KPMG

MERITUS MEDICAL CENTER, INC.

Consolidated Financial Statements and
Supplementary Financial Information

June 30, 2020 and 2019

(With Independent Auditors' Report Thereon)

MERITUS MEDICAL CENTER, INC.

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KPMG LLP
750 East Pratt Street, 18th Floor
Baltimore, MD 21202

Independent Auditors' Report

The Board of Directors
Meritus Medical Center, Inc.:

We have audited the accompanying consolidated financial statements of Meritus Medical Center, Inc. (Meritus), which comprise the consolidated balance sheets as of June 30, 2020 and 2019, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with 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 Meritus as of June 30, 2020 and 2019, and the results of its operations and changes in net assets and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in note 2(t) and note 8 to the consolidated financial statements, Meritus adopted Financial Accounting Standards Board Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)* during the year ended June 30, 2020. Our opinion is not modified with respect to this matter.

As discussed in note 2(m) to the consolidated financial statements, Meritus adopted Financial Accounting Standards Board ASU No. 2014-19, *Revenue from Contracts with Customers (Topic 606)* and ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities* during the year ended June 30, 2019. Our opinion is not modified with respect to this matter.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included in Schedules 1 and 2 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

Baltimore, Maryland
October 2, 2020

MERITUS MEDICAL CENTER, INC.

Consolidated Balance Sheets

June 30, 2020 and 2019

(Dollars in thousands)

Assets		**2020**	**2019**
Current assets:			
Cash and cash equivalents	$	15,561	32,040
Short-term investments		126,524	34,770
Current portion of assets whose use is limited		10,691	10,577
Accounts receivable		31,644	41,028
Supplies		6,347	5,783
Prepaid and other current assets		10,478	6,142
Total current assets		201,245	130,340
Assets whose use is limited		212,962	207,404
Property, plant and equipment, net		235,138	244,608
Equity investments in affiliates		40,204	36,658
Other assets		23,885	8,001
Total assets	$	713,434	627,011
Liabilities and Net Assets			
Current liabilities:			
Accounts payable and accrued expenses	$	26,055	18,195
Accrued salaries, wages and withholdings		14,754	13,100
Accrued compensation benefit		13,828	12,418
Advances from third-party payors		79,736	13,650
Accrued interest payable		5,808	5,928
Current portion of long-term debt		5,481	6,644
Total current liabilities		145,662	69,935
Long-term debt, net of current portion		245,751	251,233
Accrued retirement benefits		6,379	6,365
Other long-term liabilities		21,530	6,298
Total liabilities		419,322	333,831
Net assets:			
Unrestricted		288,377	287,159
Restricted		5,735	6,021
Total net assets		294,112	293,180
Total liabilities and net assets	$	713,434	627,011

See accompanying notes to consolidated financial statements.

MERITUS MEDICAL CENTER, INC.

Consolidated Statements of Operations and Changes in Net Assets

Years ended June 30, 2020 and 2019

(Dollars in thousands)

		2020	2019
Unrestricted revenue, gains and other support:			
Net patient service revenue	$	367,971	376,849
Other revenue		21,831	9,612
Equity earnings in affiliates		4,448	4,572
Net assets released from restriction used for operations		1,133	1,045
Total revenues		395,383	392,078
Expenses:			
Salaries and wages		166,928	160,540
Employee benefits		37,416	36,111
Professional fees		16,521	15,904
Supplies and other		141,264	153,908
Interest		11,203	11,449
Depreciation and amortization		26,007	24,975
Total expenses		399,339	402,887
Operating losses		(3,956)	(10,809)
Nonoperating gains (losses), net:			
Investment returns, net		4,877	8,636
Other, net		(75)	(148)
Income tax expense		(333)	(59)
Excess (deficit) of revenues over expenses	$	513	(2,380)

(Continued)

MERITUS MEDICAL CENTER, INC.

Consolidated Statements of Operations and Changes in Net Assets

Years ended June 30, 2020 and 2019

(Dollars in thousands)

		2020	2019
Unrestricted net assets:			
Excess (deficit) of revenues over expenses	$	513	(2,380)
Other		705	16
Increase (decrease) in unrestricted net assets		1,218	(2,364)
Restricted net assets:			
Contributions		689	1,098
Other		158	(25)
Net assets released from restriction for operations		(1,133)	(1,045)
(Decrease) increase in restricted net assets		(286)	28
Increase (decrease) in net assets		932	(2,336)
Net assets:			
Beginning of year		293,180	295,516
End of year	$	294,112	293,180

See accompanying notes to the consolidated financial statements.

MERITUS MEDICAL CENTER, INC.

Consolidated Statements of Cash Flows

Years ended June 30, 2020 and 2019

(Dollars in thousands)

		2020	2019
Cash flows from operating activities:			
Increase (decrease) in net assets	$	932	(2,336)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:			
Depreciation and amortization		26,007	24,975
Net realized and unrealized gains on investments		(2,949)	(6,488)
(Gain) loss on disposal of assets		134	(1,181)
Equity earnings in affiliates		(4,448)	(4,572)
Restricted contributions and other		(1,552)	(1,089)
Changes in assets and liabilities:			
Accounts receivable		9,384	952
Supplies, prepaid, and other current assets		(4,900)	49
Other assets		(15,883)	(4,039)
Accounts payable, accrued expenses and long-term liabilities		23,092	(4,609)
Accrued salaries, wages and withholdings		1,654	2,038
Accrued compensation benefit		1,410	1,363
Advances from third-party payors		66,086	(861)
Interest payable		(120)	(110)
Accrued retirement benefits		14	(177)
Net cash provided by operating activities		98,861	3,915
Cash flows from investing activities:			
Purchase of property, plant and equipment		(17,111)	(17,737)
Proceeds from the disposal of assets		440	1,245
Purchases of short term investments using advances from third party payors		(66,000)	—
Purchases of alternative investments		—	(425)
(Purchases)/sales of short-term investments, and assets whose use is limited, net		(28,478)	12,485
Equity contributions to affiliates, net		902	1,295
Net cash used in investing activities		(110,247)	(3,137)
Cash flows from financing activities:			
Payments on long-term debt and capital leases		(6,645)	(6,798)
Restricted contributions and other		1,552	1,089
Net cash used in financing activities		(5,093)	(5,709)
Net decrease in cash and cash equivalents		(16,479)	(4,931)
Cash and cash equivalents:			
Beginning of year		32,040	36,971
End of year	$	15,561	32,040
Supplemental disclosure of cash flow information:			
Cash paid for interest	$	11,203	11,449
Cash paid for income taxes		144	113

See accompanying notes to consolidated financial statements.

(1) Description of Organization

Organization

Meritus Medical Center, Inc. (the Hospital or the Company) is the parent corporation of the Meritus Healthcare Foundation, Inc. (the Foundation), the Meritus Insurance Company, Ltd. (MIC), Meritus Health ACO, LLC (MACO) and Meritus Holdings, LLC (Holdings), which owns Meritus Enterprises (MEI). These entities are collectively referred to as “Meritus”.

The Hospital is a not-for-profit acute care hospital located in Hagerstown, Maryland and serves the residents of western Maryland, southern Pennsylvania, and the panhandle of West Virginia. The Hospital currently offers acute general hospital inpatient services, including adult medical/surgical care, obstetrics and newborn care, including a family birthing center, cardiac catheterizations, comprehensive inpatient rehabilitation, radiology and diagnostic services, inpatient and outpatient mental health services, a regional Level III Trauma Center, an intensive care unit, an intermediate care unit, and a pediatric unit. The Hospital also manages gifts, donations or bequests given for the benefit of Meritus and owns real estate properties for rental to medical provider entities and development opportunities.

The Foundation is a not-for-profit corporation whose purpose is to raise philanthropic support for the capital and endowment campaigns of the Hospital. The Foundation also raises money for the Hospital’s medical programs, healthcare objectives, scientific research, educational programs, and related community activities. Resources for the Foundation’s activities are primarily provided by donors.

MIC is a Cayman Island captive insurance company, wholly owned by the Hospital that provides primary limits of insurance to Meritus for professional liability, employed physician’s professional liability, comprehensive general liability, deductible, and stop-loss coverage for health insurance.

As of June 30, 2020, MEI, a for-profit corporation, held ownership interests in the following joint venture:

- Diagnostic Imaging Services, LLC (DIS), an outpatient imaging services provider

Holdings is the sole member of Medical Practices of Antietam, LLC, which employs physicians and operates clinics in the Meritus primary service area.

As of June 30, 2020, Holdings, held ownership interests in the following joint venture:

- General Surgery Real Estate, LLC (GSRE), a real estate holding company

MEI also owns and operates Equipped for Life, a durable medical equipment company (EFL).

MACO is an Accountable Care Organization (ACO), wholly owned by the Hospital. MACO participates in the following CMS programs:

- Medicare Shared Savings Plan (“MSSP”), effective January 1, 2017 through December 31, 2019
- Maryland Primary Care Program (“MDPCP”), as an approved Care Transformation Organization for Washington County, MD, effective January 1, 2019

(2) Summary of Significant Accounting Policies

(a) Principles of Consolidation

The Company's consolidated financial statements include the subsidiaries in which the Company has more than 50% voting interests or when the Company is deemed to have control. Significant intercompany accounts and transactions have been eliminated in consolidation. The accompanying consolidated financial statements include the accounts of the Hospital, Holdings, MEI, the Foundation, MACO, and MIC. All material inter-company balances and transactions have been eliminated in consolidation.

(b) Use of Estimates

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

(c) Cash and Cash Equivalents

Cash and cash equivalents consist of short-term, highly liquid investments that are readily convertible to cash and have original maturities of three months or less. Cash and cash equivalents are carried at cost which approximates fair value.

(d) Patient Accounts Receivable

Patient accounts receivable result from the healthcare services provided by Meritus and are recorded at the net realizable value based on certain assumptions determined by each payor. For third-party payors, including Medicare, Medicaid, and commercial insurance, the net realizable value is based on the estimated contract adjustments, which is based on approved discounts on charges as permitted by the Health Services Cost Review Commission (HSCRC). For self-pay accounts, which included patients who are uninsured and the patient responsibility portion for patients with insurance, the net realizable value is determined using estimates of historical collection experience. See note 2(m) for revenue recognition policies.

(e) Assets Whose Use is Limited

Assets whose use is limited include assets set aside by the Board of Directors for specific purposes, for supplemental retirement benefit investments, to fulfill donor purposes, assets held by trustees under bond indenture agreement, and funds designated for insurance purposes. Amounts required to meet current liabilities are shown as current assets in the consolidated balance sheets. Cash and cash equivalents, as defined above, within assets whose use is limited are treated as investments.

(f) Investments and Investment Income

Investments in equity securities (i.e., investments that have readily determinable fair values and are not accounted for by the equity method) and all investments in debt securities are reported at fair value on the consolidated balance sheets. Institutional funds are recorded at their readily determinable fair values (RDFV). All securities with the exception of alternative investments are reported at fair value. Alternative investments are recorded under the equity method of accounting.

A significant portion of the Meritus' investments are held in an investment portfolio maintained for the benefit of Meritus and its affiliates and its subsidiaries. Investments are classified as trading securities except for certain investments, which are limited or restricted as to use or do not have the liquidity to qualify as trading securities and are classified as investments available for sale.

Investment income and realized gains are recorded as nonoperating revenue. Unrealized gains and losses on trading securities are recorded as nonoperating revenue. Unrealized gains and losses on available for sale investments are included in other changes in net assets. Investment income and realized gains and losses on assets restricted by donors for specific purposes or endowment are included in restricted net assets.

Investment income, which includes interest and dividends, on proceeds of borrowings that are held by a trustee are reported as other revenue. Other investment income, which includes interest, dividends and realized and unrealized gains and losses on assets limited as to use by Board of Directors and funds designated for insurance purposes are recorded as nonoperating gains (losses), net, unless the income or loss is restricted by donor or law.

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

(g) Supplies

Supplies for the Hospital are carried at cost on a weighted average basis.

(h) Property, Plant and Equipment

Property, plant and equipment acquisitions are recorded at cost. Those assets acquired by gift are carried at amounts established as fair value at the time of acquisition. Depreciation is provided over the estimated useful life of each class of depreciable assets and is computed using the straight-line method. Equipment under finance leases are amortized by the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated financial statements. 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. No interest was capitalized during the years ended June 30, 2020 and 2019. Leasehold improvements are amortized over the lesser of the useful life or the lease life. Durable medical equipment held for resale is included in supplies. The remainder of durable medical equipment is rented to patients and is included in property, plant and equipment. Assets are retired or disposed of at book value and related gains or losses are recorded for assets sold. Useful lives range as follows:

Land improvements	5–25 years
Buildings	10–40 years
Equipment	3–20 years
Leasehold improvements	The lesser of the useful life or lease term

Gifts of long-lived assets such as land, buildings, or equipment are reported as other changes in unrestricted net assets unless explicit donor stipulations specify how the donated assets must be used. When applicable, gifts of long-lived assets with explicit 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 restricted support. Absent explicit donor stipulations about how long-lived assets must be maintained, expirations of donor restrictions, occur when the donated or acquired long-lived assets are placed into service.

Meritus continually evaluates whether events and circumstances have occurred that indicate the remaining estimated useful life of long-lived assets is appropriate, or whether the remaining balance may not be recoverable. When factors indicate that long-lived assets should be evaluated for possible impairment, Meritus uses an estimate of the related undiscounted operating income over the remaining life of the long lived asset in measuring whether the long-lived asset is recoverable.

The impairment loss on these assets is measured as the excess of the carrying amount of the asset over its fair value. Fair value is based upon market prices, where available, or discounted cash flows. Management believes that no revision to the remaining useful lives is required and there was no impairment of long-lived assets during the years ended June 30, 2020 and 2019.

(i) Deferred Financing Costs

Financing costs incurred in issuing debt have been capitalized and are being amortized over the life of the debt using the effective interest method.

(j) Compensated Absences

Meritus records a liability for amounts due to employees for future absences which are attributable to services performed in the current and prior periods. This liability is included in accrued compensation benefit on the consolidated balance sheets.

(k) Restricted Net Assets

Restricted net assets are those whose use by Meritus have been limited by donors to a specific time period or purpose. When donor restrictions expire, that is, when a time restriction ends or a purpose restriction is accomplished, restricted net assets are reclassified into unrestricted net assets and reported as net assets released from restrictions. Restricted net assets also include funds that have been restricted by donors to be maintained by Meritus in perpetuity.

Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions if for operating purposes and as other changes in unrestricted net assets if for capital purposes in the consolidated statements of operations and changes in net assets.

(l) Excess (Deficit) of Revenues over Expenses

The consolidated statements of operations include a performance indicator, the excess (deficit) of revenue over expenses. Changes in unrestricted net assets that are excluded from the excess (deficit) of revenues over expenses, consistent with industry practice, include net assets released from restrictions for property, plant and equipment.

(m) Net Patient Service Revenue

For services provided at the Hospital’s campus, all payors are required to pay the Maryland Health Services Cost Review Commission (HSCRC) approved rates. The major third-party payors, as recognized by the HSCRC, are allowed discounts of up to 6% on approved rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered.

The Hospital’s charges are subject to review and approval by the HSCRC. The total rate of reimbursement for services to patients under the Medicare and Medicaid programs is based on an arrangement between the Centers for Medicare and Medicaid Service and the HSCRC. The Hospital has an agreement with the HSCRC under a rate regulation concept called Global Budget Revenue (GBR) which was renewed as of July 1, 2016 and renews annually. GBR is a revenue constraint methodology which provides for inflation, bad debt, payor differential and adjustments for population growth, but excludes case mix and volume changes. For the years ended June 30, 2020 and 2019, the regulated revenue cap was $396,395 and $370,257, respectively. The Hospital was below its GBR regulated revenue cap in the current year mainly due to the impact of COVID-19 (see note 15). The HSCRC issued regulations due to the impact of COVID-19 on all hospitals in Maryland that allows hospitals to carry over any undercharge less amount recouped from other federal programs to the following fiscal year GBR regulated revenue cap. The HSCRC also may impose various other revenue adjustments that could be significant in the future.

Services not located on the Hospital’s campus and certain other services are not regulated by the HSCRC. Medicare and Medicaid pay the revenues associated with these services based upon established fee schedules. Commercial payors pay at negotiated rates for these services.

Laws and regulations governing the HSCRC, Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Meritus believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action.

The Company adopted Topic 606, Revenue Recognition, effective July 1, 2018 using the modified retrospective transition method. Topic 606 provides a principles-based framework for recognizing revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Upon adoption, the majority of what was previously classified as provision for uncollectible accounts and presented as a reduction to net patient service revenue in the consolidated statements of operations is treated as a price concession that reduces the transaction price, which is reported as a reduction to net patient service revenue. Other than these changes in presentation, the impact of adopting ASC 606 was not material to consolidated operating revenues, excess of revenues over expenses or total net assets.

Net patient service revenue is recognized, over time, as performance obligations are satisfied. Performance obligations are determined based on the nature of the services provided. Revenue for performance obligations satisfied over time is recognized at the estimated net realizable amounts from patients and third-party payors for services rendered.

The Company generates revenues, primarily by providing healthcare services to its customers. Revenues are recognized when control of the promised good or service is transferred to our customers, in an amount that reflects the consideration to which the Company expects to be entitled from patients, third-party payors (including government programs and insurers) and others, in exchange for those goods and services.

The majority of the Company’s healthcare services represent a bundle of services that are not capable of being distinct and as such, are treated as a single performance obligation satisfied over time as services are rendered. The Company also provides certain ancillary services which are not included in the bundle of services, and as such, are treated as separate performance obligations satisfied at a point in time, if and when those services are rendered.

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.

(Dollars in thousands)

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, 2020 and 2019 was not significant to the consolidated financial statements

Patient service revenue as a percentage for the years ended June 30, 2020 and 2019, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period from these major payor sources based on primary insurance designation, is as follows:

		Third-party 2020	2019
Net patient service revenue:			
Hospital inpatient	$	209,984	209,568
Hospital outpatient		155,736	160,394
Other outpatient		143,862	151,709
Gross charges		509,582	521,671
Less contractual and other allowances		(141,611)	(144,822)
Net patient service revenue	$	367,971	376,849

(n) Charity Care

Meritus provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Meritus does not pursue collection on amounts deemed to qualify as charity. Meritus also estimates that the direct and indirect cost of services and supplies furnished to patients eligible for charity care using a ratio of cost to gross charges based on internal data is $11,889 and $9,998 for the years ended June 30, 2020 and 2019, respectively.

Meritus' patient acceptance policy is based upon its mission statement and its charitable purposes. This policy results in Meritus' assumption of higher-than-normal credit risk from its patients. To the extent that Meritus realizes additional losses resulting from such higher credit risks and clients are not identified or do not meet Meritus' defined charity care policy, such additional losses are recognized as a reduction to net patient service revenue.

Meritus also sponsors certain other charitable programs, which provide substantial benefit to the broader community. Such programs include services to needy and elderly populations that require special support, as well as health and education for the general community welfare. In addition, all other uncollectable amounts resulting from the patients' inability to pay are recorded as a reduction to net patient service revenue, consistent with Meritus' policy.

(o) Other Revenue

Other revenue is comprised of rental income, gains and losses on disposal of assets, grants related to Covid-19 funding including CARES Act funding (see note 14) and other miscellaneous items.

(p) Income Taxes

The Internal Revenue Service has ruled that the Hospital, and the Foundation qualify under Section 501(c)(3) of the Internal Revenue Code and are, therefore, not subject to tax under present income tax regulations.

Holdings and MACO are considered a disregarded entity for tax purposes and are reported through the Hospital.

MEI accounts for income taxes through the current recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between tax bases and financial reporting bases of other assets and liabilities.

At present, no income, profit or capital gain taxes are levied in the Cayman Islands and accordingly, no provision for taxation has been made for MIC. In the event that such taxes are levied, MIC has been granted an exemption until September 9, 2023 for any such taxes that might be introduced. MIC intends to conduct its affairs so as not to be liable for taxes in any other jurisdiction.

Meritus follows the accounting guidance for uncertainties in income tax positions, which requires that a tax position be recognized or derecognized based on a “more likely than not” threshold. This applies to positions taken or expected to be taken in a tax return. Meritus does not believe its consolidated financial statements include any material uncertain tax positions. As of June 30, 2020, the Meritus tax years ended June 30, 2016 through June 30, 2020 for federal tax jurisdiction remain open to examination.

(q) Concentration of Credit Risk

Meritus invests its excess cash, investments, and assets in financial institutions which are federally insured under the Federal Deposit Insurance Act (FDIA). Deposits in certain accounts exceed federally insured deposit limits. Meritus has experienced no losses on its deposits.

Meritus grants credit without collateral to the patients it serves who primarily live in the tri-state area. The majority of these patients have either insurance through Blue Cross, another insurance company or a health maintenance organization, or qualify for the Maryland Medical Assistance or the Centers for Medicare and Medicaid Services (CMS) programs.

(Continued)

(Dollars in thousands)

At June 30, Meritus' patient accounts receivable was made up of the following:

	2020	2019
Medical assistance HMO/Medicaid	22 %	22 %
Medicare	35	31
Commercial insurance, HMO and other	22	26
Blue cross/blue shield	12	13
Self-pay	9	8
	100 %	100 %

(r) Deferred Compensation Plan

The Hospital is party to a 457(b) deferred compensation plan and a 457(f) deferred compensation plan, both are intended to provide retirement benefits to certain eligible employees. Assets are deposited with the plan managers, pursuant to this agreement, such that the value of the assets determined by the fair value approximately equals the related accrued deferred compensation liability. The funds are placed into a range of investment strategies from conservative to aggressive. The liability associated with this plan is included in accrued retirement benefits on the consolidated balance sheets.

(s) Management's Assessment and Plans

The Company adopted ASU 2014-5, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, (ASU 2014-15) during 2015. ASU 2014-15 requires management to evaluate an entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or available to be issued, when applicable). Management determined that there were no conditions or events that raise substantial doubt about the Company's ability to continue as a going concern and the Company will continue to meet its obligations through October 3, 2021.

(t) Leases

In February 2016, FASB issued ASU No. 2016-02, *Leases* (ASU 2016-02). The standard requires Meritus to recognize the assets and liabilities related to leases on the balance sheet. Additionally, in July 2018, FASB issued ASU-2018-11, *Leases* – Targeted Improvements, which provides an additional transition method that would allow entities to not apply the guidance in ASU 2016-02 in the comparative periods presented in the financial statements and instead recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Meritus adopted ASU 2016-02 and its related amendments as of July 1, 2019, using the modified retrospective method applying the transition provisions at the beginning of the period of adoption, rather than at the beginning of the earliest comparative period presented, which resulted in the recognition of operating right-of-use assets totaling $22,248 and operating right-of-use liabilities totaling $22,248. There was no cumulative effect adjustment to the opening balance of retained earnings required.

(Continued)

(Dollars in thousands)

The Company has elected the practical expedient package to not reassess at adoption (i) expired or existing contracts for whether they are or contain a lease, (ii) the lease classification of any existing leases or (iii) initial indirect costs for existing leases. We have also elected the policy exemption that allows lessees to choose to not separate lease and non-lease components by class of underlying asset and are applying this expedient to all relevant asset classes.

The adoption of ASC 842 had a material impact on the Company's consolidated balance sheet through the recording of the operating lease liabilities and related ROU assets for leases in effect at July 1, 2019, but the adoption did not have a material impact on the Company's consolidated statement of operations or consolidated statement of cash flows for the year ended June 30, 2020. Additional lease disclosures can be found in Note 8.

(3) Investments and Investment Income

Investments at June 30 consisted of the following:

		2020	2019
Short-term investments:			
US government notes	$	16,602	761
Fixed income bonds – corporate		42,857	512
Mutual funds		1,065	33,497
Certificates of deposit		66,000	—
Total	$	126,524	34,770
Assets whose use is limited:			
Cash and cash equivalents	$	17,957	10,692
Fixed income:			
Corporate debt securities		6,587	5,391
Mortgage backed securities		227	104
Asset backed securities		2,439	2,047
US government notes		4,691	3,458
Equities:			
Mutual funds		63,005	64,727
Institutional funds:			
Domestic equities		39,105	33,860
International equities		52,721	54,251
Fixed income		19,897	25,291
Alternative investments		17,024	18,160
Total	$	223,653	217,981

The amount of the board designated funds whose use is limited is $187,829 and $183,942 as of June 30, 2020 and 2019, respectively.

(Dollars in thousands)

Investment returns, net of investments included in the consolidated statements of operations and changes in net assets are comprised of the following for the years ended June 30:

		2020	2019
Investment returns, net:			
Interest and dividends, net of investment fees of $602 and $572 in 2020 and 2019, respectively	$	1,928	2,148
Net realized gains on investments		2,381	913
Change in unrealized gains on investments		568	5,575
	$	4,877	8,636

At June 30, 2020 and 2019, the Hospital had invested $17,204 and $18,160, or 7.6% and 8.3%, respectively, of the portfolio in alternative investments, which are invested in hedge funds. The following table summarizes redemption terms for the hedge fund-of-funds vehicles held as of June 30, 2020:

	Fund 1	Fund 2
Redemption timing:		
Redemption frequency	Semi-Annually	Monthly
Required notice	95 days	30 days

Additionally, at June 30, 2020 and 2019, the Company has invested in $112,964 and $113,402 of institutional funds for which the value is based on either readily determinable fair value (RDFV) or net asset value (NAV). At June 30, 2020, $49,313 was based on RDFV and $63,651 was based on NAV. At June 30, 2019, $66,101 was based on RDFV and $47,301 was based on NAV.

The redemption terms and notification requirements of the institutional funds range from daily to monthly.

(4) Fair Value Measurements

Meritus measures fair value as the price that would be received to sell an asset or paid to transfer a liability (the exit price) in an orderly transaction between market participants at the measurement date. The accounting guidance outlines a valuation framework and creates a fair value hierarchy in order to increase the consistency and comparability of fair value measurements and the related disclosures. The fair value hierarchy is broken down into three levels based on the source of inputs as follows:

Level I – Quoted prices are available in active markets for identical assets or liabilities as of the report date. A quoted price for an identical asset or liability in an active market provides the most reliable fair value measurement because it is directly observable to the market.

Level II – Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the report date. The nature of these securities include investments for which quoted prices are available but traded less frequently and investments that are fair valued using other securities, the parameters of which can be directly observed.

Level III – Securities that have little to no pricing observability as of the report date. These securities are measured using management's best estimate of fair value, where the inputs into the determination of fair value are not observable and require significant management judgment or estimation.

Financial instruments consist of cash equivalents, patient accounts receivable, investments, excluding those accounted for by the equity method, accounts payable and accrued expenses and long-term debt. The carrying amounts reported in the consolidated balance sheets for cash equivalents, patient accounts receivable, and accounts payable and accrued expenses approximate fair value. Management's estimates of other financial instruments are described elsewhere in the notes to the consolidated financial statements.

Meritus does not have any Level 3 financial instruments as of June 30, 2020 and 2019.

Investments are valued using a market approach as follows:

Cash and cash equivalents – Cash equivalents are classified as Level 1 inputs and represent short-term, highly liquid investments that are readily convertible to cash and have original maturities of three months or less.

Stock and equity funds – Common stock and equity funds consist of stock and are valued based upon unadjusted quoted prices in the market.

Mutual Funds – Valued at the closing price reported in the active market in which the mutual fund is traded.

Fixed income bonds – Valued at the closing price reported in the active market in which the bond is traded.

(Dollars in thousands)

The following table presents Meritus' assets measured at fair value on a recurring basis using the market approach, as of June 30:

	Level 1	Level 2	Level 3	Total
2020:				
Cash and cash equivalents	$ 17,957	—	—	17,957
Mutual funds	52,666	—	—	52,666
Certificates of Deposit	66,000	—	—	66,000
Fixed income bonds:				
Corporate debt securities	—	49,444	—	49,444
Mortgage backed securities	—	227	—	227
Asset backed securities	—	2,439	—	2,439
U.S. government notes	—	21,293	—	21,293
Institutional funds:				
Domestic equities	—	39,105	—	39,105
International equities	—	26,735	—	26,735
Fixed income	—	10,660	—	10,660
Total assets	$ 136,623	149,903	—	286,526

	Level 1	Level 2	Level 3	Total
2019:				
Cash and cash equivalents	$ 10,693	—	—	10,693
Mutual funds	90,182	—	—	90,182
Fixed income bonds:				
Corporate debt securities	—	5,384	—	5,384
Mortgage backed securities	—	104	—	104
Asset backed securities	—	2,047	—	2,047
U.S. government notes	—	3,458	—	3,458
Institutional funds:				
Domestic equities	—	33,859	—	33,859
International equities	—	17,906	—	17,906
Fixed income	—	14,240	—	14,240
Total assets	$ 100,875	76,998	—	177,873

There were no Level 3 investments or transfers during the years ended June 30, 2020 and 2019.

(Dollars in thousands)

(5) Property, Plant and Equipment

Property, plant and equipment at June 30 is comprised of the following:

		2020	2019
Land	$	26,690	26,099
Buildings, and improvements		219,822	218,152
Leasehold Improvements		3,188	3,184
Equipment		196,838	196,263
		446,538	443,698
Less accumulated depreciation and amortization		(219,710)	(200,889)
		226,828	242,809
Construction in progress		8,310	1,799
Property, plant and equipment, net	$	235,138	244,608

Equipment under finance leases		2020	2019
Equipment	$	—	9,000
Less accumulated amortization		—	(7,120)
	$	—	1,880

Total depreciation and amortization expense for property, plant and equipment for the years ended June 30, 2020 and 2019 was $26,007 and $24,975, respectively.

(6) Equity Investments in Affiliates

The following investments, recorded under the equity method of accounting, are included in the consolidated balance sheets.

The Hospital holds a 25% equity interest in Maryland Care, Inc. (“MPC”), a managed care organization (MCO) that was established to serve Maryland’s Medicaid population as a result of the State’s requirement for Medicaid patients to be a member of an MCO, and Maryland Care Management, Inc. (“MCMI”), a management services organization that provides management services to MPC.

Holdings holds a 50% interest in General Surgery Real Estate and held a 50% interest in GRI Real Estate it was dissolved on March 31, 2020, both are real estate holding companies. MEI has a 50% interest in Diagnostic Imaging, which provides radiology imaging services.

(Dollars in thousands)

Summary of financial information as of June 30, 2020 and 2019 and for the years then ended appears below for the significant equity investments:

	Maryland Care, Inc.		MEI Diagnostic Imaging Services, LLC	
	2020	2019	2020	2019
Assets	$ 390,504	349,769	12,448	10,670
Liabilities	263,567	231,951	5,313	4,027
Equity	$ 126,937	117,818	7,135	6,643
Revenue	$ 1,102,210	1,097,944	18,853	20,514
Expenses	1,092,280	1,098,169	17,366	19,113
Net income	$ 9,930	(225)	1,487	1,401

	Maryland Care Management, Inc.	
	2020	2019
Assets	$ 14,202	7,494
Liabilities	2,436	678
Equity	$ 11,766	6,816
Revenue	$ 14,080	14,203
Expenses	9,316	7,328
Net income	$ 4,764	6,875

(Dollars in thousands)

(7) Long-Term Debt

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

		2020	2019
MHHEFA Revenue Bonds:			
Series 2015 3.50%–5.00% serial bonds, including issue premiums of $12,895	$	252,970	258,171
City of Hagerstown note		—	20
Mortgages and equipment loans with banks, with interest rates ranging from 2.24% to 7.75%		211	300
Capital lease obligations, with interest rates ranging from 1.76% to 2.30%		—	1,413
		253,181	259,904
Less current portion of long-term debt		(5,481)	(6,644)
Less debt issuance costs and discounts		(1,949)	(2,027)
	$	245,751	251,233

On July 9, 2015, Meritus issued Series 2015 Bonds to (i) refund all of the Maryland Health and Higher Educational Facilities Authority's Revenue Bonds, Washington County Hospital Issue, Series 2008 (Series 2008 Bonds), and (ii) finance and refinance the cost of construction, renovation and equipping of certain additional facilities for Meritus (the 2015 Project). The Series 2015 Bonds were issued in the principal amount of $257,300 plus a premium of $15,100. The Series 2015 Bonds proceeds, together with the outstanding Series 2008 Bonds escrow fund balance totaled $22,000, and Meritus' internal cash of $7,400 were used to pay the cost of issuance, refund Series 2008 Bonds and receive $20,000 of proceeds for capital expenditures. The Series 2015 Bonds are due in annual principal installments through 2045, and bear interest at 3.5% to 5.0% due semiannually in January and July.

The long-term debt related to the Series 2015 Bonds is reflected in the consolidated financial statements including the unamortized bond premium. The original issue bond premiums are being amortized over the life of the debt and are netted against interest expense in the consolidated statements of operations and changes in net assets.

All bonds are collateralized by a first lien and claims on all receipts of Meritus, except restricted donations and contributions. In connection with the Series 2015 Bonds, the bond holders have a security interest in existing facilities of Meritus. All bonds require the Hospital to maintain certain financial ratios and stipulated insurance coverage as defined.

(Dollars in thousands)

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

2021	$	5,481
2022		5,672
2023		5,867
2024		6,085
2025		6,353
Thereafter		221,774
	$	251,232

(8) Leases Commitments

The company determines if an arrangement contains a lease at the inception of the contract. Right-of-use assets and liabilities are recognized at the contract commencement date for the present value of lease payments over the lease term. The company uses our estimated incremental borrowing rate when no implicit rate is noted within the contract. A right-of-use asset and lease liability was not recognized for leases with an initial term of 12 months or less and rent expense for these types of leases are recognized on a straight-line basis over the lease term, or when incurred if a month-to-month lease.

Meritus utilizes operating leases primarily for real estate, including medical facilities and office space. The real estate lease agreements have initial terms of five to twenty years. Some real estate leases include one or more options to renew, the exercise of lease renewal options is at our sole discretion. When determining the lease term, options to extend or terminate the lease were included when it was reasonably certain the Meritus would exercise that option.

The components of the lease cost and rent expense for the year ended June 30, 2020 are as follows:

Lease cost		2020
Operating lease cost:		
Operating lease cost	$	3,715
Short-term lease expense		854
Total operating lease cost	$	4,569

Rent expense under all operating leases was $6,592 for the year ended June 30, 2019.

(Dollars in thousands)

Supplemental balance sheet information related to leases are as follows:

	Balance sheet classification		2020
Operating leases:			
Operating lease ROU assets – current	Prepaid and other current assets	$	2,379
Operating lease ROU assets – noncurrent	Other assets		16,727
Operating lease ROU liabilities – current	Accounts payable and accrued expenses		2,379
Operating lease ROU liabilities – noncurrent	Other long term liabilities		16,727

Supplemental cash flow and other information related to leases as of and for the year ended June 30, 2020 are as follows:

Other information		2020
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases (1)	$	3,142
Weighted average remaining lease term:		
Operating leases		15 years
Weighted average discount rate:		
Operating leases		4.4 %

(1) Included in other assets and accounts payable, accrued expenses and long-term liabilities in the statement of cash flows.

(Continued)

(Dollars in thousands)

Future maturities of lease liabilities as of June 30, 2020 are as follows:

	Operating leases
Year ending June 30:	
2021	$ 2,978
2022	2,171
2023	1,776
2024	1,654
2025	1,663
Thereafter	16,138
Total minimum lease payments	26,380
Impact of present value discount	(7,274)
Present value of minimum lease payments	$ 19,106

Future minimum lease payments for operating leases and capital leases (with initial or remaining lease terms in excess of one year) as of June 30, 2019 are as follows:

	Operating leases	Capital leases
Year ending June 30:		
2020	$ 2,526	1,428
2021	2,401	—
2022	1,723	—
2023	1,345	—
2024	1,295	—
Thereafter	17,382	—
Total minimum lease payments	$ 26,672	1,428
Less amount representing interest		(14)
Present value of minimum lease payments		$ 1,414

(Dollars in thousands)

(9) Income Taxes

Holdings and its subsidiaries file a consolidated federal return and separate state returns. The income tax (expense) benefit for the years ended June 30, consists of:

		2020	2019
Current:			
Federal	$	(154)	(4)
State		10	(25)
		(144)	(29)
Deferred:			
Federal		(144)	(23)
State		(45)	(7)
		(189)	(30)
	$	(333)	(59)

The significant components of the deferred tax assets and deferred tax liabilities, which are included in prepaid and other current assets and other assets at June 30, are as follows:

		2020	2019
Deferred tax asset:			
Accrued vacation	$	112	106
Deferred compensation		938	1,093
Allowance for bad debts		31	43
NOL carryover		987	1,071
Fixed assets		118	97
Other		84	41
		2,270	2,451
Deferred tax liabilities:			
Unrealized gain/loss		(17)	(10)
Captive insurance premiums		(9)	(9)
		(26)	(19)
	$	2,244	2,432

In assessing deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon positive operation trends through 2020, and projections for future taxable income, management believes that it is more likely than not that the Company will realize the benefits of the deductible differences at June 30, 2020 and 2019. Accordingly, the Company has determined that there is no valuation allowance as of June 30, 2020 and 2019. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

As of June 30, 2020 and 2019, the Company has no unrecognized tax benefits. Therefore, the Company does not expect any impact on the effective tax rate related to recognition of unrecognized tax benefits. In addition, there are no anticipated reversals of uncertain tax positions in the next twelve months. The Company's policy is to recognize interest and penalties related to unrecognized tax benefits as a component of income tax expense. As of June 30, 2020 and 2019, the Company has no accrued interest or penalties related to uncertain tax positions.

(10) Post Retirement Benefit Plans

Defined Contribution Plans

Meritus has a 401(k) Savings Plan. The plan is available to all Meritus employees. Meritus matches employee contributions for an amount up to 6% of each employee's base salary, subject to limitations. Amounts charged to expense for the years ended June 30, 2020 and 2019 were $5,931 and $5,675, respectively.

The Hospital has frozen a 403(b) plan. Effective July 1, 2011, the plan was frozen to future contributions.

The Hospital and MEI each maintain an employee funded supplemental nonqualified retirement plan for certain employees. The plan requires the benefits be paid upon termination, retirement or death. The related liability is $6,379 and $6,365 at June 30, 2020 and 2019, respectively. Management has designated investments for the intended purpose of funding the liability when payable.

(11) Insurance Coverage

Meritus has a wholly owned insurance captive, MIC, to provide primary limits of insurance of $1,000 per occurrence/$3,000 aggregate for professional and general liability. In addition, MIC purchased reinsurance from an A rated reinsurer in the amount of $25,000 to cover any potential liabilities above the $1,000/$3,000 primary limits, which were covered by MIC. The self-insured liabilities determined by an actuary for professional and general liability claims are included in other long-term liabilities in the consolidated balance sheets. As of June 30, 2020 and 2019, Meritus recorded a liability of $4,797 and $6,257, respectively.

Consistent with most companies with similar insurance operations, the liability for losses is ultimately based on management's reasonable expectations of future events. It is reasonably possible that the expectations associated with these amounts could change in the near term (i.e., within one year) and that the effect of such changes could be material to the consolidated financial statements.

(Continued)

In 2020 and 2019, the Company participated in a self-insured plan for workers' compensation claims. Stop-loss coverage has been purchased through a commercial carrier for claims in excess of $300 and not to exceed $700. As of June 30, 2020 and 2019, Meritus recorded a liability of $3,600 and $3,300 respectively, which is included in accrued salaries, wages and withholdings in the consolidated balance sheets.

(12) Risk and Uncertainties

The Company provides general acute healthcare services in the State of Maryland. The Company and other healthcare providers are subject to certain inherent risks, including the following:

- Dependence on revenues derived from reimbursement by the federal Medicare and state Medicaid programs
- Regulation of hospital rates by the State of Maryland Health Services Cost Review Commission
- Government regulation, government budgetary constraints and proposed legislative and regulatory changes, and
- Lawsuits alleging malpractice or other claims

Such inherent risks require the use of certain management estimates in the preparation of the Company's consolidated financial statements and it is reasonably possible that a change in such estimates may occur.

The Medicare and state Medicaid reimbursement programs represent a substantial portion of the Company's revenues and the Company's operations are subject to a variety of other federal, state and local regulatory requirements. Failure to maintain required regulatory approvals and licenses and/or changes in such regulatory requirements could have a significant adverse effect on the Company.

Changes in federal and state reimbursement funding mechanisms and related government budgetary constraints could have a significant adverse effect on the Company.

The federal government and many states have aggressively increased enforcement under Medicare and Medicaid anti-fraud and abuse laws and physician self-referral laws (STARK law and regulation). Federal healthcare reform initiatives continue to prompt a national review of federally funded healthcare programs. In addition, the federal government and many states continue to fund programs to audit and recover potential overpayments to providers from the Medicare and Medicaid programs. The Company has devoted resources to implement a compliance program to monitor conformance with applicable laws and regulations, but the possibility of future government review and enforcement action exists. However, any negative findings from a future proceeding, if any, could result in substantial financial penalties or awards against the Company, exclusion from future participation in the Medicare and Medicaid programs and if criminal proceedings were initiated against the Company, possible criminal penalties. At this time, the Company cannot predict the ultimate outcome of any potential inquiries, or the potential range of damages, if any.

As a result of recently enacted and pending federal healthcare reform legislation, substantial changes are anticipated in the United States healthcare system. Such legislation includes numerous provisions affecting the delivery of healthcare services, the financing of healthcare costs, reimbursement to healthcare providers and the legal obligations of health insurers, providers and employers. These provisions are currently slated to take effect at specified times over the next decade. This federal healthcare reform legislation did not affect the 2020 or 2019 consolidated financial statements.

(Dollars in thousands)

Litigation

Additionally, Meritus is involved in litigation and regulatory investigations arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without a material adverse effect on Meritus' financial position or results of operations.

(13) Functional Expenses

Meritus provides general healthcare services to residents within its geographic location. Expenses related to providing these services for the years ended June 30 are as follows:

		Program services	General and administrative	Fundraising	Total
2020:					
Salaries and wages	$	131,312	35,616	—	166,928
Employee benefits		30,258	7,158	—	37,416
Professional fees		13,368	3,153	—	16,521
Supplies and other		110,602	30,473	189	141,264
Interest		8,933	2,270	—	11,203
Depreciation and amortization		21,056	4,951	—	26,007
Total expenses	$	315,529	83,621	189	399,339

		Program services	General and administrative	Fundraising	Total
2019:					
Salaries and wages	$	124,607	35,933	—	160,540
Employee benefits		28,889	7,222	—	36,111
Professional fees		12,723	3,181	—	15,904
Supplies and other		122,974	30,743	191	153,908
Interest		9,159	2,290	—	11,449
Depreciation and amortization		19,980	4,995	—	24,975
Total expenses	$	318,332	84,364	191	402,887

(Dollars in thousands)

(14) Liquidity and Availability of Financial Assets

The following reflects financial assets as of June 30, 2020 and 2019, reduced by amounts not available for general expenditure because of contractual or donor-imposed restrictions within one year.

		2020	2019
Financial assets as of June 30, 2020	$	404,639	327,858
Less those unavailable for general expenditures within on year, due to:			
Contractual and donor-imposed restriction:			
Funds designated for insurance purpose		(17,589)	(16,470)
Assets held by trustee		(10,691)	(10,577)
Supplemental retirement benefits investment		(6,399)	(5,848)
Donor restricted		(1,145)	(1,144)
Financial assets available within one year to meet cash needs for general expenditures within one year	$	368,815	293,809

Included in financial assets available are $187,829 and $183,492 of funds set aside for long-term investments as designated by the Board of Directors as of June 30, 2020 and 2019, respectively.

(15) Covid-19

The CARES Act, which was enacted on March 27, 2020, authorizes $100 billion in funding to hospitals and other healthcare providers to be distributed through the Public Health and Social Services Emergency Fund (the “PHSSEF”). Payments from the PHSSEF are intended to compensate healthcare providers for lost revenues and incremental expenses incurred in response to the COVID-19 pandemic and are not required to be repaid provided the recipients attest to and comply with certain terms and conditions, including limitations on balance billing and not using PHSSEF funds to reimburse expenses or losses that other sources are obligated to reimburse. The U.S. Department of Health and Human Services (the “HHS”) initially distributed $30 billion of this funding based on each provider’s share of total Medicare fee-for-service reimbursement in 2019, but announced that $50 billion in CARES Act funding (including the $30 billion already distributed) will be allocated proportional to providers’ share of 2018 net patient revenue. HHS indicated that distributions of the remaining $50 billion were targeted primarily to hospitals in COVID-19 high impact areas, to rural providers, and to reimburse providers for COVID-19-related treatment of uninsured patients. Meritus received approximately $9,956 in payments from the initial PHSSEF payments of which $9,956 were recognized as revenue for the year ended June 30, 2020.

As a way to increase cash flow to Medicare providers impacted by the COVID-19 pandemic, the CARES Act expanded the Medicare Accelerated and Advance Payment Program. Inpatient acute care hospitals may request accelerated payments of up to 100% of the Medicare payment amount for a six-month period (not including Medicare Advantage payments), although CMS is now reevaluating pending and new applications in light of direct payments made available through PHSSEF. CMS based payment amounts for inpatient acute care hospitals on the provider's Medicare fee-for-service reimbursements in the last six months of 2019. Such accelerated payments are interest free for inpatient acute care hospitals for 12 months, and the program currently requires CMS to recoup the payments beginning 120 days after receipt by the provider, by withholding future Medicare fee-for-service payments for claims until the full accelerated payment has been recouped. The program currently requires any outstanding balance remaining after 12 months to be repaid by the provider or be subject to an interest rate currently set at 10.25%. The payments are made for services a healthcare entity has provided or will provide to its Medicare patients who are the healthcare entity's customers. Therefore, they are accounted for under Topic 606 as revenue. In April 2020, Meritus received approximately $66,070 of accelerated payments, which have been accrued on the consolidated balance sheet as of June 30, 2020 as a contract liability and is included in advances from third-party payors, in accordance with ASC 606. This contract liability will be reduced over time as revenue is recognized for claims submitted for services provided after the 120-day period.

Meritus received loan proceeds in the amount of $991 under the Paycheck Protection Program established as part of the CARES Act. As of June 30, 2020, Meritus had reasonable assurance that the conditions of loan forgiveness were met, therefore applying government grant accounting and the loan proceeds were recognized as a reduction in salary expense.

Lastly, the Washington County Health Department granted Meritus $6,000 in CARES Act public health response funding. As of June 30, 2020, the Company had $3,625 in qualified grant expenditures, of which $2,184 was recorded within other operating revenue and $1,441 recorded as a change in net assets in the accompanying statement of operations and changes in net assets.

Due to the recent enactment of the CARES Act and the PPPHCE Act, there is still a high degree of uncertainty surrounding their implementation, and the public health emergency continues to evolve. We continue to assess the potential impact of the CARES Act, the PPPHCE Act, the potential impact of future stimulus measures, if any, and the impact of other laws, regulations, and guidance related to COVID-19 on our business, results of operations, financial condition and cash flows.

(16) Subsequent Events

Meritus evaluated subsequent events through October 2, 2020, the date these consolidated financial statements were available to be issued. All material matters are disclosed in the notes to the consolidated financial statements.

SUPPLEMENTARY INFORMATION

Schedule 1

MERITUS MEDICAL CENTER, INC.

Consolidating Balance Sheet

June 30, 2020

(Dollars in thousands)

Assets	Meritus Medical Center	Meritus Healthcare Foundation	Meritus other	Consolidating total	Consolidating entries	Consolidated total
Current assets:						
Cash and cash equivalents	$ 11,998	—	3,563	15,561	—	15,561
Short-term investments	126,524	—	—	126,524	—	126,524
Current portion of assets whose use is limited	10,691	—	—	10,691	—	10,691
Accounts receivable	27,976	—	3,668	31,644	—	31,644
Supplies	5,493	—	854	6,347	—	6,347
Prepaid and other current assets	56,908	171	2,874	59,953	(49,475)	10,478
Total current assets	239,590	171	10,959	250,720	(49,475)	201,245
Assets limited as to use	185,116	6,845	21,001	212,962	—	212,962
Property, plant and equipment, net	230,883	—	4,255	235,138	—	235,138
Equity investments in affiliates	39,659	—	3,669	43,328	(3,124)	40,204
Other assets	21,451	125	5,047	26,623	(2,738)	23,885
Total assets	$ 716,699	7,141	44,931	768,771	(55,337)	713,434

(Continued)

Schedule 1

MERITUS MEDICAL CENTER, INC.

Consolidating Balance Sheet

June 30, 2020

(Dollars in thousands)

Liabilities and Net Assets	**Meritus Medical Center**	**Meritus Healthcare Foundation**	**Meritus other**	**Consolidating total**	**Consolidating entries**	**Consolidated total**
Current liabilities:						
Accounts payable and accrued expenses	$ 17,316	66	44,891	62,273	(36,218)	26,055
Accrued salaries, wages and withholdings	13,239	—	1,515	14,754	—	14,754
Accrued compensation benefit	10,748	11	3,069	13,828	—	13,828
Advances from third party payors	75,552	—	4,184	79,736	—	79,736
Accrued interest payable	5,808	—	—	5,808	—	5,808
Current maturity of long-term debt	5,434	—	47	5,481	—	5,481
Total current liabilities	128,097	77	53,706	181,880	(36,218)	145,662
Long term debt, net of current portion	245,686	—	65	245,751	—	245,751
Accrued retirement benefits	2,972	—	3,407	6,379	—	6,379
Other long term liabilities	14,639	—	20,148	34,787	(13,257)	21,530
Total liabilities	391,394	77	77,326	468,797	(49,475)	419,322
Stockholder's equity:						
Common stock	—	—	820	820	(820)	—
Paid-in capital	—	—	1,150	1,150	(1,150)	—
Total stockholders' equity	—	—	1,970	1,970	(1,970)	—
Net assets:						
Unrestricted	321,390	2,506	(34,365)	289,531	(1,154)	288,377
Restricted net assets	3,915	4,558	—	8,473	(2,738)	5,735
Total net assets	325,305	7,064	(34,365)	298,004	(3,892)	294,112
Total liabilities and net assets	$ 716,699	7,141	44,931	768,771	(55,337)	713,434

See accompanying independent auditors' report.

Schedule 2

MERITUS MEDICAL CENTER, INC.

Consolidating Statement of Operations and Change in Net Assets

Year ended June 30, 2020

(Dollars in thousands)

Fiscal period ending June 30, 2020		Meritus Medical Center	Meritus Healthcare Foundation	Meritus other	Consolidating total	Consolidating entries	Consolidated total
Unrestricted revenue, gains and other support:							
Net patient revenue	$	314,201	—	66,189	380,390	(12,419)	367,971
Other revenue		23,018	260	2,049	25,327	(3,496)	21,831
Equity earnings in affiliates		3,517	—	931	4,448	—	4,448
Net assets released from restriction used for operations		1,051	712	—	1,763	(630)	1,133
		341,787	972	69,169	411,928	(16,545)	395,383
Operating expenses:							
Salaries and wages		129,925	297	36,706	166,928	—	166,928
Benefits		30,676	81	6,936	37,693	(277)	37,416
Professional fees		16,170	—	351	16,521	—	16,521
Supplies and other		113,760	132	42,760	156,652	(15,388)	141,264
Interest		11,197	—	6	11,203	—	11,203
Depreciation and amortization		24,664	—	1,343	26,007	—	26,007
		326,392	510	88,102	415,004	(15,665)	399,339
Operating income (loss)		15,395	462	(18,933)	(3,076)	(880)	(3,956)
Nonoperating gains (losses), net:							
Investment returns, net		3,385	117	1,375	4,877	—	4,877
Other, net		(64)	(892)	1	(955)	880	(75)
Income tax expense		(46)	—	(287)	(333)	—	(333)
Excess (deficit) of revenue over expenses	$	18,670	(313)	(17,844)	513	—	513

(Continued)

Schedule 2

MERITUS MEDICAL CENTER, INC.

Consolidating Statement of Operations and Change in Net Assets

Year ended June 30, 2020

(Dollars in thousands)

Fiscal period ending June 30, 2020		Meritus Medical Center	Meritus Healthcare Foundation	Meritus other	Consolidating total	Consolidating entries	Consolidated total
Unrestricted net assets:							
Excess (deficit) of revenues over expenses	$	18,670	(313)	(17,844)	513	—	513
Other		1,178	(253)	(219)	706	(1)	705
Increase (decrease) in unrestricted net assets		19,848	(566)	(18,063)	1,219	(1)	1,218
Restricted net assets:							
Contributions		790	529	—	1,319	(630)	689
Other		(1,845)	158	—	(1,687)	1,845	158
Net assets released to restriction for operations		(1,051)	(712)	—	(1,763)	630	(1,133)
(Decrease) increase restricted net assets		(2,106)	(25)	—	(2,131)	1,845	(286)
Increase (decrease) in net assets		17,742	(591)	(18,063)	(912)	1,844	932
Net assets:							
Beginning of year		307,563	7,655	(14,332)	300,886	(7,706)	293,180
End of year	$	325,305	7,064	(32,395)	299,974	(5,862)	294,112

See accompanying independent auditors' report.