# SHEPPARD AND ENOCH PRATT FOUNDATION, INC.
# AND SUBSIDIARIES

Consolidated Financial Statements and Supplementary Information

June 30, 2017 and 2016

(With Independent Auditors' Report Thereon)

**SHEPPARD AND ENOCH PRATT FOUNDATION, INC.**
**AND SUBSIDIARIES**

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KPMG LLP
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Baltimore, MD 21202-1128

# Independent Auditors' Report

The Board of Trustees
Sheppard and Enoch Pratt Foundation, Inc.:

## Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Sheppard and Enoch Pratt Foundation, Inc. and its subsidiaries (the Company), which comprise the consolidated balance sheets as of June 30, 2017 and 2016, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

*Management's Responsibility for the Financial Statements*

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

*Auditors' Responsibility*

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

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sheppard and Enoch Pratt Foundation, Inc. and its subsidiaries as of June 30, 2017 and 2016, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

*Other Matter*

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying supplementary information in Schedules 1 through 3 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

October 19, 2017

**SHEPPARD AND ENOCH PRATT FOUNDATION, INC.**
**AND SUBSIDIARIES**

Consolidated Balance Sheets

June 30, 2017 and 2016

| Assets | | 2017 | 2016 |
|---|---|---|---|
| Current assets: | | | |
| Cash and cash equivalents | $ | 76,277,561 | 72,181,517 |
| Investments limited or restricted as to use | | 865,824 | 504,874 |
| Accounts receivable, net | | 32,366,167 | 31,083,734 |
| Prepaid expenses and other current assets | | 11,227,367 | 12,188,182 |
| Total current assets | | 120,736,919 | 115,958,307 |
| Investments limited or restricted as to use, less current portion | | 192,272,718 | 160,320,064 |
| Notes receivable | | 1,877,631 | 2,009,394 |
| Third-party payor settlements receivable | | 9,755,493 | 10,902,769 |
| Property and equipment, net | | 215,912,516 | 219,485,628 |
| Other assets | | 4,281,301 | 3,662,216 |
| Total assets | $ | 544,836,578 | 512,338,378 |
| **Liabilities and Net Assets** | | | |
| Current liabilities: | | | |
| Note payable | $ | 12,900,000 | — |
| Current maturities of long-term debt | | 5,005,333 | 4,831,797 |
| Current portion of obligations under capital leases | | 610,932 | 637,831 |
| Accounts payable | | 7,055,763 | 6,844,334 |
| Accrued salaries, wages and employee benefits | | 22,723,817 | 27,120,911 |
| Third-party payor settlements payable | | — | 33,250 |
| Self-insurance liabilities | | 3,950,703 | 4,324,333 |
| Other accrued expenses | | 3,938,653 | 4,925,910 |
| Total current liabilities | | 56,185,201 | 48,718,366 |
| Long-term liabilities: | | | |
| Long-term debt, less current portion | | 92,893,443 | 98,833,867 |
| Obligations under capitalized leases, less current portion | | 5,839,691 | 4,933,000 |
| Self-insurance liabilities | | 7,386,614 | 7,500,302 |
| Accrued pension liabilities | | 32,687,089 | 43,989,963 |
| Other long-term liabilities | | 3,313,228 | 3,296,672 |
| Total liabilities | | 198,305,266 | 207,272,170 |
| Net assets: | | | |
| Unrestricted | | 325,785,684 | 286,728,700 |
| Temporarily restricted | | 16,836,253 | 14,253,048 |
| Permanently restricted | | 3,909,375 | 4,084,460 |
| Total net assets | | 346,531,312 | 305,066,208 |
| Total liabilities and net assets | $ | 544,836,578 | 512,338,378 |

See accompanying notes to consolidated financial statements.

**SHEPPARD AND ENOCH PRATT FOUNDATION, INC.**
**AND SUBSIDIARIES**

Consolidated Statements of Operations

Years ended June 30, 2017 and 2016

| | | 2017 | 2016 |
|---|---|---|---|
| Unrestricted revenues, gains, and other support: | | | |
| Patient service revenue (net of allowances and discounts) | $ | 146,775,829 | 140,768,161 |
| Residential and educational service revenue (net of allowances) | | 161,266,392 | 171,372,179 |
| Total net service revenue | | 308,042,221 | 312,140,340 |
| Less provision for bad debts | | 1,990,523 | 1,997,945 |
| Net service revenue less provision for bad debts | | 306,051,698 | 310,142,395 |
| Net assets released from restrictions used for operations | | 1,367,441 | 1,454,508 |
| Other revenue | | 60,441,512 | 48,139,884 |
| Total unrestricted revenues, gains, and other support | | 367,860,651 | 359,736,787 |
| Expenses: | | | |
| Salaries and wages | | 216,823,012 | 211,388,886 |
| Employee benefits | | 49,402,450 | 47,376,426 |
| Expendable supplies | | 18,287,982 | 19,824,467 |
| Purchased services | | 47,849,285 | 45,659,073 |
| Interest | | 2,744,683 | 2,677,426 |
| Repairs and minor alterations | | 9,297,754 | 8,429,297 |
| Depreciation and amortization | | 18,726,251 | 18,756,062 |
| Impairment of long-lived assets | | — | 102,781 |
| Loss on disposal of assets, net | | 220,448 | 246,004 |
| Total expenses | | 363,351,865 | 354,460,422 |
| Operating income | | 4,508,786 | 5,276,365 |
| Other income (expense): | | | |
| Investment income | | 1,717,523 | 2,494,975 |
| Realized gain (loss) on investments, net | | (1,637,695) | 2,420,056 |
| Change in unrealized gain (loss) on investments, net | | 20,383,687 | (6,964,040) |
| Other | | 1,430,329 | 1,082,382 |
| Total other income (expense) | | 21,893,844 | (966,627) |
| Excess of revenues over expenses | | 26,402,630 | 4,309,738 |
| Other changes in net assets: | | | |
| Net assets released from restrictions used for purchases of property and equipment | | 199,551 | 4,295,009 |
| Pension liability adjustment | | 12,020,415 | (16,483,713) |
| Capital grants and other | | 434,388 | (27,830) |
| Increase (decrease) in unrestricted net assets | $ | 39,056,984 | (7,906,796) |

See accompanying notes to consolidated financial statements.

**SHEPPARD AND ENOCH PRATT FOUNDATION, INC.**
**AND SUBSIDIARIES**

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| Unrestricted net assets: | | |
| Excess of revenues over expenses | $ 26,402,630 | 4,309,738 |
| Other changes in net assets: | | |
| Net assets released from restrictions used for purchases of property and equipment | 199,551 | 4,295,009 |
| Pension liability adjustment | 12,020,415 | (16,483,713) |
| Capital grants and other | 434,388 | (27,830) |
| Increase (decrease) in unrestricted net assets | 39,056,984 | (7,906,796) |
| Temporarily restricted net assets: | | |
| Gifts and grants | 3,318,280 | 2,662,225 |
| Investment income | 65,326 | 95,827 |
| Net realized gain (loss) on investments | (49,727) | 89,408 |
| Net unrealized gain (loss) on investments | 616,318 | (257,136) |
| Net assets released from restrictions for operations | (1,367,441) | (1,454,508) |
| Net assets released from restrictions for purchases of property and equipment | (199,551) | (4,295,009) |
| Reclassification of net assets | 200,000 | (4,412) |
| Increase (decrease) in temporarily restricted net assets | 2,583,205 | (3,163,605) |
| Permanently restricted net assets: | | |
| Gifts | 11,600 | 55,163 |
| Investment gain (loss) | 13,315 | (11,115) |
| Reclassification of net assets | (200,000) | 4,412 |
| Increase (decrease) in permanently restricted net assets | (175,085) | 48,460 |
| Increase (decrease) in net assets | 41,465,104 | (11,021,941) |
| Net assets, beginning of year | 305,066,208 | 316,088,149 |
| Net assets, end of year | $ 346,531,312 | 305,066,208 |

See accompanying notes to consolidated financial statements.

**SHEPPARD AND ENOCH PRATT FOUNDATION, INC.**
**AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years ended June 30, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| Cash flows from operating activities: | | |
| Increase (decrease) in net assets | $ 41,465,104 | (11,021,941) |
| Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | 18,726,251 | 18,756,062 |
| Pension liability adjustment | (12,020,415) | 16,483,713 |
| Provision for doubtful accounts | 1,990,523 | 1,997,945 |
| Gifts and grants, net | (1,962,439) | (1,262,880) |
| Net realized loss (gain) on investments | 1,687,422 | (2,509,464) |
| Net unrealized (gain) loss on investments | (21,000,005) | 7,221,176 |
| Restricted investment income on restricted net assets | (78,641) | (84,712) |
| Capital grant and loss on disposal of assets | (213,940) | 273,834 |
| Impairment of long-lived assets | — | 102,781 |
| (Increase) decrease in accounts receivable, net | (3,272,956) | 2,097,989 |
| Increase in prepaid expenses and other current assets | (398,843) | (2,447,441) |
| Decrease (increase) in third-party payor settlements receivable | 1,114,026 | (3,773,061) |
| (Decrease) increase in accounts payable, accrued expenses and other | (5,229,256) | 1,730,312 |
| Decrease in self-insurance liabilities | (604,326) | (1,083,876) |
| Increase in accrued pension liability | 717,541 | 818,487 |
| Net cash provided by operating activities | 20,920,046 | 27,298,924 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (14,063,770) | (16,872,905) |
| Increase in other assets | (219,463) | (49,996) |
| Proceeds from sale of property and equipment and related litigation | 273,204 | 658,940 |
| Decrease in notes receivable | 131,763 | 131,764 |
| Purchases of alternative investments | (7,107,132) | — |
| Sales of alternative investments | 2,804,231 | — |
| Decrease (increase) in investments limited or restricted as to use, net | (7,557,735) | 893,791 |
| Net cash used in investing activities | (25,738,902) | (15,238,406) |
| Cash flows from financing activities: | | |
| Proceeds from debt and other liabilities | 17,025,341 | 777,750 |
| Payment of long-term debt principal | (9,595,539) | (5,325,487) |
| Payment on capital lease obligations | (598,229) | (578,140) |
| Payment of deferred financing costs | (313,500) | — |
| Capital grants and advances | 434,388 | 72,170 |
| Gifts and grants, net | 1,962,439 | 1,262,880 |
| Net cash provided by (used in) financing activities | 8,914,900 | (3,790,827) |
| Net increase in cash and cash equivalents | 4,096,044 | 8,269,691 |
| Cash and cash equivalents, beginning of year | 72,181,517 | 63,911,826 |
| Cash and cash equivalents, end of year | $ 76,277,561 | 72,181,517 |

See accompanying notes to consolidated financial statements.

## (1) Summary of Significant Accounting Policies

### *(a) Organization*

Sheppard and Enoch Pratt Foundation, Inc. (Foundation or the Company), a not-for-profit, nonstock Company, was organized on June 15, 1984 to engage in activities necessary to provide mental health services to the public through the planning and implementation of programs provided by its various subsidiaries. Subsidiary companies, controlled by Foundation, include Sheppard Pratt Health System, Inc. (Health System), Sheppard Pratt Physicians, P.A. (Physicians), Sheppard Pratt Investment, Inc. (Investment Company), Alliance, Inc. (Alliance), Mosaic Community Services, Inc. (Mosaic), Way Station, Inc. (Way Station), Family Services, Inc. (Family Services), and Sheppard Pratt Preferred Resources, Inc. (Resources).

On July 1, 2016, Mosaic became the sole member of Alliance. No consideration was exchanged in this transaction. The Company accounted for such transaction using the “as-if” pooling of interests method at carrying value since both entities are under common control.

Health System is a not-for-profit, nonstock company that operates two inpatient hospitals, day hospitals, residential and educational services for children and adolescents, and outpatient programs.

Physicians is a professional company of licensed medical professionals organized on July 1, 1985 exclusively to carry out the charitable, educational and scientific purposes of Foundation and its affiliates. The common stock of Physicians is held by several individuals who are employed by a member of Foundation, Health System, or Physicians and are subject to the terms of a stock agreement. Under the terms of the agreement, the stockholders are required to consult with Foundation regarding its views on any matter with respect to which the stockholder is entitled to vote, and the stockholders may not transfer shares (by sale or gift) without the permission of Foundation. The stock agreement does not allow for the stockholders to receive dividends or any other benefit for having held the stock. If the stockholders cease to be employed by Foundation, Health System, or Physicians, Physicians shall require the stockholders to sell and transfer all of the stock such stockholder owns to a person designated by Foundation. The purchase price for each share of stock of the Company is $1 per share.

Investment Company is a not-for-profit, nonstock company that manages the investments of certain subsidiaries.

Mosaic, Way Station and Family Services (collectively, the Affiliates) are not-for-profit, nonstock Maryland companies that provide residential, rehabilitation, vocational, and outpatient mental health services across the state of Maryland.

Resources is a for-profit company that was formed for the purpose of providing employee assistance program services to other entities. Resources was inactive as an operating entity for the years ended June 30, 2017 and 2016.



(Continued)

### *(b) Basis of Presentation*

The consolidated financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles. All majority-owned and affiliated member entities are consolidated. All entities where Foundation exercises significant influence but for which it does not have control are accounted for under the equity method. All other entities are accounted for under the cost method. All significant intercompany accounts and transactions have been eliminated.

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

*Unrestricted net assets* – Net assets that are not subject to donor-imposed stipulations. Board-designated funds are included within this category of net assets.

*Temporarily restricted net assets* – Net assets whose use by Foundation has been limited by donors to a specific time or purpose.

*Permanently restricted net assets* – Net assets that have been restricted by donors to be maintained by the Foundation in perpetuity. Generally, the donors of these assets permit Foundation 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.

Unconditional promises to give cash and other assets to Foundation with donor-imposed restrictions are reported as increases in temporarily or permanently restricted net assets at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. When the donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

### *(c) Charity Care*

Foundation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because Foundation does not pursue collection of amounts determined to qualify for charity care, such amounts are not reported as revenue.

### *(d) Cash and Cash Equivalents*

Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less that are not limited or restricted as to use.



(Continued)

### (e) *Allowance for Doubtful Accounts*

Patient accounts receivable are reduced by allowances for bad debts. In evaluating the collectability of accounts receivable, Foundation analyzes historical collections and write-offs and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for bad debts and provision for uncollectible accounts. Management regularly reviews its estimate and evaluates the sufficiency of the allowance for bad debts. For patient accounts receivable associated with self-pay patients, which includes those patients without existing insurance coverage for a portion of the bill, Foundation records a significant provision for bad debts for patients that are unable or unwilling to pay for the portion of the bill representing their financial responsibility. Account balances are charged off against the allowance for doubtful accounts after all means of collection have been exhausted.

### (f) *Investments Limited or Restricted as to Use*

Investments limited or restricted as to use, primarily recorded at fair value, represent assets that have been designated by the board of trustees for special purposes and self-insurance trust arrangements. The principal, income and capital appreciation of the Moses Sheppard and Enoch Pratt bequests are legally unrestricted but are classified, for financial reporting purposes, as board-designated and limited as to use. Assets designated by the board of trustees for particular purposes are controlled by the board of trustees, who at their discretion may subsequently use the assets for other purposes.

Investments of board-designated, temporarily restricted and permanently restricted funds are maintained in a combined investment pool or in a related investment account. Related income, and realized and unrealized gains and losses on sales of investments are apportioned on the basis of the shares held by each of the respective funds and in accordance with donor restrictions on the use of investment earnings.

Foundation classifies its investment portfolio as trading securities with unrealized gains and losses included in other income (expense), which is included in the excess of revenues over expenses. Investment income and realized gains and losses from all other investments are reported as other income (expense), unless the income is restricted by donors, which is reported as previously described above. The investment portfolio is classified as current or noncurrent assets based on management’s intention as to use.

Alternative investments represent both subscriptions in private equity venture capital funds and subscriptions in funds-of-funds utilized to diversify the portfolio of Foundation. Annual audited financial statements for these funds are submitted to Foundation and reviewed by management. The funds’ financial statements are presented at fair value as estimated in an unquoted market. Foundation’s alternative investments are accounted for under the equity method of accounting. The investment balance is equal to Foundation’s proportionate interest in the fund’s net equity. Individual investment holdings within the investment portfolio may, in turn, include investments in both nonmarketable and market-traded securities. Valuations of these investments are primarily based on financial data supplied by the underlying investee funds. Values may be based on historical cost, appraisals, or other estimates that require varying degrees of judgment. Certain of these investments contain additional capital call requirements, based upon the provisions of the investment agreements.

Investment income from unrestricted cash equivalents and the self-insurance trust are reported as other operating revenue since such income is considered to be a part of Foundation's ongoing central operations of providing healthcare services.

### *(g) Pledges*

Pledges, less an allowance for uncollectible amounts, are recorded as receivables in the year the pledge is made unless the pledge carries conditions that have not been met. Conditional pledges are recorded as contributions when the conditions of the pledge have been satisfied. Pledges receivable are recorded at net realizable value, which is calculated using a discount rate of 3% at June 30, 2017 and 2016.

### *(h) Property and Equipment*

Property and equipment acquisitions are recorded at cost (except donated property and equipment that are recorded at their fair market value at the date of receipt). Depreciation is computed on the straight-line method and charged to operations over estimated useful lives ranging from 20 to 40 years for buildings and improvements and 3 to 10 years for furniture, equipment, information systems hardware and software and motor vehicles. Property and equipment under capital lease obligations are amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the property and equipment. Interest costs incurred on borrowed funds during the period of construction are capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets such as land, buildings, or equipment are reported as other changes in unrestricted net assets, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

### *(i) Costs of Borrowing*

Deferred financing costs and debt premiums, which are included with long term debt, are amortized using the effective-interest method and charged to operations as a component of interest expense over the term of the related debt.

### *(j) Estimated Self-Insurance Liability Claims*

The estimated self-insured professional liability claims are reflected as a liability and include actuarially determined estimates of the ultimate costs for both reported claims and claims incurred but not reported. Costs under self-insurance programs for employee health benefits and workers' compensation include estimates for both reported claims and claims incurred but not reported, based on an evaluation of pending claims and past experience. These estimates are based on actuarial analysis of historical trends, claims asserted and reported incidents. Receivables for amounts in excess of self-insurance retention limits are recorded at their net realizable value and are due from highly rated commercial insurance companies.



(Continued)

### *(k) Pension Benefits*

Pension benefits are recorded in accordance with Accounting Standards Codification (ASC) Subtopic 715-30, *Defined Benefit Plans – Pension*, which requires the recognition of the funded status of pension plans within the accompanying consolidated balance sheets.

### *(l) Patient Service Revenue*

Foundation has agreements with third-party payors that provide for payments to Foundation at amounts different from its established rates. Payment arrangements include prospectively determined rates per day, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with certain third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Differences between the estimated amounts and final settlements are reported in operations in the year of settlement.

Foundation's revenues may be subject to adjustment as a result of examination by government agencies or contractors, and as a result of differing interpretation of government regulations, medical diagnosis, charge coding, medical necessity, or other contract terms. The resolution of these matters, if any, often is not finalized until subsequent to the period during which the services were rendered (note 15).

### *(m) Residential and Educational Service Revenue*

Foundation provides educational services to special needs children under arrangements with the Maryland State Department of Education (MSDE). On an annual basis, a prospective rate per student is set with MSDE based upon an approved operating budget. Subsequently, as services are provided, invoices are submitted to each student's local school district for payment on a monthly basis.

Foundation also operates a residential treatment center for adolescents. Substantially all of the RTC services are reimbursed by the State of Maryland Medicaid Program on a cost basis subject to annual ceilings. Foundation receives an interim per diem rate during the year and ultimately settles final payment based upon an audited cost report filing.

### *(n) Other Operating Revenue*

Other operating revenue as of June 30, 2017 is primarily comprised of grant revenue, business service revenue, and rental income.

### *(o) Impairment of Long-Lived Assets*

Management regularly evaluates whether events or changes in circumstances have occurred that could indicate an impairment in the value of long-lived assets. In accordance with the provisions of ASC Subtopic 360-10, *Property, Plant, and Equipment – Overall*, if there is an indication that the carrying amount of an asset is not recoverable, Foundation estimates the projected undiscounted cash flows, excluding interest, to determine if an impairment loss should be recognized. The amount of impairment loss is determined by comparing the historical carrying value of the asset to its estimated fair value. Estimated fair value is determined through an evaluation of recent and projected financial performance using standard industry valuation techniques.

In addition to consideration of impairment upon the events or changes in circumstances described above, management regularly evaluates the remaining lives of its long-lived assets. If estimates are changed, the carrying value of affected assets is allocated over the remaining lives.

In estimating the future cash flows for determining whether an asset is impaired and if expected future cash flows used in measuring assets are impaired, Foundation groups its assets at the lowest level for which there are identifiable cash flows independent of other groups of assets. No impairment charges were recorded during the years ended June 30, 2017 and 2016.

### *(p) Rental Income*

Foundation has agreements with various organizations and individual clinicians to rent office space and land. Foundation recognizes the rent under the leases, using the straight-line method, net of an allowance for doubtful accounts, where necessary, in other income (expense).

### *(q) Excess of Revenues over Expenses*

The consolidated statements of operations include a performance indicator, the excess of revenues over expenses. Changes in unrestricted net assets that are excluded from excess of revenues over expenses, consistent with industry practice, include changes in pension liability adjustments, contributions of long-lived assets (including assets acquired using contributions that by donor restriction were to be used for the purposes of acquiring such assets) and grants for capital purposes.

### *(r) Income Taxes*

Foundation and its subsidiaries, except for Resources, have been recognized as tax-exempt organizations under Section 501(a) as organizations described in Section 501(c)(3) of the Internal Revenue Code and are not subject to income taxes on related income pursuant to Section 501(a) of the Internal Revenue Code. The operations of Resources, a for-profit company, are not significant to the consolidated financial statements. Foundation has cumulative net operating losses of $2.8 million for unrelated business activities, which expire at various dates through 2037. The Foundation’s deferred tax assets, including the asset related to its net operating losses, are fully reserved as they are not expected to be utilized. Foundation accounts for income taxes under ASC Topic 740, *Income Taxes*.

### *(s) Leases*

Lease arrangements, including assets under construction, are capitalized when such leases convey substantially all the risks and benefits incidental to ownership. Capital leases are amortized over either the lease term or the life of the related assets, depending upon available purchase options and lease renewal features. Amortization related to capital leases is included in the statements of operations within depreciation or amortization expense.

### *(t) Use of Estimates*

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles 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 reporting period. Actual results could differ from those estimates

### *(u) New Accounting Pronouncements*

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU establishes principles for reporting useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts with customers. Particularly, that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for fiscal year 2019. The Company expects to record a decrease in net patient service revenue related to self-pay patients and a corresponding decrease in bad debt expense upon the adoption of the standard.

The FASB issued ASU No. 2016-02, *Leases*, which will require lessees to recognize most leases on-balance sheet, increasing their reported assets and liabilities – sometimes very significantly. This update was developed to provide financial statement users with more information about an entity's leasing activities, and will require changes in processes and internal controls. The adoption of ASU 2016-02 is effective fiscal year 2020, and will require application of the new guidance at the beginning of the earliest comparable period presented. The Company is currently assessing the impact of the adoption of ASU No. 2016-02, which is expected to have a material impact on its financial position.

The FASB issued ASU No. 2016-14, *Not-for-Profit Entities*, which amends the requirements for financial statements and notes in Topic 958, *Not-for-Profit Entities* (NFP), require a NFP to:

- Reduces the number of net asset classes presented from three to two: with donor restrictions and without donor restrictions;
- Requires all NFPs to present expenses by their functional and their natural classifications in one location in the financial statements;
- Requires NFPs to provide quantitative and qualitative information about management of liquid resources and availability of financial assets to meet cash needs within one year of the balance sheet date; and

The adoption of ASU 2016-14 is effective in fiscal year 2019, and is applied retrospectively in the year of adoption. The Company does not anticipate that the adoption of this ASU will have a material impact on its financial position and results of operations.

The FASB issued ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The



(Continued)

amendments in this ASU require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost as defined in paragraphs 715-30-35-4 and 715-60-35-9 are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. The amendments also allow only the service cost component to be eligible for capitalization when applicable (for example, as a cost of internally manufactured inventory of a self-constructed asset). ASU No. 2017-07 is effective for fiscal year 2020. This ASU requires retrospective application to all prior periods presented. The Company does not anticipate that the adoption of this ASU will have a material impact on its financial position and results of operations.

### *(v) Recently Adopted Pronouncements*

The FASB issued ASU 2015-03, *Interest – Imputation of Interest*. This ASU requires 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 recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The Company has implemented this ASU in 2017, and has reclassified $583,183 in deferred financing costs to be a reduction of debt as of June 30, 2016 to reflect the change.

The FASB issued ASU 2015-07, *Fair Value Measurement (Topic 820) Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share*. This ASU removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The amendments also remove the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. Rather, those disclosures are limited to investments for which the entity has elected to measure the fair value using that practical expedient. The Company has implemented this ASU in 2017.

### *(w) Management's Assessment and Plans*

The Company adopted Accounting Standards Update (ASU) 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, (ASU 2014-15) during 2017. ASU 2014-15 requires management to evaluate an entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or available to be issued, when applicable). Management determined that there were no conditions or events that raise substantial doubt about the Company's ability to continue as a going concern and the Company will continue to meet its obligations through October 19, 2018.

### *(x) Reclassifications*

Certain prior year amounts have been reclassified to conform to current year presentation.

## (2) Charity Care and Community Services

Foundation maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy and equivalent service statistics. The estimated cost of charity care provided during the years ended June 30, 2017 and 2016 was $4,374,354 and $5,159,013, respectively.

Foundation provides the community with other healthcare services and programs, including teaching of psychiatric residents, providing programs and facilities for teaching other medical health professionals, providing behavioral health educational programs for the general public, and conducting research to improve treatment of behavioral health problems.

## (3) Investments Limited or Restricted as to Use

Investments limited or restricted as to use, stated at fair value, except for the real estate investment, which is recorded at cost and investments in partnerships and alternative investments, which are recorded under the equity method, include the following at June 30:

| | | 2017 | 2016 |
|---|---|---|---|
| Board-designated, unrestricted: | | | |
| Portion of pooled investments | $ | 155,681,432 | 139,482,818 |
| Other investments | | 23,821,720 | 9,274,303 |
| Held by trustees: | | | |
| Under self-insurance trusts | | 4,541,304 | 3,785,267 |
| Donor-restricted: | | | |
| Temporarily restricted portion of pooled investments | | 2,559,934 | 1,793,708 |
| Other temporarily restricted investments | | 2,624,777 | 2,404,381 |
| Permanently restricted portion of pooled investments | | 3,350,408 | 3,338,808 |
| Other permanently restricted investments | | 558,967 | 745,653 |
| Total investments limited or restricted as to use | | 193,138,542 | 160,824,938 |
| Current portion | | 865,824 | 504,874 |
| Investments limited or restricted as to use, less current portion | $ | 192,272,718 | 160,320,064 |

Foundation manages a significant component of its investments limited or restricted as to use in a combined investment pool. The combined investment pool has been allocated based on donor restrictions, where applicable, as follows at June 30:

| | | 2017 | 2016 |
|---|---|---|---|
| Board-designated unrestricted | $ | 155,681,432 | 139,482,818 |
| Temporarily restricted | | 2,559,934 | 1,793,708 |
| Permanently restricted | | 3,350,408 | 3,338,808 |
| Total | $ | 161,591,774 | 144,615,334 |

The combined investment pool is comprised of the following at June 30:

| | | 2017 | 2016 |
|---|---|---|---|
| Cash and cash equivalents | $ | 3,013,198 | 5,036,882 |
| Corporate bonds | | 12,715,999 | 12,506,136 |
| Marketable equity securities | | 4,417 | 7,422 |
| Mutual and common trust funds | | 92,739,623 | 86,007,805 |
| Other (primarily alternative investments under equity method) | | 53,118,537 | 41,057,089 |
| Total | $ | 161,591,774 | 144,615,334 |

Other board-designated investments consist of the following at June 30:

| | | 2017 | 2016 |
|---|---|---|---|
| Cash and cash equivalents | $ | 3,596,363 | 3,042,820 |
| Mutual funds | | 3,124,313 | 1,823,969 |
| Real estate held for future development, at cost | | 15,908,001 | 3,092,501 |
| Other | | 1,193,043 | 1,315,013 |
| | $ | 23,821,720 | 9,274,303 |

The funds held by trustees under self-insurance trusts are comprised of the following at June 30:

| | | 2017 | 2016 |
|---|---|---|---|
| Cash and cash equivalents | $ | 358,406 | 190,738 |
| Fixed income investments | | 4,182,898 | 3,594,529 |
| | $ | 4,541,304 | 3,785,267 |

A Foundation trustee serves as an investment manager for a portion of the investments limited or restricted as to use totaling approximately $13,100,000 and $12,970,000 as of June 30, 2017 and 2016, respectively.

The total investment return, net of investment fees, including the return from the combined investment pool, is summarized as follows for the years ended June 30:

| | | 2017 | 2016 |
|---|---|---|---|
| Investment income (loss): | | | |
| Unrestricted | $ | 1,717,523 | 2,494,975 |
| Temporarily restricted | | 65,326 | 95,827 |
| Permanently restricted | | 13,315 | (11,115) |
| | | 1,796,164 | 2,579,687 |
| Net realized (losses) gains on sales of investments: | | | |
| Unrestricted | | (1,637,695) | 2,420,056 |
| Temporarily restricted | | (49,727) | 89,408 |
| | | (1,687,422) | 2,509,464 |
| Net unrealized gains (losses) on investments: | | | |
| Unrestricted | | 20,383,687 | (6,964,040) |
| Temporarily restricted | | 616,318 | (257,136) |
| Total unrealized gains (losses) | | 21,000,005 | (7,221,176) |
| Total investment gain (loss) income | | 21,108,747 | (2,132,025) |
| Investment income on other unrestricted investments and cash and cash equivalents | | 922,751 | 849,665 |
| Investment income on self-insurance trust assets | | 1,876 | 476 |
| Total investment income (loss) | $ | 22,033,374 | (1,281,884) |

## (4) Disclosures about Fair Value of Financial Instruments

Foundation accounts for its financial assets and liabilities, in accordance with ASC Subtopic 820-10 as discussed in note 1. ASC Subtopic 820-10 defines fair value, establishes a framework for measuring fair value in accordance with U.S. generally accepted accounting principles, and expands disclosures about fair value measurements. Specifically, the guidance provides for the following:

- Defines 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 establishes a framework for measuring fair value;
- Establishes a three-level hierarchy for fair value measurement;
- Requires consideration of Foundation’s nonperformance risk when valuing liabilities; and
- Expands disclosures about instruments measured at fair value.

The three-level valuation hierarchy for fair value measurements is based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Foundation's market assumptions. The three-level valuation hierarchy is defined as follows:

- Level 1 – Quoted prices for identical instruments in active markets;
- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar investments in markets that are not active; and model-derived valuations whose significant inputs are observable; and
- Level 3 – Instruments whose significant inputs are unobservable.

The table below presents Foundation's investable assets and liabilities as of June 30, 2017, aggregated by the three-level valuation hierarchy:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Assets: | | | | |
| Cash and cash equivalents | $ 9,607,512 | — | — | 9,607,512 |
| Equities: | | | | |
| Common stocks | 9,055,320 | — | — | 9,055,320 |
| Mutual funds | 80,886,263 | — | — | 80,886,263 |
| Other | 1,864,728 | 4,207,680 | — | 6,072,408 |
| Fixed income: | | | | |
| Collateralized mortgage obligations | — | 802,659 | — | 802,659 |
| Corporate bonds | — | 8,340,084 | — | 8,340,084 |
| Government issued bonds | — | 7,756,154 | — | 7,756,154 |
| Other financial instruments | — | 804 | — | 804 |
| Total assets | $ 101,413,823 | 21,107,381 | — | 122,521,204 |
| Liabilities: | | | | |
| Interest rate swap | $ — | 67,452 | — | 67,452 |

The table below presents Foundation's investable assets and liabilities as of June 30, 2016, aggregated by the three-level valuation hierarchy:

| | | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|---|
| Assets: | | | | | |
| Cash and cash equivalents | $ | 8,447,195 | — | — | 8,447,195 |
| Equities: | | | | | |
| Common stocks | | 5,873,655 | — | — | 5,873,655 |
| Mutual funds | | 76,630,019 | — | — | 76,630,019 |
| Other | | 1,826,011 | 4,122,867 | — | 5,948,878 |
| Fixed income: | | | | | |
| Collateralized mortgage obligations | | — | 1,166,084 | — | 1,166,084 |
| Corporate bonds | | — | 10,022,598 | — | 10,022,598 |
| Government issued bonds | | — | 4,911,982 | — | 4,911,982 |
| Other financial instruments | | — | 1,038 | — | 1,038 |
| Total assets | $ | 92,776,880 | 20,224,569 | — | 113,001,449 |

Foundation did not have significant transfers between Levels, or Level 3 measurements, thus, no additional disclosures were necessary.

Foundation's Level 1 securities primarily consist of common stock, exchange-traded mutual funds, and cash. Foundation determines the estimated fair value for its Level 1 securities using quoted (unadjusted) prices for identical assets or liabilities in active markets.

Foundation's Level 2 securities consist of collateralized mortgage obligations, corporate bonds, government issued bonds, mutual funds, and derivative instruments, which are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active or model-derived valuations whose significant inputs are observable. Valuation models require a variety of inputs, including contractual terms, market fixed prices, inputs from forward price yield curves, notional quantities, measures of volatility, and correlations of such inputs.

Investments classified within Level 3 have significant unobservable inputs, as they trade infrequently or not at all. The classification of a financial instrument within Level 3 is based upon the significance of the unobservable inputs to the overall fair value measurement.

The carrying amount of cash and cash equivalents, accounts receivable, third-party payor settlements receivable or payable, other current assets, accounts payable and accrued expenses approximates fair value because of the short-term maturity of these instruments. The fair value of Foundation's long-term debt, except for the Series A portion of the 2012 Bonds, is estimated to approximate the carrying amount because interest rates are variable and determined frequently based on prevailing market conditions. The estimated fair value of the Series A portion of the 2012 Bonds at June 30, 2017 and 2016 was approximately $32,039,000 and $32,191,000, respectively. Due to the subjective nature of the terms of the Foundation's notes receivable and capital lease obligations, their fair values cannot be estimated.

### (5) Temporarily Restricted Assets

Temporarily restricted assets consist of the following at June 30:

| | | 2017 | 2016 |
|---|---|---|---|
| Pledges receivable, net of unamortized discount of $17,000 at June 30, 2017 and $10,000 at June 30, 2016 | $ | 278,752 | 184,750 |
| Less allowance for uncollectible pledges | | 9,000 | 6,000 |
| Net pledges receivable | | 269,752 | 178,750 |
| Other investments (primarily property) | | 11,651,542 | 10,054,959 |
| Portion of pooled investments (note 3) | | 2,559,934 | 1,793,708 |
| Restricted cash and investments | | 2,355,025 | 2,225,631 |
| | $ | 16,836,253 | 14,253,048 |

The net realizable value of the unconditional pledges receivable at June 30, 2017 was calculated using an average discount rate of 3%. The net present value of pledges receivable and the expected collection period at June 30, 2017 are as follows:

| | | |
|---|---|---|
| 2018 | $ | 118,804 |
| 2019 | | 87,803 |
| 2020 | | 36,606 |
| 2021 | | 35,539 |
| | $ | 278,752 |

### (6) Note Receivable

In conjunction with the land lease described in note 7, Investment Company provided a loan and a line of credit to the Maryland Economic Development Company (MEDCO) to help finance the development of university student housing located on the campus of Foundation. The unsecured term loan of $3.75 million is payable in equal quarterly installments between the initial repayment date (January 2004) and June 30, 2031. MEDCO repaid approximately $132,000 during each of the years ended June 30, 2017 and 2016, which resulted in an outstanding balance of $1,877,631 and $2,009,394 June 30, 2017 and 2016, respectively. The loan bears interest at the rate of 12% per annum. Foundation has included approximately $234,000 and $251,000 of interest income from the loan in investment income during the fiscal years ended June 30, 2017 and 2016, respectively.

## (7) Property and Equipment

Property and equipment at June 30 are summarized as follows:

| | | 2017 | 2016 |
|---|---|---|---|
| Land | $ | 22,339,800 | 21,969,755 |
| Land improvements | | 12,118,225 | 12,825,695 |
| Buildings and building improvements | | 321,026,595 | 312,829,099 |
| Furniture and equipment | | 66,687,458 | 63,356,942 |
| Vehicles | | 8,269,913 | 8,261,538 |
| Construction in progress | | 12,241,843 | 10,833,186 |
| | | 442,683,834 | 430,076,215 |
| Less accumulated depreciation | | 226,771,318 | 210,590,587 |
| | $ | 215,912,516 | 219,485,628 |

Assets under capital lease at June 30, 2017 and 2016 of $9,621,041 and $8,143,020, respectively, were included in buildings and building improvements and furniture and equipment in the table above. Accumulated depreciation of assets under capital leases totaled $4,559,995 and $3,735,585 at June 30, 2017 and 2016, respectively.

Certain land, buildings, improvements, and equipment are pledged as collateral for the debt described in note 9.

Depreciation expense for the years ended June 30, 2017 and 2016 was $18,691,954 and $18,721,765, respectively.

In June 2001, the Health System entered into a 40-year ground lease with MEDCO, whereby MEDCO leases certain parcels of land from Foundation. The base year rental income, included in other revenue in the accompanying consolidated statements of operations is $885,500 and increases by 3.00% per annum over the life of the lease. MEDCO has constructed student housing on the leased parcels of land (the MEDCO lease). Unpaid accrued rent bears interest at 12.65% per annum.

The payment of ground rent is subordinate to the payment of debt on the MEDCO loan. Based on current cash flow projections, it is anticipated that the full amount of rent accruing will not be paid. Foundation has recorded an allowance for a portion of the unpaid accrued rent, and the related interest on the unpaid rents for fiscal years 2013 through 2017. Partial ground rent payments of approximately $2,640,000 and $2,320,000 were accrued as a receivable at June 30, 2017 and 2016. As of June 30, 2017 and 2016, Foundation has recorded total ground rent receivable in other assets in the accompanying consolidated balance sheets of $7,537,246 and $7,729,915, respectively, with a related reserve of $4,901,111 and $5,411,142, respectively.

On September 20, 2016 the State Health Planning and Development Agency approved Foundation’s application to build a new hospital in Elkridge, Maryland. The new hospital will replace Sheppard Pratt at

Ellicott City which is currently housed in a leased facility in Ellicott City, Maryland. The project is expected to span multiple years with a cumulative investment of approximately $96,530,000.

## (8) Other Assets

The other assets balance is composed of the following at June 30:

| | | 2017 | 2016 |
|---|---|---|---|
| Workers' compensation excess insurance receivable | $ | 376,638 | 312,934 |
| Intangible assets | | 1,307,000 | 1,307,000 |
| Cash surrender value of life insurance and other | | 3,105,163 | 2,526,520 |
| | | 4,788,801 | 4,146,454 |
| Accumulated amortization | | (507,500) | (484,238) |
| | $ | 4,281,301 | 3,662,216 |

## (9) Long-Term Debt and Note Payable

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

| | | 2017 | 2016 |
|---|---|---|---|
| Maryland Health and Higher Educational Facilities Authority (MHHEFA) Revenue Bonds, Series 2012 | $ | 80,420,179 | 83,714,907 |
| MHHEFA Series D pooled loan program | | — | 3,685,000 |
| MHHEFA Revenue Bond – 2013 | | 5,480,650 | 5,910,955 |
| MHHEFA Revenue Bond – 2014 | | 3,799,748 | 3,920,748 |
| MHHEFA Revenue Bond – 2016 | | 3,820,000 | — |
| Bank notes | | 1,707,562 | 3,009,104 |
| Mortgages on real estate | | 3,354,042 | 3,630,409 |
| Other debt | | 124,399 | 377,724 |
| | | 98,706,580 | 104,248,847 |
| Less deferred financing cost | | 807,804 | 583,183 |
| Less current portion | | 5,005,333 | 4,831,797 |
| | $ | 92,893,443 | 98,833,867 |

In March 2012, Health System, Physicians, Foundation and Investment (Obligated Group) refinanced certain outstanding indebtedness including the 2003 Series A and Series B bonds and the Bank of America financing agreement. The Series 2012 bonds were issued by MHHEFA and purchased by a bank in a direct placement loan arrangement.

The Series 2012 A bonds are fixed rate bonds with an original principal amount of $34,032,000 bearing interest at a fixed rate of 2.84%. The initial term of the credit facility provided by the direct placement loan arrangement is 15 years, and the final scheduled maturity of the bonds is July 1, 2036. The Series 2012 B bonds are variable rate bonds with an original principal amount of $62,182,000 bearing interest at 77% of the sum of one-month London Interbank Offered Rate (LIBOR) plus 1.1% (1.75% at June 30, 2017). The initial term of the credit facility provided by the direct placement loan arrangement is 10 years and the final scheduled maturity of the bonds is July 1, 2035. The Series 2012 A and B bonds are being repaid using a 24-year amortization schedule.

The Series 2012 bonds are secured by a trust indenture and Obligated Group has granted the bank and MHHEFA a security interest in its revenues. The Series 2012 Bonds require Obligated Group to satisfy certain measures of financial performance as long as the Series 2012 Bonds are outstanding.

In September 2006, Mosaic borrowed $5,420,000 through the MHHEFA Series D pooled loan program. This loan was used to defease certain bonds issued in 1996 by the Maryland Economic Development Company and certain bonds issued in 2001 by Baltimore County, Maryland for Revisions, Inc. (an entity which subsequently merged with Mosaic) and for certain renovations and equipment purchases. The variable rate bonds are supported by a bank letter-of-credit, which expired in November 2016. The terms of the loan, while subject to long-term amortization (20 years) may be put at the option of the bond holders. At such time, the letter-of-credit bank would advance fund the put bonds on behalf of Mosaic under the terms of the letter of credit. Mosaic would be required to repay such advances under the letter of credit on November 1, 2016. This note was refinanced on September 28, 2016.

On September 28, 2016, Mosaic closed a transaction to refinance its MHHEFA Series D pooled loan program revenue bonds along with three existing mortgages. The total amount refinanced was $4,066,000. The refinance occurred via a taxable nonbank qualified direct purchase by a commercial bank. The bonds accrue interest at a variable rate based on 68% of LIBOR plus 1.17% (2.0% at June 30, 2017) and are being amortized over ten years. The loan is secured by Mosaic’s gross revenues, cash accounts and certain fixed assets, and the loan requires Mosaic to satisfy certain measures of financial performance as long as the loan is outstanding. In conjunction with the refinance, Mosaic entered into a 10-year interest rate swap agreement with a third party under which the Company will make monthly payments at a fixed rate of 2.09% in exchange for payments based on the (LIBOR), (1.1714% as of June 30, 2017).

On May 2, 2013, MHHEFA issued $7,200,000 bank-qualified tax-exempt revenue bonds (MHHEFA Revenue Bond – 2013) for the purpose of reimbursing Way Station for certain capital expenditures associated with the acquisition and development of two properties in Frederick, Maryland, a property in Hagerstown, Maryland, and a property in Columbia, Maryland. The bonds were purchased by a bank and Way Station is required to make payments over 15 years with a fixed interest rate of 2.645%. As part of the same transaction, the same bank loaned Way Station $1,700,000 in a taxable term loan payable over 15 years, at a fixed interest rate of 3.305%. The Company owed $1,408,597 as of June 30, 2016. The taxable loan was paid off in February 2017. The tax-exempt loan is secured by a deed of trust covering six of the Company’s properties in Frederick, Hagerstown, and Columbia, Maryland and this loan requires Way Station to satisfy certain measures of financial performance as long as the loan is outstanding. The Company is limited in additional borrowings, which cannot occur without the bank’s consent.

On March 4, 2014, MHHEFA issued a $4,430,000 bank-qualified tax-exempt revenue bond (MHHEFA Revenue Bond – 2014) for the purpose of refinancing Family Services existing mortgage debt. The bond was purchased by a bank, and Family Services is required to make payments over 25 years at varying interest rates. As part of the same transaction, the same bank loaned Family Services $1,683,000 in a taxable term loan that is amortized over 25 years; however, it is due in 10 years, at fixed interest rates that vary from 4.25% in year one to 5.25% in subsequent years. The tax-exempt and taxable term loans are secured by a deed in trust covering the Company's properties, and these loans require Family Services to satisfy certain measures of financial performance as long as the loans are outstanding.

The Affiliates have mortgages on multiple properties with a total outstanding balance of $3,354,042 as of June 30, 2017 and $3,630,409 as of June 30, 2016. The interest rates and years of maturity range from 0% to 8.5%, and 2018 to 2038, respectively.

The Affiliates have other nonmortgage debt, consisting primarily of auto and renovation loans, with a total outstanding balance of $124,399 as of June 30, 2017 and $377,724 as of June 30, 2016. The interest rates range from 0% to 5.9%.

The affiliates have combined variable rate lines of credit the amount of $5,000,000. As of June 30, 2017 and 2016, there were no outstanding balances on the lines of credit.

Repayment of long-term debt, including mandatory sinking fund redemptions, in each of the next five fiscal years is as follows:

| | | |
|---|---|---|
| 2018 | $ | 5,005,333 |
| 2019 | | 4,694,388 |
| 2020 | | 4,774,708 |
| 2021 | | 4,859,790 |
| 2022 | | 4,970,604 |
| 2023 and thereafter | | 74,401,757 |
| | $ | 98,706,580 |

Interest payments were $2,410,257 and $2,323,975 in 2017 and 2016, respectively.

In December 2016, the Health System obtained a short term note which was used to fund working capital for the purchase of certain land and improvements. The note is a 364 day nonrevolving term loan of up to $15,000,000, with an outstanding balance of $12,900,000 as of June 30, 2017. Maturity is 364 days from closing (May 2018) with interest only payable prior to maturity. The rate is the sum of the one month LIBOR (1.1714% as of June 30, 2017), plus 100 basis points. Collateral is a double negative pledge on the property.

## (10) Other Financial Instruments

During the year ended June 30, 2006, Foundation received a gift annuity from donors. Under the terms of such agreement, Foundation agreed to pay 6% annually of the contributed amount (approximately $1 million) on a quarterly basis over the remaining lives of the donors. Accordingly, as of June 30, 2017 and 2016, the net present value of the estimated remaining payments of approximately $401,493 and $442,309, respectively, have been recorded as an other long-term liability.

**(11) Pension Plan, Employees' Thrift Plan and Life, Accident and Health Plan**

Foundation has a noncontributory defined benefit pension plan that covers eligible employees of Health System and Physicians. The benefits are based on the employees' credited service and average compensation during the five consecutive years, taken from the last 10 years of service before retirement, which produces the highest result. The funding policy is to contribute annually amounts actuarially determined to provide for benefits attributed to service to date and benefits expected to be earned in the future. Prior service cost is being amortized on a straight-line basis over the estimated term of employment of current employees.

ASC Subtopic 715-30, *Defined Benefit Plans-Pension*, requires Foundation to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its pension plan in the accompanying consolidated balance sheets, with a corresponding adjustment to unrestricted net assets. The pension liability adjustment to unrestricted net assets represents the change in net unrecognized actuarial losses and unrecognized prior service costs that have not yet been recognized as part of excess of revenues over expenses. Those amounts will be subsequently recognized as a component of net periodic pension cost pursuant to Foundation's historical accounting policy for amortizing such amounts.

The following are deferred pension costs that have not yet been recognized in periodic pension expense but instead are included as a component of unrestricted net assets, as of June 30, 2017 and 2016. Unrecognized actuarial losses represent unexpected changes in the projected benefit obligation and plan assets over time, primarily due to changes in assumed discount rates and investment experience. Unrecognized prior service cost is the impact of changes in plan benefits applied retrospectively to employee service previously rendered. Deferred pension costs are amortized into annual pension expense over the average remaining assumed service period for active employees.

| | | Amounts in unrestricted net assets to be recognized during the next fiscal year | Amounts recognized in unrestricted net assets at June 30, 2017 | Amounts recognized in unrestricted net assets at June 30, 2016 |
|---|---|---|---|---|
| Net prior service cost | $ | 29,137 | 33,129 | 62,266 |
| Net actuarial loss | | 4,153,441 | 50,548,367 | 62,539,645 |
| Total | $ | 4,182,578 | 50,581,496 | 62,601,911 |

During 2013, the Plan was amended to permanently allow certain vested terminated participants to take a lump sum payment of Plan benefits not previously available as a lump sum in lieu of a deferred monthly benefit. This offer will be available to terminating participants with a vested benefit value of less than

$25,000. As a result of these changes, Foundation made lump sum payments of approximately $147,807 and $217,000 in 2017 and 2016, respectively.

Foundation previously adopted the new RP-2014 Mortality Table with generational improvements using projection scale MP-2014. During 2017, Foundation updated its mortality table assumption to the projection scale MP-2015.

The Plan's change in benefit obligations, the change in plan assets, current funded status and the components of net periodic pension cost as of and for the years ended June 30 are as follows:

| | | 2017 | 2016 |
|---|---|---|---|
| Accumulated benefit obligation at the end of the year | $ | 217,317,683 | 214,334,727 |
| Changes in benefit obligations: | | | |
| Projected benefit obligation at the beginning of the year | $ | 232,328,224 | 206,323,539 |
| Service cost | | 5,125,827 | 5,083,540 |
| Interest cost | | 7,392,919 | 9,493,719 |
| Actuarial loss (gain) | | (2,410,313) | 18,343,819 |
| Benefits paid | | (7,757,330) | (6,916,393) |
| Projected benefit obligation at the end of the year | | 234,679,327 | 232,328,224 |
| Changes in plan assets: | | | |
| Fair value of plan assets at beginning of the year | | 188,338,261 | 179,635,776 |
| Actual return on plan assets | | 16,411,307 | 10,618,878 |
| Contributions to the plan | | 5,000,000 | 5,000,000 |
| Benefits paid | | (7,757,330) | (6,916,393) |
| Fair value of plan assets at end of the year | | 201,992,238 | 188,338,261 |
| Funded status | $ | (32,687,089) | (43,989,963) |

Net periodic pension expense includes the following components for the years ended June 30:

| | | 2017 | 2016 |
|---|---|---|---|
| Service cost | $ | 5,125,827 | 5,083,540 |
| Interest cost | | 7,392,919 | 9,493,719 |
| Expected return on plan assets | | (12,685,992) | (12,650,228) |
| Amortization of prior service cost | | 29,137 | 29,137 |
| Amortization of net loss | | 5,855,650 | 3,862,319 |
| Net pension expense | $ | 5,717,541 | 5,818,487 |

The following table presents the weighted average assumptions used to determine benefit obligations and net periodic benefit expense for the Plan:

| | 2017 | 2016 |
|---|---|---|
| Discount rates (benefit obligation) | 4.02 % | 3.93 % |
| Discount rates (benefit expense) | 3.93 | 4.65 |
| Rate of compensation increase | 4.00 | 4.00 |
| Expected long-term return on plan assets | 6.80 | 6.80 |

***(a) Determination of Expected Long-Term Rate of Return***

In developing the expected long-term rate of return on assets assumption, Foundation considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested, and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target allocation to develop the expected long-term rate of return on assets assumption for the portfolio.

***(b) Investment Policy and Objectives***

The investment policy and objectives are established by the trustees of Foundation. The plan objectives include achieving and maintaining fully funded status and minimizing volatility with reasonable and prudent levels of risk. The investment policy is based on a long-term perspective. An investment advisory firm engaged by Foundation trustees selects investment managers, makes investment decisions in keeping with the Pension Investment Policy Statement developed by the trustees, and reviews fund performance and funding status routinely. The percentage allocation to each asset class may vary depending upon the funded status of the Plan.

Foundation monitors the investment managers' performance and ensures adequate diversification by asset class to further mitigate the risks associated with the investment program. Management believes that its assets are invested in accordance with its overall investment policies at June 30, 2017 and 2016.



(Continued)

### *(c) Plan Assets*

Foundation's pension plan weighted average asset allocations at the measurement dates of June 30, 2017 and 2016 by asset category are as follows:

| | Target allocation | 2017 | 2016 |
|---|---|---|---|
| Equity securities | 44 % | 46 % | 44 % |
| Debt securities | 56 | 53 | 54 |
| Cash and cash equivalents | — | 1 | 1 |
| Other (including private equity/real estate funds) | — | — | 1 |
| | 100 % | 100 % | 100 % |

In accordance with ASC Subtopic 715-20, *Defined Benefit Plans-General-Disclosures*, nonpublic entities are required to report the fair value of each major category of pension plan asset within the fair value hierarchy. ASC Subtopic 820-10, *Fair Value Measurements-Overall*, provides guidance for the fair value hierarchy, which is a valuation technique that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Refer to note 3 for descriptions of each of the three levels within the valuation hierarchy.

The table below presents Foundation's pension plan investable assets as of June 30, 2017 aggregated by the three level valuation hierarchy:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Assets: | | | | |
| Cash and cash equivalents | $ 2,558,921 | — | — | 2,558,921 |
| Collective trusts – equity | — | 92,423,415 | — | 92,423,415 |
| Collective trusts – fixed income | — | 105,582,511 | — | 105,582,511 |
| Private equity and real estate funds | — | — | 1,427,391 | 1,427,391 |
| Total assets | $ 2,558,921 | 198,005,926 | 1,427,391 | 201,992,238 |

The table below presents Foundation's pension plan investable assets as of June 30, 2016 aggregated by the three level valuation hierarchy:

| | | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|---|
| Assets: | | | | | |
| Cash and cash equivalents | $ | 2,002,164 | — | — | 2,002,164 |
| Collective trusts – equity | | — | 82,914,651 | — | 82,914,651 |
| Collective trusts – fixed income | | — | 101,504,324 | — | 101,504,324 |
| Private equity and real estate funds | | — | — | 1,917,122 | 1,917,122 |
| Total assets | $ | 2,002,164 | 184,418,975 | 1,917,122 | 188,338,261 |

The majority of the investments held by the plan are Level 2 securities. There were no significant transfers between levels during the years ended June 30, 2017 and 2016. Foundation has the ability to liquidate the collective trusts on a daily basis.

Foundation's pension plan invests in six alternative investments, which are primarily hedge funds of funds and private equity funds. Such investments are carried at their estimated fair value. Foundation uses the practical expedient to report the net asset values of these funds as an estimate of fair value. Most of the funds have not had changes in the redemption policies during the year ended June 30, 2017, and the policies range primarily from 30 to 90 days. Determination of fair value is performed on a quarterly basis by the General Partner(s) of the funds. Because of the inherent uncertainty of valuation, the determined values may differ significantly from the values that would have been used had a ready market for these investments existed.

ASC 715-20 also requires that nonpublic entities provide a reconciliation of the beginning and ending balances for the Level 3 plan assets. In accordance with this guidance, changes to Foundation's Level 3 plan assets are summarized as follows:

| | Private equity and real estate funds |
|---|---|
| Balance as of June 30, 2015 | $ 2,589,645 |
| Additions: | |
| Contributions/purchases | — |
| Disbursements: | |
| Withdrawals/sales | (841,286) |
| Realized gain | 161,942 |
| Net unrealized gains | 6,821 |
| Net change | (672,523) |
| Balance as of June 30, 2016 | 1,917,122 |
| Additions: | |
| Contributions/purchases | |
| Disbursements: | |
| Withdrawals/sales | (607,091) |
| Realized gain | 288,103 |
| Net unrealized gains | (170,743) |
| Net change | (489,731) |
| Balance as of June 30, 2017 | $ 1,427,391 |

***(d) Contributions***

The Foundation expects to contribute $5 million to its pension plan during the fiscal year ending June 30, 2018.

### *(e) Estimated Future Benefit Payments*

The following benefit payments, which reflect expected future employee service, as appropriate, are expected to be paid from the plan in each of the fiscal years as follows:

| | |
|---|---|
| 2018 | $ 9,597,000 |
| 2019 | 9,994,000 |
| 2020 | 10,713,000 |
| 2021 | 11,482,000 |
| 2022 | 12,013,000 |
| 2023–2027 | 67,349,000 |

The expected benefits to be paid are based on the same assumptions used to measure Foundation's benefit obligation at June 30, 2017.

Effective July 1, 2006, Foundation elected to not allow employees hired on or after July 1, 2006 to participate in either the defined benefit pension plan or the current employees' thrift plan. Instead, such employees participate in a new employees' thrift plan. The new employee's thrift plan expense was $4,336,557 and $3,468,256 in 2017 and 2016, respectively. The retirement benefits for employees hired on or prior to June 30, 2006 under the defined benefit plan and employees' thrift plan remain unchanged.

Foundation sponsors an employees' thrift plan for certain employees of Health System and Physicians. Foundation may provide a discretionary contribution to the employees' thrift plan. There were no discretionary contributions to the thrift plan in 2017 and 2016.

Foundation maintains a self-insured life, accident and health plan for employees of Health System and Physicians, which provides for monthly contributions in amounts sufficient to cover the costs of basic hospital, surgical and diagnostic benefits and administrative expenses. The life, accident, and health plan expense was $12,224,546 in 2017 and $12,551,258 in 2016.

Certain of the subsidiaries maintain various tax sheltered annuity accounts, defined contribution plans or other retirement benefit plans. These subsidiaries have the option to issue discretionary matching contributions to the plans. During the years ended June 30, 2017 and 2016, these subsidiaries contributed $361,026 and $379,749, respectively, to the plans.

## (12) Leases

Foundation leases office space under long-term operating leases, which expire at various dates through 2035, some of which require increasing monthly payments expiring over the next several years. The following is a schedule of the future minimum lease payments under operating leases as of June 30, 2017 that have initial or remaining lease terms in excess of one year for each of the years ending June 30:

| | | |
|---|---|---|
| 2018 | $ | 4,389,517 |
| 2019 | | 3,540,961 |
| 2020 | | 3,248,181 |
| 2021 | | 1,921,213 |
| 2022 | | 1,077,241 |
| Thereafter | | 1,233,747 |
| Total minimum lease payments | $ | 15,410,860 |

Rent expense was approximately $7,325,771 and $5,758,017 in 2017 and 2016, respectively. Foundation also leases various equipment under short-term leases.

Foundation has various capital leases for buildings and software the majority of which are related to its electronic medical records system.

The following is a schedule of future minimum lease payments under capital leases as of June 30, 2017:

| | | |
|---|---|---|
| 2018 | $ | 937,556 |
| 2019 | | 903,214 |
| 2020 | | 887,001 |
| 2021 | | 918,597 |
| 2022 | | 951,340 |
| Thereafter | | 3,596,987 |
| Total minimum lease payments | | 8,194,695 |
| Less amount representing interest | | 1,744,072 |
| Present value of net minimum lease payments | | 6,450,623 |
| Less obligations under capital leases, current portion | | 610,932 |
| Obligations under capital leases, less current portion | $ | 5,839,691 |

### (13) Self-Insurance Programs and Litigation

Foundation is from time to time subject to claims and suits arising in the ordinary course of business. In the opinion of management, the ultimate resolution of pending legal proceedings will not have a material effect on the consolidated financial statements. In this regard, Foundation maintains a self-insurance program for professional liability claims, and a related trust fund has been established for the purpose of setting aside



(Continued)

assets based on actuarial funding recommendations. Under the trust agreement, the assets can only be used for the payment of professional and general liability claims, related expenses, and the cost of administering the trust. Certain claims-made based professional and occurrence-based general liability insurance coverages have been purchased to provide protection for claims in excess of the self-insured amounts. The assets of the trust are classified as investments limited as to use in the accompanying consolidated balance sheets in the amount of approximately $358,000 and $191,000 at June 30, 2017 and 2016, respectively. The related claims liabilities of approximately $4,080,000 and $4,430,000 as of June 30, 2017 and 2016, respectively, are recorded on an undiscounted basis and represent estimates for asserted claims and unasserted claims arising from reported incidents and unreported incidents. Management believes that the provision for loss is adequate at June 30, 2017 and 2016; however, the ultimate liability may differ significantly. Management is aware of certain asserted and unasserted legal claims, none of which, in the opinion of management, are expected to result in losses in excess of insurance limits.

Health System and Physicians are also self-insured for unemployment claims and have established a letter of credit arrangement of approximately $1,365,000 in 2017 and $1,421,000 in 2016 in accordance with the requirements of the Maryland Department of Employment and Training.

Also, Foundation is self-insured for workers' compensation claims up to $550,000 for both 2017 and 2016. Investments of approximately $4,200,000 at June 30, 2017 and 2016 are being held in an account at a financial institution to secure the payment of claims. These investments are included in the balance of investments limited or restricted as to use. The related liabilities of approximately $5,370,000 and $5,280,000 as of June 30, 2017 and 2016, respectively, are recorded in the accompanying consolidated balance sheets. Foundation records outstanding losses and loss expenses for workers' compensation liability claims based on the estimates of the amount of reported losses together with a provision for losses incurred but not reported, the recommendations of an independent actuary, and management's judgment using its past experience and industry experience.

Foundation offers employees a self-insured health plan. Foundation maintains an accrual for claims that have been incurred but not reported to the plan administrator. The accrued liability for claims incurred but not reported is based on the historical claim lag period and current payment trends of health insurance claims. The accrued liability for health claims is approximately $1,890,000 and $2,120,000, respectively, as of June 30, 2017 and 2016.

While management believes that the provision for claims on unemployment, workers' compensation, and employee health benefits is adequate, at June 30, 2017 and 2016, the ultimate liability may be significantly different from the estimates.

### (14) Net Assets

Net assets at June 30 are summarized as follows:

| | 2017 | 2016 |
|---|---|---|
| Unrestricted: | | |
| Undesignated | $ 195,144,404 | 167,852,776 |
| Board-designated: | | |
| Moses Sheppard bequest | 49,972,310 | 43,972,497 |
| Enoch Pratt bequest | 31,870,384 | 28,043,927 |
| Other | 48,798,586 | 46,859,500 |
| Total board-designated | 130,641,280 | 118,875,924 |
| Total unrestricted | $ 325,785,684 | 286,728,700 |

Temporarily restricted net assets are available for the purposes of providing indigent care, health and educational programs and the purchase of property and equipment. Permanently restricted net assets are restricted in perpetuity, the income from which is expendable to provide health and educational programs.

### (15) Rate Setting Matters and Business and Credit Concentrations

Foundation provides healthcare services through its inpatient and outpatient care facilities located throughout Maryland. Foundation grants credit to patients and 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, Blue Cross/Blue Shield, health maintenance organizations (HMOs), and commercial insurance policies).

Net patient, residential and educational service revenue, by payor class, consisted of the following for the years ended June 30:

| | 2017 | 2016 |
|---|---|---|
| Medicare | 8 % | 9 % |
| Medicaid | 43 | 40 |
| Commercial insurers and HMOs | 13 | 13 |
| Local government | 19 | 21 |
| Blue Cross/Blue Shield | 10 | 11 |
| Self-pay and other | 7 | 6 |
| | 100 % | 100 % |



(Continued)

Foundation accepts all patients covered by the Medicare and Medicaid programs. These programs reimburse Foundation at amounts less than charges. The difference between the charges for healthcare services and the related reimbursement amounts for these and other third-party payors is as follows for the years ended June 30:

| | | 2017 | 2016 |
|---|---|---|---|
| Medicare | $ | 8,357,308 | 9,248,096 |
| Medicaid | | 7,603,675 | 5,528,310 |
| Other third-party payors | | 5,987,169 | 6,329,298 |
| | $ | 21,948,152 | 21,105,704 |

Patient charges of the Health System (other than Medicare and Medicaid) are recorded at rates established by the State of Maryland Health Services Cost Review Commission (HSCRC), reviewed on an annual basis and adjusted prospectively giving effect to, among other things, the anticipated impact of inflation on operating expenses, variances between actual volume of patient services and the volume budgeted for such services, and variances between actual unit rates and approved unit rates during the previous rate year. Such rate adjustments are reflected in revenue of Health System in the subsequent rate year, which coincides with Health System's fiscal year.

The Foundation is reimbursed for certain services to their Medicare and Medicaid program beneficiaries based upon cost reimbursement methodologies. The Maryland Medicaid program's inpatient reimbursement methodology is a prospective payment system, which is set at 94% of HSCRC rates. Medicaid outpatient services continue to be reimbursed on a cost report basis. Effective July 1, 2005, the Medicare program changed its reimbursement methodology to a prospective payment system. Health System has received either the final settlement or the notice of final settlement on Medicare cost reports through June 30, 2016 and on Medicaid cost reports for all programs through June 30, 2013. As of June 30, 2017 and 2016, the Company has recorded third-party payor settlements receivable of $9,755,493 and $10,902,769 respectively.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount. Management periodically reviews recorded amounts receivable from or payable to third-party payors and may adjust these balances as new information becomes available. In addition, revenue received under certain third-party agreements are subject to audit.

During 2017 and 2016, some of Foundation's prior year third-party cost reports were audited and settled, or tentatively settled, by third-party payors. Adjustments resulting from such audits and management reviews of unaudited years and open claims are reflected as adjustments to revenue in the year the adjustment becomes known. The effect of these adjustments was to increase net patient service revenue by approximately $700,291 and $1,547,000 during the years ended June 30, 2017 and 2016, respectively. Although certain other prior year cost reports submitted to third-party payors remain subject to audit and retroactive adjustment, management does not expect any material adverse settlements.

Patient accounts receivable are as follows at June 30:

| | | 2017 | 2016 |
|---|---|---|---|
| Patient accounts receivable, net of contractuals | $ | 20,635,931 | 19,369,700 |
| Residential and educational accounts receivable, net of contractuals | | 18,292,451 | 18,744,078 |
| Less allowance for doubtful accounts | | (6,562,215) | (7,030,044) |
| Patient accounts receivable, net | $ | 32,366,167 | 31,083,734 |

The activity in the allowance for bad debts is summarized as follows for the years ended June 30:

| | | 2017 | 2016 |
|---|---|---|---|
| Beginning Balance July 1 | $ | 7,030,044 | 8,656,425 |
| Provisions for bad debts | | 1,990,523 | 1,997,945 |
| Less writeoffs | | (2,458,352) | (3,624,326) |
| Ending Balance as of June 30 | $ | 6,562,215 | 7,030,044 |

## (16) Functional Expenses

Members of Foundation provide healthcare and educational services to the patients, which they serve. Expenses related to providing these services, based on management's estimates of expense allocations, are as follows:

| | | 2017 | 2016 |
|---|---|---|---|
| Healthcare and educational services | $ | 297,627,962 | 312,442,565 |
| General and administrative | | 65,723,903 | 42,017,857 |
| | $ | 363,351,865 | 354,460,422 |

## (17) Certain Significant Risks and Uncertainties

Foundation provides psychiatric healthcare services in the State of Maryland. Foundation and other healthcare providers are subject to certain inherent risks, including the following:

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

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

The Medicare and state Medicaid reimbursement programs represent a substantial portion of Foundation’s revenues and Foundation’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 Foundation.

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

The healthcare industry is subject to numerous laws and regulations from federal, state, and local governments, and the government has aggressively increased enforcement of Medicare and Medicaid anti-fraud and abuse laws. Foundation’s compliance with these laws and regulations is subject to periodic governmental review, which could result in enforcement actions unknown or unasserted at this time. The federal government and many states have aggressively increased enforcement under Medicare and Medicaid anti-fraud and abuse laws and physician self-referral laws (STARK law and regulation). Recent federal initiatives have prompted a national review of federally funded healthcare programs. In addition, the federal government and many states have implemented programs to audit and recover potential overpayments to providers from the Medicare and Medicaid programs.

As a result of recently enacted and pending federal healthcare reform legislation, substantial changes are anticipated in the U.S. 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.

## (18) Endowment Net Assets

Foundation’s endowments consist of both individual donor-restricted funds established for a variety of purposes and funds designated by the Board of Trustees to function as endowments. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

### *(a) Interpretation of Relevant Law*

Foundation has interpreted the 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, Foundation classifies its permanently restricted net assets as (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. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by

SPMIFA. In accordance with SPMIFA, Foundation 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 Foundation and the donor-restricted endowment fund

(3) General economic conditions

(4) The possible effect of inflation and deflation

(5) The expected total return from income and the appreciation of investments

(6) Other resources of Foundation

(7) The investment policies of Foundation

***(b) Net Asset Classification by Type of Endowment as of June 30, 2017***

| | | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|---|---|---|---|---|---|
| Donor-restricted endowment funds | $ | — | — | 3,909,375 | 3,909,375 |
| Board-designated endowment funds | | 130,641,280 | — | — | 130,641,280 |
| | $ | 130,641,280 | — | 3,909,375 | 134,550,655 |

Changes in endowment net assets for the year ended June 30, 2017:

| | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|---|---|---|---|---|
| Endowment net assets beginning of year | $ 118,875,924 | — | 4,084,460 | 122,960,384 |
| Investment return: | | | | |
| Investment income | 1,435,054 | — | 3,016 | 1,438,070 |
| Net appreciation (realized and unrealized gains and losses) | 14,533,926 | — | 10,299 | 14,544,225 |
| Total investment return | 15,968,980 | — | 13,315 | 15,982,295 |
| Contributions | — | — | 11,600 | 11,600 |
| Appropriation of endowment assets for expenditure | (4,203,624) | — | (200,000) | (4,403,624) |
| | $ 130,641,280 | — | 3,909,375 | 134,550,655 |

***(c) Net Asset Classification by Type of Endowment as of June 30, 2016***

| | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|---|---|---|---|---|
| Donor-restricted endowment funds | $ — | — | 4,084,460 | 4,084,460 |
| Board-designated endowment funds | 118,875,924 | — | — | 118,875,924 |
| | $ 118,875,924 | — | 4,084,460 | 122,960,384 |

Changes in endowment net assets for the year ended June 30, 2016:

| | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|---|---|---|---|---|
| Endowment net assets beginning of year | $ 123,740,462 | — | 4,036,000 | 127,776,462 |
| Investment return: | | | | |
| Investment income | 2,175,599 | — | 1,474 | 2,177,073 |
| Net appreciation (realized and unrealized gains and losses) | (3,730,062) | — | (12,589) | (3,742,651) |
| Total investment return | (1,554,463) | — | (11,115) | (1,565,578) |
| Contributions | — | — | 59,575 | 59,575 |
| Appropriation of endowment assets for expenditure | (3,310,075) | — | — | (3,310,075) |
| | $ 118,875,924 | — | 4,084,460 | 122,960,384 |

### *(d) Funds with Deficiencies*

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or SPMIFA requires Foundation to retain as a fund of perpetual duration as a result of unfavorable market fluctuations. During the years ended June 30, 2017 and 2016, the fair value did not fall below the specified amounts.

### *(e) Investment Strategies*

Foundation has adopted policies for corporate investments, including endowment assets that seek to maximize risk-adjusted returns with preservation of principal. Endowment assets include those assets of donor-restricted funds that Foundation must hold in perpetuity or for a donor-specified period(s). The endowment assets are invested in a manner that is intended to hold a mix of investment assets designed to meet the objectives of the account. Foundation expects its endowment funds, over time, to provide an average rate of return that generates earnings to achieve the endowment purpose.

To satisfy its long-term rate-of-return objectives, Foundation 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). Foundation employs a diversified asset allocation structure to achieve its long-term return objectives within prudent risk constraints.

Foundation monitors the endowment funds returns and appropriates average returns for use. In establishing this practice, Foundation considered the long-term expected return on its endowment. This is consistent with Foundation's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

### (19) Subsequent Events

Foundation has evaluated all events and transactions from the balance sheet date through October 19, 2017, the date at which the consolidated financial statements were issued, and determined there are no other items to be recognized or disclosed.

# SUPPLEMENTARY INFORMATION

Schedule 1

**SHEPPARD AND ENOCH PRATT FOUNDATION, INC.**
**AND SUBSIDIARIES**

Consolidating Balance Sheet Information

June 30, 2017

| Assets | Sheppard and Enoch Pratt Foundation, Inc. | Sheppard Pratt Health System, Inc. | Sheppard Pratt Investment, Inc. | Sheppard Pratt Physicians, P.A. | Obligated group combining eliminations | Combined obligated group subtotal |
|---|---|---|---|---|---|---|
| Current assets: | | | | | | |
| Cash and cash equivalents | $ 319,160 | 60,287,300 | — | 246,088 | — | 60,852,548 |
| Investments limited or restricted as to use | 122,601 | — | — | — | — | 122,601 |
| Accounts receivable, net | — | 22,030,515 | — | 841,703 | — | 22,872,218 |
| Due from affiliates | — | 13,431,785 | 3,145,971 | 185,567 | (15,999,402) | 763,921 |
| Prepaid expenses and other current assets | 25,088 | 7,153,691 | 19,350 | 736,799 | — | 7,934,928 |
| Total current assets | 466,849 | 102,903,291 | 3,165,321 | 2,010,157 | (15,999,402) | 92,546,216 |
| Investments limited or restricted as to use, less current portion | 10,218,314 | 35,431,332 | 142,640,449 | — | — | 188,290,095 |
| Interest in net assets of Foundation | — | 7,703,111 | — | — | (7,703,111) | — |
| Notes receivable | — | — | 1,877,631 | — | — | 1,877,631 |
| Third-party payor settlements receivable | — | 9,755,493 | — | — | — | 9,755,493 |
| Property and equipment, net | — | 163,610,053 | — | — | — | 163,610,053 |
| Other assets | — | 2,458,032 | 417,000 | — | — | 2,875,032 |
| Total assets | $ 10,685,163 | 321,861,312 | 148,100,401 | 2,010,157 | (23,702,513) | 458,954,520 |
| **Liabilities and Net Assets** | | | | | | |
| Current liabilities: | | | | | | |
| Note payable | $ — | 12,900,000 | — | — | — | 12,900,000 |
| Current maturities of long-term debt | — | 3,369,625 | — | — | — | 3,369,625 |
| Current portion of obligations under capital leases | — | 594,065 | — | — | — | 594,065 |
| Accounts payable | — | 4,686,938 | — | 87,753 | — | 4,774,691 |
| Accrued salaries, wages and employee benefits | — | 13,418,037 | — | 2,408,602 | — | 15,826,639 |
| Due to affiliates | 343,648 | 2,903,239 | 17,186,962 | — | (15,999,402) | 4,434,447 |
| Self-insurance liabilities | — | 3,351,826 | — | 257,812 | — | 3,609,638 |
| Other accrued expenses | 24,396 | 1,729,897 | 272,158 | 43,208 | — | 2,069,659 |
| Total current liabilities | 368,044 | 42,953,627 | 17,459,120 | 2,797,375 | (15,999,402) | 47,578,764 |
| Long-term liabilities: | | | | | | |
| Long-term debt, less current portion | — | 76,951,559 | — | — | — | 76,951,559 |
| Obligations under capitalized leases, less current portion | — | 5,839,691 | — | — | — | 5,839,691 |
| Self-insurance liabilities | — | 6,418,742 | — | — | — | 6,418,742 |
| Accrued pension liabilities | — | 25,232,025 | — | 7,455,064 | — | 32,687,089 |
| Other long-term liabilities | 401,494 | — | — | — | — | 401,494 |
| Total liabilities | 769,538 | 157,395,644 | 17,459,120 | 10,252,439 | (15,999,402) | 169,877,339 |
| Net assets (deficit): | | | | | | |
| Unrestricted | 1,904,160 | 156,638,312 | 130,641,281 | (8,242,282) | — | 280,941,471 |
| Temporarily restricted | 4,352,703 | 7,827,356 | — | — | (7,703,111) | 4,476,948 |
| Permanently restricted | 3,658,762 | — | — | — | — | 3,658,762 |
| Total net assets | 9,915,625 | 164,465,668 | 130,641,281 | (8,242,282) | (7,703,111) | 289,077,181 |
| Total liabilities and net assets | $ 10,685,163 | 321,861,312 | 148,100,401 | 2,010,157 | (23,702,513) | 458,954,520 |



(Continued)

Schedule 1

**SHEPPARD AND ENOCH PRATT FOUNDATION, INC.**
**AND SUBSIDIARIES**

Consolidating Balance Sheet Information

June 30, 2017

| Assets | | Alliance, Inc. | Family Services Inc. | Mosaic Community Services, Inc. | Way Station, Inc. | Consolidating eliminations | Consolidated totals |
|---|---|---|---|---|---|---|---|
| Current assets: | | | | | | | |
| Cash and cash equivalents | $ | — | 1,782,935 | 4,926,310 | 8,593,308 | 122,460 | 76,277,561 |
| Investments limited or restricted as to use | | — | 223,000 | 245,179 | 275,044 | — | 865,824 |
| Accounts receivable, net | | — | 2,006,764 | 5,436,907 | 2,050,278 | — | 32,366,167 |
| Due from affiliates | | — | 1,313 | 5,110 | 1,000 | (771,344) | — |
| Prepaid expenses and other current assets | | — | 118,431 | 691,875 | 2,482,133 | — | 11,227,367 |
| Total current assets | | — | 4,132,443 | 11,305,381 | 13,401,763 | (648,884) | 120,736,919 |
| Investments limited or restricted as to use, less current portion | | — | — | 3,743,038 | 4,672,236 | (4,432,651) | 192,272,718 |
| Interest in net assets of Foundation | | — | — | — | — | — | — |
| Notes receivable | | — | — | — | — | — | 1,877,631 |
| Third-party payor settlements receivable | | — | — | — | — | — | 9,755,493 |
| Property and equipment, net | | — | 8,802,781 | 21,381,328 | 22,118,354 | — | 215,912,516 |
| Other assets | | — | 89,345 | 747,050 | 569,874 | — | 4,281,301 |
| Total assets | $ | — | 13,024,569 | 37,176,797 | 40,762,227 | (5,081,535) | 544,836,578 |
| **Liabilities and Net Assets** | | | | | | | |
| Current liabilities: | | | | | | | |
| Note payable | $ | — | — | — | — | — | 12,900,000 |
| Current maturities of long-term debt | | — | 215,096 | 974,933 | 445,679 | — | 5,005,333 |
| Current portion of obligations under capital leases | | — | — | 16,867 | — | — | 610,932 |
| Accounts payable | | — | 273,488 | 1,554,040 | 453,544 | — | 7,055,763 |
| Accrued salaries, wages and employee benefits | | — | 1,441,297 | 3,672,229 | 1,783,652 | — | 22,723,817 |
| Due to affiliates | | — | — | 298,091 | 115,276 | (4,847,814) | — |
| Self-insurance liabilities | | — | — | 105,932 | 235,133 | — | 3,950,703 |
| Other accrued expenses | | — | 540,682 | 868,108 | 531,925 | (71,721) | 3,938,653 |
| Total current liabilities | | — | 2,470,563 | 7,490,200 | 3,565,209 | (4,919,535) | 56,185,201 |
| Long-term liabilities: | | | | | | | |
| Long-term debt, less current portion | | — | 5,626,811 | 5,427,221 | 4,887,852 | — | 92,893,443 |
| Obligations under capitalized leases, less current portion | | — | — | — | — | — | 5,839,691 |
| Self-insurance liabilities | | — | — | 286,410 | 681,462 | — | 7,386,614 |
| Accrued pension liabilities | | — | — | — | — | — | 32,687,089 |
| Other long-term liabilities | | — | 214,918 | 679,202 | 2,179,614 | (162,000) | 3,313,228 |
| Total liabilities | | — | 8,312,292 | 13,883,033 | 11,314,137 | (5,081,535) | 198,305,266 |
| Net assets (deficit): | | | | | | | |
| Unrestricted | | — | 3,898,655 | 18,764,160 | 22,181,398 | — | 325,785,684 |
| Temporarily restricted | | — | 813,622 | 4,278,991 | 7,266,692 | — | 16,836,253 |
| Permanently restricted | | — | — | 250,613 | — | — | 3,909,375 |
| Total net assets | | — | 4,712,277 | 23,293,764 | 29,448,090 | — | 346,531,312 |
| Total liabilities and net assets | $ | — | 13,024,569 | 37,176,797 | 40,762,227 | (5,081,535) | 544,836,578 |

See accompanying independent auditors' report.

Schedule 2

**SHEPPARD AND ENOCH PRATT FOUNDATION, INC.**
**AND SUBSIDIARIES**

Consolidating Statement of Operations Information

Year ended June 30, 2017

| | Sheppard and Enoch Pratt Foundation, Inc. | Sheppard Pratt Health System, Inc. | Sheppard Pratt Investment, Inc. | Sheppard Pratt Physicians, P.A. | Obligated group combining eliminations | Combined obligated group subtotal |
|---|---|---|---|---|---|---|
| Unrestricted revenues, gains, and other support: | | | | | | |
| Patient service revenue (net of allowances and discounts) | $ — | 133,232,739 | — | 13,543,090 | — | 146,775,829 |
| Residential and educational service revenue (net of allowances) | — | 85,804,217 | — | — | — | 85,804,217 |
| Total net service revenue | — | 219,036,956 | — | 13,543,090 | — | 232,580,046 |
| Less provision for bad debts | — | 706,120 | — | 227,958 | — | 934,078 |
| Net service revenue less provision for bad debts | — | 218,330,836 | — | 13,315,132 | — | 231,645,968 |
| Net assets released from restrictions used for operations | — | 1,037,761 | — | — | — | 1,037,761 |
| Other revenue | — | 12,363,577 | — | 16,938,730 | (15,292,406) | 14,009,901 |
| Total unrestricted revenues, gains, and other support | — | 231,732,174 | — | 30,253,862 | (15,292,406) | 246,693,630 |
| Expenses: | | | | | | |
| Salaries and wages | — | 118,890,283 | — | 25,689,478 | — | 144,579,761 |
| Employee benefits | — | 29,918,230 | — | 4,632,689 | — | 34,550,919 |
| Expendable supplies | — | 12,232,566 | — | 235 | — | 12,232,801 |
| Purchased services | 13,851 | 37,266,529 | — | 5,936,545 | (15,489,477) | 27,727,448 |
| Interest | — | 2,010,158 | — | — | — | 2,010,158 |
| Repairs and minor alterations | — | 6,632,060 | — | — | — | 6,632,060 |
| Depreciation and amortization | — | 14,554,787 | — | — | — | 14,554,787 |
| Loss on disposal of assets, net | — | 65,792 | — | — | — | 65,792 |
| Total expenses | 13,851 | 221,570,405 | — | 36,258,947 | (15,489,477) | 242,353,726 |
| Operating income (loss) | (13,851) | 10,161,769 | — | (6,005,085) | 197,071 | 4,339,904 |
| Other income (expense): | | | | | | |
| Investment income | — | 326,961 | 1,435,054 | — | (197,071) | 1,564,944 |
| Realized loss on investments, net | — | (296,707) | (1,298,399) | — | — | (1,595,106) |
| Change in unrealized gain on investments, net | — | 3,676,994 | 16,092,248 | — | — | 19,769,242 |
| Other | — | 1,690,252 | (259,923) | — | — | 1,430,329 |
| Total other income (expense) | — | 5,397,500 | 15,968,980 | — | (197,071) | 21,169,409 |
| Excess (deficiency) of revenues over expenses | (13,851) | 15,559,269 | 15,968,980 | (6,005,085) | — | 25,509,313 |
| Other changes in net assets: | | | | | | |
| Net assets released from restrictions used for purchases of property and equipment | — | 36,649 | — | — | — | 36,649 |
| Transfer from (to) affiliates | — | (1,046,376) | (4,203,624) | 5,250,000 | — | — |
| Pension liability adjustment | — | 12,020,415 | — | — | — | 12,020,415 |
| Capital grants and other | — | — | — | — | — | — |
| Increase (decrease) in unrestricted net assets | $ (13,851) | 26,569,957 | 11,765,356 | (755,085) | — | 37,566,377 |



(Continued)

Schedule 2

**SHEPPARD AND ENOCH PRATT FOUNDATION, INC.**
**AND SUBSIDIARIES**

Consolidating Statement of Operations Information

Year ended June 30, 2017

| | Alliance, Inc. | Family Services Inc. | Mosaic Community Services, Inc. | Way Station, Inc. | Consolidating eliminations | Consolidated totals |
|---|---|---|---|---|---|---|
| Unrestricted revenues, gains, and other support: | | | | | | |
| Patient service revenue (net of allowances and discounts) | $ — | — | — | — | — | 146,775,829 |
| Residential and educational service revenue (net of allowances) | — | 12,878,832 | 37,220,154 | 25,363,189 | — | 161,266,392 |
| Total net service revenue | — | 12,878,832 | 37,220,154 | 25,363,189 | — | 308,042,221 |
| Less provision for bad debts | — | 621,132 | 199,172 | 236,141 | — | 1,990,523 |
| Net service revenue less provision for bad debts | — | 12,257,700 | 37,020,982 | 25,127,048 | — | 306,051,698 |
| Net assets released from restrictions used for operations | — | — | 214,988 | 114,692 | — | 1,367,441 |
| Other revenue | — | 11,490,519 | 25,555,603 | 10,127,939 | (742,450) | 60,441,512 |
| Total unrestricted revenues, gains, and other support | — | 23,748,219 | 62,791,573 | 35,369,679 | (742,450) | 367,860,651 |
| Expenses: | | | | | | |
| Salaries and wages | — | 14,007,327 | 35,363,507 | 22,872,417 | — | 216,823,012 |
| Employee benefits | — | 2,410,202 | 7,774,825 | 4,666,504 | — | 49,402,450 |
| Expendable supplies | — | 1,726,716 | 2,745,460 | 1,583,005 | — | 18,287,982 |
| Purchased services | — | 4,048,954 | 13,417,111 | 3,398,222 | (742,450) | 47,849,285 |
| Interest | — | 259,530 | 285,977 | 189,018 | — | 2,744,683 |
| Repairs and minor alterations | — | 384,482 | 1,604,267 | 676,945 | — | 9,297,754 |
| Depreciation and amortization | — | 746,382 | 2,268,980 | 1,156,102 | — | 18,726,251 |
| Loss on disposal of assets, net | — | 147,349 | 6,641 | 666 | — | 220,448 |
| Total expenses | — | 23,730,942 | 63,466,768 | 34,542,879 | (742,450) | 363,351,865 |
| Operating income (loss) | — | 17,277 | (675,195) | 826,800 | — | 4,508,786 |
| Other income (expense): | | | | | | |
| Investment income | — | — | 71,083 | 81,496 | — | 1,717,523 |
| Realized loss on investments, net | — | — | — | (42,589) | — | (1,637,695) |
| Change in unrealized gain on investments, net | — | — | 86,590 | 527,855 | — | 20,383,687 |
| Other | — | — | — | — | — | 1,430,329 |
| Total other income | — | — | 157,673 | 566,762 | — | 21,893,844 |
| Excess (deficiency) of revenues over expenses | — | 17,277 | (517,522) | 1,393,562 | — | 26,402,630 |
| Other changes in net assets: | | | | | | |
| Net assets released from restrictions used for purchases of property and equipment | — | — | — | 162,902 | — | 199,551 |
| Transfer from (to) affiliates | (5,357,236) | — | 5,357,236 | — | — | — |
| Pension liability adjustment | — | — | — | — | — | 12,020,415 |
| Capital grants and other | — | — | 4,148 | 430,240 | — | 434,388 |
| Increase (decrease) in unrestricted net assets | $ (5,357,236) | 17,277 | 4,843,862 | 1,986,704 | — | 39,056,984 |

See accompanying independent auditors' report.

Schedule 3

**SHEPPARD AND ENOCH PRATT FOUNDATION, INC.**
**AND SUBSIDIARIES**

Consolidating Statement of Changes in Net Assets Information

Year ended June 30, 2017

| | Sheppard and Enoch Pratt Foundation, Inc. | Sheppard Pratt Health System, Inc. | Sheppard Pratt Investment, Inc. | Sheppard Pratt Physicians, P.A. | Obligated group combining eliminations | Combined obligated group subtotal |
|---|---|---|---|---|---|---|
| Unrestricted net assets: | | | | | | |
| Excess (deficiency) of revenues over expenses | $ (13,851) | 15,559,269 | 15,968,980 | (6,005,085) | — | 25,509,313 |
| Other changes in net assets: | | | | | | |
| Net assets released from restrictions used for purchases of property and equipment | — | 36,649 | — | — | — | 36,649 |
| Transfer from (to) affiliates | — | (1,046,376) | (4,203,624) | 5,250,000 | — | — |
| Pension liability adjustment | — | 12,020,415 | — | — | — | 12,020,415 |
| Capital grants and other | — | — | — | — | — | — |
| Increase (decrease) in unrestricted net assets | (13,851) | 26,569,957 | 11,765,356 | (755,085) | — | 37,566,377 |
| Temporarily restricted net assets: | | | | | | |
| Gifts and grants | 1,204,515 | — | — | — | — | 1,204,515 |
| Investment income | 52,856 | — | — | — | — | 52,856 |
| Net realized loss on investments | (49,727) | — | — | — | — | (49,727) |
| Net unrealized gain on investments | 616,318 | — | — | — | — | 616,318 |
| Interest in net assets of Foundation | — | 761,150 | — | — | (761,150) | — |
| Transfer from (to) affiliates | — | — | — | — | — | — |
| Net assets released from restrictions for operations | — | (1,037,761) | — | — | — | (1,037,761) |
| Net assets released from restrictions for purchases of property and equipment | — | (36,649) | — | — | — | (36,649) |
| Reclassification of net assets | (1,074,412) | 1,074,412 | — | — | — | — |
| Increase (decrease) in temporarily restricted net assets | 749,550 | 761,152 | — | — | (761,150) | 749,552 |
| Permanently restricted net assets: | | | | | | |
| Gifts | 11,600 | — | — | — | — | 11,600 |
| Investment loss | 10,299 | — | — | — | — | 10,299 |
| Reclassification of net assets | — | — | — | — | — | — |
| Increase in permanently restricted net assets | 21,899 | — | — | — | — | 21,899 |
| Increase (decrease) in net assets | 757,598 | 27,331,109 | 11,765,356 | (755,085) | (761,150) | 38,337,828 |
| Net assets (deficit), beginning of year | 9,158,027 | 137,134,559 | 118,875,925 | (7,487,197) | (6,941,961) | 250,739,353 |
| Net assets (deficit), end of year | $ 9,915,625 | 164,465,668 | 130,641,281 | (8,242,282) | (7,703,111) | 289,077,181 |



(Continued)

Schedule 3

**SHEPPARD AND ENOCH PRATT FOUNDATION, INC.**
**AND SUBSIDIARIES**

Consolidating Statement of Changes in Net Assets Information

Year ended June 30, 2017

| | | Alliance, Inc. | Family Services Inc. | Mosaic Community Services, Inc. | Way Station, Inc. | Consolidating eliminations | Consolidated totals |
|---|---|---|---|---|---|---|---|
| Unrestricted net assets: | | | | | | | |
| Excess (deficiency) of revenues over expenses | $ | — | 17,277 | (517,522) | 1,393,562 | — | 26,402,630 |
| Other changes in net assets: | | | | | | | |
| Net assets released from restrictions used for purchases of property and equipment | | — | — | — | 162,902 | — | 199,551 |
| Transfer from (to) affiliates | | (5,357,236) | — | 5,357,236 | — | — | — |
| Pension liability adjustment | | — | — | — | — | — | 12,020,415 |
| Capital grants and other | | — | — | 4,148 | 430,240 | — | 434,388 |
| Increase (decrease) in unrestricted net assets | | (5,357,236) | 17,277 | 4,843,862 | 1,986,704 | — | 39,056,984 |
| Temporarily restricted net assets: | | | | | | | |
| Gifts and grants | | — | 813,622 | 344,180 | 955,963 | — | 3,318,280 |
| Investment income | | — | — | 12,470 | — | — | 65,326 |
| Net realized loss on investments | | — | — | — | — | — | (49,727) |
| Net unrealized gain on investments | | — | — | — | — | — | 616,318 |
| Interest in net assets of Foundation | | — | — | — | — | — | — |
| Transfer from (to) affiliates | | (3,787,843) | — | 3,787,843 | — | — | — |
| Net assets released from restrictions for operations | | — | — | (214,988) | (114,692) | — | (1,367,441) |
| Net assets released from restrictions for purchases of property and equipment | | — | — | — | (162,902) | — | (199,551) |
| Reclassification of net assets | | — | — | 200,000 | — | — | 200,000 |
| Increase (decrease) in temporarily restricted net assets | | (3,787,843) | 813,622 | 4,129,505 | 678,369 | — | 2,583,205 |
| Permanently restricted net assets: | | | | | | | |
| Gifts | | — | — | — | — | — | 11,600 |
| Investment gain | | — | — | 3,016 | — | — | 13,315 |
| Reclassification of net assets | | — | — | (200,000) | — | — | (200,000) |
| Decrease in permanently restricted net assets | | — | — | (196,984) | — | — | (175,085) |
| Increase (decrease) in net assets | | (9,145,079) | 830,899 | 8,776,383 | 2,665,073 | — | 41,465,104 |
| Net assets, beginning of year | | 9,145,079 | 3,881,378 | 14,517,381 | 26,783,017 | — | 305,066,208 |
| Net assets, end of year | $ | — | 4,712,277 | 23,293,764 | 29,448,090 | — | 346,531,312 |

See accompanying independent auditors' report.