

The Union Hospital of Cecil County, Inc.

Financial Statements

**Period from January 1, 2020 through June 30, 2020
(Successor) and Period from July 1, 2019 through
December 31, 2019 and for the year ended June 30,
2019 (Predecessor)**

The Union Hospital of Cecil County, Inc.

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Report of Independent Auditors

To the Management of
The Union Hospital of Cecil County, Inc.

We have audited the accompanying financial statements of The Union Hospital of Cecil County, Inc. (the "Hospital") (Predecessor), which comprise the statements of operations, changes in net assets, and cash flows for the period from July 1, 2019 through December 31, 2019.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit 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 financial statements are free from material misstatement.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Union Hospital of Cecil County, Inc. (Predecessor) as of June 30, 2019 and the results of its operations and its cash flows for the period from July 1, 2019 through December 31, 2019 in accordance with accounting principles generally accepted in the United States of America.



Other Matter

The financial statements of The Union Hospital of Cecil County, Inc. as of June 30, 2019 and for the year then ended were audited by other auditors whose report, dated October 25, 2019, expressed an unmodified opinion on those statements.

PricewaterhouseCoopers LLP

Baltimore, Maryland
October 16, 2020



Report of Independent Auditors

To the Management of
The Union Hospital of Cecil County, Inc.

We have audited the accompanying financial statements of The Union Hospital of Cecil County, Inc. (the "Hospital") (Successor), which comprise the balance sheet as of June 30, 2020 and the related statements of operations, changes in net assets, and cash flows for the period from January 1, 2020 through June 30, 2020.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit 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 financial statements are free from material misstatement.

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



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Union Hospital of Cecil County, Inc. (Successor) as of June 30, 2020 and the results of its operations and its cash flows for the period from January 1, 2020 through June 30, 2020 in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

Baltimore, Maryland
October 16, 2020

The Union Hospital of Cecil County, Inc.
Balance Sheets

	<u>Successor</u> <u>June 30, 2020</u>	<u>Predecessor</u> <u>June 30, 2019</u>
Assets		
Current assets		
Cash and cash equivalents	\$ 37,308,503	\$ 6,198,168
Short-term investments	34,629,418	37,137,168
Accounts receivable, patients	13,455,601	13,863,566
Other receivables	722,193	206,146
Inventories of supplies	2,523,066	2,307,404
Prepaid expenses	3,244,897	2,940,202
Total current assets	<u>91,883,678</u>	<u>62,652,654</u>
Long-term Investments	3,829,768	3,840,647
Property and equipment, net	50,230,601	82,932,993
Due from affiliates	330,510	324,527
Other assets	9,136,009	9,027,240
Interest in net assets of affiliate	5,243,103	5,147,489
Total assets	<u>\$ 160,653,669</u>	<u>\$ 163,925,550</u>
Liabilities and Net Assets		
Current liabilities		
Current portion of long-term debt	\$ 2,290,577	\$ 2,609,452
Current portion of finance leases	749,669	881,128
Accounts payable and accrued expenses	6,202,032	5,662,200
Accrued salaries and benefits	5,357,123	4,712,969
Third-party advances	31,554,344	3,485,157
Total current liabilities	<u>46,153,745</u>	<u>17,350,906</u>
Due to affiliates	461,343	419,040
Long-term debt, net of current portion	51,337,640	53,570,536
Finance leases, net of current portion	635,273	1,392,113
Other long term liabilities	9,888,880	8,853,756
Total liabilities	<u>108,476,881</u>	<u>81,586,351</u>
Net assets		
Net assets without donor restrictions	49,027,095	79,490,139
Net assets with donor restrictions	3,149,693	2,849,060
Total net assets	<u>52,176,788</u>	<u>82,339,199</u>
Total liabilities and net assets	<u>\$ 160,653,669</u>	<u>\$ 163,925,550</u>

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

The Union Hospital of Cecil County, Inc.

Statements of Operations

	Successor		Predecessor	
	Period from January 1, 2020 through June 30, 2020		Period from July 1, 2019 through December 31, 2019	Year Ended June 30, 2019
Revenues, gains, and other support				
Net patient service revenues	\$ 72,735,716		\$ 77,129,027	\$ 153,762,303
Other operating revenues	5,021,155		1,303,208	2,724,951
Net assets released from restrictions for use in operations	99,935		77,799	149,168
Total revenues, gains, and other support	<u>77,856,806</u>		<u>78,510,034</u>	<u>156,636,422</u>
Expenses				
Salaries and employee benefits	41,491,859		42,849,506	87,612,068
Supplies and other expenses	15,360,031		15,291,412	31,537,094
Purchased services and professional fees	17,860,774		16,166,811	30,330,026
Depreciation and amortization	4,053,845		4,974,733	11,026,334
Interest	945,120		953,716	1,942,655
Total expenses	<u>79,711,629</u>		<u>80,236,178</u>	<u>162,448,177</u>
Total operating loss	<u>(1,854,823)</u>		<u>(1,726,144)</u>	<u>(5,811,755)</u>
Nonoperating income				
Investment income	1,131,975		1,387,763	1,296,224
Other income	13,783		26,245	42,622
Total nonoperating income	<u>1,145,758</u>		<u>1,414,008</u>	<u>1,338,846</u>
Revenues less than expenses	<u>(709,065)</u>		<u>(312,136)</u>	<u>(4,472,909)</u>
Change in interest in net assets of affiliate	(273,647)		68,630	(152,510)
Net transfers from affiliates	(2,975,732)		-	9,393,938
Net assets released from restriction used for purchase of property and equipment	336,438		4,275	164,059
Increase (decrease) in net assets without donor restrictions	<u>\$ (3,622,006)</u>		<u>\$ (239,231)</u>	<u>\$ 4,932,578</u>

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

The Union Hospital of Cecil County, Inc.

Statements of Changes in Net Assets

	Successor	Predecessor	
	Period from January 1, 2020 through June 30, 2020	Period from July 1, 2019 through December 31, 2019	Year Ended June 30, 2019
Net assets without donor restrictions			
Revenues less than expenses	\$ (709,065)	\$ (312,136)	\$ (4,472,909)
Change in interest in net assets of affiliate	(273,647)	68,630	(152,513)
Net transfer from affiliates	(2,975,732)	-	9,393,938
Net assets released from restriction used for purchase of property and equipment	336,438	4,275	164,059
Increase (decrease) in net assets without donor restrictions	<u>(3,622,006)</u>	<u>(239,231)</u>	<u>4,932,575</u>
Net assets with donor restrictions			
Change in interest in net assets of affiliate	86,008	214,624	301,898
Increase in net assets with donor restrictions	<u>86,008</u>	<u>214,624</u>	<u>301,898</u>
Increase (decrease) in net assets	(3,535,998)	(24,607)	5,234,473
Net assets at beginning	<u>55,712,786</u>	<u>82,339,196</u>	<u>77,104,723</u>
Net assets at ending	<u>\$ 52,176,788</u>	<u>\$ 82,314,589</u>	<u>\$ 82,339,196</u>

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

The Union Hospital of Cecil County, Inc.

Statements of Cash Flows

	Successor		Predecessor	
	Period from January 1, 2020 through June 30, 2020		Period from July 1, 2019 through December 31, 2019	Year Ended June 30, 2019
Cash flows from operating activities				
Increase (decrease) in net assets	\$ (3,535,998)		\$ (24,607)	\$ 5,234,476
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities				
Depreciation and amortization	4,053,845		4,974,733	11,026,334
Gain/Loss on disposal of property plant and equipment	144		(5,900)	1,315
Amortization of deferred financing costs	33,292		33,292	66,584
Net transfers to affiliates for property, plant, and equipment	1,422,237		-	-
Change in beneficial interest in net assets of The Union Hospital of Cecil County Foundation, Inc.	187,639		(283,254)	(149,388)
Net realized and unrealized gains and losses on investments	(843,325)		(528,019)	371,072
Changes in assets and liabilities				
Accounts receivable, patients	3,457,224		(3,049,259)	1,036,735
Other receivables, inventories of supplies, and prepaid expenses	(468,133)		(568,271)	667,656
Due to/from affiliates	767,981		(731,661)	530,868
Other assets, net	(52,519)		(56,250)	(1,127,373)
Accounts payable and accrued expenses	(297,632)		445,455	(4,639,008)
Accrued salaries and benefits	434,956		209,198	233,056
Third-party advances	28,388,011		(318,824)	(479,063)
Other LT Liabilities	1,035,123		1	668,081
Net cash provided by operating activities	<u>34,582,845</u>		<u>96,634</u>	<u>13,441,345</u>
Cash flows from investing activities				
Purchases of property and equipment	(2,497,235)		(1,463,402)	(5,350,168)
Proceeds from sale of investments and assets limited as to use	5,213,365		5,576,761	9,594,964
Purchase of investments and assets limited as to use	(5,458,347)		(1,433,631)	(11,238,814)
Net cash used in investing activities	<u>(2,742,217)</u>		<u>2,679,728</u>	<u>(6,994,018)</u>
Cash flows from financing activities				
Repayment of long-term debt	(1,282,519)		(1,335,837)	(2,616,442)
Repayment of finance leases	(419,479)		(468,820)	(802,728)
Net cash provided by (used in) financing activities	<u>(1,701,998)</u>		<u>(1,804,657)</u>	<u>(3,419,170)</u>
Net increase (decrease) in cash and cash equivalents	30,138,630		971,705	3,028,157
Cash and cash equivalents				
Beginning	7,169,873		6,198,168	3,170,011
Ending	<u>\$ 37,308,503</u>		<u>\$ 7,169,873</u>	<u>\$ 6,198,168</u>
Supplemental disclosure of cash flow information				
Cash paid for interest	\$ 873,035		\$ 892,856	\$ 1,767,140
Supplemental disclosure of noncash investing and financing activities				
Payable for property and equipment	336,525		55,484	189,634
Capital lease obligation incurred for equipment	-		-	282,544

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

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

1. Organizational Structure and Nature of Operations

The Union Hospital of Cecil County, Inc. (the "Hospital") is a Maryland not-for-profit corporation and is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code ("IRC"). The Hospital operates a general community hospital in Elkton, Maryland, which serves residents from Cecil County and the surrounding area.

The Hospital is an affiliate of Affinity Health Alliance, Inc. ("Affinity"). Affinity is a nonstock, not-for-profit corporation. Affinity is the parent organization of other related healthcare organizations, one of which is a for-profit corporation.

In June 2019, the board of directors approved the signing of a letter of intent for Affinity to enter into a nonbinding agreement to become a member of Christiana Care Health System (the "System"). The purchase was closed on January 1, 2020. Affinity is now an affiliate of the System which is the parent organization of Affinity, Health Services, Christiana Care Health Initiatives ("Health Initiatives"), Christiana Care Home Health and Community Services, Inc. ("CCHHCS") and Christiana Care Health Plans, Inc. ("Health Plans").

2. Summary of Significant Accounting Policies

Basis of Presentation

The Hospital's financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 4, amounts for the period July 1, 2019, through December 31, 2019, and for the year ended June 30, 2019, presented as "Predecessor" within the financial statements and notes to financial statements represent the historical operations of the Hospital prior to the acquisition and the related application of pushdown accounting. The amounts as of June 30, 2020 and for the period from January 1, 2020, through June 30, 2020, presented as "Successor", include the effects of pushdown accounting and have been separated by a black line in our financial statements to highlight the lack of comparability between the periods.

Application of Pushdown Accounting

Pushdown accounting means establishing a new basis for the assets and liabilities of an acquired company based on a "pushdown" of the acquirer's stepped-up basis to the acquired company in connection with a change-in-control event. The application of pushdown accounting was elected in the reporting period in which the change-in-control event occurred, specifically the period from January 1, 2020 through June 30, 2020. The decision to apply pushdown accounting is irrevocable. The election of pushdown accounting required the Hospital to record the new basis of accounting established by the acquirer, the System, for the individual assets and liabilities of the Hospital.

Use of Estimates

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

Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less at date of purchase, excluding investments and assets held in trust.

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

Patient Accounts Receivable

The Hospital assesses collectability on patient contracts prior to the recognition of net patient service revenues. Patient accounts receivable are reported at their net realizable value. Accounts are written off through bad debt expense when the Hospital has exhausted all collection efforts and determines accounts are impaired based on changes in patient credit worthiness. Patient accounts receivable also includes management's estimate of the impact of certain undercharges to be recouped or overcharges to be paid back for inpatient and outpatient services in subsequent years rates.

Other Receivables

Other receivables are reported at net realizable value. Accounts are written off when they are determined to be uncollectible based upon management's assessment of individual accounts. No allowance for doubtful accounts was recorded because management believes realization losses on other receivables will be immaterial.

Inventories of Supplies

Inventories, which consist primarily of medical supplies and drugs, are recorded at the lower of cost (using the weighted average method) or net realizable value.

Investments and Investment Risk

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value. Mutual funds are valued at quoted market prices, which represent the net asset value of shares held. Cash and cash equivalents are carried at cost which approximates fair value. Managed hedge funds represent ownership in limited partnerships that invest in hedge funds, limited partnerships and private equity capital funds. Managed hedge funds are valued based on the current market values of the underlying assets reported by the investment advisor using audited financial statements of the funds at year end using net asset value of shares held. Investment income or loss (including realized gains and losses on investments, interest and dividends and unrealized gains and losses on investments) is included in the determination of revenues less expenses unless the income or loss is restricted by donor or law.

The Hospital's investments are comprised of a variety of financial instruments and are managed by investment advisors. The fair values reported in the balance sheets are subject to various risks including changes in the equity markets, the interest rate environment, and general economic conditions. Due to the level of risk associated with certain investment securities and the level of uncertainties related to changes in the fair value of investment securities, it is reasonably possible that the amounts reported in the accompanying financial statements could change materially in the near term.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is computed using the straight-line method based on estimated useful lives.

Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the improvements and equipment. Such amortization is included in depreciation and amortization in the financial statements.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. 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 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 Union Hospital of Cecil County, Inc.

Notes to Financial Statements

Interest in Net Assets of Affiliate

Generally accepted accounting principles establish standards for transactions in which a donor makes a contribution by transferring assets to a not-for-profit recipient organization that agrees to use those assets on behalf of or transfer them to a beneficiary entity. Under certain circumstances, a beneficiary organization is required to recognize its rights to assets held by a recipient organization as an asset on the balance sheets, and changes in value of that asset as a change in net assets in the period of change. The Hospital is the beneficiary of the net assets of an unconsolidated affiliate, The Union Hospital of Cecil County Foundation, Inc. (the "Foundation"). The Hospital's interest in the net assets of the Foundation as at June 30, 2020 and June 30, 2019 was \$5,243,103 and \$5,147,489, respectively.

Net Assets

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

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

Net assets with donor restrictions includes amounts subjected to donor-imposed restrictions which are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. All revenues restricted by donors as to either timing or purpose of the related expenditures or required to be maintained in perpetuity as a source of investment income are accounted for in net assets with donor restrictions. When a donor restriction expires, that is when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions.

Unconditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as net assets with donor restrictions if they are received with donor stipulations that limit the use of the donated assets.

Deferred Financing Costs

The Hospital accounts for deferred financing costs in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2015-03, *Interest-Imputations of Interest: Simplifying the Presentation of Debt Issuance Costs*.

Costs incurred in connection with the issuance of long-term debt have been deferred and are being amortized over the terms of the related debt using the straight-line method, which approximates the effective interest method. Amortization expense was \$33,292 for the period January 1, 2020 through June 30, 2020 (Successor) and \$33,292 for the period July 1, 2019 through December 31, 2019 and \$66,584 for the year ended June 30, 2019 (Predecessor).

Estimated Malpractice Claims Liability

The provision for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported, including costs associated with litigating or settling claims. Anticipated insurance recoveries associated with reported claims are reported separately in the Hospital's balance sheets at net realizable value.

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

Measure of Operations

The Hospital's statements of operations reflect all changes in net assets without donor restrictions, including changes from both operating and nonoperating activities. Operating revenues and expenses consist of those items that are in integral part of the Hospital's provision of healthcare and related supporting activities. Nonoperating activities are limited to resources that generate return from investments and other activities considered to be of a more unusual or nonrecurring nature.

Revenues Less Than Expenses

The statements of operations include the determination of revenues less than expenses. Changes in net assets without donor restrictions which are excluded from the determination of revenues less than expenses, consistent with industry practice, include permanent transfers of assets to and from subsidiaries for other than goods and services, changes in net assets without donor restrictions of affiliate and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purpose of acquiring such long-lived assets).

Net Patient Service Revenues

Certain hospital charges are subject to review and approval by the Maryland Health Services Cost Review Commission ("HSCRC"). The HSCRC has jurisdiction over hospital reimbursement in Maryland by agreement with the Centers for Medicare and Medicaid Services ("CMS"). This agreement is based on a waiver from the Medicare Prospective Payment System reimbursement principles granted under Section 1814 (b) of the Social Security Act. Management has filed the required forms with the Commission and believes all entities that fall under the HSCRC's jurisdiction are in compliance with applicable requirements.

As a result of the waiver, the HSCRC introduced revenue arrangements, including the Global Budget Revenue ("GBR") model. The GBR methodology encourages hospitals to focus on population health strategies by establishing a fixed annual revenue cap for each GBR hospital. The agreement establishes a fixed amount of charging authority (i.e. revenue) at the beginning of the rate year. It is evergreen in nature and covers both regulated inpatient and outpatient revenues. Annual revenue is calculated from a base year and is adjusted annually for inflation, infrastructure requirements, population changes, performance in quality-based programs and changes in levels of uncompensated care. Revenue may also be adjusted annually for market levels and shifts of services from one health system to another and from a regulated setting to an unregulated setting (or vice versa).

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

Performance obligations are determined based on the nature of the services provided by the Hospital. Revenues for performance obligations satisfied over time are recognized based on actual charges incurred in relation to total expected (or actual) charges. The Hospital believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the Hospital receiving services over multiple days. The Hospital 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 are generally recognized when goods or services are provided, and the Hospital does not believe it is required to provide

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

additional services to the patient. Generally, performance obligations satisfied at a point in time relate to patients receiving outpatient services in a single day. The Hospital measures the performance obligation from the commencement of the outpatient service, to the point when it is no longer required to provide services to that patient, which is generally the completion of the outpatient service.

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

The Hospital determines the transaction price based on standard charges for services provided, reduced by contractual adjustments provided to third party payors, financial assistance provided to uninsured or underinsured patients in accordance with the Hospital's policies, and/or implicit price concessions provided to uninsured or underinsured patients. The Hospital determines its estimates of contractual adjustments based on contractual agreements, its financial assistance policies, and historical experience. The Hospital determines its estimates of implicit price concessions based on its historical collection experience with a respective class of patient. Certain amounts categorized as implicit price concessions under ASC 606 were previously categorized as provision for doubtful accounts. The Hospital pursues collection of amounts defined as implicit price concessions.

The Hospital has elected the practical expedient allowed under FASB ASC 606-10-32-18 and does not adjust the promised amount of consideration from patients and third party payors for the effects of a significant financing component due to the Hospital's expectation that the period between the time the service is provided to a patient and the time that the patient or a third party payor pays for that service will be one year or less.

Uncompensated Care

The Hospital provides care to patients who meet certain criteria under its uncompensated care programs; the services are offered and/or provided at a reduced cost based on demonstrated inability to pay or at amounts less than its established rates. Records are maintained to estimate the level of patient service revenue forgone. Uncompensated care includes charity care. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as a component of net patient service revenues or patient accounts receivable.

The amount of uncompensated care, based on estimated direct and indirect costs incurred, provided during period January 1, 2020 to June 30, 2020 (Successor) and period July 1, 2019 through December 31, 2019 and the year ended June 30, 2019 (Predecessor) was approximately \$551,993 and \$880,736 and \$1,836,442, respectively.

Income Taxes

The Hospital is a not-for-profit corporation as described in Section 501 (c)(3) of the IRC and is exempt from federal income taxes on their exempt income under Section 501 (a) of the IRC.

The Hospital accounts for uncertainty in income taxes by prescribing a recognition threshold of more-likely-than-not to be sustained upon examination by the appropriate taxing authority. Measurement of the tax uncertainty occurs if the recognition threshold has been met. There were no tax uncertainties that met the recognition threshold for the period January 1, 2020 through

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2020 (Successor) and period July 1, 2019 through December 31, 2019 and the year ended June 30, 2019 (Predecessor).

The Hospital's policy is to recognize interest related to unrecognized tax benefits in interest expense and penalties in operating expenses.

New Accounting Standards

Financial Instruments

In 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)*. ASU No. 2016-01 was issued to enhance the reporting model for financial instruments in financial statements. The provisions of ASU No. 2016-01 requires marketable equity securities to be reported at fair value with changes in fair value recognized within the performance indicator, establishes a qualitative factor in evaluating impairment on equity investments without readily determinable fair values, and eliminates the requirement to disclose the fair value on financial instruments measured at amortized cost. The Hospital prospectively adopted the guidance in ASU No. 2016-01 in the current year. There was no resulting financial impact to our statements.

Lease Accounting

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. ASU No. 2016-02 was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Under the provisions of ASU No. 2016-02, a lessee is required to recognize a right-to-use asset and lease liability, initially measured at the present value of the lease payments, in the balance sheet. In addition, lessees are required to provide qualitative and quantitative disclosures that enable users to understand more about the nature of the Hospital's leasing activities. The Hospital will be required to retrospectively adopt the guidance in ASU No. 2016-02 in the year ending June 30, 2021. The Hospital is currently assessing the impact ASU No. 2016-02 will have on its financial statements.

Statement of Cash Flows

During August 2016, the FASB issued ASU No. 2016-15, *Classification of Certain Cash Receipts and Cash Payments*. ASU No. 2016-15 addresses eight cash flow issues with specific guidance on how certain cash receipts and cash payments should be presented on the statement of cash flows. Effective July 1, 2019, the Hospital adopted ASU 2016-15 retrospectively. We have not made any changes to the presentation of its Statements of Cash Flows as a result of adopting the new standard.

Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

3. CARES Act

In December 2019, a novel strain of coronavirus (now referred to as COVID-19) surfaced in Wuhan, China, and rapidly spread around the world, resulting in significant business and social disruption along with the loss of thousands of lives. The coronavirus was declared a "Public Health Emergency of International Concern" by the World Health Organization (WHO) on January 30, 2020, which is a designation reserved for extraordinary events (this is the 6th time in history that this type of event has been declared). By mid-March, the WHO characterized the outbreak as a "pandemic".

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In the United States, the coronavirus outbreak began in late January 2020 in Washington state, and on March 13, 2020, President Donald Trump declared a national emergency. By March 17, 2020, the coronavirus was present in all 50 states. On March 27, 2020, President Trump signed a \$2 trillion stimulus bill, known as the CARES (Coronavirus Aid, Relief, and Economic Security) Act, which provided financial aid to hospitals, among many other provisions.

Provider Relief Funds

The CARES Act provided additional waivers, reimbursement, grants and other funds to assist health care providers during the COVID-19 pandemic, including \$100 billion in appropriations for the Public Health and Social Services Emergency Fund, also referred to as the Provider Relief Fund, to be used for preventing, preparing, and responding to the coronavirus, and for reimbursing eligible health care providers for lost revenues and health care related expenses that are attributable to COVID-19. These health care related expenses could include costs associated with constructing temporary structures or emergency operation centers, retrofitting facilities, purchasing medical supplies and equipment including personal protective equipment and testing supplies, and increasing workforce and trainings.

As part of the CARES Act, the Hospital received \$4,165,621 in provider relief funding during fiscal year 2020. The Hospital accounted for the relief funding under the contribution model of accounting in ASC 958 Not-for-Profit Entities. Thus, the Hospital recognized revenue when both the conditions and restrictions associated with the relief funding were met. Other operating revenue was recognized as the System incurred a loss of revenues or health care related expenses attributable to COVID-19.

In September 2020, the U.S. Department of Health and Human Services (HHS) issued new reporting requirements for the CARES Act provider relief funding. The new requirements first require the Hospital to identify healthcare related expenses attributable to COVID-19 that another source has not reimbursed. If those expenses do not exceed the funding received, the Hospital will need to demonstrate that the remaining provider relief funds were used for a negative change in calendar year 2020 patient care operating income compared to calendar year 2019. These new reporting requirements are considered a nonrecognized subsequent event under ASC 855. HHS is entitled to recoup amounts in excess of the negative change in patient care operating income reported net of healthcare related expenses attributable to COVID-19. Due to these new reporting requirements, it is reasonably possible that amounts recorded under CARES Act provider relief fund by the Hospital may change in future periods.

Medicare Accelerated and Advance Payments Program

In accordance with the CARES Act, CMS temporarily expanded its current Accelerated and Advance Payment Program for Medicare providers. Under this program, qualified healthcare providers could receive advanced or accelerated payments from CMS. The Hospital received \$26,759,965 of advanced payments under this program. These payments were received in April 2020. Amounts received under the Accelerated and Advance Payment Program are reflected in advances from third party payers on the consolidated balance sheet.

Repayment of amounts received under the Accelerated and Advance Payment Program are due 210 days after the advanced payment was issued. Failure to repay the advanced payments when due results in interest charges on the outstanding balance owed. CMS has the ability to recoup the advanced payments through future Medicare claims billed by the Hospital, beginning 121 days after the advanced payment was issued. At this time, CMS has not started the recoupment process for the Hospital.

Employer Payroll Tax Deferral

In April 2020, the Hospital began deferring payment on its share of payroll taxes owed, as allowed by the CARES Act through December 31, 2020. The Hospital is able to defer half of its share of

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payroll taxes owed until December 31, 2021, with the remaining half due on December 31, 2022. As of June 30, 2020, the Hospital deferred \$906,591 of payroll taxes. These amounts are reflected in other liabilities on the consolidated balance sheet

4. Business Combination

On January 1, 2020, the Hospital was acquired by the System. No consideration was given for this transaction. The Hospital adjusted the balances of certain assets and liabilities as of January 1, 2020 to reflect the basis that the System has in those assets and liabilities (i.e., application of “pushdown” accounting).

The restated values of the hospital’s assets and liabilities have been determined using various fair value techniques including independent appraisals for land, buildings and equipment. The resulting decreases in the Hospital’s assets were recognized consistent with business combination accounting rules. This resulted in the pushdown of \$26,601,803, accounted for as an adjustment to the beginning balance of unrestricted net assets of the Successor entity.

The table below summarizes the effect of this revaluation on the financial statements at the date of acquisition:

Property and equipment	\$ (26,601,803)
Change in total assets	<u>\$ (26,601,803)</u>
Change in total liabilities	\$ -
Change in unrestricted net assets	<u>(26,601,803)</u>
Change in liabilities and net assets	<u>\$ (26,601,803)</u>

5. Regulatory Environment

In 1983, Congress approved a Medicare prospective payment plan for most inpatient services as part of the Social Security Amendment Act of 1983. Hospitals in Maryland are currently exempt from these federal reimbursement regulations under a special waiver. The waiver currently in effect is subject to renewal based upon criteria defined in the federal law. Under these payment arrangements with Medicare, a retroactive adjustment could occur if certain performance standards are not attained by all hospitals on a statewide basis. The impact, if any, of any retroactive adjustment of the Medicare prospective payment system, should hospitals in Maryland become subject to such system, on future operations of the Hospital has not been determined.

The Hospital’s rate structure is subject to review and approval by the Maryland Health Services Cost Review Commission. During 2011, the Hospital adopted the Total Patient Revenue Reimbursement System (“TPR”). The Hospital’s patient revenue is 100 percent fixed regardless of increases and decreases in volumes and changes in case mix. This TPR system is typically in effect for three-year periods. The previous agreement was amended effective July 1, 2016 through June 30, 2019, to bring all existing TPR agreements into the new global budget revenue (GBR) format. The GBR agreement was renewed July 1, 2019 through June 30, 2022. There are no material modifications to the current agreement.

6. Net Patient Service Revenues

The Hospital routinely obtains assignments of (or is otherwise entitled to receive) patient benefits receivable under their health insurance programs, plans or policies (i.e. third party payors). Third

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party payors include both government payors, which include Medicare, Medicaid, and Management Care Organizations, and commercial insurance carriers. 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 Hospital also provides services to uninsured patients, and offers those uninsured or underinsured patients financial assistance, by either policy or law, from standard charges. The Hospital estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charges by any contractual adjustment, financial assistance, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustment to net patient service revenues in the period of the change. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

Consistent with the Hospital's mission, care is provided to patients regardless of their ability to pay. Therefore, the Hospital has determined it has provided implicit price concessions to uninsured patients and other patient balances (for example, copays and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts the Hospital expects to collect based on its collection history with those patients.

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

Net patient service revenues disaggregated by service type for the period January 1, 2020 to June 30, 2020 (Successor) and period July 1, 2019 through December 31, 2019 (Predecessor) are as follows:

	Successor		Predecessor			
	Period from January 1, 2020 through June 30, 2020		Period from July 1, 2019 through December 31, 2019	Year Ended June 30, 2019		
Global budget revenue	\$	67,129,862	\$	69,367,301	\$	138,676,567
Physician practice services		4,864,986		7,142,181		13,844,659
Other services revenue		740,868		619,545		1,241,077
	\$	72,735,716	\$	77,129,027	\$	153,762,303

Net patient service revenues disaggregated by payor for the period January 1, 2020 to June 30, 2020 (Successor) and period July 1, 2019 through December 31, 2019 and the year ended June 30, 2019 (Predecessor) are approximately as follows:

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	Third-Party Government Payers	Third-Party Commercial Payers	Self-Pay	Total All Payers
Successor				
January 1, 2020 through June 30, 2020	\$ 50,153,378	\$ 20,644,282	\$ 1,938,056	\$ 72,735,716
Predecessor				
July 1, 2019 through December 31, 2019	\$ 51,500,698	\$ 23,154,493	\$ 2,473,836	\$ 77,129,027
Year ended June 30, 2019	\$ 104,296,183	\$ 44,991,698	\$ 4,474,422	\$ 153,762,303

7. Investments

Investments consist of the following for as at June 30, 2020 and June 30, 2019:

	Successor June 30, 2020	Predecessor June 30, 2019
Investments		
Cash and cash equivalents	\$ 596,495	\$ 750,278
Corporate bonds	326,970	1,282,650
Mutual funds		
Fixed income	20,304,597	19,161,008
International equities	2,683,896	3,535,088
Large value	1,637,644	1,890,196
Large growth	1,523,735	2,042,377
Small cap	1,257,633	1,286,109
Other	499,810	446,084
Exchange-traded products	1,840,190	1,943,378
Managed hedge funds	7,788,216	8,640,647
	<u>\$ 38,459,186</u>	<u>\$ 40,977,815</u>

Investment income and unrealized gains and losses for investments and cash and cash equivalents are comprised of the following for the period January 1, 2020 through June 30, 2020 (Successor) and period July 1, 2019 through December 31, 2019 and the year ended June 30, 2019 (Predecessor):

	Successor Period from January 1, 2020 through June 30, 2020	Predecessor Period from July 1, 2019 through December 31, 2019	Predecessor Year Ended June 30, 2019
Investment income			
Interest and dividend income, net	\$ 288,650	\$ 859,744	\$ 1,667,296
Realized gains, net	98,210	357,814	287,850
Unrealized gains and losses on investments	745,115	170,205	(658,922)
	<u>\$ 1,131,975</u>	<u>\$ 1,387,763</u>	<u>\$ 1,296,224</u>

8. Fair Value Measurements

The Hospital measures its investments on a recurring basis in accordance with accounting principles generally accepted in the United States of America.

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Fair value is defined as the price that would be received to sell an asset or the price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. The framework that the authoritative guidance establishes for measuring fair value includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs used in determining valuations into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement.

The levels of the fair value hierarchy are as follows:

- Level 1 Fair value is based on unadjusted quoted prices in active markets that are accessible to the Hospital for identical assets. These generally provide the most reliable evidence and are used to measure fair value whenever available.
- Level 2 Fair value is based on significant inputs, other than Level 1 inputs, that are observable either directly or indirectly for substantially the full term of the asset through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets, quoted market prices in markets that are not active for identical or similar assets, and other observable inputs.
- Level 3 Fair value would be based on significant unobservable inputs. Examples of valuation methodologies that would result in Level 3 classification include option pricing models, discounted cash flows, and other similar techniques.

The following tables present financial instruments measured at fair value at June 30, 2020 and June 30, 2019, by caption on the balance sheet:

	June 30, 2020 (Successor)			Total
	Level 1	Level 2	Level 3	
Reported at fair value				
Cash and cash equivalents	\$ 596,495	\$ -	\$ -	\$ 596,495
Corporate bonds		326,970	-	326,970
Mutual funds	27,907,315	-	-	27,907,315
Exchange-traded products	1,840,190	-	-	1,840,190
Total assets at fair value	30,344,000	326,970	-	30,670,970
Other investments measured as net asset value				7,788,216
Disclosed at fair value				
Cash and cash equivalents	37,308,503			37,308,503

	June 30, 2019 (Predecessor)			Total
	Level 1	Level 2	Level 3	
Reported at fair value				
Cash and cash equivalents	\$ 750,278	\$ -	\$ -	\$ 750,278
Corporate bonds	-	1,282,650	-	1,282,650
Mutual funds	28,360,862	-	-	28,360,862
Exchange-traded products	1,943,378	-	-	1,943,378
Total assets at fair value	31,054,518	1,282,650	-	32,337,168
Other investments measured as net asset value				3,840,647
Disclosed at fair value				
Cash and cash equivalents	6,198,168	-	-	6,198,168

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The following is a description of the valuation methodologies used for assets measured at fair value and for financial instruments disclosed at fair value.

Cash and Cash Equivalents

Include certain investments in highly liquid debt instruments with original maturities of three months or less at date of purchase. The carrying amount approximates fair value due to the short-term nature of these investments.

Managed Hedge Funds

As a practical expedient, the Hospital estimates the fair value of managed hedge funds using the reported net asset value (NAV). The Hospital has assessed factors such as the managed hedge funds' compliance with fair value reporting standards, price transparencies and valuation procedures, the ability to redeem at NAV at the measurement date, and existence of redemption restrictions at the measurement dates. The Hospital is required to provide written notice of at least 90 calendar days prior to a calendar quarter-end to redeem these funds. Managed hedge funds are subject to redemption on a monthly or annual basis. There are no lock-up provisions.

Corporate Bonds

Based on quoted market prices, if available, or estimated using quoted market prices of similar securities.

Long-Term Debt

Fair value is calculated based on quoted market prices, if available, or estimated using quoted market prices of similar securities.

9. Property and Equipment and Accumulated Depreciation and Amortization

Property and equipment consisted of the following at June 30, 2020 and June 30, 2019:

	<u>Successor</u> <u>June 30, 2020</u>	<u>Predecessor</u> <u>June 30, 2019</u>
Land and improvements	\$ 2,722,893	\$ 2,672,845
Buildings and improvements	46,891,729	90,785,847
Fixed equipment	41,589,247	48,785,239
Major movable equipment	82,602,334	82,785,471
Construction in progress	1,786,393	366,445
	<u>175,592,596</u>	<u>225,395,847</u>
Less: Accumulated depreciation and amortization	<u>(125,361,995)</u>	<u>(142,462,854)</u>
Property and equipment, net	<u>\$ 50,230,601</u>	<u>\$ 82,932,993</u>

Included above is leased equipment at a cost of \$9,585,854 and \$9,607,397 with accumulated amortization of \$8,206,223 and \$7,605,560 for the years ended June 30, 2020 and June 30, 2019, respectively.

During 2020, \$1,422,237 in fixed assets were transferred to an affiliate of the Hospital.

Certain property and equipment were disposed of in 2020 and 2019, reducing accumulated depreciation by \$1,739,459 and \$707,075, respectively.

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10. Long-Term Debt

Long-term debt consists of the following at June 30, 2020 and June 30, 2019:

	<u>Successor</u> <u>June 30, 2020</u>	<u>Predecessor</u> <u>June 30, 2019</u>
MHHEFA Series 2014 Revenue Bonds	\$ 30,118,000	\$ 30,238,000
MHHEFA Series 2012 Revenue Bonds	3,212,590	4,752,737
Town of Elkton, Maryland Series 2012 Revenue Bonds (held by SunTrust Bank)	<u>20,616,000</u>	<u>21,574,208</u>
	53,946,590	56,564,945
Less: Unamortized deferred financing costs, net	(318,373)	(384,957)
Less: Current portion	<u>(2,290,577)</u>	<u>(2,609,452)</u>
Long-term debt and capital lease obligations, net	<u>\$ 51,337,640</u>	<u>\$ 53,570,536</u>

On December 1, 2014, the Hospital participated in MHHEFA revenue bond issuances that totaled \$30,778,000. The MHHEFA Series 2014 Revenue Bonds (the "2014 Revenue Bonds") were issued to refund the remaining portion of the MHHEFA Series 2005 Revenue Bonds and finance certain capital projects. The 2014 Revenue Bonds bear interest at 3.42 and 3.42 percent as of June 30, 2020 and 2019, respectively, and are payable in monthly annual installments through July 2039.

On July 18, 2012, the Hospital participated in MHHEFA revenue bond issuances that totaled \$13,931,000. The MHHEFA Series 2012 Revenue Bonds (the "2012 Revenue Bonds") were issued to refund the remaining portion of the MHHEFA Series 2002 Revenue Bonds, finance certain capital projects and increase the debt service reserve fund for the 2005 Revenue Bonds. The 2012 Revenue Bonds bear interest at various rates from 2.75 – 3.34 percent and are payable in monthly annual installments through June 2022.

On May 18, 2012, the Town of Elkton, Maryland ("Elkton") issued \$27,662,336 in Economic Development Refunding Revenue Bonds ("EDRRB"), Series 2012 ("Series 2012 Bonds"). Also, on May 18, 2012, the Hospital entered into a Loan and Financing Agreement with Elkton (the "Agreement") to borrow the proceeds from the Series 2012 Bonds in a series of notes as follows:

- \$10,000,000 from the EDRRB, Series 2012A Bonds to partially refund the Economic Development Revenue Bond, Series 2009, and pay costs of issuance. The note bears interest at 2.73 percent and is payable in monthly installments through December 2036.
- \$5,842,234 from the EDRRB, Series 2012B-1 Bonds to refund the remaining portion of the Economic Development Revenue Bond, Series 2009, and pay costs of issuance. This note bears interest at 2.73 and 2.73 percent as of June 30, 2020 and 2019, respectively, and is payable in monthly installments through December 2036.
- \$2,820,102 from the EDRRB, Series 2012B-2 Bonds to refund Elkton's 2000 Revenue Bonds and pay costs of issuance. This note bears interest at 2.27 and 2.27 percent as of June 30, 2020 and 2019, respectively, and is payable in monthly installments through June 2020.
- \$9,000,000 from the EDRRB, Series 2012C Bonds to partially refund the MHHEFA Series 2002 Revenue Bonds and pay costs of issuance. This note bears interest at 2.73 and 2.73

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percent as of June 30, 2020 and 2019, respectively, and provides interest-only installments until July 2022, at which time principal and interest monthly installments through June 2031.

Scheduled repayments of long-term debt, discussed in Note 10, are as follows:

Years Ending June 30:	
2021	\$ 2,290,577
2022	2,348,833
2023	2,318,377
2024	2,368,481
2025	2,441,491
Thereafter	42,178,831
	<u>\$ 53,946,590</u>

11. Capital Lease Obligations

The Hospital has various capital lease agreements for medical equipment, which expire through 2023. Future minimum lease payments under these agreements are as follows:

Years Ending June 30:	
2021	\$ 797,743
2022	568,002
2023	82,687
	<u>1,448,432</u>
Total minimum lease payments	1,448,432
Less: Amount representing interest	63,490
	<u>1,384,942</u>
Less: Current portion, principal	749,669
Long term portion, principal	<u>\$ 635,273</u>

12. Concentration of Credit Risk

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

Included in accounts receivable are amounts related to the services performed for individuals. The payment for the majority of these services are covered under Maryland HSCRC rules which require payers to reimburse Hospitals at regulated rates less approved discounts.

The mix of gross receivables from patients and third-party payors was as follows at June 30, 2020 and June 30, 2019:

	<u>Successor</u> June 30, 2020	<u>Predecessor</u> June 30, 2019
Medicare	37 %	39 %
Medicaid	26	28
Blue Cross/Blue Shield	16	20
Health maintenance organizations	1	1
Self-pay patients	1	0
Other third-party payors	19	12
	<u>100 %</u>	<u>100 %</u>

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The Hospital maintains its cash and cash equivalents with several financial institutions. Cash and cash equivalents on deposit with any one financial institution exceed FDIC coverage from time to time.

13. Liquidity and Availability

The Hospital's financial assets available for general expenditure within one year of the balance sheet date, consist of the following for the year ended June 30, 2020:

	<u>Successor</u> <u>June 30, 2020</u>	<u>Predecessor</u> <u>June 30, 2019</u>
Cash and cash equivalents	\$ 37,308,503	\$ 6,198,168
Short-term investments	34,629,418	37,137,168
Accounts receivable, patients	13,455,601	13,863,566
Other receivables	722,193	206,146
	<u>\$ 86,115,715</u>	<u>\$ 57,405,048</u>

As part of the Hospital's liquidity management plan, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, the Hospital invests excess cash in short-term investments.

14. Functional Expenses

A summary of the Hospital's expenses by function for the period from January 1, 2020 to June 30, 2020 (Successor) is as follows:

	<u>Successor</u> <u>January 1, 2020 through June 30, 2020</u>			
	<u>Hospital Acute and Ambulatory Services</u>	<u>Other Health Care Services</u>	<u>Management and General</u>	<u>Total</u>
Salaries and wages	\$ 18,452,088	\$ 7,331,133	\$ 10,044,968	\$ 35,828,189
Employee benefits	2,509,957	1,201,224	1,952,489	5,663,670
Professional fees	2,112,116	4,357,927	86,381	6,556,424
Purchased services	3,318,198	1,585,628	6,400,524	11,304,350
Supplies	8,700,725	490,406	955,721	10,146,852
Interest	-	-	945,120	945,120
Depreciation and amortization	-	73,317	3,980,528	4,053,845
Other	361,219	1,115,956	3,736,004	5,213,179
	<u>\$ 35,454,303</u>	<u>\$ 16,155,591</u>	<u>\$ 28,101,735</u>	<u>\$ 79,711,629</u>

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A summary of the Hospital's expenses by function for the period July 1, 2019 through December 31, 2019 and the year ended June 30, 2019 (Predecessor) is as follows:

	Predecessor			
	July 1, 2019 through December 31, 2019			
	Hospital Acute and Ambulatory Services	Other Health Care Services	Management and General	Total
Salaries and wages	\$ 18,552,311	\$ 7,812,014	\$ 9,185,817	\$ 35,550,142
Employee benefits	4,149,439	1,072,848	2,077,077	7,299,364
Professional fees	1,493,616	3,299,004	31,310	4,823,930
Purchased services	2,904,292	2,025,662	6,412,927	11,342,881
Supplies	9,133,054	661,276	885,194	10,679,524
Interest	-	-	953,716	953,716
Depreciation and amortization	-	144,122	4,830,611	4,974,733
Other	235,132	1,199,865	3,176,891	4,611,888
	<u>\$ 36,467,844</u>	<u>\$ 16,214,791</u>	<u>\$ 27,553,543</u>	<u>\$ 80,236,178</u>

	Predecessor			
	Year ended June 30, 2019			
	Hospital Acute and Ambulatory Services	Other Health Care Services	Management and General	Total
Salaries and wages	\$ 37,089,932	\$ 16,891,313	\$ 18,969,345	\$ 72,950,590
Employee benefits	7,452,340	2,637,091	4,572,047	14,661,478
Professional fees	2,277,666	6,271,734	91,168	8,640,568
Purchased services	6,444,213	3,437,729	11,807,516	21,689,458
Supplies	19,031,321	1,040,357	1,375,888	21,447,566
Interest	-	-	1,942,655	1,942,655
Depreciation and amortization	-	311,453	10,714,881	11,026,334
Other	492,796	2,449,249	7,147,483	10,089,528
	<u>\$ 72,788,268</u>	<u>\$ 33,038,926</u>	<u>\$ 56,620,983</u>	<u>\$ 162,448,177</u>

15. Commitments and Contingencies

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, governmental activity has increased with respect to investigations and allegations concerning possible violations and fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

The Hospital has been named as a defendant in several lawsuits arising from the performance of its normal activities. In the opinion of the Hospital's management, after consultation with legal counsel, the amount, if any, of the Hospital's ultimate liability under these lawsuits will not have a significant impact on the financial position of the Hospital.

The Hospital self-reported to the Office of Inspector General ("OIG") under the Self Disclosure Matter, related to Federal Stark and Anti-Kickback laws and other physician based services. As of

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June 30, 2019, the Hospital had accrued approximately \$406,264 for this matter, which is included in accounts payable and accrued liabilities in the accompanying balance sheet as of June 30, 2019; All funds were paid out during 2020. There is no remaining liability as at June 30, 2020.

16. Medical Malpractice Claims Coverage

As of January 1, 2005, when existing policies expired, the Hospital elected to obtain its professional and general liability insurance from Freestate Healthcare Insurance Company, Ltd., a Cayman Islands company ("Freestate"). Freestate was incorporated as of January 1, 2005 as a chartered captive insurance company for eight non-profit hospitals in the State of Maryland, including the Hospital. Freestate is currently composed of five remaining Maryland non-profit hospitals which, each with a one-fifth share interest in Freestate. The Hospital accounts for this interest as a cost method investment of \$20,000 included within Other Assets. Freestate is governed by a Board of Directors selected by the shareholders

Freestate's primary insurance is under the terms of a claims-made insurance policy and has limits of liability of \$1 million per claim and historically no aggregate limit per policy year. In March 2020, an annual aggregate limit of \$2,000,000 per policy year was introduced. Freestate's excess liability coverage insures against losses in excess of the above primary coverage reported during the period of policy coverage. This excess liability insurance policy has an individual occurrence limit of \$15 million and an annual aggregate limit of \$15 million. Prior acts of coverage for newly employed physicians will not be provided without prior approval of Freestate's Board of Directors. Each hospital's annual premium will be established through a retrospective rating process, with initial premiums based on actuarial estimates. Initial premiums will be charged at the 75 percent confidence level and retrospective premium assessments will be capped at an amount equal to the expected losses for the policy period at an 85 percent confidence level, in each case as determined by an independent actuary.

The total estimated reported medical malpractice claims liability is \$8,895,187 at June 30, 2020 and \$8,853,757 at June 30, 2019. The estimated medical malpractice claims liability is included in other long-term liabilities in the balance sheets. The Hospital has recorded a receivable, and related claim liability, for anticipated insurance recoveries of \$7,699,683 in 2020 and \$7,666,493 in 2019. The estimated insurance recoveries receivable is included in other assets in the balance sheets. These amounts have been discounted using a 3.5% discount rate.

The undiscounted amount of the medical malpractice claims liability is \$9,815,721 and the undiscounted amount of the receivable for anticipated insurance recoveries is \$8,420,489 at June 30, 2020.

The Hospital believes that it has adequate insurance coverages for all asserted claims and has no knowledge of unasserted claims which would exceed insurance coverages. The Hospital would claim charitable immunity for claims exceeding coverage limits. Legal expenses associated with covered claims are also covered and included under policy limits.

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

17. Related Party Transactions

The Hospital periodically receives or advances funds for working capital purposes. Interest is not charged and there are no fixed repayment terms on these transactions. Receivables (payables) from (to) other affiliates of the Hospital at June 30, 2020 and June 30, 2019 are shown below:

	<u>Successor</u> <u>June 30, 2020</u>	<u>Predecessor</u> <u>June 30, 2019</u>
CCHS Health System	\$ (365,840)	\$ -
Affinity	(84,641)	(411,175)
Union Hospital of Cecil County Foundation, Inc.	319,647	316,662
	<u>\$ (130,834)</u>	<u>\$ (94,513)</u>

The Hospital pays a management fee to the Affinity for administrative, finance, and human resources services. The management fee was calculated at 1 percent of the Hospital's net operating revenues (including the provision for doubtful accounts) for the period January 1, 2020 through June 30, 2020 (Successor) and period July 1, 2019 through December 31, 2019 and the year ended June 30, 2019 (Predecessor). Fees of \$553,446 and \$430,162 and \$910,899 are included in purchased services in the accompanying statements of operations for the period January 1, 2020 through June 30, 2020 (Successor) and period July 1, 2019 through December 31, 2019 and year ended June 30, 2019 (Predecessor), respectively.

For the years ended June 30, 2020 and June 30, 2019, the Hospital recorded net asset transfers from (to) affiliates of \$(2,975,732) and \$9,393,938, respectively. This amount includes \$1,422,237 in fixed assets transferred in 2020.

18. Subsequent Events

The Hospital evaluated subsequent events for recognition or disclosure through October 16, 2020, the date the financial statements were issued.