following benefit payments are expected to be paid for the fiscal years ending June 30:

2020	\$	22,587
2021		24,564
2022		26,184
2023		27,649
2024		29,057
2025 through 2029		161,718

(12) Net Assets with Donor Restrictions

Net asset with donor restriction are available for the following purposes at June 30:

		2019	2018
Various health care services	\$	21,721	17,850
Permanent endowment funds, the interest and dividend income from which is expendable to support health care services		18,029	16,987
Total donor restricted net assets	\$	39,750	34,837

(13) Insurance Arrangements

The System participates in the Pennsylvania Medical Care Availability and Reduction of Error Fund or Mcare Fund established under the Commonwealth of Pennsylvania. The Mcare Fund presently provides coverage excess of up to \$500 to the System's primary per occurrence retention (which is currently \$500) with annual aggregate coverage of \$1,500.

TOWER HEALTH AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(Dollars in thousands)

The System established a self-insurance trust fund to provide protection against professional liability claims. The trust is actuarially funded on an annual basis to provide single limit professional liability coverage of \$500 per occurrence and \$4,500 in the annual aggregate for the Hospital and certain employees. For incidents occurring since April 30, 2009, the System purchased commercial insurance to provide coverage on a claims-made basis in an amount up to \$25,000 in excess of a total retention of \$3,000, \$500 primary; \$500 Mcare excess and a \$2,000 self-insured buffer. Claim liabilities are presented gross of any insurance recoveries. Certain claim liabilities are discounted at an interest rate of 3% for years ended June 30, 2019 and 2018, and decreased the undiscounted liability as of June 30, 2019 and 2018 by \$1,193 and \$2,889, respectively. For the years ended June 30, 2019 and 2018, the insurance recoverable amount was \$3,500 and \$3,500, respectively, which is included in other receivables and other assets on the consolidated balance sheets. Funding requirements of the plan are subject to increase depending on the plan's claim experience. Premium payments for the Mcare Fund are based upon each individually licensed healthcare provider's rating with the Joint Underwriters Association and the amount of the surcharge to be assessed is determined by the Mcare Fund on an annual basis. The System's annual surcharge premium for participation in the Mcare Fund was \$3,573 and \$3,220 for the years ended June 30, 2019 and 2018, respectively.

During the fiscal year ended June 30, 2018, in conjunction with the acquisition of CMP, Tower Health formed a captive Reciprocal Risk Retention Group (RRG) subsidiary for the purpose of self-insuring malpractice at CMP. Subsequent to June 30, 2018, a decision was made to extend the RRG coverage not only to the CMP professional liabilities, but to cover Reading hospital and all affiliates as well. All reserves and liabilities accrued to Reading Hospital will be borne by the existing self-insurance coverages and, beginning in the second quarter of fiscal 2019, all new reserves incurred and liabilities will accrue to the RRG. Statutory funding of \$0 and second year's premiums in the amount of \$8,359 were paid during the 2019 fiscal year. Statutory funding is included in assets under regulatory requirements on the consolidated balance sheets.

Additionally, the System self-insures its workers' compensation and minor general liability risks. The System's self-insurance plan has been reviewed and approved by the Commissioner of Insurance of Pennsylvania. The System purchases excess workers' compensation insurance for all controlled entities of the hospital with statutory limits over a self-retention of \$1,000 per occurrence subject to a policy maximum of \$1,000 for the policy period. Workers' compensation liabilities are discounted at an interest rate of 3% for the years ended June 30, 2019 and 2018, and decreased the undiscounted liability as of June 30, 2019 and 2018 by \$1,832 and \$2,269, respectively.

TOWER HEALTH AND SUBSIDIARIES
Notes to Consolidated Financial Statements
June 30, 2019 and 2018
(Dollars in thousands)

Reserves for self-insurance claims at June 30 are summarized as follows:

	<u>2019</u>	<u>2018</u>
Professional liability claims payable	\$ 25,411	31,580
Workers' compensation	9,118	10,625
Total self-insurance claims reserve	34,529	42,205
Less current portion	(9,430)	(13,669)
Self-insurance claims reserve, net of current portion	\$ <u>25,099</u>	<u>28,536</u>

(14) Commitment and Contingencies

(a) Operating and Capital Leases

The System leases equipment and facilities under operating and capital leases expiring at various dates. Total rental expense under all operating leases was \$34,112 and \$26,382 for the years ended June 30, 2019 and 2018, respectively.

The following table summarizes future minimum rental commitments under noncancelable operating leases with initial or remaining terms of more than one year and capital leases for the fiscal years ending June 30:

	<u>Capital leases</u>	<u>Operating leases</u>
2020	\$ 2,215	26,085
2021	2,243	18,780
2022	2,286	15,534
2023	2,309	15,836
2024	2,341	14,729
Thereafter	15,655	101,774
Total future minimum lease payments	27,049	\$ <u>192,738</u>
Less amount representing interest	(6,706)	
Total capital leases	20,343	
Less current portion	(2,215)	
Total capital leases, net of current	\$ <u>18,128</u>	

The capital leases represent the present value of future minimum lease payments, bear imputed interest at 4.33%, and mature at dates ranging from 2028 to 2031.

TOWER HEALTH AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(Dollars in thousands)

(b) *Litigation*

The System and its controlled entities are involved in certain litigation, which involves professional and general liability. In the opinion of management and legal counsel, the ultimate liability, if any, will not have a material effect on the consolidated financial condition of the Parent and its subsidiaries.

(c) *Regulatory Compliance*

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs.

(15) Concentrations

(a) *Concentrations of Credit Risk*

Financial instruments, which potentially subject the System to concentrations of credit risk, consist primarily of cash, cash equivalents, investments, and accounts receivable.

Management periodically evaluates the credit standing of the financial institutions with which the System maintains its cash, cash equivalents, and investments. Amounts held in its accounts often exceed the federally insured levels.

The fair value of the System's investments is subject to various market fluctuations, which include changes in the interest rate environment and general economic conditions.

(b) *Unions and Collective Bargaining*

As of June 30, 2019 and 2018, approximately 6% and 7% of the System's employees are subject to collective bargaining agreements with various unions, respectively. The bargaining agreements have various expiration dates, with the next expiration in 2021.

TOWER HEALTH AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(Dollars in thousands)

(16) Functional Expenses

Expenses attributed to each program or supporting function of Tower Health are reported in the following table. Expenses attributable to more than one program require allocation, which is consistently applied and based upon reasonable statistics such as revenue, expenses or full-time equivalents. The System considers health program services and general/administrative to be its primary functional categories for purposes of expense classification. General/administrative includes information systems, general corporate management, advertising and marketing. Functional categories of expenses for the years ended June 30 are as follows:

	2019		
	Healthcare services	General and administrative	Total
Salaries and benefits	\$ 944,915	93,371	1,038,286
Supplies	289,765	1,519	291,284
Interest	42,010	—	42,010
Depreciation	94,412	—	94,412
Purchased services	212,231	45,958	258,189
Repairs and maintenance	64,043	633	64,676
Other	80,558	41,457	122,015
Transaction related expenses	—	21,637	21,637
Total 2019	<u>\$ 1,727,934</u>	<u>204,575</u>	<u>1,932,509</u>
Total 2018	\$ 1,529,215	102,505	1,631,720

(17) Certain Significant Risks and Uncertainties

The Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (collectively, Health Care Reform), enacted in March 2010, have changed and will continue to make broad-based changes to the U.S. health care system which could significantly affect the U.S. economy and which the System expects will continue to impact the System's business operations and financial results. Since its enactment in 2010, key components of Health Care Reform have been phased in, including health insurance exchanges (Public Exchanges), new Medicare products, and the individual coverage mandate. Although Health Care Reform is to be phased in through 2018, many significant changes occurred in 2014. The System is dedicating material resources to monitor the potential impacts of Health Care Reform as well as state level health care reform. While the federal government has issued a number of regulations implementing Health Care Reform, certain significant parts of Health Care Reform, including aspects of Public Exchanges, Medicaid expansion, enforcement related reporting for the individual and employer mandates, and the implementation of Medicare Advantage, require further guidance and clarification at the federal level and/or in the form of regulations and actions by state legislatures to implement the law. The federal government also has announced significant changes to and/or delays in effective dates of various aspects of Health Care Reform, and it is likely that further changes will be made at the federal and/or state level based on implementation experience. As a result, key aspects and impacts of Health Care Reform will not be known for several years, and given the inherent difficulty of foreseeing how individuals and

TOWER HEALTH AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(Dollars in thousands)

businesses will respond to the choices afforded them by Health Care Reform, the System cannot predict the full effect Health Care Reform will have on the System. It is reasonably possible that Health Care Reform, in the aggregate, could have an adverse effect on the System's business operations and financial results.

Federal budget negotiations, ongoing regulatory changes to Health Care Reform, pending efforts in the U.S. Congress to amend or restrict funding for various aspects of Health Care Reform and litigation challenging aspects of the law continue to create uncertainty about the ultimate impact of Health Care Reform.

In addition, the federal and state governments continue to enact or seriously consider many other broad-based legislative and regulatory proposals that have impacted or could materially impact various aspects of the health care system. The System cannot predict whether pending or future federal or state legislation, will change various aspects of the health care system or Health Care Reform or the impact those changes will have on the System's business operations or financials results, but the effects could be adverse.

(18) Subsequent Events

The System has evaluated subsequent events from the consolidated balance sheet date through October 2, 2019, the date at which the consolidated financial statements were available to be issued, and determined there are no other items to disclose.

TOWER HEALTH AND SUBSIDIARIES

Consolidating Balance Sheet Information

June 30, 2019

(Dollars in thousands)

	Parent	Hospital	CMP	THP	THMG	RHF	THE	Consolidating and eliminating entries	Tower Health consolidated
Current assets:									
Cash and cash equivalents	\$ 3,275	697	87	—	91	—	(332)	—	3,818
Patient accounts receivable	—	148,521	131,994	—	29,074	—	5,041	—	314,630
Other receivables	926	1,918	2,214	103	3,462	423	1,711	—	10,757
Receivable from affiliates	8,632	4,481	906	—	—	—	(7,395)	(6,312)	312
Inventories	—	26,948	20,926	—	511	—	7	—	48,392
Estimated third-party payor receivables	—	18,376	3,085	—	—	—	—	—	21,461
Prepaid expenses and other current assets	5,555	18,487	6,746	7	1,419	—	301	—	32,515
Assets held for sale	19,875	—	—	—	—	—	—	—	19,875
Assets whose use is limited – required for current liabilities:									
Self-insurance funding arrangements	1	7,482	—	—	—	—	—	—	7,483
Total current assets	38,264	226,910	165,958	110	34,557	423	(667)	(6,312)	459,243
Assets whose use is limited:									
Self-insurance funding arrangements	7,723	12,179	—	—	—	—	—	—	19,902
Under regulatory requirements	2,000	—	—	—	—	—	—	—	2,000
By board for capital improvements	697,780	42	—	—	—	—	616	—	698,438
Investments with donor restrictions	—	3,869	—	—	—	33,669	3,460	—	40,998
Total assets whose use is limited, net of current portion	707,503	16,090	—	—	—	33,669	4,076	—	761,338
Long-term receivables from affiliates	378,108	—	—	—	—	—	—	(378,108)	—
Property, plant and equipment, net	16,121	791,507	305,735	—	13,449	—	4,652	—	1,131,464
Goodwill	—	—	128,127	—	—	—	27,064	—	155,191
Investments in joint ventures	13,053	199	—	—	—	—	4,098	—	17,350
Other assets	—	(456)	—	—	225	1,536	275	—	1,580
Total assets	\$ 1,153,049	1,034,250	599,820	110	48,231	35,628	39,498	(384,420)	2,526,166

TOWER HEALTH AND SUBSIDIARIES

Consolidating Balance Sheet Information

June 30, 2019

(Dollars in thousands)

	Parent	Hospital	CMP	THP	THMG	RHF	THE	Consolidating and eliminating entries	Tower Health consolidated
Current liabilities:									
Current installments of long-term debt	\$ 6,312	—	—	—	—	—	—	—	6,312
Line of credit	17,802	—	—	—	—	—	—	—	17,802
Capital leases	—	—	2,201	—	—	—	14	—	2,215
Accounts payable	(2)	91,743	42,057	47	2,363	—	414	—	136,622
Estimated third-party settlements	—	3,680	597	—	—	—	—	—	4,277
Current portion of estimated self-insurance costs	—	9,430	—	—	—	—	—	—	9,430
Accrued expenses	7,026	11,884	5,823	162	26,362	—	485	—	51,742
Accrued vacation	—	22,359	11,182	88	15,683	—	1,203	—	50,515
Current installments of long-term affiliated payables	—	6,312	—	—	—	—	—	(6,312)	—
Other current liabilities	—	15,915	7,673	89	695	—	—	—	24,372
Total current liabilities	31,138	161,323	69,533	386	45,103	—	2,116	(6,312)	303,287
Long-term debt, net of current portion and unamortized discount/premium									
	1,117,656	—	—	—	—	—	—	—	1,117,656
Capital leases	—	—	18,831	—	—	—	56	—	18,887
Accrued pension liabilities	—	226,031	—	—	—	—	—	—	226,031
Other liabilities	—	6,735	229	27	80	10	2,033	—	9,114
Estimated self-insurance costs, net of current portion	7,445	17,654	—	—	—	—	—	—	25,099
Swap contracts	31,387	—	—	—	—	—	—	—	31,387
Long-term affiliates payables, net of current portion	—	378,108	—	—	—	—	—	(378,108)	—
Total liabilities	1,187,626	789,851	88,593	413	45,183	10	4,205	(384,420)	1,731,461
Net assets (deficit):									
Without donor restrictions	(34,577)	240,530	511,220	(303)	3,048	(10)	35,047	—	754,955
With donor restrictions	—	3,869	7	—	—	35,628	246	—	39,750
Total net assets (deficit)	(34,577)	244,399	511,227	(303)	3,048	35,618	35,293	—	794,705
Total liabilities and net assets (deficit)	\$ 1,153,049	1,034,250	599,820	110	48,231	35,628	39,498	(384,420)	2,526,166

See accompanying independent auditors' report.

TOWER HEALTH SYSTEM AND SUBSIDIARIES

Consolidating Statement of Operations Information

Year ended June 30, 2019

(Dollars in thousands)

	Parent	Hospital	CMP	THP	THMG	RHF	THE	Consolidating and eliminating entries	Tower Health consolidated
Revenues and other support:									
Net patient service revenue	\$ —	976,053	525,498	—	205,001	—	20,186	(38,474)	1,688,264
Other revenue	6,998	41,404	8,171	1,836	5,126	2,320	3,897	(4,288)	65,464
Total revenues and other support	6,998	1,017,457	533,669	1,836	210,127	2,320	24,083	(42,762)	1,753,728
Expenses:									
Salaries and benefits	—	475,010	287,533	2,525	296,149	491	16,332	(39,754)	1,038,286
Supplies	—	154,724	125,197	11	10,597	3	752	—	291,284
Interest	—	13,156	28,830	—	—	—	24	—	42,010
Depreciation	—	66,012	25,469	830	1,660	—	441	—	94,412
Purchased services	263	60,720	151,360	91	44,397	59	1,363	(64)	258,189
Repairs and maintenance	36	42,023	20,580	793	857	35	352	—	64,676
Other	45	61,719	34,976	208	22,291	2,386	3,334	(2,944)	122,015
Transaction related expenses	—	19,424	—	—	2,213	—	—	—	21,637
Total expenses	344	892,788	673,945	4,458	378,164	2,974	22,598	(42,762)	1,932,509
Income (loss) from operations	6,654	124,669	(140,276)	(2,622)	(168,037)	(654)	1,485	—	(178,781)
Nonoperating (losses) gains:									
Investment income	49,623	(141)	—	—	—	—	110	—	49,592
Change in fair value of swap contracts net of settlement payments	(9,072)	—	—	—	—	—	—	—	(9,072)
Other (losses) gains	(521)	(3,323)	70	—	(25)	—	194	—	(3,605)
Nonoperating (losses) gains, net	40,030	(3,464)	70	—	(25)	—	304	—	36,915
Excess (deficiency) of revenues, (losses) gains, and other support over expenses	\$ 46,684	121,205	(140,206)	(2,622)	(168,062)	(654)	1,789	—	(141,866)

See accompanying independent auditors' report.

TOWER HEALTH AND SUBSIDIARIES

Consolidating Balance Sheet Information

June 30, 2018

(Dollars in thousands)

	Parent	Hospital	CMP	THP	THMG	RHF	THE	Consolidating and eliminating entries	Tower Health consolidated
Current assets:									
Cash and cash equivalents	\$ 98,549	(16,367)	(14,614)	—	(66)	—	—	—	67,502
Patient accounts receivable, less allowance for uncollectible accounts of \$84,771	—	138,446	151,764	—	24,022	—	—	—	314,232
Other receivables	327	1,145	565	47	3,073	182	—	—	5,339
Receivable from affiliates	5,095	(6,962)	19,649	(1)	(10,397)	(1,642)	—	(5,600)	142
Inventories	—	16,542	20,032	—	559	—	—	—	37,133
Estimated third-party payor receivables	—	7,876	6,211	—	—	—	—	—	14,087
Prepaid expenses and other current assets	2,179	19,502	4,878	7	1,197	—	—	—	27,763
Assets held for sale	19,875	—	—	—	—	—	—	—	19,875
Assets whose use is limited – required for current liabilities:									
Self-insurance funding arrangements	—	7,482	—	—	—	—	—	—	7,482
Total current assets	126,025	167,664	188,485	53	18,388	(1,460)	—	(5,600)	493,555
Assets whose use is limited:									
Self-insurance funding arrangements	—	11,988	—	—	—	—	—	—	11,988
Under regulatory requirements	2,000	—	—	—	—	—	—	—	2,000
By board for capital improvements	850,820	48	—	—	—	—	—	—	850,868
Investments with donor restrictions	—	372	—	—	—	33,229	—	—	33,601
Total assets whose use is limited, net of current portion	852,820	12,408	—	—	—	33,229	—	—	898,457
Long-term receivables from affiliates	389,973	—	—	—	—	—	—	(389,973)	—
Property, plant and equipment, net	16,121	726,867	302,344	830	8,614	—	—	—	1,054,776
Goodwill	—	—	128,127	—	—	—	—	—	128,127
Investments in joint ventures	15,650	605	—	—	—	—	3,685	—	19,940
Other assets	—	3,195	—	—	114	1,039	—	—	4,348
Total assets	\$ 1,400,589	910,739	618,956	883	27,116	32,808	3,685	(395,573)	2,599,203

TOWER HEALTH AND SUBSIDIARIES

Consolidating Balance Sheet Information

June 30, 2018

(Dollars in thousands)

	Parent	Hospital	CMP	THP	THMG	RHF	THE	Consolidating and eliminating entries	Tower Health consolidated
Current liabilities:									
Current installments of long-term debt	\$ 5,600	—	—	—	—	—	—	—	5,600
Capital leases	—	—	2,120	—	—	—	—	—	2,120
Accounts payable	—	47,669	27,297	82	2,542	(1)	—	—	77,589
Estimated third-party settlements	—	4,099	4,866	—	—	—	—	—	8,965
Current portion of estimated self-insurance costs	—	13,669	—	—	—	—	—	—	13,669
Accrued expenses	7,266	15,806	11,359	98	21,916	—	—	—	56,445
Accrued vacation	—	19,933	8,740	33	12,291	—	—	—	40,997
Current installments of long-term affiliated payables	—	5,600	—	—	—	—	—	(5,600)	—
Other current liabilities	—	11,472	1,344	34	352	—	—	—	13,202
Total current liabilities	12,866	118,248	55,726	247	37,101	(1)	—	(5,600)	218,587
Long-term debt, net of current portion and unamortized discount/premium	1,126,194	—	—	—	—	—	—	—	1,126,194
Capital leases	—	—	19,651	—	—	—	—	—	19,651
Accrued pension liabilities	—	201,974	—	—	—	—	—	—	201,974
Other liabilities	—	7,080	181	23	56	12	—	—	7,352
Estimated self-insurance costs, net of current portion	50	28,486	—	—	—	—	—	—	28,536
Swap contracts	26,776	—	—	—	—	—	—	—	26,776
Long-term affiliates payables, net of current portion	—	389,973	—	—	—	—	—	(389,973)	—
Total liabilities	1,165,886	745,761	75,558	270	37,157	11	—	(395,573)	1,629,070
Net assets (deficit):									
Without donor restrictions	234,703	164,606	543,391	613	(10,041)	(1,661)	3,685	—	935,296
With donor restriction	—	372	7	—	—	34,458	—	—	34,837
Total net assets (deficit)	234,703	164,978	543,398	613	(10,041)	32,797	3,685	—	970,133
Total liabilities and net assets (deficit)	\$ 1,400,589	910,739	618,956	883	27,116	32,808	3,685	(395,573)	2,599,203

See accompanying independent auditors' report.

TOWER HEALTH SYSTEM AND SUBSIDIARIES

Consolidating Statement of Operations Information

Year ended June 30, 2018

(Dollars in thousands)

	Parent	Hospital	CMP	THP	THMG	RHF	Highlands	THE	Consolidating and eliminating entries	Tower Health consolidated
Revenues and other support:										
Net patient service revenue	\$ —	1,012,462	504,198	—	192,318	—	1,189	—	(35,766)	1,674,401
Provision for uncollectible accounts	—	(58,106)	(38,969)	—	(10,796)	—	—	—	—	(107,871)
Net patient service revenue less provision for uncollectible accounts	—	954,356	465,229	—	181,522	—	1,189	—	(35,766)	1,566,530
Other revenue	6,132	33,279	6,636	3,355	4,118	197	6,361	167	(5,827)	54,418
Total revenues and other support	6,132	987,635	471,865	3,355	185,640	197	7,550	167	(41,593)	1,620,948
Expenses:										
Salaries and benefits	—	447,495	195,954	1,992	260,273	488	3,157	—	(38,443)	870,916
Supplies	—	156,417	94,071	9	9,489	7	548	—	—	260,541
Interest	—	18,448	17,845	—	—	—	287	—	—	36,580
Depreciation	—	70,836	16,242	830	1,621	—	962	—	—	90,491
Purchased services	166	71,097	100,822	452	25,499	34	639	—	(62)	198,647
Repairs and maintenance	—	39,207	12,152	557	760	46	112	—	—	52,834
Other	18	64,422	24,033	315	16,345	229	870	—	(3,088)	103,144
Transaction related expenses	6,390	9,352	2,825	—	—	—	—	—	—	18,567
Total expenses	6,574	877,274	463,944	4,155	313,987	804	6,575	—	(41,593)	1,631,720
Income (loss) from operations	(442)	110,361	7,921	(800)	(128,347)	(607)	975	167	—	(10,772)
Nonoperating (losses) gains:										
Investment income	117,292	(306)	—	—	—	—	2,681	—	—	119,667
Change in fair value of swap contracts net of settlement payments	7,308	(1)	—	—	—	—	—	—	—	7,307
Loss on early extinguishment of debt	(4,314)	—	—	—	—	—	—	—	—	(4,314)
Other (losses) gains	—	(3,232)	7	—	—	—	21	—	—	(3,204)
Nonoperating (losses) gains, net	120,286	(3,539)	7	—	—	—	2,702	—	—	119,456
Excess (deficiency) of revenues, (losses) gains, and other support over expenses	\$ 119,844	106,822	7,928	(800)	(128,347)	(607)	3,677	167	—	108,684

See accompanying independent auditors' report.