



The Union Hospital of Cecil County, Inc.

Financial Statements

June 30, 2019 and 2018

The Union Hospital of Cecil County, Inc.

Table of Contents
June 30, 2019 and 2018

	<u>Page</u>
Independent Auditors' Report	1
Financial Statements	
Balance Sheets	2
Statements of Operations	3
Statements of Changes in Net Assets	4
Statements of Cash Flows	5
Notes to Financial Statements	6

Independent Auditors' Report

To the Board of Directors of
The Union Hospital of Cecil County, Inc.

We have audited the accompanying financial statements of The Union Hospital of Cecil County, Inc. (a Maryland not-for-profit corporation) (the "Hospital"), which comprise the balance sheets as of June 30, 2019 and 2018, and the related statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Union Hospital of Cecil County as of June 30, 2019 and 2018, and the results of its operations, changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Baker Tilly Virchow Krause, LLP

Philadelphia, Pennsylvania
October 25, 2019

The Union Hospital of Cecil County, Inc.

Balance Sheets

June 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>		<u>2019</u>	<u>2018</u>
Assets			Liabilities and Net Assets		
Current Assets			Current Liabilities		
Cash and cash equivalents	\$ 6,198,168	\$ 3,170,011	Accounts payable and accrued expenses	\$ 5,662,200	\$ 10,111,574
Investments	40,977,815	39,705,037	Accrued salaries and benefits	4,712,969	4,479,913
Accounts receivable, patients	13,863,566	14,900,301	Third-party advances	3,485,157	3,964,220
Other receivables	206,146	1,716,899	Current portion of long-term debt and capital lease obligations	<u>3,490,580</u>	<u>3,572,129</u>
Inventories of supplies	2,307,404	2,268,203			
Prepaid expenses	<u>2,940,202</u>	<u>2,136,306</u>	Total current liabilities	17,350,906	22,127,836
Total current assets	66,493,301	63,896,757			
			Due to Affiliates, Net	419,040	261,822
Property and Equipment, Net	82,932,993	88,138,296			
			Long-Term Debt and Capital Lease Obligations, Net	54,962,648	58,233,683
Due from Affiliates, Net	324,527	698,177			
			Estimated Medical Malpractice Claims Liability	<u>8,853,757</u>	<u>7,903,134</u>
Other Assets, Net	9,027,240	7,899,867	Total liabilities	<u>81,586,351</u>	<u>88,526,475</u>
Interest in Net Assets of Affiliate	<u>5,147,489</u>	<u>4,998,101</u>	Net Assets		
			Net assets without donor restrictions	79,490,139	74,557,561
			Net assets with donor restrictions	<u>2,849,060</u>	<u>2,547,162</u>
			Total net assets	<u>82,339,199</u>	<u>77,104,723</u>
Total assets	<u>\$ 163,925,550</u>	<u>\$ 165,631,198</u>	Total liabilities and net assets	<u>\$ 163,925,550</u>	<u>\$ 165,631,198</u>

See notes to financial statements

The Union Hospital of Cecil County, Inc.

Statements of Operations

Years Ended June 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Revenues, Gains, and Other Support		
Net patient service revenues	\$ 153,762,303	\$ 157,971,001
Provision for bad debts	-	(8,807,407)
Net patient service revenues	153,762,303	149,163,594
Other operating revenues	2,724,951	2,218,243
Net assets released from restrictions for use in operations	149,168	582,275
Total revenues, gains, and other support	<u>156,636,422</u>	<u>151,964,112</u>
Expenses		
Salaries and employee benefits	87,612,068	84,855,967
Supplies and other expenses	31,537,094	28,461,005
Purchased services	30,330,026	37,236,585
Depreciation and amortization	11,026,334	11,476,003
Interest	1,942,655	2,024,928
Total expenses	<u>162,448,177</u>	<u>164,054,488</u>
Operating loss before impairment loss	(5,811,755)	(12,090,376)
Impairment loss	-	(569,956)
Total operating loss	<u>(5,811,755)</u>	<u>(12,660,332)</u>
Nonoperating Income (Loss)		
Investment income	1,296,224	3,135,075
Other income (loss), net	42,622	(133,907)
Total nonoperating income	<u>1,338,846</u>	<u>3,001,168</u>
Revenues less than expenses	(4,472,909)	(9,659,164)
Change in Interest in Net Assets of Affiliate	(152,510)	(221,688)
Net Transfers from Affiliates	9,393,938	974,172
Net Assets Released from Restriction Used for Purchase of Property and Equipment	<u>164,059</u>	<u>59,168</u>
Increase (decrease) in net assets without donor restrictions	<u>\$ 4,932,578</u>	<u>\$ (8,847,512)</u>

See notes to financial statements

The Union Hospital of Cecil County, Inc.

Statements of Changes in Net Assets
Years Ended June 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Net Assets Without Donor Restrictions		
Revenues less than expenses	\$ (4,472,909)	\$ (9,659,164)
Change in interest in net assets of affiliate	(152,510)	(221,688)
Net transfer from affiliates	9,393,938	974,172
Net assets released from restriction used for purchase of property and equipment	164,059	59,168
	<u>4,932,578</u>	<u>(8,847,512)</u>
Increase (decrease) in net assets without donor restrictions		
Net Assets Without Donor Restrictions		
Contributions, net of event expenses of \$119,316 and \$216,673 in 2019 and 2018, respectively	478,940	737,581
Contributions for capital	139,410	-
Net assets released from restriction	(316,452)	(635,791)
	<u>301,898</u>	<u>101,790</u>
Increase in net assets without donor restrictions		
Increase (decrease) in net assets	5,234,476	(8,745,722)
Net Assets, Beginning	<u>77,104,723</u>	<u>85,850,445</u>
Net Assets, Ending	<u>\$ 82,339,199</u>	<u>\$ 77,104,723</u>

See notes to financial statements

The Union Hospital of Cecil County, Inc.

Statements of Cash Flows

Years Ended June 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Cash Flows from Operating Activities		
Increase (decrease) in net assets	\$ 5,234,476	\$ (8,745,722)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	11,026,334	11,476,003
Loss on disposal of property plant and equipment	1,315	78,570
Impairment loss on property plant and equipment	-	569,956
Provision for bad debts	-	8,807,407
Amortization of deferred financing costs	66,584	66,584
Net transfers from affiliates	(9,393,938)	(974,172)
Net realized and unrealized gains and losses on investments	371,072	(1,460,965)
Restricted contributions	(478,940)	(737,581)
Changes in assets and liabilities:		
Accounts receivable, patients	1,036,735	(6,455,335)
Other receivables, inventories of supplies, and prepaid expenses	667,656	(382,447)
Due to/from affiliates	530,868	(2,501,591)
Other assets, net	(1,127,373)	1,673,862
Accounts payable and accrued expenses	(4,639,008)	4,163,925
Accrued salaries and benefits	233,056	(363,609)
Third-party advances	(479,063)	703,794
Estimated medical malpractice claims liability	950,623	(1,059,834)
Net cash provided by operating activities	<u>4,000,397</u>	<u>4,858,845</u>
Cash Flows from Investing Activities		
Purchases of property and equipment	(5,350,168)	(8,438,199)
Purchases and sales of investments	(1,643,850)	2,536,787
Change in beneficial interest in net assets of The Union Hospital of Cecil County Foundation, Inc.	<u>(149,388)</u>	<u>119,898</u>
Net cash used in investing activities	<u>(7,143,406)</u>	<u>(5,781,514)</u>
Cash Flows from Financing Activities		
Restricted contributions	478,940	737,581
Transfers to affiliates	9,393,938	1,356,975
Payment of long-term debt and capital lease obligations	<u>(3,701,712)</u>	<u>(3,855,003)</u>
Net cash provided by (used in) financing activities	<u>6,171,166</u>	<u>(1,760,447)</u>
Net increase (decrease) in cash and cash equivalents	3,028,157	(2,683,116)
Cash and Cash Equivalents, Beginning	<u>3,170,011</u>	<u>5,853,127</u>
Cash and Cash Equivalents, Ending	<u>\$ 6,198,168</u>	<u>\$ 3,170,011</u>
Supplemental Disclosure of Cash Flow Information		
Cash paid for interest	<u>\$ 1,767,140</u>	<u>\$ 1,814,945</u>
Supplemental Disclosure of Noncash Investing and Financing Activities		
Payable for property and equipment	<u>\$ 189,634</u>	<u>\$ 1,133,946</u>
Capital lease obligation incurred for equipment	<u>\$ 282,544</u>	<u>\$ 2,019,643</u>

See notes to financial statements

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

1. Organizational Structure and Nature of Operations

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

Affinity Health Alliance, Inc. (the "Health System") is a non-stock, not-for-profit corporation and the sole corporate member of the Hospital. The Health System is also the sole corporate member or sole stockholder of other related healthcare organizations, one of which is a for-profit corporation.

In June 2019, the board of directors approved the signing of a letter of intent for the Hospital to enter into a non-binding agreement to become a member of Christiana Care Health System, pending due diligence, board resolution and regulatory approvals.

Subsequent Events

The Hospital evaluated subsequent events for recognition or disclosure through October 25, 2019, the date the financial statements were issued.

2. Summary of Significant Accounting Policies

Use of Estimates

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

Cash and Cash Equivalents

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

Patient Accounts Receivable

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

Other Receivables

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

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

Inventories of Supplies

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

Investments and Investment Risk

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value. Mutual funds are valued at quoted market prices, which represent the net asset value of shares held. Cash and cash equivalents are carried at cost which approximates fair value. Managed hedge funds represent ownership in limited partnerships that invest in hedge funds, limited partnerships and private equity capital funds. Managed hedge funds are valued based on the current market values of the underlying assets reported by the investment advisor using audited financial statements of the funds at year end using net asset value of shares held. Due to redemption restrictions, these funds are classified as Level 3 on the fair value table. Investments in limited partnerships representing less than 3 percent ownership are recorded at cost and excluded from the fair value table. Investments representing greater than 3 percent ownership are accounted for under the equity method which approximates fair value. Investment income or loss (including realized gains and losses on investments, interest and dividends and unrealized gains and losses on investments) is included in the determination of revenues less expenses unless the income or loss is restricted by donor or law.

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

Property and Equipment

Property and equipment acquisitions are recorded at cost. Donated property and equipment are recorded at fair market value at the date of receipt. Depreciation is computed using the straight-line method based on estimated useful lives.

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

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

In 2018, management reviewed certain related party subsidiary's long-lived assets for potential impairment noting the carrying value of their leasehold improvements and equipment were not recoverable in the ordinary course of business. As such, an impairment loss of \$569,956 was recognized for the year ended June 30, 2018, which represents the write-down to fair value of the building the Hospital leases to Union Hospital of Cecil County Oncology, Inc. No impairment loss was recognized for the year ended June 30, 2019.

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

Interest in Net Assets of Affiliate

Generally accepted accounting principles establish standards for transactions in which a donor makes a contribution by transferring assets to a not-for-profit recipient organization that agrees to use those assets on behalf of or transfer them to a beneficiary entity. Under certain circumstances, a beneficiary organization is required to recognize its rights to assets held by a recipient organization as an asset on the balance sheets, and changes in value of that asset as a change in net assets in the period of change. The Hospital is the beneficiary of the net assets of an unconsolidated affiliate, The Union Hospital of Cecil County Foundation, Inc. (the "Foundation"). The Hospital's interest in the net assets of the Foundation as of June 30, 2019 and 2018 was \$5,147,489 and \$4,998,101, respectively.

Net Assets

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

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

Net assets with donor restrictions includes amounts subjected to donor imposed restrictions which are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. All revenues restricted by donors as to either timing or purpose of the related expenditures or required to be maintained in perpetuity as a source of investment income are accounted for in net assets with donor restrictions. When a donor restriction expires, that is when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions. Net assets were released from donor restriction by satisfying their restricted purposes in the amount of \$177,042 in 2019 and \$635,791 in 2018.

Net assets with donor restrictions includes those whose use by the Hospital has been limited by donors to specific purposes in the amount of \$2,849,060 and \$2,547,162 as of June 30, 2019 and 2018, respectively.

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

Deferred Financing Costs

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

Costs incurred in connection with the issuance of long-term debt have been deferred and are being amortized over the terms of the related debt using the straight-line method, which approximates the effective interest method. Amortization expense was \$66,584 in 2019 and 2018.

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

Estimated Malpractice Claims Liability

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

Measure of Operations

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

Revenues Less Than Expenses

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

Net Patient Service Revenues

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

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

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

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

Performance obligations are determined based on the nature of the services provided by the Hospital. Revenues for performance obligations satisfied over time are recognized based on actual charges incurred in relation to total expected (or actual) charges. The Hospital believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the Hospital receiving services over multiple days. The Hospital measures the performance obligation from admission into the Hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time are generally recognized when goods or services are provided and the Hospital does not believe it is required to provide additional services to the patient. Generally, performance obligations satisfied at a point in time relate to patients receiving outpatient services in a single day. The Hospital measures the performance obligation from the commencement of the outpatient service, to the point when it is no longer required to provide services to that patient, which is generally the completion of the outpatient service.

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

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

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

Uncompensated Care

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

The amount of uncompensated care, based on estimated direct and indirect costs incurred, provided during fiscal years 2019 and 2018 was approximately \$1,836,000 and \$1,822,000, respectively.

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

Income Taxes

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

The Hospital accounts for uncertainty in income taxes by prescribing a recognition threshold of more-likely-than-not to be sustained upon examination by the appropriate taxing authority. Measurement of the tax uncertainty occurs if the recognition threshold has been met. There were no tax uncertainties that met the recognition threshold in 2019 and 2018.

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

3. Regulatory Environment

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

The Hospital's rate structure is subject to review and approval by the Maryland Health Services Cost Review Commission. During 2011, the Hospital adopted the Total Patient Revenue Reimbursement System ("TPR"). The Hospital's patient revenue is 100 percent fixed regardless of increases and decreases in volumes and changes in case mix. The original TPR system was in effect for a three-year period ending June 30, 2013.

The agreement was renewed for another three-year period commencing on July 1, 2016. The renewal does not include any additional incentives, but does include a provision for an annual rate increase for inflation and a population adjustment. The agreement was amended to bring all existing TPR agreements into the global budget revenue format, but this process made no material modifications to the Hospital's existing agreement. The TPR agreement has not been amended since July 1, 2016.

4. New Accounting Standards

Revenue Recognition

In 2019, the Hospital adopted the FASB ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, using the modified retrospective approach. ASU No. 2014-09 supersedes the revenue recognition requirements in *Topic 605, Revenue Recognition*, and most industry specific guidance. The core principle under ASU No. 2014-09 is that revenues are recognized to depict the transfer of promised goods or services to customers (patients) in an amount that reflects the consideration at which the entity expects to be entitled in exchange for those goods or services. Additionally, ASU No. 2014-09 requires enhanced disclosures of revenue arrangements.

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

The Hospital applied the modified retrospective approach to all contracts when adopting ASU No. 2014-09. As a result of the adoption, what was previously classified as the provision for doubtful collections in the statements of operations is now reflected as implicit price concessions, as defined in Topic 606, and therefore included as a reduction of net patient service revenues. For changes in transaction price related to changes in patient circumstances, the Hospital will prospectively recognize those amounts as a provision for bad debts within operating expenses on the statements of operations. For periods prior to July 1, 2018, the provision for doubtful collections has been presented consistent with the previous revenue recognition standards that required separate presentation of these amounts as a component of net patient service revenues. Additionally, as a result of the adoption of ASU No. 2014-09, the allowance for doubtful collections of approximately \$20,392,000 as of July 1, 2018 became a component of patient accounts receivable.

Not-for-Profit Entities

In 2019, the Hospital adopted the FASB's Accounting Standards Update No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. ASU No. 2016-14 addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment return. The Hospital has adjusted the presentation of these financial statements accordingly. ASU No. 2016-14 has been applied retrospectively to all periods presented, except for the disclosures around liquidity and availability of resources and analysis of expenses by nature and function. These disclosures have been presented for 2019 only, as allowed by ASU No. 2016-14.

The new standard changes the following aspects of the financial statements:

- The unrestricted net assets class has been renamed Net Assets Without Donor Restrictions;
- The temporarily restricted net assets class has been renamed Net Assets With Donor Restrictions;
- The financial statements include a disclosure about liquidity and availability of resources at June 30, 2019 (Note 13).
- The functional expense disclosure for 2019 includes expenses reported both by nature and function (Note 14).

Financial Instruments

In 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)*. ASU No. 2016-01 was issued to enhance the reporting model for financial instruments in financial statements. The provisions of ASU No. 2016-01 requires marketable equity securities to be reported at fair value with changes in fair value recognized within the performance indicator, establishes a qualitative factor in evaluating impairment on equity investments without readily determinable fair values, and eliminates the requirement to disclose the fair value on financial instruments measured at amortized cost. The Hospital will be required to prospectively adopt the guidance in ASU No. 2016-01 in the year ending June 30, 2019. The Hospital has not yet determined the impact of adoption of ASU No. 2016-01 on its financial statements.

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

Lease Accounting

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. ASU No. 2016-02 was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Under the provisions of ASU No. 2016-02, a lessee is required to recognize a right-to-use asset and lease liability, initially measured at the present value of the lease payments, in the balance sheet. In addition, lessees are required to provide qualitative and quantitative disclosures that enable users to understand more about the nature of the Hospital's leasing activities. The Hospital will be required to retrospectively adopt the guidance in ASU No. 2016-02 in the year ending June 30, 2020. The Hospital has not yet determined the impact of adoption of ASU No. 2016-02 on its financial statements.

Statement of Cash Flows

During August 2016, the FASB issued ASU No. 2016-15, *Classification of Certain Cash Receipts and Cash Payments*. ASU No. 2016-15 addresses eight cash flow issues with specific guidance on how certain cash receipts and cash payments should be presented on the statement of cash flows. The Hospital will be required to adopt the guidance in ASU No. 2016-15 for the year ending June 30, 2020. The Hospital is currently assessing the impact that ASU No. 2016-15 will have on its statements of cash flows.

5. Net Patient Service Revenues

The Hospital routinely obtains assignments of (or is otherwise entitled to receive) patient benefits receivable under their health insurance programs, plans or policies (i.e. third party payors). Third party payors include both government payors, which include Medicare, Medicaid, and Management Care Organizations, and commercial insurance carriers. Agreements with third party payors typically provide for payments at amounts less than established charges.

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

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

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

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

Net patient service revenues disaggregated by service type for the year ended June 30, 2019 are as follows:

Global budget revenue	\$ 138,676,567
Physician practice services	13,844,659
Other services revenue	<u>1,241,077</u>
Total	<u>\$ 153,762,303</u>

Net patient service revenues disaggregated by payor for the years ended June 30, 2019 and 2018 are approximately as follows:

	<u>Third-Party Government Payors</u>	<u>Third-Party Commercial Payors</u>	<u>Self-Pay</u>	<u>Total All Payors</u>
June 30, 2019	<u>\$ 104,296,000</u>	<u>\$ 44,992,000</u>	<u>\$ 4,474,000</u>	<u>\$ 153,762,000</u>
June 30, 2018	<u>\$ 99,837,000</u>	<u>\$ 44,984,000</u>	<u>\$ 4,342,000</u>	<u>\$ 149,163,000</u>

6. Investments

Investments consist of the following as of June 30:

	<u>2019</u>	<u>2018</u>
Investments:		
Cash and cash equivalents	\$ 750,278	\$ 779,884
Corporate bonds	1,282,650	1,701,195
Mutual funds:		
Fixed income	19,161,008	12,344,327
International equities	3,535,088	3,730,129
Large value	1,890,196	1,098,009
Large growth	2,042,377	2,693,366
Mid cap	-	782,599
Small cap	1,286,109	703,167
Other	446,084	3,696,971
Exchange-traded products	1,943,378	3,911,273
Managed hedge funds	<u>8,640,647</u>	<u>8,264,117</u>
Total	<u>\$ 40,977,815</u>	<u>\$ 39,705,037</u>

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

Investment income and unrealized gains and losses for investments and cash and cash equivalents are comprised of the following for the years ended June 30:

	<u>2019</u>	<u>2018</u>
Investment income:		
Interest and dividend income, net	\$ 1,667,296	\$ 1,674,110
Realized gains, net	287,850	715,902
Changes in net unrealized gains and losses on investments	<u>(658,922)</u>	<u>745,063</u>
Total	<u>\$ 1,296,224</u>	<u>\$ 3,135,075</u>

7. Fair Value Measurements

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

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

The levels of the fair value hierarchy are as follows:

Level 1 - Fair value is based on unadjusted quoted prices in active markets that are accessible to the Hospital for identical assets. These generally provide the most reliable evidence and are used to measure fair value whenever available.

Level 2 - Fair value is based on significant inputs, other than Level 1 inputs, that are observable either directly or indirectly for substantially the full term of the asset through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets, quoted market prices in markets that are not active for identical or similar assets, and other observable inputs.

Level 3 - Fair value would be based on significant unobservable inputs. Examples of valuation methodologies that would result in Level 3 classification include option pricing models, discounted cash flows, and other similar techniques.

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

The following tables present financial instruments measured at fair value at June 30, 2019 and 2018, by caption on the balance sheet:

	June 30, 2019			
	Total	Level 1	Level 2	Level 3
Reported at Fair Value				
Cash and cash equivalents	\$ 750,278	\$ 750,278	\$ -	\$ -
Corporate bonds	1,282,650	-	1,282,650	-
Mutual funds	28,360,862	28,360,862	-	-
Exchange-traded products	1,943,378	1,943,378	-	-
Managed hedge funds	3,840,647	-	-	3,840,647
Managed Hedge Funds at Cost	4,800,000			
Disclosed at Fair Value				
Cash and cash equivalents	6,198,168	6,198,168	-	-
Long-term debt, excluding capital leases (carrying value of \$56,564,945)	56,564,945	-	56,564,945	-
June 30, 2018				
Reported at Fair Value				
Cash and cash equivalents	\$ 779,884	\$ 779,884	\$ -	\$ -
Corporate bonds	1,701,195	-	1,701,195	-
Mutual funds	25,048,568	25,048,568	-	-
Exchange-traded products	3,911,273	3,911,273	-	-
Managed hedge funds	3,444,116	-	-	3,444,116
Managed Hedge Funds at Cost	4,820,001			
Disclosed at Fair Value				
Cash and cash equivalents	3,170,011	3,170,011	-	-
Long-term debt, excluding capital leases (carrying value of \$59,181,386)	59,181,386	-	59,181,386	-

The following is a description of the valuation methodologies used for assets measured at fair value and for financial instruments disclosed at fair value. There have been no changes in methodologies used at June 30, 2019 and 2018.

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

Mutual funds and exchange-traded products: Valued at the net asset value ("NAV") of shares held by the Hospital at year end.

Managed hedge funds: These investments are not readily marketable, and are recognized using the cost method or equity method of accounting based on the percentage of the fund owned. Those with redemption restrictions are valued based on the current market values of the underlying assets reported by the investment advisor using audited financial statements of the funds at year end using NAV. Investments in limited partnerships representing less than 3 percent ownership are recorded at cost. Funds in which the Hospital owns greater than 3 percent of the fund are recognized on the equity method. The equity method recognizes gains and losses on these investments.

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

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

Long-term debt, excluding capital lease obligations: Fair value is calculated based on quoted market prices, if available, or estimated using quoted market prices of similar securities.

8. Property and Equipment and Accumulated Depreciation and Amortization

Property and equipment consisted of the following as of June 30:

	<u>2019</u>	<u>2018</u>
Land and improvements	\$ 2,672,845	\$ 2,624,182
Buildings and improvements	90,785,847	86,283,092
Fixed equipment	48,785,239	46,037,103
Major movable equipment	82,785,471	80,478,161
Construction in progress	366,445	4,859,353
Total	225,395,847	220,281,891
Less accumulated depreciation and amortization	<u>(142,462,854)</u>	<u>(132,143,595)</u>
Property and equipment, net	<u>\$ 82,932,993</u>	<u>\$ 88,138,296</u>

Included above is leased equipment at a cost of \$9,607,397 and \$9,324,853 with accumulated amortization of \$7,605,560 and \$6,374,210 as of June 30, 2019 and 2018, respectively.

During 2018, \$382,803 in assets were transferred to an affiliate of the Hospital and subsidiary of the Health System and \$705,908 in assets were transferred to the Hospital from an affiliate and subsidiary of the Health System.

During 2019 and 2018, certain property and equipment was disposed of, reducing accumulated depreciation by \$707,075 and \$3,691,596, respectively. In addition, as described in Note 2, one of the Hospital's buildings was impaired in 2018, reducing accumulated depreciation by \$687,167.

9. Long-Term Debt and Capital Lease Obligations

Long-term debt and capital lease obligations consists of the following as of June 30:

	<u>2019</u>	<u>2018</u>
MHHEFA Series 2014 Revenue Bonds	\$ 30,238,000	\$ 30,358,000
MHHEFA Series 2012 Revenue Bonds	4,752,737	6,250,863
Town of Elkton, Maryland Series 2012 Revenue Bonds (held by SunTrust Bank)	21,574,208	22,572,523
Capital lease obligations (Note 10)	<u>2,273,241</u>	<u>3,075,968</u>
Total	58,838,186	62,257,354
Less unamortized deferred financing costs, net	(384,958)	(451,542)
Less current portion	<u>(3,490,580)</u>	<u>(3,572,129)</u>
Long-term debt and capital lease obligations, net	<u>\$ 54,962,648</u>	<u>\$ 58,233,683</u>

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

On December 1, 2014, the Hospital participated in MHHEFA revenue bond issuances that totaled \$30,778,000. The MHHEFA Series 2014 Revenue Bonds (the "2014 Revenue Bonds") were issued to refund the remaining portion of the MHHEFA Series 2005 Revenue Bonds and finance certain capital projects. The 2014 Revenue Bonds bear interest at 3.42 and 3.01 percent as of June 30, 2019 and 2018, respectively, and are payable in monthly annual installments through July 2039.

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

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

- \$10,000,000 from the EDRRB, Series 2012A Bonds to partially refund the Economic Development Revenue Bond, Series 2009, and pay costs of issuance. The note bears interest at 2.25 percent and is payable in monthly installments of \$44,477 through December 2036.
- \$5,842,234 from the EDRRB, Series 2012B-1 Bonds to refund the remaining portion of the Economic Development Revenue Bond, Series 2009, and pay costs of issuance. This note bears interest at 2.73 and 2.25 percent as of June 30, 2019 and 2018, respectively, and is payable in monthly installments of \$25,995 through December 2036.
- \$2,820,102 from the EDRRB, Series 2012B-2 Bonds to refund Elkton's 2000 Revenue Bonds and pay costs of issuance. This note bears interest at 2.27 and 1.87 percent as of June 30, 2019 and 2018, respectively, and is payable in monthly installments of \$31,708 through June 2020.
- \$9,000,000 from the EDRRB, Series 2012C Bonds to partially refund the MHHEFA Series 2002 Revenue Bonds and pay costs of issuance. This note bears interest at 2.73 and 2.25 percent as of June 30, 2019 and 2018, respectively, and provides interest-only installments until July 2022, at which time \$92,268 in monthly installments through June 2031.

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

Years ending June 30:	
2020	\$ 2,609,453
2021	2,290,577
2022	3,021,833
2023	2,318,377
2024	2,383,481
Thereafter	<u>43,941,224</u>
Total	<u>\$ 56,564,945</u>

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

10. Capital Lease Obligations

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

Years ending June 30:	
2020	\$ 954,617
2021	797,744
2022	568,002
2023	<u>82,687</u>
Total minimum lease payments	2,403,050
Less amount representing interest	<u>129,809</u>
Total	2,273,241
Less current portion, principal	<u>881,127</u>
Long term portion, principal	<u>\$ 1,392,114</u>

11. Pension Plan

Effective January 1, 1999, the Hospital established a 403(b) defined contribution plan (the "403(b) plan") which includes a matching provision, for employees of the Health System, the Hospital and the Foundation. The Hospital has used the 403(b) plan as its primary retirement plan as of January 1, 2000. The 403(b) plan expenses may include a discretionary employer contribution for employees who work at least 1,000 hours in a calendar year and a 50 percent employer match contribution up to 1.5 percent of gross wages for those employees who choose to make voluntary contributions. Pension expense related to the 403(b) plan was approximately \$755,000 and \$762,000 for the years ended June 30, 2019 and 2018, respectively, and is included in salaries and employee benefits in the accompanying statements of operations. There was no discretionary contribution made during 2019 and 2018.

12. Concentration of Credit Risk

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of gross revenues from patients and third-party payors was as follows for the years ended June 30:

	<u>2019</u>	<u>2018</u>
Medicare	44 %	42 %
Medicaid	25	26
Blue Cross/Blue Shield	16	17
Health maintenance organizations	1	1
Self-pay patients	3	3
Other third-party payors	<u>11</u>	<u>11</u>
Total	<u>100 %</u>	<u>100 %</u>

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

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

13. Liquidity and Availability

The Hospital's financial assets available for general expenditure within one year of the balance sheet date, consist of the following at June 30, 2019:

Cash and cash equivalents	\$ 6,198,168
Short-term investments	40,977,815
Accounts receivable, patients	13,863,566
Other receivables	<u>206,146</u>
Total	<u>\$ 61,245,695</u>

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

14. Functional Expenses

A summary of the Hospital's operating expenses by function for the year ended June 30, 2019 is as follows:

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

A summary of the Hospital's operating expenses by function for the year ended June 30, 2018 is as follows:

Healthcare services	\$ 104,697,000
Support services	<u>59,927,000</u>
Total	<u>\$ 164,624,000</u>

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

15. Commitments and Contingencies

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

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

After June 30, 2018, the Hospital submitted a voluntary refund to Novitas Solutions, the Medicare Administrative Contractor, for Medicare overpayments associated with inpatient services provided to Medicare patients of certain physicians for whom the Company had not completed the re-credentialing process. The Hospital had accrued approximately \$2.7 million within accounts payable and accrued liabilities in the balance sheet as of June 30, 2018; the refund was paid on July 23, 2018. While no regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Also, future changes in federal and state reimbursement funding mechanisms and related government budgeting constraints could have an adverse effect on the Hospital.

The Hospital also self-reported to the Office of Inspector General ("OIG") under the Self Disclosure Matter, related to Federal Stark and Anti-Kickback laws and other physician based services. The Hospital is working with the OIG regarding this matter and is currently awaiting a settlement proposal. As of June 30, 2018, the Hospital had accrued approximately \$1.3 million for this matter, which is included in accounts payable and accrued liabilities in the accompanying balance sheet as of June 30, 2018; \$1.14 million was paid out during 2019. The remaining liability as of June 30, 2019 is approximately \$406,000.

16. Medical Malpractice Claims Coverage

For the period October 17, 2003 through December 31, 2004, the Hospital maintained its malpractice insurance coverage with the Zurich Insurance Company under a claims-made policy.

As of January 1, 2005, when existing policies expired, the Hospital elected to obtain its professional and general liability insurance from Freestate Healthcare Insurance Company, Ltd., a Cayman Islands company ("Freestate"). Freestate was incorporated as of January 1, 2005 as a chartered captive insurance company for eight nonprofit hospitals in the State of Maryland, including the Hospital. Each of the hospitals contributed an equal amount of \$15,000 as capital to Freestate in return for a one-eighth share interest in Freestate. Freestate is governed by a Board of Directors selected by the shareholders. The policy has no stated deductible.

The Union Hospital of Cecil County, Inc.

Notes to Financial Statements

June 30, 2019 and 2018

Freestate's primary insurance is under the terms of a claims-made insurance policy and has limits of liability of \$1 million per claim and no aggregate limit per policy year. Freestate's excess liability coverage insures against losses in excess of the above primary coverage reported during the period of policy coverage. This excess liability insurance policy has an individual occurrence limit of \$10 million and an annual aggregate limit of \$10 million. Prior acts of coverage for newly employed physicians will not be provided without prior approval of Freestate's Board of Directors. Each hospital's annual premium will be established through a retrospective rating process, with initial premiums based on actuarial estimates. Initial premiums will be charged at the 75 percent confidence level and retrospective premium assessments will be capped at an amount equal to the expected losses for the policy period at an 85 percent confidence level, in each case as determined by an independent actuary.

The total estimated reported medical malpractice claims liability is \$8,853,757 at June 30, 2019 and \$7,903,134 at June 30, 2018. The Hospital has recorded a receivable, and related claim liability, for anticipated insurance recoveries of \$7,666,493 at June 30, 2019 and \$6,692,333 at June 30, 2018. The estimated insurance recoveries receivable is included in other assets in the balance sheets.

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

17. Related Party Transactions

The Hospital periodically receives or advances funds for working capital purposes. Interest is not charged and there are no fixed repayment terms on these transactions. Receivables (payables) from (to) other affiliates of the Hospital as of June 30, 2019 and 2018 are shown below:

	<u>2019</u>	<u>2018</u>
Health System	\$ (411,175)	\$ (124,455)
Union Hospital of Cecil County Foundation, Inc.	<u>316,662</u>	<u>560,810</u>
Total	<u>\$ (94,513)</u>	<u>\$ 436,355</u>

The Hospital pays a management fee to the Health System for administrative, finance, and human resources services. The management fee was calculated at 1 percent of the Hospital's net operating revenues (including the provision for doubtful accounts) for fiscal years 2019 and 2018. Fees of \$910,899 and \$1,574,678 are included in purchased services in the accompanying statements of operations for the years ended June 30, 2019 and 2018, respectively.

During 2019 and 2018, the Hospital recorded net asset transfers from (to) affiliates of \$9,393,938 and \$974,172, respectively. These amounts included \$382,803 in fixed assets transferred in 2018.

Effective February 1, 2014, the Hospital entered into a 2 year management services agreement with the University of Maryland Medical System ("UMMS"). Under the agreement, UMMS provides support for quality initiatives, physician recruitment, supply chain saving and for the oncology programs. The agreement was renewed January 1, 2016 until June 30, 2018; however, it was terminated early on January 31, 2018. For the year ending June 30, 2018, the Hospital paid approximately \$70,000 to UMMS.