

Calvert Health System, Inc. and Subsidiaries

**Consolidated Financial Statements and
Supplementary Consolidating Information**

Years Ended June 30, 2016 and 2015

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Independent Auditors' Report

Board of Directors
Calvert Health System, Inc.
Prince Frederick, Maryland

We have audited the accompanying consolidated financial statements of Calvert Health System, Inc. and Subsidiaries (the System) which comprise the consolidated statements of financial position as of June 30, 2016 and 2015, and related consolidated statements of operations and other changes in unrestricted net assets, changes in net assets, and cash flows for the years then ended and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's 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 Calvert Health System, Inc. and Subsidiaries as of June 30, 2016 and 2015, and the consolidated changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



Report on Consolidating Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The 2016 consolidating schedules on pages 33 - 39 are presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and are 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 2016 information has been subjected to the auditing procedures applied in the audit of the 2016 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 2016 information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Dixon Hughes Goodman LLP

**Tysons, Virginia
October 26, 2016**

Calvert Health System, Inc. and Subsidiaries
Consolidated Statements of Financial Position
June 30, 2016 and 2015
(dollars in thousands)

	<u>2016</u>	<u>2015</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 38,963	\$ 29,628
Short-term investments	118	944
Patient accounts receivable, net of allowance for uncollectible accounts of \$3,649 in 2016 and \$4,118 in 2015	16,583	15,758
Inventories	2,382	2,522
Prepaid expenses and other assets	5,421	2,901
Assets limited as to use, current	840	977
Total current assets	<u>64,307</u>	<u>52,730</u>
Investments and other assets:		
Investments	100,972	98,640
Investments in affiliated enterprises	4,451	4,450
Assets limited as to use	4,213	4,277
Property and equipment, net	70,967	62,989
Insurance recoverable	3,723	4,120
Other assets	2,564	754
Total assets	<u>\$ 251,197</u>	<u>\$ 227,960</u>
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable and accrued expenses	\$ 20,302	\$ 19,541
Current portion of long-term debt	2,223	1,370
Advances from third party payers	4,632	4,362
Total current liabilities	<u>27,157</u>	<u>25,273</u>
Long-term debt, less current portion	63,886	45,714
Accrued pension cost	14,751	8,190
Professional liability	4,625	5,010
Other long-term liabilities	593	467
Total liabilities	<u>111,012</u>	<u>84,654</u>
Net assets:		
Unrestricted - general	135,450	138,415
Unrestricted - board designated	3,261	3,264
Unrestricted - noncontrolling interest in subsidiary	(238)	257
Temporarily restricted	719	341
Permanently restricted	993	1,029
Total net assets	<u>140,185</u>	<u>143,306</u>
Total liabilities and net assets	<u>\$ 251,197</u>	<u>\$ 227,960</u>

See accompanying notes.

Calvert Health System, Inc. and Subsidiaries
Consolidated Statements of Operations and Other Changes in Unrestricted Net Assets
Years Ended June 30, 2016 and 2015
(dollars in thousands)

	<u>2016</u>	<u>2015</u>
Revenue:		
Patient service revenue (net of contractual adjustments and discounts)	\$ 149,474	\$ 143,901
Provision for bad debts	(852)	(1,388)
Net patient service revenue less provision for bad debts	<u>148,622</u>	<u>142,513</u>
Rental revenue	319	317
Other operating revenue	4,849	5,910
Total operating revenue	<u>153,790</u>	<u>148,740</u>
Expenses:		
Salaries and wages	67,920	65,766
Employee benefits	14,160	14,419
Supplies	25,897	24,054
Purchased services	8,031	7,344
Professional fees	5,899	6,095
Depreciation and amortization	9,358	9,425
Interest	2,408	1,990
Other	17,739	16,213
Total operating expenses	<u>151,412</u>	<u>145,306</u>
Income from operations	2,378	3,434
Nonoperating gains (losses):		
Investment income	5,931	3,960
Income from equity investments	176	414
Loss on pension settlement	-	(2,413)
Gain on sale of assets	0	0
Loss on extinguishment of debt	0	0
Total nonoperating gains, net	<u>6,107</u>	<u>1,961</u>
Excess of revenue over expenses	8,485	5,395
Net assets released from restrictions for capital acquisitions	118	608
Distributions to noncontrolling interest holders	-	(69)
Pension-related changes other than net periodic pension cost	(6,213)	3,277
Net unrealized losses on marketable investments	<u>(5,853)</u>	<u>(2,026)</u>
Increase (decrease) in unrestricted net assets	<u>\$ (3,463)</u>	<u>\$ 7,185</u>

See accompanying notes.

Calvert Health System, Inc and Subsidiaries
Consolidated Statements of Changes in Net Assets
Years Ended June 30, 2016 and 2015
(dollars in thousands)

	<u>Unrestricted</u>	<u>Noncontrolling Interest</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Balance - June 30, 2014	\$ 134,478	\$ 273	\$ 398	\$ 1,040	\$ 136,189
Excess of revenue over expenses	5,342	53	-	-	5,395
Transfer of net assets	-	-	36	(36)	-
Contributions	-	-	1,045	-	1,045
Net assets released from restrictions for capital acquisitions	608	-	(608)	-	-
Net assets released from restrictions to fund operating programs	-	-	(530)	-	(530)
Distributions to noncontrolling interest holders	-	(69)	-	-	(69)
Investment income on restricted net assets	-	-	-	42	42
Pension-related changes other than net periodic pension cost	3,277	-	-	-	3,277
Net unrealized losses on marketable investments	(2,026)	-	-	(17)	(2,043)
Balance - June 30, 2015	141,679	257	341	1,029	143,306
Excess of revenue over expenses (revenue over expenses)	8,980	(495)	-	-	8,485
Transfer of net assets	-	-	29	(29)	-
Contributions	-	-	1,046	-	1,046
Net assets released from restrictions for capital acquisitions	118	-	(118)	-	-
Net assets released from restrictions to fund operating programs	-	-	(579)	-	(579)
Investment income on restricted net assets	-	-	-	213	213
Pension-related changes other than net periodic pension cost	(6,213)	-	-	-	(6,213)
Net unrealized losses on marketable investments	(5,853)	-	-	(220)	(6,073)
Balance - June 30, 2016	<u>\$ 138,711</u>	<u>\$ (238)</u>	<u>\$ 719</u>	<u>\$ 993</u>	<u>\$ 140,185</u>

See accompanying notes.

Calvert Health System, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended June 30, 2016 and 2015
(dollars in thousands)

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Increase (decrease) in net assets	\$ (3,122)	\$ 7,115
Adjustments to reconcile to net cash from operating activities:		
Provision for bad debts	772	1,388
Depreciation and amortization	9,358	9,425
Donations restricted for capital acquisition	(418)	(520)
Equity in earnings of affiliated enterprises	(176)	(414)
Investment income on restricted assets	(213)	(42)
Realized net gains on investments	(4,245)	(3,267)
Unrealized net losses on investments	6,073	2,043
Pension-related changes other than net periodic pension cost	6,213	(3,277)
Change in:		
Patient accounts receivable	(1,597)	(2,265)
Inventories	139	(214)
Prepaid expenses and other assets	(3,797)	122
Accounts payable, accrued expenses & other liabilities	915	2,688
Net cash from operating activities	<u>9,902</u>	<u>12,782</u>
Cash flows from investing activities:		
Purchases of investments	(50,436)	(44,757)
Sales of investments	47,470	45,549
Net (increase) decrease in assets limited as to use	(148)	(1,079)
Purchases of property and equipment	(17,272)	(10,609)
Net cash used in investing activities	<u>(20,386)</u>	<u>(10,896)</u>
Cash flows from financing activities:		
Repayment of long-term debt	(1,986)	(1,120)
Proceeds from issuance of long-term debt	21,000	-
Donations received restricted for capital acquisitions	418	520
Net distributions from investees	174	365
Investment income on restricted assets	213	42
Net cash provided (used) in financing activities	<u>19,819</u>	<u>(193)</u>
Net increase in cash and cash equivalents	9,335	1,693
Cash and cash equivalents - beginning of year	<u>29,628</u>	<u>27,935</u>
Cash and cash equivalents - end of year	<u>\$ 38,963</u>	<u>\$ 29,628</u>

See accompanying notes.

Notes to Consolidated Financial Statements

1. Organization and Nature of Business

Organization

Calvert Health System, Inc. and Subsidiaries (the System), a Maryland corporation formed on January 1, 2000, is the sole member of Calvert Memorial Hospital of Calvert County (the Hospital), Calvert Health Ventures, Inc. (CHV), Calvert Physician Associates, LLC (CPA), CMH Holding Company (Holding Co. I), and CMH II Holding Company (Holding Co. II).

The System and the Hospital are nonprofit, nonstock membership corporations formed under the laws of the State of Maryland, organized for charitable purposes and exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC).

The Hospital, located in Prince Frederick, Maryland provides inpatient, outpatient and emergency care services for the residents of Calvert County and the surrounding areas. The Hospital was incorporated in Maryland in 1917. The Hospital has two wholly owned or controlled subsidiaries: Calvert Memorial Hospital Foundation, Inc. (the Foundation) and Calvert Community Health, Inc. (CCH). The Foundation is a non-profit corporation that operates exclusively for the charitable purpose of supporting the Hospital. CCH is the Hospital's for-profit subsidiary organized to establish managed care contracts. CCH is currently inactive.

CHV is a for-profit corporation that owns and manages investments in certain health care related entities, including Calvert Medical Management, LLC (CMM), Calvert Surgery Center, LLC (CSC), an imaging center, and a physical therapy and sports rehabilitation center. CMM is a medical service organization that supports CPA's operations. CSC holds a 25% interest in Prince Frederick Surgery Center, LLC (PFSC).

CHV holds a 51% indirect interest in Calvert Physical Therapy and Sports Fitness Center (CPTSFC), a joint venture between CHV, Kubb Physical Therapy Partnership (Kubb) and NRH Ambulatory Services, Inc. (NRH). The System's consolidated financial statements include CPTSFC as a consolidated subsidiary and reflect Kubb's and NRH's noncontrolling interests in CPTSFC's net assets and net income. CPTSFC dissolved operations as of June 30, 2016.

CPA is a limited liability company that employs physicians who provide health care services for the residents of Calvert County and the surrounding area.

Holding Co. I and Holding Co. II are nonprofit, nonstock membership corporations formed under the laws of the State of Maryland, organized for charitable purposes and exempt from federal income taxes under Section 501(c)(2) of the IRC. Holding Co. I owns a medical office building in Solomon's Island, Maryland. Holding Co. II owns a 100% interest in Calvert Medical Arts Center, LLC (CMAC).

Principles of consolidation

At June 30, 2016 and 2015, the System's consolidated financial statements include the accounts of the Hospital and its wholly owned or controlled subsidiaries, CHV, CPA, Holding Co. I and Holding Co. II. All material intercompany transactions are eliminated.

2. Summary of Significant Accounting Policies

Basis of presentation

The consolidated financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles. The System classifies net assets, revenues, expenses, gains and losses based on the existence or absence of donor-imposed restrictions; accordingly, net assets of the System and changes therein are classified and reported as follows:

Unrestricted net assets - Net assets that are not subject to donor-imposed stipulations.

Temporarily restricted net assets - Net assets subject to donor-imposed stipulations that may or will be met either by actions of the System or the passage of time.

Permanently restricted net assets - Net assets subject to donor-imposed stipulations that will be maintained permanently by the System. Generally, the donors of these assets permit the System to use all or part of the income earned on related investments for general or specific purposes.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Contributions with no donor-imposed restrictions are recognized as revenues in the period received as increases in unrestricted net assets. Contributions with donor-imposed restrictions are reported as increases in temporarily or permanently restricted net assets unless such contributions are expended in the same fiscal year, in which case they are recorded as unrestricted contributions. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as net assets released from restriction and reclassified between the applicable classes of net assets. In accordance with applicable accounting standards, assets that have been released to support the System's operating programs are reported as a component of other operating revenue in the accompanying consolidated statements of operations, whereas assets that are released for the acquisition of property and equipment are reported as a direct increase to unrestricted net assets in the accompanying consolidated statements of changes in net assets.

Income and realized net gains or losses on investments are reported as:

- Increases or decreases in permanently restricted net assets if the terms of the gift or the System's interpretation of relevant state law require that they be added to the principal of a permanent endowment fund;
- Increases or decreases in temporarily restricted net assets if the terms of the gift impose restrictions on the use of the income; or
- Increases or decreases in unrestricted net assets in all other cases.

Use of estimates

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

Calvert Health System, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(dollars in thousands)

Cash and cash equivalents

Cash and cash equivalents consist primarily of highly liquid, unrestricted, investments in U.S. Treasury bills, commercial paper, and other interest-bearing deposits with maturities of three months or less. Primarily all of the System's cash and cash equivalents are maintained in one commercial bank, of which an aggregate maximum of \$250 is insured by the Federal Deposit Insurance Corporation (FDIC). The System's cash balance routinely exceeds the maximum amount insured by the FDIC.

Short-term investments

Short-term investments consist primarily of investments with maturities of less than one year from the date of purchase.

Inventories

Inventories consist primarily of drugs and medical supplies and are carried at the lower of cost or market, as determined principally by the first-in, first-out method.

Investments

Investments in fixed maturity and equity securities are recorded at fair value. Investment income, realized gains and losses and unrealized gains and losses on available-for-sale securities are reported in the accompanying consolidated statements of operations and other changes in unrestricted net assets unless restricted by the donor, in which case they are reported as an addition to, or deduction from, the appropriate donor-restricted net asset balance.

As of June 30, 2016 and 2015, \$712 and \$1,411 of the investments balance, respectively, are available to fund an executive severance and deferred compensation plan that has been established to provide benefits to the System's executive management team. These amounts are recorded as noncurrent liabilities in the accompanying consolidated statements of financial position as of June 30, 2016 and 2015.

Investments are exposed to certain risks such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, changes in the value of investment securities could occur in the near term, and these changes could materially differ from the amounts reported in the accompanying consolidated financial statements.

Investments in affiliated enterprises

Investments in affiliated, noncontrolled enterprises are accounted for using the equity method of accounting.

Assets limited as to use

Assets limited as to use primarily include assets held by trustees under indenture agreements and designated assets set aside by the Board of Directors for future capital improvements, over which the Board retains control and may, at its discretion, subsequently use for other purposes.

Property and equipment

Property and equipment acquisitions are recorded at cost, except for donated items, which are recorded at fair value at the date of donation. Renovations, alterations, and improvements that increase the useful lives or the functionality of the related assets are capitalized and subsequently depreciated over the remaining useful life of each class of depreciable assets. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets. Useful lives range from 20 - 40 years for buildings, 5 - 10 years for equipment and 10 - 20 years for leasehold improvements. Interest cost incurred on borrowed funds during the construction period for capital assets is capitalized as a component of the cost of acquiring those assets.

Calvert Health System, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(dollars in thousands)

Other assets

Other assets consist of deferred financing costs, insurance recoverables, and long-term other amounts receivable. Gross deferred financing costs are amortized over the life of the related bonds and amounted to \$952 and \$732 at June 30, 2016 and 2015, respectively. Accumulated amortization of such costs amounted to \$175 and \$111 at June 30, 2016 and 2015, respectively. Long-term other receivables include a promissory note that was entered into between the Hospital and PFSC on July 1, 2015 in the amount of \$1,800. Terms and conditions of the promissory note include a fixed rate of 3.75%, eighty-three fixed monthly payments that commenced on August 1, 2015 and a final balloon payment due on July 1, 2022. The long-term portion of the outstanding principal amounted to \$1,622 at June 30, 2016.

Third-party advances

The Hospital receives advances from third-party payers to provide working capital for services rendered to the beneficiaries of such services. These advances are subject to periodic adjustment, and are principally determined based on the timing difference between the provision of care and the anticipated payment date of the claim for service.

Consolidated statements of operations

For purposes of display, transactions deemed by management to be ongoing, major or central to the provision of health care services are reported as revenue or expenses, as applicable. Peripheral or incidental transactions are reported as non-operating gains or losses, as applicable.

Excess of revenue over expenses

The consolidated statements of operations and other changes in unrestricted net assets report excess of revenue over expenses. Changes in unrestricted net assets which are excluded from this performance indicator, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, contributions of (and assets released from donor restrictions related to) long-lived assets.

Net patient service revenue and patient accounts receivable

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, after contractual adjustments and discounts. For uninsured patients who do not qualify for charity care, the Hospital recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of the Hospital's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Hospital records a significant provision for bad debts related to uninsured patients in the period the services are provided. The Hospital has not changed its charity care or uninsured discount policies during 2016 or 2015. Patient accounts receivable include charges for amounts due from Medicare, Maryland Medical Assistance (Medicaid), Blue Cross, commercial insurers, and self-pay patients. Contractual adjustments represent the differences between amounts billed as patient service revenue and amounts allowed by third-party payers, and are accrued on an estimated basis in the period in which the related services are rendered and adjusted in future periods as final settlements are determined. Contractual adjustments and provision for uncollectible self-pay amounts are included in the determination of net patient service revenue as reported in the accompanying consolidated statements of operations and other changes in unrestricted net assets. Rates charged are based primarily on rates established by the State of Maryland Health Services Cost Review Commission (HSCRC); accordingly, revenue reflects actual charges to patients based on rates in effect during the period in which the services are rendered.

Calvert Health System, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(dollars in thousands)

The Hospital grants credit without collateral to its patients, most of whom are local residents insured under third-party payer agreements. Accounts receivable are reported at their net realizable value from third-party payers, patients, residents and others for services rendered. Allowances are provided for third-party payers based on estimated reimbursement rates. Allowances are also provided for bad debts on an estimate of uncollectible accounts. Allowance for bad debts is based upon management's assessment of historical and expected net collections. Management assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience by payer category. The results of this analysis are then used to make modifications to the allowances for bad debts and to establish an allowance for uncollectible patient accounts receivable. Write-off of uncollectible accounts is determined on a case-by-case basis after a review of the circumstances surrounding individual patient accounts.

Charity care and other community services

The Hospital provides care to patients regardless of their ability to pay. In identifying charity care, the Hospital assesses the patient's ability to pay, utilizing generally recognized poverty income levels for the community, and identifies certain cases where incurred charges are considered to be beyond the patient's ability to pay. 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 revenue or patient accounts receivable. The Hospital maintains records to identify and monitor the level of charity care it provides. These records represent the amount of charges forgone under its charity care policy. The charity policy of the Hospital provides free care to patients up to 200% of the federal poverty level and provides free care on a sliding scale between 200% and 300% of the federal poverty level.

The cost of charity care provided by the Hospital amounted to approximately \$3,808 and \$3,944 in 2016 and 2015, respectively. Rates charged by the Hospital for regulated services are determined based on an assessment of direct and indirect costs calculated pursuant to the methodology established by the HSCRC and, therefore, the cost of charity services noted above for the Hospital is equivalent to its established rates for those services. For any charity services rendered by the System other than the regulated services of the Hospital, the cost of charity care is calculated by applying the estimated total cost-to-charge ratio for the non-Hospital services to the total amount of charges for services provided to patients benefitting from the charity care policies of the System's non-Hospital affiliates.

The Hospital receives monthly payments from the HSCRC or submits monthly payments with respect to an Uncompensated Care Fund (UCC) established for rate-regulated hospitals in Maryland. The UCC is intended to provide Maryland hospitals with funds to support the provision of uncompensated care at those hospitals as determined by the HSCRC. The Hospital contributed \$1,170 and \$837 for 2016 and 2015, respectively, to the UCC as required by the HSCRC.

In addition to charity and uncompensated care, the System provides various health education programs, community screenings, classes, partnerships and neighborhood health centers, such as the following:

- Clinic eligibility workers that assist indigent patients to obtain healthcare and dental services,
- Health promotion programs and services, such as smoking cessation, blood pressure screenings and wellness programs, and
- Social services to assist patients in arranging for nonhospital healthcare services.

The HSCRC requires all Maryland hospitals to complete and submit a Community Benefit Report annually on December 15th for the preceding fiscal year. The Hospital's Community Benefit Report for the year ended June 30, 2015 reported \$16,781 in community benefit services.

Calvert Health System, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(dollars in thousands)

Other operating revenue

Other operating revenue of the System includes “meaningful use” incentive, cafeteria income, grant income, and revenue from instructional classes and other operating programs. Under the provisions of the American Recovery and Reinvestment Act of 2009, incentive payments are available to certain healthcare providers that can demonstrate “meaningful use” of certified electronic health records technology. The System recognizes these incentive payments when it is reasonably assured that they will successfully demonstrate compliance with meaningful use criteria. The System recognized approximately \$244 and \$771 of these incentive payments for the years ended June 30, 2016 and 2015, respectively. These payments are subject to settlement and audit in future years.

Tax-exempt status

The System is exempt from federal income tax under section 501(c)(3) of the IRC as a public charity. The System is entitled to rely on this determination as long as there are no substantial changes in its character, purposes, or methods of operation. Management has concluded that there have been no such changes and, therefore, the System’s status as a public charity exempt from federal income taxation remains in effect.

The state in which the System operates also provides general exemption from state income taxation for organizations that are exempt from federal income taxation. However, the System is subject to both federal and state income taxation at corporate tax rates on its unrelated business income. Exemption from other state taxes, such as real and personal property taxes, is separately determined.

The System had no unrecognized tax benefits or such amounts were immaterial during the periods presented. For tax periods with respect to which no unrelated business income was recognized, no tax return was required.

Management has also considered the impact of unrelated business activities and has concluded that the Hospital is not subject to unrelated business tax or any other taxes that could be imposed by the IRC or state taxing authorities. As such, no provision is made for income taxes and no asset or liability has been recognized for deferred taxes.

Subsequent events

In preparing these consolidated financial statements, the System has evaluated events and transactions for potential recognition or disclosure through, October 26, 2016, the date the consolidated financial statements were available to be issued.

Recent accounting pronouncements

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-02, *Leases (Topic 842)*. The amendments in this ASU revise the accounting related to lessee accounting. Under the new guidance, lessees will be required to recognize a lease liability and a right-of-use asset for all leases. The amendments in this ASU are effective for the System beginning on July 1, 2019, with early adoption permitted, and should be applied through a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. Early adoption is permitted. Management has not yet determined what the effects of adopting this ASU will be on its financial statements.

Calvert Health System, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(dollars in thousands)

In April 2015, the FASB issued ASU 2015-03, *“Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs”*. ASU 2015-03 amends current presentation guidance by requiring that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The standard is effective for the System beginning July 1, 2016. Upon adoption, the System will reclassify debt issuance costs which are currently presented as a component of non-current assets in the accompanying balance sheets to long-term debt. Management expects the adoption of this standard will not have a significant impact on the System's financial position and will have no impact on the results of operations or cash flows.

In May 2014, the FASB issued ASU 2014-09 *“Revenue from Contracts with Customers,”* which will eliminate the transaction and industry-specific revenue recognition guidance under current accounting standards and replace it with a principle-based approach using the following steps: identify the contract(s) with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract and recognize revenue when (or as) the entity satisfies a performance obligation. In August 2015, the FASB issued ASU 2015-14 *“Revenue from Contracts with Customers (Topic 606), Deferral of the Effective Date”* which granted a one-year deferral of this ASU. The guidance in ASU 2014-09 will now be effective for the System beginning July 1, 2018, with early adoption permitted beginning July 1, 2017. The guidance allows for either a full retrospective or a modified retrospective transition method. The System is currently evaluating the impact of this guidance, including the transition method, on its financial position, results of operations and cash flows. At the present time, management has not yet determined what the effects of adopting this ASU will be on its financial statements.

In August 2016, FASB issued ASU 2016-14, *“Not-For-Profit Entities (Topic 842), Presentation of Financial Statements of Not-for Profit Entities.”* The amendments in this ASU make certain improvements that address many, but not all, of the identified issues about the current financial reporting for Not-for-Profit (NFP) entities. Under the new guidance, financial statements and noted disclosures requirements for NFP entities include the following:

1. Present on the face of the statement of financial position net assets with and without donor restrictions
2. Present on the statement of activities additional operation measures.
3. Continue to present on the face of the statement of cash flows the net amount for operating cash flows using either the direct or indirect method of reporting but no longer require the presentation or disclosure of the indirect method (reconciliation) if using the direct method.
4. Enhanced disclosures that provide quantitative and qualitative information about liquidity management.

The amendments in ASU 2016-14 are effective for the System beginning on July 1, 2018, with early adoption permitted. Management has not yet determined what the effects of adopting this ASU will be on its consolidated financial statements.

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3. Investments in Affiliated Enterprises

A summary of investments in affiliated enterprises at June 30 follows:

	<u>2016</u>		<u>2015</u>	
	<u>Investment</u>	<u>Income</u>	<u>Investment</u>	<u>Income</u>
Calvert Medical Imaging Center	\$ 1,207	\$ 218	\$ 1,515	\$ 221
NRH/CPT Regional Rehab, LLC	(31)	(131)	101	54
Chesapeake-Potomac Healthcare Alliance, LLC	2,914	109	2,804	101
Chesapeake Physical Medicine, LLC	-	-	-	6
Freestate Healthcare Insurance Company, LTD	20	0	20	-
Maryland eCare, LLC	9	0	9	32
Prince Frederick Surgery Center, LLC	332	(18)	-	-
Calvert Medical Office Building Limited Partnership	-	(2)	1	-
	<u>\$ 4,451</u>	<u>\$ 176</u>	<u>\$ 4,450</u>	<u>\$ 414</u>

An overview of these organizations is presented in this note. Because CHV's investment in Calvert Medical Imaging Center (CMIC) represents approximately 27% and 34% of the reported investment balance in affiliates as of June 30, 2016 and 2015, respectively, and the Hospital's investment in Chesapeake-Potomac Healthcare Alliance (the Alliance) represents approximately 65% and 63% of the reported investment balance in affiliates as of June 30, 2016 and 2015, respectively, summarized financial information for CMIC and the Alliance is also presented in this note.

Calvert Medical Imaging Center

Calvert Medical Imaging Center (CMIC) is a joint venture between CHV and American Radiology Services, Inc. that operates diagnostic imaging facilities. CHV maintains a 50% interest in CMIC.

Summarized unaudited financial information of CMIC as of and for the years ended June 30 is presented below:

	<u>2016</u>	<u>2015</u>
Total assets	<u>\$ 2,797</u>	<u>\$ 3,192</u>
Total liabilities	\$ 349	\$ 512
Partners' capital	<u>2,448</u>	<u>2,680</u>
Total liabilities and partners' capital	<u>\$ 2,797</u>	<u>\$ 3,192</u>
	<u>2016</u>	<u>2015</u>
Total revenue	\$ 7,171	\$ 7,078
Net income	\$ 473	\$ 442

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NRH/CPT Regional Rehab, LLC

CHV invested in NRH/CPT Regional Rehab, LLC (NRH/CPT) for the purpose of providing comprehensive and coordinated physical therapy and rehabilitation services in St. Mary's and Charles counties. CHV maintains a 15% interest in NRH/CPT.

Chesapeake-Potomac Healthcare Alliance, LLC

Chesapeake-Potomac Healthcare Alliance, LLC (the Alliance) is a joint venture in which the Hospital and two other hospitals have invested equally. It was created to provide certain healthcare services to the population of southern Maryland. The Alliance is a 60% owner of Chesapeake Potomac Regional Cancer Center, LLC (CPRCC), a limited liability company which owns and operates two outpatient radiation oncology centers. The other 40% of CPRCC is owned by Holy Cross Hospital of Silver Spring and Adventist Healthcare, Inc. The Alliance is also one of two members in Chesapeake-Potomac Home Health Agency, Inc., a Maryland nonstock corporation that was formed in 1995 for the purpose of providing home health care and other health care services to individuals in need of such services in Calvert, Charles and St. Mary's counties.

Summarized unaudited financial information of the Alliance as of and for the years ended June 30 is presented below:

	<u>2016</u>	<u>2015</u>
Total assets	<u>\$ 14,148</u>	<u>\$ 13,482</u>
Total liabilities	\$ 2,252	\$ 2,150
Members' equity	<u>11,896</u>	<u>11,332</u>
Total liabilities and members' equity	<u>\$ 14,148</u>	<u>\$ 13,482</u>
Total revenue	\$ 13,211	\$ 12,768
Net income	\$ 329	\$ 48

Freestate Healthcare Insurance Company, LTD

Freestate Healthcare Insurance Company, LTD is a captive insurance company formed in the Cayman Islands. It is owned by five Maryland hospitals. Freestate provides insurance coverage to its shareholders for professional liability and comprehensive general liability (see Note 9).

Maryland eCare, LLC

Maryland eCare, LLC is a joint venture formed by six Maryland hospitals to provide remote monitoring technology with clinical decision support and physician/nursing services for their use in intensive care units and other clinical areas within their respective hospitals. The Hospital maintains a 6.90% and 8.33% interest in this joint venture at June 30, 2016 and 2015, respectively.

Prince Frederick Surgery Center, LLC

Prince Frederick Surgery Center, LLC (PFSC) operates a surgical center in Prince Frederick Maryland. It was formed initially as a joint venture by five physicians in May 2009. On July 1, 2015, CSC acquired a 25% interest in PFSC.

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4. Investments

Unrestricted investments, stated at market value, which approximates fair value, at June 30 include:

	<u>2016</u>	<u>2015</u>
Equity mutual funds	\$ 48,437	\$ 52,709
Fixed income mutual funds	24,838	21,903
Guaranteed investment account	145	339
Corporate and municipal bonds	11,547	12,377
U.S. government issues	8,268	5,669
Agency securities	1,002	1,001
CMO and asset backed securities	1,827	-
Alternative investments	<u>5,026</u>	<u>5,586</u>
	<u>101,090</u>	<u>99,584</u>
Less - short-term investments	<u>118</u>	<u>944</u>
Long-term investments	<u>\$ 100,972</u>	<u>\$ 98,640</u>

Assets limited as to use, stated at fair value, at June 30 include:

	<u>2016</u>	<u>2015</u>
Internally designated for capital acquisition and scholarships:		
Cash and cash equivalents	\$ 910	\$ 983
Net pledges receivable	50	-
Equity mutual funds	<u>3,253</u>	<u>3,294</u>
	<u>\$ 4,213</u>	<u>\$ 4,277</u>

Assets held by a trustee under the indenture agreement consist of the following funds at June 30:

	<u>2016</u>	<u>2015</u>
Held by trustee under indenture agreement:		
Cash and cash equivalents	<u>\$ 840</u>	<u>\$ 977</u>
	<u>2016</u>	<u>2015</u>
Debt service fund	<u>\$ 840</u>	<u>\$ 977</u>

The debt service fund was comprised of principal and interest funds held by a trustee in accordance with the Hospital's bond indentures.

Investment income and gains or losses for assets limited as to use, cash equivalents and other investments are comprised of the following for the years ended June 30:

	<u>2016</u>	<u>2015</u>
Income:		
Interest and dividend income	\$ 2,431	\$ 1,731
Realized gains	<u>3,714</u>	<u>2,272</u>
Total investment income	<u>\$ 6,145</u>	<u>\$ 4,003</u>
Unrealized losses on investments	<u>\$ (6,073)</u>	<u>\$ (2,043)</u>

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Current accounting standards define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and establish a framework for measuring fair value, and establish a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date, as follows:

- Level 1:** Quoted prices in active markets for identical assets or liabilities.
- Level 2:** Observable input other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3:** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The following discussion describes the valuation methodologies used for financial assets measured at fair value. The techniques utilized in estimating the fair values are affected by the assumptions used, including discount rates, and estimates of the amount and timing of future cash flows. Care should be exercised in deriving conclusions about System's business, its value, or financial position based on the fair value information of financial assets presented below.

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial asset, including estimates of the timing, amount of expected future cash flows, and the credit standing of the issuer. In some cases, the fair value estimates cannot be substantiated by comparison to independent markets. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial asset. Furthermore, the disclosed fair values do not reflect any premium or discount that could result from offering for sale at one time an entire holding of a particular financial asset. Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in the amounts disclosed.

Fair values for the System's fixed maturity securities are based on prices provided by its investment managers, who use a variety of pricing sources to determine market valuations. Each designate specific pricing services or indexes for each sector of the market based upon the provider's experience. The System's fixed maturity securities portfolio is highly liquid, which allows for a high percentage of the portfolio to be priced through pricing services.

Fair values of equity securities have been determined by the System from observable market quotations, when available. Private placement securities and other equity securities where a public quotation is not available are valued by using broker quotes.

The guaranteed investment account is valued at contract value, (which includes contributions made, adjusted for interest earned, withdrawals, and administrative expenses) which approximates fair value.

The System's investments include investments in limited partnerships and other alternative investments, which are made in accordance with the System's investment policies. The limited partnerships acquire, hold, invest, manage, dispose of, and otherwise deal in and with securities of all kinds and descriptions. Publicly traded securities are generally valued by reference to closing market prices on one or more national securities exchange or generally accepted pricing services selected by the fund managers of the limited partnership. Securities not valued by such pricing services will be valued upon bid quotations obtained from independent dealers in the securities. The equity in earnings or losses from these investments is recorded as a component of investment income in the accompanying consolidated statements of operations and other changes in unrestricted net assets.

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Although the various fund managers use their best judgment at estimating the fair value of the alternative investments, there are inherent limitations in any valuation technique. Therefore, the value is not necessarily indicative of the amount that could be realized in a current transaction. Future events will also affect the estimates of fair value, and the effect of such events on the estimates of the fair value could be material.

The following table presents the System's fair value hierarchy for assets measured at fair value on a recurring basis as of June 30, 2016:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 1,750	\$ -	\$ -	\$ 1,750
Equity mutual funds				
Diversified emerging markets	1,406	-	-	1,406
Foreign large blend	54	-	-	54
Foreign large value	4,106	-	-	4,106
Foreign large growth	4,119	-	-	4,119
Foreign small/mid value	1,521	-	-	1,521
Large growth	9,440	-	-	9,440
Large value	11,311	-	-	11,311
Large blend	90	-	-	90
Mid cap growth	4,716	-	-	4,716
Mid cap value	5,158	-	-	5,158
Mid cap blend	21	-	-	21
Small value	1,759	-	-	1,759
Small blend	4,717	-	-	4,717
World stock	18	-	-	18
Moderate allocation	3,253	-	-	3,253
Fixed income mutual funds				
Intermediate term bond	20,315	-	-	20,315
Inflation-protected bond	102	-	-	102
World bond	16	-	-	16
Short-term	4,404	-	-	4,404
Corporate bonds	8,977	-	-	8,977
Municipal bonds	2,571	-	-	2,571
Alternative investments	-	2,257	2,769	5,026
Agency securities	1,002	-	-	1,002
CMO and asset backed securities	1,827	-	-	1,827
U.S. government issues (Maturity 1 - 10 years)	8,269	-	-	8,269
Guaranteed investment account	145	-	-	145
	<u>\$ 101,067</u>	<u>\$ 2,257</u>	<u>\$ 2,769</u>	<u>\$ 106,093</u>

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The following table presents the System's fair value hierarchy for assets measured at fair value on a recurring basis as of June 30, 2015:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 1,960	\$ -	\$ -	\$ 1,960
Equity mutual funds				
Diversified emerging markets	3,238	-	-	3,238
Foreign large blend	118	-	-	118
Foreign large value	9,547	-	-	9,547
Foreign small/mid value	1,676	-	-	1,676
Large growth	9,539	-	-	9,539
Large value	16,170	-	-	16,170
Large blend	458	-	-	458
Mid cap growth	4,935	-	-	4,935
Mid cap value	52	-	-	52
Mid cap blend	15	-	-	15
Small value	1,740	-	-	1,740
Small blend	5,196	-	-	5,196
World allocation	2,507	-	-	2,507
World stock	25	-	-	25
Moderate allocation	787	-	-	787
Fixed income mutual funds				
Intermediate term bond	17,629	-	-	17,629
World bond	10	-	-	10
Short-term	4,264	-	-	4,264
Corporate bonds	7,655	-	-	7,655
Municipal bonds	4,722	-	-	4,722
Alternative investments	-	2,516	3,070	5,586
Agency securities	1,001	-	-	1,001
U.S. government issues (Maturity 1 - 10 years)	5,669	-	-	5,669
Guaranteed investment account	339	-	-	339
	<u>\$ 99,252</u>	<u>\$ 2,516</u>	<u>\$ 3,070</u>	<u>\$ 104,838</u>

The following table presents the activity during 2016 and 2015 for the Level 3 funds:

	<u>2016</u>	<u>2015</u>
Market value, beginning of year	\$ 3,070	\$ 3,125
Net realized gains	238	3
Purchases	2,654	0
Disbursements	(2,681)	(36)
Unrealized losses gains	<u>(512)</u>	<u>(22)</u>
Market value, end of year	<u>\$ 2,769</u>	<u>\$ 3,070</u>

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The total restricted and unrestricted hedge fund alternative investments as of June 30, 2016 and 2015 are as follows:

Investment Strategy	Liquidity Restrictions	2016		2015	
		Level 2	Level 3	Level 2	Level 3
The fund invests in a diversified portfolio of underlying hedge funds. The underlying funds use a variety of investment strategies and have restrictions on redemptions. The fund may use leverage and has a secured credit line available which had an outstanding balance owed at December 31, 2014 and 2015.	Quarterly at net asset value with 65-days' notice. Payments are subject to holdback until after the annual audit if more than 95% of the capital account is redeemed.	\$ 2,257	\$ -	\$ 2,516	\$ -
The fund invests in the Master Fund which is in underlying hedge funds. The underlying funds use a variety of investment strategies with distressed/structured products being the largest. The fund owned more than 50% of the Master Fund at December 31, 2014 and 2015.	Quarterly at net asset value with 95-days' notice.	-	2,769	-	3,070
		<u>\$ 2,257</u>	<u>\$ 2,769</u>	<u>\$ 2,516</u>	<u>\$ 3,070</u>

5. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at June 30:

	2016	2015
Purchase of equipment	\$ 416	\$ 66
Health education	157	115
Health care services	146	160
	<u>\$ 719</u>	<u>\$ 341</u>

Permanently restricted net assets at June 30 are restricted to:

	2016	2015
Investments to be held in perpetuity, the income		

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from which is expendable to support health education	<u>\$ 993</u>	<u>\$ 1,029</u>
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6. Property and Equipment

A summary of property and equipment at June 30 follows:

	<u>2016</u>	<u>2015</u>
Land improvements	\$ 2,574	\$ 2,580
Buildings	38,612	38,612
Building improvements	44,843	37,852
Fixed equipment	5,268	5,123
Movable equipment	<u>80,711</u>	<u>74,286</u>
	172,008	158,453
Less - accumulated depreciation and amortization	<u>116,065</u>	<u>106,756</u>
	55,943	51,697
Land	6,016	5,658
Construction in progress	<u>9,008</u>	<u>5,634</u>
Property and equipment, net	<u>\$ 70,967</u>	<u>\$ 62,989</u>

Depreciation expense for the years ended June 30, 2016 and 2015 amounted to \$9,294 and \$9,380, respectively.

7. Long-Term Debt

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

	<u>2016</u>	<u>2015</u>
Maryland Health and Higher Educational Facilities Authority Revenue Bonds (2012 Revenue Bonds); maturing in varying amounts from September 1, 2012 to June 1, 2027; interest due monthly at a fixed rate of 2.6% per annum until July 24, 2022 at which time the interest rate shall be adjusted.	\$ 14,941	\$ 16,095
Maryland Health and Higher Educational Facilities Authority Revenue Bonds (2013 Revenue Bonds); maturing in varying amounts from July 1, 2014 to July 1, 2038; interest due semi-annually at rates ranging from 3.0% to 5.18%; (4.0% and 3.0% at June 30 2016, and 2015, respectively).	30,880	31,095
Maryland Health and Higher Educational Facilities Authority Revenue Bonds (2015 Revenue Bonds); maturing in varying amounts from October 1, 2015 to September 1, 2035; interest due monthly at a fixed rate of 2.7% per annum.	<u>20,389</u>	-
	66,210	47,190
Less - current portion	<u>2,223</u>	<u>1,370</u>
	63,987	45,820
Less - amortized original issue discount	<u>101</u>	<u>106</u>
	<u>\$ 63,886</u>	<u>\$ 45,714</u>

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Series 2012 Revenue Bonds

The 2012 Revenue Bonds were issued by the Authority on July 1, 2012 for the purpose of refunding the 1998 Revenue Bonds. The master loan agreement for the 1998 Revenue Bonds remained substantially unchanged. The remaining financing costs and original issue discount from the 1998 Revenue Bonds were written off in July 2012 and resulted in a loss on extinguishment of debt. The related debt service reserve fund was liquidated.

The Obligated Group for the 2012 Revenue Bonds is composed of the Hospital and the System. The financing was completed through SunTrust Bank and is a tax exempt issuance. Terms of the financing agreement include a fixed rate of 2.6% per annum until July 24, 2022, at which time the interest rate shall be adjusted and the 2012 Revenue Bonds are subject to mandatory purchase unless SunTrust Bank agrees to extend such period, the Obligated Group obtains another purchaser, or the Authority, at the request of the Obligated Group, converts the interest mode applicable to the 2012 Revenue Bonds to another interest mode for which a purchaser can be found. The 2012 Revenue Bonds mature on June 1, 2027. The required days cash on hand is 90 days and the required debt service coverage ratio is 1.25.

Series 2013 Revenue Bonds

The 2013 Revenue Bonds were issued by the Authority on August 7, 2013 for the purpose of refunding the 2004 Revenue Bonds. The remaining financing costs and original issue discount from the 2004 Revenue Bonds were written off in August 2013 and resulted in a loss on extinguishment of debt. The related debt service reserve fund was liquidated.

The Obligated Group for the 2013 Revenue Bonds is composed of the Hospital and the System. As security for the performance of its obligations under the related Loan Agreement, the Obligated Group members have granted a security interest in its receipts, revenues, rental income and other amounts received by or on behalf of any Obligated Group member to the Authority. The Obligated Group is not required to maintain a debt service reserve fund. The Series 2013 Revenue Bonds also place limits on the incurrence of additional borrowings. The required debt service coverage ratio is 1.10. Series 2013 bonds maturing on or after July 1, 2024 are subject to redemption prior to maturity beginning on July 1, 2023 at the option of the Authority upon the direction of the Hospital.

Series 2015 Revenue Bonds

The 2015 Revenue Bonds were issued by the Authority on September 10, 2015 for the purpose of financing the expansion and renovation of the radiology department at the Hospital, the acquisition and installation of a new information technology system, the acquisition of a parcel of land and the acquisition and installation of certain fixtures, equipment and machinery for the Hospital.

The Obligated Group for the 2015 Revenue Bonds is composed of the Hospital and the System. The financing was completed through The Columbia Bank and is a tax exempt issuance. Terms of the financing agreement include a fixed rate of 2.7% for ten years with an amortization schedule of twenty years. The Obligated Group is not required to maintain a debt service reserve fund.

Principal payments due under all debt instruments as of June 30, 2016 are as follows:

2017	\$	2,223
2018		2,287
2019		2,353
2020		2,418
2021		2,489
Thereafter		<u>54,440</u>
Total	\$	<u>66,210</u>

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8. Employee Pension Plans

The Hospital has a defined contribution plan whereby contributions are made on an annual basis by participating employees and the Hospital. Substantially all employees are eligible to participate, subject to meeting the criteria specified by the plan. Participating employees are permitted to contribute up to 20% of their annual compensation, not to exceed a maximum threshold as set forth by the Internal Revenue Service on an annual basis. The Hospital provides a matching contribution not to exceed 2% of each employee's base annual compensation. Employees hired January 1, 2008 and later are only eligible to participate in the defined contribution plan, and cannot participate in the defined benefit plan sponsored by the Hospital described below. They receive an employer contribution of 2.5% of their annual W-2 wages, and they may receive an additional employer matching contribution of up to 2% based upon the participant's contribution. The employer contributions were \$808 and \$634 during the years ended June 30, 2016 and 2015, respectively.

Additionally, the Hospital has a qualified non-contributory defined benefit pension plan covering substantially all employees who were employed by the Hospital prior to January 1, 2008, as well as certain employees of the Hospital who meet certain age and service requirements. Effective January 1, 2008, the Hospital instituted a "soft freeze" of the defined benefit plan. Employees hired or rehired after January 1, 2008 are not eligible to join the plan. Benefits will continue to accrue in the plan for current participants, and no change to the formula used to calculate benefits will be made. The plan was amended effective January 1, 1993 from a defined benefit plan, the benefits of which were calculated primarily upon age and employee compensation near retirement, to a cash balance defined benefit plan, which calculates benefits based upon age and years of service. The Hospital makes annual contributions to the plan based on the advice of consulting actuaries. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. The Hospital used a June 30 measurement date for its plan in 2016 and 2015. During 2016, the Hospital began purchasing annuity contracts to settle certain benefit obligations.

The following table sets forth the changes in the projected benefit obligation at June 30:

	<u>2016</u>	<u>2015</u>
Benefit obligation at beginning of year	\$ 40,433	\$ 46,360
Service cost	1,221	1,307
Interest cost	1,785	2,177
Plan amendments	90	(2,468)
Actuarial loss	4,488	952
Benefits paid	<u>(2,725)</u>	<u>(7,895)</u>
Benefit obligation at end of year	<u>\$ 45,292</u>	<u>\$ 40,433</u>

The following table sets forth the changes in the plan assets at June 30:

	<u>2016</u>	<u>2015</u>
Fair value of plan assets at beginning of year	\$ 32,242	\$ 36,970
Actual return on plan assets	(476)	966
Employer contributions	1,500	2,201
Actual benefits paid	<u>(2,725)</u>	<u>(7,895)</u>
Fair value of plan assets at end of year	<u>\$ 30,541</u>	<u>\$ 32,242</u>

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In accordance with current standards, the Hospital recognized the full extent of the underfunded (a liability) status of the plan as a noncurrent liability in the accompanying consolidated financial statements, and the underfunded status is measured as the difference between the fair value of the plan assets and the projected benefit obligation. As of June 30, 2016 and 2015, the plan's projected benefit obligation exceeded the fair value of the plan's assets by \$14,751 and \$8,190, respectively. The plan's accumulated benefit obligation was \$42,747 and \$38,355 as of June 30, 2016 and 2015, respectively.

Net periodic pension cost for the years ended June 30 include the following components:

	<u>2016</u>	<u>2015</u>
Service cost	\$ 1,221	\$ 1,307
Interest cost	1,785	2,177
Expected return on plan assets	(2,070)	(2,817)
Amortization of prior service cost	(308)	(30)
Recognized net actuarial loss	<u>1,220</u>	<u>1,229</u>
Preliminary periodic benefit cost	1,848	1,866
Settlement expense	<u>-</u>	<u>2,413</u>
	<u>\$ 1,848</u>	<u>\$ 4,279</u>

The following table sets forth the weighted average assumptions used to determine benefit obligations as of June 30:

	<u>2016</u>	<u>2015</u>
Discount rate	3.86%	4.55%
Rate of compensation increase	3.00%	3.00%

The following table sets forth the weighted average assumptions used to determine net periodic benefit costs for the years ended June 30:

	<u>2016</u>	<u>2015</u>
Discount rate	4.55%	4.55%
Expected return on plan assets	6.50%	7.50%
Rate of compensation increase	3.00%	3.00%

Cumulative amounts recognized in unrestricted net assets as of June 30 consist of:

	<u>2016</u>	<u>2015</u>
Net loss	\$ 19,751	\$ 13,937
Prior service credit	<u>(2,073)</u>	<u>(2,472)</u>
Total	<u>\$ 17,678</u>	<u>\$ 11,465</u>

Calvert Health System, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(dollars in thousands)

The investment of plan assets is guided by the pension investment policy. Plan assets are invested to ensure that the pension plan has the ability to pay all benefit and expense obligations when due, to maximize return within prudent levels of risk for pension assets and to maintain a funding cushion for unexpected developments. The target weighted-average asset allocation of pension investments in mutual funds is 60% equities and 40% debt securities and cash. Mutual fund investments in equity securities primarily include investments in large-cap and mid-cap companies. Fixed maturity securities primarily include corporate bonds. Mutual funds (fixed maturity and equity) are valued by observable market quotations.

The guaranteed deposit account is valued at contract value, (which includes contributions made, adjusted for interest earned, participant withdrawals, and administrative expenses) which approximates fair value. There were no significant transfer between the indicated levels during 2016 and 2015.

The fair values of the Hospital's pension plan assets at June 30, 2016, by asset category are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Short-term investments	\$ 71	\$ -	\$ 71
Equity mutual funds			
Mid-cap growth	1,773	-	1,773
Foreign large blend	2,661	-	2,661
Mid-cap value	1,790	-	1,790
Large growth	3,858	-	3,858
Large value	3,848	-	3,848
Large blend	4,131	-	4,131
Fixed income mutual funds			
Intermediate-term bond	1,133	-	1,133
High yield bond	3,085	-	3,085
Inflation-protected bond	2,202	-	2,202
Short-term bond	3,079	-	3,079
Guaranteed deposit account	-	2,910	2,910
	<u>\$ 27,631</u>	<u>\$ 2,910</u>	<u>\$ 30,541</u>

The fair values of the Hospital's pension plan assets at June 30, 2015, by asset category are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Short-term investments	\$ 32	\$ -	\$ 32
Equity mutual funds			
Mid-cap growth	1,960	-	1,960
Foreign large blend	2,771	-	2,771
Mid-cap value	1,874	-	1,874
Large growth	4,341	-	4,341
Large value	4,062	-	4,062
Large blend	4,409	-	4,409
Fixed income mutual funds			
Intermediate-term bond	1,209	-	1,209
High yield bond	3,175	-	3,175
Inflation-protected bond	2,263	-	2,263
Short-term bond	3,155	-	3,155
Guaranteed deposit account	-	2,991	3,075
	<u>\$ 29,251</u>	<u>\$ 2,991</u>	<u>\$ 32,242</u>

Calvert Health System, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(dollars in thousands)

The Hospital expects to contribute \$2,340 to its pension plan for fiscal year ending June 30, 2017. The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

2017	\$	2,516
2018		2,475
2019		2,547
2020		2,631
2021		2,686
2022 to 2026		<u>14,586</u>
Total	\$	<u>27,441</u>

9. Malpractice Insurance

Prior to March 1, 2005, the Hospital maintained a professional liability insurance policy on a claims-made basis. Under this insurance policy, the Hospital was insured for individual claims up to \$1,000 with a total annual aggregate of \$3,000 with no deductible for claims made. The Hospital also had excess coverage of up to \$10,000 for individual claims and in the aggregate.

Effective March 1, 2005, the Hospital became a shareholder of the newly formed Freestate Healthcare Insurance Company, Ltd. (Freestate), a captive insurance company formed in the Cayman Islands. As of June 30, 2016, the Hospital maintains a 20% shareholder interest in Freestate. The Hospital decided to become a shareholder of Freestate when the Hospital's insurance company decided not to continue to write insurance policies for hospitals within the State of Maryland effective March 1, 2005. The Hospital believes that becoming a shareholder of a captive insurance company provides the best long-term solution to providing insurance coverage that is cost effective and predictable. Freestate provides insurance coverage on a claims-made basis to its owners and their affiliates for professional liability claims and comprehensive general liability of \$1,000 for each and every claim. Freestate has entered into reinsurance and excess policy agreements with independent insurance companies to limit its losses for professional liability and comprehensive general liability claims. The Hospital has \$10,000 of additional insurance in the aggregate through such reinsurance arrangements. Retrospective premium assessments and credits are calculated based on the aggregate experience of all named insureds under the policy. Each named insured's assessment or credit is based on the percentage of their actual exposure to the actual exposure of all named insureds. In management's opinion, the assets of Freestate are sufficient to meet its obligations as of June 30, 2016. If the financial condition of Freestate were to materially deteriorate in the future, and Freestate was unable to pay its claim obligations, the responsibility to pay those claims would return to the member hospitals.

CPTSFC maintains a professional liability insurance policy on a claims-made basis. CPTSFC is insured for individual claims up to \$1,000 with a total annual aggregate of \$3,000 with no deductible.

The Hospital is involved in litigation arising in the ordinary course of business. Claims alleging malpractice have been asserted against the Hospital and are currently in various stages of litigation. Additional claims may be asserted against the Hospital arising from services provided through June 30, 2016.

As of June 30, 2016 and 2015, the System recorded insurance recoverables and related professional claims liability of \$3,723 and \$4,120, respectively, in long-term assets and liabilities, respectively, in the accompanying consolidated statements of financial position. An estimated liability for incurred but not reported professional liability claims has also been recorded in the amount of approximately \$902 and \$890 in long-term liabilities as of June 30, 2016 and 2015, respectively. Management believes this estimate is adequate to provide for all professional liability claims that have been incurred through June 30, 2016 but not reported to its insurance carriers.

Calvert Health System, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(dollars in thousands)

10. Maryland Health Services Cost Review Commission

Patient service revenue is recorded at rates established by the HSCRC. Effective July 1, 2010, the Hospital entered into a Total Patient Revenue (TPR) rate agreement with the HSCRC. This agreement was effective for three years and the Hospital executed a second three-year TPR agreement effective July 1, 2013. Under the TPR system, the Hospital is provided a fixed revenue amount (CAP) under which it must operate each year. The CAP is adjusted annually for inflation, change in the Hospital's payer mix and uncompensated care, and change in population. Approximately 95% of the total operating revenue of the Hospital falls under the TPR system.

11. Concentration of Credit and Business Risk

The System provides health care services to residents located primarily in Calvert, St. Mary's, southern Anne Arundel and Charles counties. The System generally does not require collateral or other security in extending credit; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits receivable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid, health maintenance organizations and commercial insurance policies).

At June 30, the System had patient accounts receivable from third-party payers and others as follows:

	<u>2016</u>		<u>2015</u>	
Medicare	\$ 7,045	29.6%	\$ 5,719	25.3%
Medicaid (including managed care)	3,227	13.6%	3,799	16.8%
Blue Cross	3,550	14.9%	2,925	12.9%
Commercial and other	2,222	9.3%	2,419	10.7%
HMO	4,091	17.2%	3,878	17.1%
Self-pay	<u>3,670</u>	<u>15.4%</u>	<u>3,895</u>	<u>17.2%</u>
	23,805	<u>100.0%</u>	22,635	<u>100.0%</u>
Less - contractual adjustments	<u>(3,573)</u>		<u>(2,759)</u>	
	<u>\$ 20,232</u>		<u>\$ 19,876</u>	

Patient service revenue, by payer class, consisted of the following for years ended June 30:

	<u>2016</u>		<u>2015</u>	
Medicare	\$ 72,431	36.8%	\$ 66,494	36.0%
Medicaid (including managed care)	31,825	16.2%	31,413	16.9%
Blue Cross	39,318	20.0%	35,438	19.2%
Commercial and other	8,461	4.3%	8,804	4.8%
HMO	41,102	20.9%	39,062	21.1%
Self-pay	<u>3,447</u>	<u>1.8%</u>	<u>3,625</u>	<u>2.0%</u>
	196,584	<u>100.0%</u>	184,836	<u>100.0%</u>
Less - contractual adjustments	(43,174)		(36,457)	
Less - charity care	(3,936)		(4,478)	
Less - provision for bad debts	<u>(852)</u>		<u>(1,388)</u>	
	<u>\$ 148,622</u>		<u>\$ 142,513</u>	

Calvert Health System, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(dollars in thousands)

12. Functional Expenses

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

	<u>2016</u>	<u>2015</u>
Health care services	\$ 126,803	\$ 120,954
General and administrative	<u>24,609</u>	<u>24,352</u>
	<u>\$ 151,412</u>	<u>\$ 145,306</u>

13. Lease Obligations

The System is obligated under various operating leases for several office facilities and equipment. Total office rent and equipment lease expense was \$3,326 and \$3,055 for the years ended June 30, 2016 and 2015, respectively, and is reported as a component of other expenses in the accompanying consolidated statements of operations and other changes in unrestricted net assets. The future minimum lease payments expected to be made to non-affiliated parties under noncancelable operating leases are as follows for the years ended June 30:

2017	\$ 3,304
2018	2,913
2019	2,718
2020	2,471
2021	<u>2,436</u>
	<u>\$ 13,842</u>

Three of the four medical office buildings owned by the System were sold on August 29, 2013. As part of the sales transaction, the System continues to lease space in the buildings from the new owners. Rents to be received in the future from affiliated enterprises and other tenants are as follows for the years ended June 30:

2017	\$ 646
2018	181
2019	127
2020	77
2021	<u>67</u>
	<u>\$ 1,098</u>

Rental income totaling \$319 and \$317 has been recognized in the accompanying consolidated statements of operations and other changes in unrestricted net assets for the years ended June 30, 2016 and 2015, respectively.

14. Certain Risks and Uncertainties

The Hospital's ability to maintain or increase future revenues could be adversely affected by: (1) proposed or future changes in the laws, rules, regulations, and policies relating to the definition, activities, or taxation of not-for-profit tax-exempt entities; (2) the enactment into law of all or any part of the current budget resolutions under consideration by Congress related to Medicare and Medicaid reimbursement methodology or further reductions in payments to hospitals and other health care providers; (3) limited supply of physicians nationally which may limit the Hospital's ability to meet the healthcare demands of the population within its primary and secondary service areas (4) the ultimate impact of the federal Patient Protection and Affordable Care Act and the Health Care Education Affordability Reconciliation Act of 2010.

The Joint Commission a non-governmental privately owned entity, provides accreditation status to hospitals and other health care organizations in the United States. Such accreditation is based upon a number of requirements such as undergoing periodic surveys conducted by Joint Commission personnel. Certain managed care payers require hospitals to have appropriate Joint Commission accreditation in order to participate in those programs. In addition, the Center for Medicare and Medicaid Services (CMS), the agency with oversight of the Medicare and Medicaid programs, provides "deemed status" for facilities having Joint Commission accreditation. By being Joint Commission accredited, facilities are "deemed" to be in compliance with the Medicare and Medicaid conditions of participation. Termination as a Medicare provider or exclusion from any or all of these programs or payers would have a materially negative impact on the future financial position, operating results and cash flows of the Hospital. In November 2014, the Hospital was surveyed by the Joint Commission and received a full three-year Joint Commission accreditation through February 2018.

The HSCRC has jurisdiction over hospital reimbursement in Maryland by an agreement with the Centers for Medicare and Medicaid Services (CMS) based on a waiver from the Medicare prospective payment system under Section 1814(b) of the Social Security Act. In January 2014, CMS approved a new waiver to modernize Maryland's unique all-payer rate-setting system for hospital services. The new waiver consists of a five year performance period. Maryland Hospitals will commit to achieving significant quality improvements including reductions in 30-day readmissions and hospital acquired conditions. Maryland will also limit annual Medicare per capita hospital cost growth to a rate lower than the national annual per capita growth rate per year for 2015 to 2018. Under this model, Medicare is estimated to save at least \$330 million over the next five years. Under the waiver, Maryland will shift virtually all of its hospital revenue over the five year performance period into global payment models.

In connection with the new waiver, the HSCRC introduced new revenue arrangements, including the Global Budget Revenue (GBR) model. This new model for Maryland Hospitals moves payment to hospitals from each individual service to a total revenue for each hospital or a combination of hospitals to provide hospitals flexibility in the objectives of better care for individuals, higher levels of overall population health, and improved health care affordability. It removes the financial incentive from increasing volume and provides incentive to work with partners to provide care in the approach setting.

The Medicare and state Medicaid reimbursement programs represent a substantial portion of the System's revenues and the System'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 System.

Calvert Health System, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(dollars in thousands)

Changes in Federal and state reimbursement funding mechanisms and related government budgetary constraints could have a significant adverse effect on the System. The healthcare industry is subject to numerous laws and regulation from federal, state and local governments, and the government has increased enforcement of Medicare and Medicaid anti-fraud and abuse laws, as well as physician self-referral laws (STARK law and regulation). The System's compliance with these laws and regulations is subject to ongoing internal monitoring as well as periodic governmental review and inquiries, and the System has responded appropriately to any such compliance matters. The System is aware of certain asserted and unasserted compliance matters, and from time to time, the System may agree to resolve certain compliance matters with the government. The System will continue to monitor its compliance and all related government inquiries and respond appropriately. The final outcomes of these matters cannot be determined at this time.

As a result of recently enacted and pending federal healthcare reform legislation, substantial changes are anticipated in the 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 does not affect the consolidated financial statements for the year ended June 30, 2016.

15. Fair Value of Financial Instruments

The carrying amounts reported in the consolidated statements of financial position for cash and cash equivalents, investments, patient accounts receivable, assets limited as of use, accounts payable and accrued expenses, and third-party advances approximate the related fair values. The composition and related fair values of assets limited as to use and investments are disclosed in Note 4. The fair value of the System's outstanding long-term obligations as of June 30, 2016 and 2015 was approximately \$71,065 and \$49,457, respectively.

16. Endowment

Current accounting standards provide guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) and additional disclosures about an organization's endowment funds. The State of Maryland has adopted UPMIFA.

The System's endowment consists of two donor-restricted funds. Net assets associated with the endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Board of Directors of the System has interpreted the Maryland State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Hospital classifies as permanently restricted net assets, (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

In accordance with SPMIFA, the System considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The purposes of the System and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation

Calvert Health System, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(dollars in thousands)

5. The expected total return from income and the appreciation of investments
6. Other resources of the System
7. The investment policies of the System

From time to time, the fair value of assets associated with the endowment fund may decline below the level that the donor or SPMIFA required the System to retain as a fund of perpetual duration. There were no such deficiencies as of June 30, 2016 or 2015.

The System has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity. Under this policy, as approved by the Board of Directors, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the Lehman Intermediate Government/Corporate Bond index while assuming a moderate level of investment risk. The System expects its endowment funds, over time, to provide an average rate of return of approximately 8% percent annually. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate-of-return objectives, the System relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The System targets a diversified asset allocation that places a greater emphasis on highly liquid investments such as money market accounts to achieve its long-term return objectives within prudent risk constraints.

The endowment's net asset composition as of June 30, 2016 and 2015 and the changes therein, all of which are reported as permanently restricted net assets, were as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>
Donor-restricted endowment, June 30, 2016	\$ -	\$ -	\$ 993
Changes in Endowment Net Assets for the Fiscal Year June 30, 2016			
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>
Endowment net assets, beginning of year	\$ -	\$ -	\$ 1,029
Investment return:			
Net appreciation (realized and unrealized)	-	-	(7)
Other changes:			
Contributions	-	-	-
Released from restriction	-	29	(29)
Endowment net assets, end of year	<u>\$ -</u>	<u>\$ 29</u>	<u>\$ 993</u>

Calvert Health System, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(dollars in thousands)

	<u>Temporarily Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>
Donor-restricted endowment, June 30, 2015	\$ -	\$ -	\$ 1,029
Changes in Endowment Net Assets for the Fiscal Year June 30, 2015			
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>
Endowment net assets, beginning of year	\$ -	\$ -	\$ 1,040
Investment return:			
Net appreciation (realized and unrealized)	-	-	25
Other changes:			
Contributions	-	-	-
Released from restriction	-	36	(36)
Endowment net assets, end of year	<u>\$ -</u>	<u>\$ 36</u>	<u>\$ 1,029</u>

Supplementary Consolidating Information

Calvert Memorial Hospital of Calvert County and Subsidiary
Consolidating Statement of Financial Position
June 30, 2016
(dollars in thousands)

	<u>Calvert Memorial Hospital</u>	<u>Calvert Memorial Hospital Foundation</u>	<u>Consolidating and Eliminating Entries</u>	<u>Consolidated Calvert Memorial Hospital</u>
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 25,921	\$ 307	\$ -	\$ 26,228
Short-term investments	118	-	-	118
Patient accounts receivable, net	15,258	-	-	15,258
Inventories	2,188	-	-	2,188
Prepaid expenses and other assets	4,925	-	-	4,925
Assets limited as of use, current	840	-	-	840
	<u>49,250</u>	<u>307</u>	<u>-</u>	<u>49,557</u>
Total current assets	49,250	307	-	49,557
Investments	594	-	-	594
Investments in wholly owned subsidiaries	4,074	-	(4,074) (2)	-
Investments in affiliated enterprises	2,943	-	-	2,943
Assets limited as of use	199	4,014	-	4,213
Property and equipment, net	67,835	-	-	67,835
Insurance recoverable	3,723	-	-	3,723
Other assets	2,415	-	-	2,415
	<u>131,033</u>	<u>4,321</u>	<u>(4,074)</u>	<u>131,280</u>
Total assets	\$ 131,033	\$ 4,321	\$ (4,074)	\$ 131,280
LIABILITIES AND NET ASSETS				
Current liabilities:				
Accounts payable and accrued expenses	\$ 18,311	\$ 6	\$ -	\$ 18,317
Intercompany accounts	(3,259)	241	-	(3,018)
Current portion of long-term debt	2,223	-	-	2,223
Advances from third-party payors	4,632	-	-	4,632
	<u>21,907</u>	<u>247</u>	<u>-</u>	<u>22,154</u>
Total current liabilities	21,907	247	-	22,154
Long-term debt, less current portion	63,886	-	-	63,886
Accrued pension cost	14,751	-	-	14,751
Professional liability	4,625	-	-	4,625
Other long-term liabilities	593	-	-	593
	<u>105,762</u>	<u>247</u>	<u>-</u>	<u>106,009</u>
Total liabilities	105,762	247	-	106,009
Net assets:				
Unrestricted - General	20,298	300	(300) (2)	20,298
Unrestricted - Board designated	3,261	2,261	(2,261) (2)	3,261
Temporarily restricted	719	520	(520) (2)	719
Permanently restricted	993	993	(993) (2)	993
	<u>25,271</u>	<u>4,074</u>	<u>(4,074)</u>	<u>25,271</u>
Total net assets	25,271	4,074	(4,074)	25,271
Total liabilities and net assets	\$ 131,033	\$ 4,321	\$ (4,074)	\$ 131,280

See independent auditors' report.

Calvert Memorial Hospital of Calvert County and Subsidiary
Consolidating Statement of Operations
Year Ended June 30, 2016
(dollars in thousands)

	<u>Calvert Memorial Hospital</u>	<u>Calvert Memorial Hospital Foundation</u>	<u>Consolidating and Eliminating Entries</u>	<u>Consolidated Calvert Memorial Hospital</u>
Revenue:				
Patient service revenue (net of contractual adjustments and discounts)	\$ 133,327	\$ -	\$ -	\$ 133,327
Provision for bad debts	(774)	-	-	(774)
Net patient service revenue less provision for bad debts	132,553	-	-	132,553
Rental revenue	24	-	-	24
Other operating revenue	3,836	639	(237) (6)(7)	4,238
Total operating revenue	136,413	639	(237)	136,815
Expense:				
Salaries & wages	54,795	-	-	54,795
Employee benefits	12,582	-	-	12,582
Supplies	21,874	-	-	21,874
Purchased services	6,271	-	-	6,271
Professional fees	5,684	-	-	5,684
Depreciation and amortization	8,653	-	-	8,653
Interest	2,408	-	-	2,408
Other	16,417	607	(237) (6)(7)	16,787
Total operating expenses	128,684	607	(237)	129,054
Income from operations	7,729	32	-	7,761
Nonoperating gains:				
Investment income	774	119	-	893
Income from equity investments	142	-	(32) (4)	110
Total nonoperating gains	916	119	(32)	1,003
Excess of revenue over expenses (expenses over revenue)	8,645	151	(32)	8,764
Transfer of net assets:				
Net assets released from restrictions	118	-	-	118
Equity transfers	(11,599)	-	-	(11,599)
Pension-related changes other than net periodic pension cost	(6,213)	-	-	(6,213)
Net unrealized gains (losses) on investments	-	(128)	-	(128)
Increase (decrease) in unrestricted net assets	\$ (9,049)	\$ 23	\$ (32)	\$ (9,058)

Calvert Memorial Hospital of Calvert County and Subsidiary
Consolidating Statement of Cash Flows
Year Ended June 30, 2016
(dollars in thousands)

	Calvert Memorial Hospital	Calvert Memorial Hospital Foundation	Consolidating and Eliminating Entries	Consolidated Calvert Memorial Hospital
Cash flows from operating activities:				
Increase (decrease) in net assets	\$ (8,712)	\$ 326	\$ (326) (2)	\$ (8,712)
Adjustments to reconcile to net cash from operating activities:				
Provision for bad debts	774	-	-	774
Depreciation and amortization	8,653	-	-	8,653
Donations restricted for capital acquisition	-	(418)	-	(418)
Equity in earnings of wholly owned subsidiaries	(32)	-	32 (4)	-
Equity in earnings of affiliated enterprises	(110)	-	-	(110)
Investment income on restricted assets	-	(213)	-	(213)
Unrealized net losses (gains) on investments	-	348	-	348
Pension-related changes other than net periodic pension cost	6,213	-	-	6,213
Change in:				
Patient accounts receivable	(1,220)	-	-	(1,220)
Inventories	133	-	-	133
Prepaid expenses and other assets	(3,650)	-	-	(3,650)
Accounts payable, accrued expenses & other liabilities	(309)	(411)	-	(720)
Net cash provided by operating activities	<u>1,740</u>	<u>(368)</u>	<u>(294)</u>	<u>1,078</u>
Cash flows from investing activities:				
Purchases of investments	(188)	-	-	(188)
Proceeds from sales of investments	907	-	-	907
Net decrease (increase) in assets limited as to use	94	(242)	-	(148)
Purchases of property and equipment	(17,156)	-	-	(17,156)
Net cash from investing activities	<u>(16,343)</u>	<u>(242)</u>	<u>-</u>	<u>(16,585)</u>
Cash flows from financing activities:				
Repayment of long-term debt	(1,986)	-	-	(1,986)
Proceeds from issuance of long-term debt	21,000	-	-	21,000
Donations received restricted for capital acquisitions	-	418	-	418
Net distributions from (to) investees	(294)	-	294 (5)	-
Investment income on restricted assets	-	213	-	213
Net cash from financing activities	<u>18,720</u>	<u>631</u>	<u>294</u>	<u>19,645</u>
Net change in cash and cash equivalents	4,117	21	-	4,138
Cash and cash equivalents - beginning of year	<u>21,804</u>	<u>286</u>	<u>-</u>	<u>22,090</u>
Cash and cash equivalents - end of year	<u>\$ 25,921</u>	<u>\$ 307</u>	<u>\$ -</u>	<u>\$ 26,228</u>

Calvert Health System, Inc. and Subsidiaries
Consolidating Statement of Financial Position
June 30, 2016
(dollars in thousands)

	Consolidated Calvert Memorial Hospital	Calvert Physician Associates	Calvert Health Ventures	CMH Holding Company	CMH II Holding Company	Calvert Health System, Inc.	Consolidating and Eliminating Entries	Consolidated Calvert Health System, Inc.
ASSETS								
Current assets:								
Cash and cash equivalents	\$ 26,228	\$ 1,149	\$ 1,148	\$ 145	\$ (1)	\$ 10,294	\$ -	\$ 38,963
Short-term investments	118	-	-	-	-	-	-	118
Patient accounts receivable, net	15,258	1,257	68	-	-	-	-	16,583
Inventories	2,188	180	14	-	-	-	-	2,382
Prepaid expenses and other assets	4,925	523	120	47	9	131	(334) (1)	5,421
Assets limited as to use, current	840	-	-	-	-	-	-	840
Total current assets	49,557	3,109	1,350	192	8	10,425	(334)	64,307
Investments	594	-	-	-	-	100,378	-	100,972
Investments in wholly owned subsidiaries	-	-	-	-	-	1,855	(1,855) (2) (5)	-
Investments in affiliated enterprises	2,943	-	1,508	-	-	-	-	4,451
Assets limited as of use	4,213	-	0	-	-	-	-	4,213
Property and equipment, net	67,835	693	109	1,805	525	-	-	70,967
Insurance recoverable	3,723	-	-	-	-	-	-	3,723
Other assets	2,415	149	-	-	-	-	-	2,564
Total assets	\$ 131,280	\$ 3,951	\$ 2,967	\$ 1,997	\$ 533	\$ 112,658	\$ (2,189)	\$ 251,197
LIABILITIES AND NET ASSETS								
Current liabilities:								
Accounts payable and accrued expenses	\$ 18,317	\$ 977	\$ 1,307	\$ 4	\$ -	\$ 31	\$ (334) (1)	\$ 20,302
Intercompany accounts	(3,018)	3,655	(637)	-	-	-	-	-
Current portion of long-term debt	2,223	-	-	-	-	-	-	2,223
Advances from third-party payors	4,632	-	-	-	-	-	-	4,632
Total current liabilities	22,154	4,632	670	4	-	31	(334)	27,157
Long-term debt, less current portion	63,886	-	-	-	-	-	-	63,886
Accrued pension cost	14,751	-	-	-	-	-	-	14,751
Professional liability	4,625	-	-	-	-	-	-	4,625
Other long-term liabilities	593	-	-	-	-	-	-	593
Total liabilities	106,009	4,632	670	4	0	31	(334)	111,012
Net assets:								
Unrestricted - General	20,298	(681)	2,535	1,993	533	112,627	(1,855) (2) (5)	135,450
Unrestricted - Board designated	3,261	-	-	-	-	-	-	3,261
Unrestricted - Noncontrolling interest in subsidiary	-	-	(238)	-	-	-	-	(238)
Temporarily restricted	719	-	-	-	-	-	-	719
Permanently restricted	993	-	-	-	-	-	-	993
Total net assets	25,271	(681)	2,297	1,993	533	112,627	(1,855)	140,185
Total liabilities and net assets	\$ 131,280	\$ 3,951	\$ 2,967	\$ 1,997	\$ 533	\$ 112,658	\$ (2,189)	\$ 251,197

See independent auditors' report.

Calvert Health System, Inc. and Subsidiaries
Consolidating Statement of Operations
Year Ended June 30, 2016
(dollars in thousands)

	Consolidated Calvert Memorial Hospital	Calvert Physician Associates	Calvert Health Ventures	CMH Holding Company	CMH II Holding Company	Calvert Health System, Inc.	Consolidating and Eliminating Entries	Consolidated Calvert Health System, Inc.
Revenue:								
Patient service revenue (net of contractual allowances and discounts)	\$ 133,327	\$ 13,806	\$ 2,341	\$ -	\$ -	\$ -	\$ -	\$ 149,474
Provision for bad debts	(774)	(38)	(40)	-	-	-	-	(852)
Net patient service revenue less provision for bad debts	132,553	13,768	2,301	-	-	-	-	148,622
Rental revenue	24	-	-	645	11	-	(361) (3)	319
Other operating revenue	4,238	493	1,034	-	6	-	(922) (3)	4,849
Total operating revenue	136,815	14,261	3,335	645	17	-	(1,283)	153,790
Expenses:								
Salaries & wages	54,795	10,336	2,479	-	-	-	310 (3)	67,920
Employee benefits	12,582	1,158	420	-	-	-	-	14,160
Supplies	21,874	3,925	98	-	-	-	-	25,897
Purchased services	6,271	1,605	484	260	-	135	(724) (3)	8,031
Professional fees	5,684	212	3	-	-	-	-	5,899
Depreciation and amortization	8,653	481	32	192	-	-	-	9,358
Interest	2,408	-	-	-	-	-	-	2,408
Other	16,787	802	832	183	4	-	(869) (3)	17,739
Total operating expenses	129,054	18,519	4,348	635	4	135	(1,283)	151,412
Income from operations	7,761	(4,258)	(1,013)	10	13	(135)	-	2,378
Nonoperating gains (losses):								
Investment income	893	-	-	-	-	5,038	-	5,931
Income (loss) from equity investments	110	-	67	(1)	-	(4,709)	4,709 (4)	176
Total nonoperating gains (losses), net	1,003	-	67	(1)	-	329	4,709	6,107
Excess of revenue over expenses (expenses over revenue)	8,764	(4,258)	(946)	9	13	194	4,709	8,485
Net assets released from restrictions for capital acquisitions	118	-	-	-	-	-	-	118
Equity contributions	(11,599)	4,099	-	(181)	(18)	11,798	(4,099) (5)	-
Distributions to noncontrolling interest holders	-	-	-	-	-	-	-	-
Pension-related changes other than net periodic pension cost	(6,213)	-	-	-	-	-	-	(6,213)
Net unrealized losses on marketable investments	(128)	-	-	-	-	(5,725)	-	(5,853)
Increase (decrease) in unrestricted net assets	\$ (9,058)	\$ (159)	\$ (946)	\$ (172)	\$ (5)	\$ 6,267	\$ 610	\$ (3,463)

See independent auditors' report.

Calvert Health System, Inc. and Subsidiaries
Consolidating Statement of Cash Flows
Year Ended June 30, 2016
(dollars in thousands)

	<u>Consolidated Calvert Memorial Hospital</u>	<u>Calvert Physician Associates</u>	<u>Calvert Health Ventures</u>	<u>CMH Holding Company</u>	<u>CMH II Holding Company</u>	<u>Calvert Health System, Inc.</u>	<u>Consolidating and Eliminating Entries</u>	<u>Consolidated Calvert Health System, Inc.</u>
Cash flows from operating activities:								
Increase (decrease) in net assets	\$ (8,712)	\$ (162)	\$ (947)	\$ (171)	\$ (5)	\$ 6,265	\$ 610 (2)	\$ (3,122)
Adjustments to reconcile to net cash from operating activities:								
Provision for bad debts	774	38	(40)	-	-	-	-	772
Depreciation and amortization	8,653	481	32	192	-	-	-	9,358
Donations restricted for capital acquisition	(418)	-	-	-	-	-	-	(418)
Equity in earnings of wholly owned subsidiaries	-	-	-	-	-	4,709	(4,709) (4)	-
Equity in earnings of affiliated enterprises	(110)	-	(67)	1	-	-	-	(176)
Investment income on restricted assets	(213)	-	-	-	-	-	-	(213)
Realized net gains on investments	-	-	-	-	-	(4,245)	-	(4,245)
Unrealized net gains on investments	348	-	-	-	-	5,725	-	6,073
Pension-related changes other than net periodic pension cost	6,213	-	-	-	-	-	-	6,213
Change in:								
Patient accounts receivable	(1,220)	(560)	183	-	-	-	-	(1,597)
Inventories	133	10	(4)	-	-	-	-	139
Prepaid expenses and other assets	(3,650)	12	(54)	(20)	(8)	(24)	(53) (1)	(3,797)
Accounts payable, accrued expenses & other liabilities	(720)	1,165	404	4	-	9	53 (1)	915
Net cash from operating activities	<u>1,078</u>	<u>984</u>	<u>(493)</u>	<u>6</u>	<u>(13)</u>	<u>12,439</u>	<u>(4,099)</u>	<u>9,902</u>
Cash flows from investing activities:								
Purchases of investments	(188)	-	-	-	-	(50,248)	-	(50,436)
Proceeds from sales of investments	907	-	-	-	-	46,563	-	47,470
Net decrease (increase) in assets limited as to use	(148)	-	-	-	-	-	-	(148)
Purchases of property and equipment	(17,156)	(79)	(12)	(25)	-	-	-	(17,272)
Net cash from investing activities	<u>(16,585)</u>	<u>(79)</u>	<u>(12)</u>	<u>(25)</u>	<u>-</u>	<u>(3,685)</u>	<u>-</u>	<u>(20,386)</u>
Cash flows from financing activities:								
Repayment of long-term debt	(1,986)	-	-	-	-	-	-	(1,986)
Proceeds from issuance of long-term debt	21,000	-	-	-	-	-	-	21,000
Donations received restricted for capital acquisitions	418	-	-	-	-	-	-	418
Net distributions from (to) investees	-	-	174	-	-	(4,099)	4,099 (5)	174
Investment income on restricted assets	213	-	-	-	-	-	-	213
Net cash from financing activities	<u>19,645</u>	<u>-</u>	<u>174</u>	<u>-</u>	<u>-</u>	<u>(4,099)</u>	<u>4,099</u>	<u>19,819</u>
Net change in cash and cash equivalents	4,138	905	(331)	(19)	(13)	4,655	-	9,335
Cash and cash equivalents - beginning of year	<u>22,090</u>	<u>244</u>	<u>1,479</u>	<u>164</u>	<u>12</u>	<u>5,639</u>	<u>-</u>	<u>29,628</u>
Cash and cash equivalents - end of year	<u>\$ 26,228</u>	<u>\$ 1,149</u>	<u>\$ 1,148</u>	<u>\$ 145</u>	<u>\$ (1)</u>	<u>\$ 10,294</u>	<u>\$ -</u>	<u>\$ 38,963</u>

See independent auditors' report.

Calvert Health System, Inc. and Subsidiaries
Description of Consolidating and Eliminating Entries
Year Ended June 30, 2016

1. To eliminate intercompany payables/receivables.
2. To eliminate investment in subsidiaries and related net asset accounts.
3. To eliminate intercompany income/expense generated from support and building service fees, staffing contracts and operating leases.
4. To eliminate income of wholly owned subsidiaries.
5. To eliminate intercompany transfer of equity and assets.
6. To eliminate revenue/expense for Calvert Memorial Hospital Foundation, Inc. for contributions transferred to the Hospital for the acquisition of property, plant and equipment.
7. To eliminate revenue/expense for Calvert Memorial Hospital Foundation, Inc. for contributions transferred to the Hospital to fund operating programs.