Consolidated Financial Statements and Supplementary Information

Western Maryland Health System Corporation
Period Ended January 31, 2020, and Year Ended June 30, 2019
With Report of Independent Auditors

Ernst & Young LLP

Western Maryland Health System Corporation

Consolidated Financial Statements and Supplementary Information

Period Ended January 31, 2020, and Year Ended June 30, 2019

Contents

Ernst & Young LLP
2100 One PPG Place
Pittsburgh, PA 15222

Tel: +1 412 644 7800
Fax: +1 412 644 0477
ey.com

Building a better working world

Report of Independent Auditors

Board of Directors
Western Maryland Health System Corporation and Subsidiaries

We have audited the accompanying consolidated financial statements of Western Maryland Hospital System Corporation and subsidiaries, which comprise the consolidated balance sheet as of January 31, 2020 and June 30, 2019, and the related consolidated statements of operations, changes in net assets, and cash flows for the seven-month period ended January 31, 2020, and the year ended June 30, 2019, 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 financial statements in conformity 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 financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Western Maryland Insurance Company, LTD, a wholly owned subsidiary, which statements reflect total assets constituting 4.0% and 4.2% as of January 31, 2020 and June 30, 2019, respectively and total revenues constituting 0.5% for both the seven-month period ended January 31, 2020, and the year ended June 30, 2019. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Western Maryland Insurance Company, LTD, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of 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 auditor's 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

Building a better working world

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, based on our audits and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Western Maryland Health System Corporation and subsidiaries at January 31, 2020 and June 30, 2019, and the consolidated results of their operations, changes in their net assets, and their cash flows for the seven-month period ended January 31, 2020, and the year ended June 30, 2019, in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying supplementary information 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 audits 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. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Ernst & Young LLP

June 4, 2020

Western Maryland Health System Corporation

Consolidated Balance Sheets

	January 31, 2020	June 30, 2019
Assets	*(Dollars in Thousands)*	
Current assets:		
Cash and cash equivalents	**$ 90,322**	$ 37,205
Investments	**70,780**	–
Funds on deposit with trustee	**18**	18,089
Accounts receivable, net	**44,641**	41,031
Pledge receivable, net	**49**	54
Other receivables, net	**2,221**	5,859
Inventories and other current assets	**11,666**	9,998
Total current assets	**219,697**	112,236
Investments	**19,471**	128,939
Board designated investments	**6,936**	7,858
Other long-term investments	**234**	225
Investments restricted by donor or grantor	**10,304**	6,821
Beneficial interest in trustee-held foundation assets	**2,191**	2,144
Property and equipment, net	**241,117**	246,598
Investments in affiliates	**40,770**	38,035
Operating lease right-of-use asset	**4,419**	–
Other assets	**6,175**	6,038
Total assets	**$ 551,314**	$ 548,894
Liabilities and net assets		
Current liabilities:		
Current portion of long-term debt	**$ 13,827**	$ 13,263
Accounts payable and accrued liabilities	**10,552**	10,588
Accrued bond interest payable	**794**	5,089
Accrued salaries and benefits	**20,837**	16,268
Payable to third-party payors	**6,012**	5,280
Other current liabilities	**1,874**	–
Deferred revenue	**525**	239
Total current liabilities	**54,421**	50,727
Long-term debt, net of current portion	**187,859**	203,661
Pension benefits in excess of pension assets	**97,326**	71,960
Operating lease noncurrent liabilities	**2,544**	–
Other liabilities	**14,818**	13,381
Total liabilities	**356,968**	339,729
Net assets:		
Net assets without donor restrictions	**180,252**	198,584
Net assets with donor restrictions	**12,545**	9,018
Total parent net assets	**192,797**	207,602
Noncontrolling interest in consolidated subsidiaries	**1,549**	1,563
Total net assets	**194,346**	209,165
Total liabilities and net assets	**$ 551,314**	$ 548,894

See accompanying notes.

Western Maryland Health System Corporation

Consolidated Statements of Operations

	Period Ended January 31, 2020	Year Ended June 30, 2019
	(Dollars in Thousands)	
Unrestricted revenues and other support:		
Patient service revenue	**$ 199,224**	$ 332,461
Other revenue	**2,846**	6,795
Total revenues and other support	**202,070**	339,256
Expenses:		
Salaries and wages	**80,666**	126,698
Employee benefits	**24,351**	38,539
Professional fees	**13,317**	22,512
Purchased services	**15,096**	36,741
Supplies	**33,979**	54,897
Utilities	**2,627**	4,302
Insurance	**2,943**	2,165
Interest	**3,405**	10,179
Depreciation and amortization	**15,683**	25,168
Other	**4,148**	7,153
Total expenses	**196,215**	328,354
Operating income	**5,855**	10,902
Nonoperating income:		
Equity in (loss) income of affiliates	**(334)**	1,533
Investment income, including realized gains on trading portfolio	**26,024**	1,723
Unrealized (losses) gains on trading portfolio	**(18,054)**	8,634
Other	**(4,961)**	81
Total nonoperating income	**2,675**	11,971
Excess of revenues over expenses	**$ 8,530**	$ 22,873

See accompanying notes.

Western Maryland Health System Corporation

Consolidated Statements of Changes in Net Assets

	Net Assets Without Donor Restrictions	Net Assets With Donor Restrictions	Total Net Assets
	(Dollars in Thousands)		
Balance at June 30, 2018	$ 208,479	$ 7,908	$ 216,387
Excess of revenues over expenses	22,873	–	22,873
Investment gain	–	111	111
Donations	–	1,344	1,344
Grants	–	237	237
Change in funded status of pension plan	(29,367)	–	(29,367)
Net assets released for operations	–	(510)	(510)
Net assets released for purchase of property and equipment	132	(137)	(5)
Unrealized gains on investments	–	65	65
Distributions to noncontrolling interest in consolidated subsidiaries	(1,970)	–	(1,970)
Change in net assets	(8,332)	1,110	(7,222)
Balance at June 30, 2019	200,147	9,018	209,165
Excess of revenues over expenses	**8,530**	**–**	**8,530**
Investment gain	**–**	**523**	**523**
Captive dividend	**(3,000)**	**–**	**(3,000)**
Donations	**–**	**6,108**	**6,108**
Grants	**–**	**443**	**443**
Change in funded status of pension plan	**(22,828)**	**–**	**(22,828)**
Net assets released for operations	**–**	**(3,145)**	**(3,145)**
Net assets released for purchase of property and equipment	**157**	**(157)**	**–**
Unrealized gains on investments	**–**	**(292)**	**(292)**
Change in beneficial interest of trustee-held foundation assets	**–**	**47**	**47**
Distributions to noncontrolling interest in consolidated subsidiaries	**(1,205)**	**–**	**(1,205)**
Change in net assets	**(18,346)**	**3,527**	**(14,819)**
Balance at January 31, 2020	**$ 181,801**	**$ 12,545**	**$ 194,346**

See accompanying notes.

Western Maryland Health System Corporation

Consolidated Statements of Cash Flows

	Period Ended January 31, 2020	Year Ended June 30, 2019
	(Dollars in Thousands)	
Operating activities		
Change in net assets	**$ (14,819)**	$ (7,222)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	**15,683**	25,168
Amortization of bond financing costs and premiums	**(2,085)**	(2,801)
Change in funded status of pension plan	**22,828**	29,367
Distributions to noncontrolling interest holder	**1,205**	1,970
Equity in income of affiliates	**334**	(1,533)
Realized and unrealized gains on investments	**(7,867)**	(11,076)
Restricted contributions	**(551)**	(1,581)
Changes in assets and liabilities:		
Accounts receivable	**(3,610)**	(3,579)
Other receivables	**3,643**	(1,200)
Inventories and other current assets	**(1,668)**	1,303
Accounts payable and accrued liabilities, accrued bond interest payable, and accrued salaries and benefits	**252**	3,642
Payable to third-party payors	**734**	(1,015)
Deferred revenue	**286**	239
Other assets, funded status of pension plan, and other liabilities	**734**	(7,703)
Net cash provided by operating activities	**15,099**	23,979
Investing activities		
Purchase of long-lived assets	**(10,185)**	(14,624)
Change in funds on deposit with trustee	**18,071**	(305)
Net change in investments	**43,938**	(1,568)
Net cash provided by (used) in investing activities	**51,824**	(16,497)
Financing activities		
Repayments of long-term debt	**(13,000)**	(12,385)
Capital lease payments	**(152)**	(336)
Proceeds from restricted contributions	**551**	1,581
Distributions to noncontrolling interest holder	**(1,205)**	(1,970)
Net cash used in financing activities	**(13,806)**	(13,110)
Increase (decrease) in cash and cash equivalents	**53,117**	(5,628)
Cash and cash equivalents at beginning of year	**37,205**	42,833
Cash and cash equivalents at end of period/year	**$ 90,322**	$ 37,205
Supplemental disclosures of cash flow information		
Cash paid for interest	**$ 4,763**	$ 10,488
Capital additions accrued but not paid	**$ 1,060**	$ 636

See accompanying notes.

Western Maryland Health System Corporation

Notes to Consolidated Financial Statements

January 31, 2020
(Dollars in Thousands)

1. Mission and Organization

Western Maryland Health System Corporation (the Health System or WMHS) is a not-for-profit community health system. The mission of the Health System is to provide patient-centered care and improve the health and well-being of people in the communities it serves. The Health System provides these patient and family centered services through responsible management of human and fiscal resources. The Health System is a values-driven health system that respects and supports life, preserves the dignity of each individual, and promotes a healthy and just society through collaboration with others who share the Health System's values.

The Health System accepts patients regardless of their ability to pay. Those patients who meet certain criteria under its charity care policies receive services at no charge or at an amount less than full charges. Essentially, these policies define charity services as those services for which no payment is anticipated. In addition to providing charity care, the Health System provides other programs and services for the general community. The Health System offers more than 90 community health programs that include programs that target health education and provide health screenings to patients. A wide variety of health screenings are offered throughout the year for the general community that are free of charge or offered for a nominal fee. The Health System provides free education programs on a variety of health topics. The Health System also sponsors community health screenings and community health fairs, which provide health screenings, education, and activities targeted to health and safety.

On February 1, 2020, University of Pittsburgh Medical Center (UPMC) and the Health System and its subsidiaries executed an Integration and Affiliation Agreement providing for an affiliation. Refer to Note 19 for additional information.

The Health System comprises the following wholly or partially owned, and controlled, consolidated subsidiaries in Cumberland, Maryland:

Acute Care Hospital

Western Maryland Regional Medical Center – a full-service community hospital located in Cumberland, Maryland, licensed for 224 acute care beds, owned and operated by the Health System

1. Mission and Organization (continued)

Long-Term Care

Frostburg Nursing & Rehabilitation Center (Frostburg)

Other

Western Maryland Health System Foundation, Inc. (Foundation)

Western Maryland Insurance Company, Ltd. (WMIC)

Haystack Consolidated Services, Inc. (Haystack)

Cumberland Properties, Inc.

Memorial Medical Center Services, Inc. (MMCS)

Johnson Heights Medical Building Partnership (Johnson Heights)

Haystack Imaging Services, LLC (Haystack Imaging)

In addition, the Health System has investments in several unconsolidated affiliates, which are accounted for under the cost or equity methods of accounting, as appropriate (see Note 6).

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles, and include the accounts of the Health System and its subsidiaries and controlled entities. Significant intercompany accounts and transactions have been eliminated in consolidation. The Health System's consolidated financial statements reflect the respective interests of the minority investors in the joint ventures' net assets and changes in net assets.

2. Summary of Significant Accounting Policies (continued)

Investments in Affiliates

Investments in certain joint ventures, which are not controlled by the Health System, are accounted for using the cost or equity method of accounting as appropriate (see Note 6). These investments are included as investments in affiliates on the accompanying consolidated balance sheets. The Health System's proportionate share of income or loss of the unconsolidated joint ventures is included in nonoperating income on the accompanying consolidated statements of operations.

Cash Equivalents

Cash equivalents consist primarily of temporary investments with maturities of three months or less when purchased and certain overnight repurchase agreements. Overnight repurchases are principally unsecured and are subject to normal credit risk.

Inventories

Inventories primarily consist of medical supplies and drugs and are carried at lower of cost or market. Cost is determined principally using the average cost method, which approximates the first-in, first-out method.

Investments

The Health System's investment portfolio, including board designated investments and investments restricted by donor or grantor, is considered a trading portfolio and is classified as current or noncurrent assets based on management's intention as to use. Accordingly, realized and unrealized gains and losses are included in investment income on the accompanying consolidated statements of operations. Dividend and interest income, as well as realized gains on sales of securities, is included in investment income.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value on the balance sheet. Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are included in the excess of revenues over expenses.

2. Summary of Significant Accounting Policies (continued)

The Health System maintains operating reserves in investments equivalent to 12 months of capital asset expenditures and interest payments on the Health System's Series 2014 Revenue Bonds. That balance is maintained in the current asset section of the accompanying consolidated balance sheets.

Property and Equipment

Property and equipment are stated at cost or, if donated, at fair market value at date of gift. Depreciation is determined using a straight-line basis over the estimated useful lives of the related assets. Repairs and maintenance are expensed as incurred.

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

The Health System opened a 275-bed capacity, state-of-the-art hospital on November 21, 2009. Adjacent to the hospital is a 120,000-square-foot medical office building (MOB) previously owned and operated by a third-party medical office building developer until the purchase of the MOB by WMHS on February 17, 2011. The MOB includes both hospital services and physicians' office space.

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 Accounting Standards Codification (ASC) Subtopic 360-10, *Property, Plant, and Equipment – Overall*, if there is an indication that the carrying amount of an asset is not recoverable, the Health System projects undiscounted cash flows, excluding interest, to determine whether 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 discounted cash flows.

2. Summary of Significant Accounting Policies (continued)

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 whether expected future cash flows used in measuring assets are impaired, the Health System groups the assets at the lowest level for which there are identifiable cash flows independent of other groups of assets. If such assets are impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Fair value is based upon market prices, where available, or discounted cash flows. Management believes that no revision to the remaining useful lives is required and there was no impairment of long-lived assets during the period ended January 31, 2020 or the year ended June 30, 2019.

Financing Costs

Financing costs incurred in issuing long-term debt have been deferred and are shown as a reduction to long-term debt on the balance sheet. These costs are being amortized using the effective interest method over the term of the related debt. In November 2014, the Health System issued new debt and refunded the previous debt. The unamortized balances were $1,792 and $1,860 at January 31, 2020 and June 30, 2019, respectively.

Net Assets With Donor Restrictions

Net assets are classified for reporting purposes in two categories as net assets with donor restrictions and net assets without donor restrictions according to the existence or absence of donor-imposed restrictions. Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as restricted support if they are received with donor stipulations that limit the use of the donated assets to a specific purpose or time period or restricted by donor to be maintained in perpetuity. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished the net asset with donor restrictions are reclassified as net assets without donor restrictions and reported as net assets released from restrictions.

2. Summary of Significant Accounting Policies (continued)

Net assets with donor restrictions related for capital purposes are recorded as a change in net assets without donor restrictions, while net assets with donor restrictions released for operating purpose are recorded as other operating revenue or as a reduction of the related expense.

Net Patient Service Revenue and Accounts Receivable

In 2011, the Health Services Cost Review Commission (HSCRC) adopted a voluntary alternative rate system known as the Total Patient Revenue (TPR) program, initially established as a demonstration project. Under TPR, a prospective, fixed revenue budget is established by the HSCRC for the upcoming year. This fixed revenue budget incorporates all payors and is not adjusted for changes in volume, case mix, or mix of inpatient services that occur during the year.

The TPR revenue budget is adjusted annually for inflation and for population in a hospital's service area.

Consistent with the objectives of health care reform, the TPR model eliminates "payment for volume" and is designed to encourage hospitals to operate efficiently by reducing utilization and managing patients in the most appropriate care delivery setting. TPR does not include physician services or other kinds of unregulated services (i.e., freestanding ambulatory centers) that fall outside of the jurisdiction of the HSCRC. The TPR agreement allows the Health System to adjust unit rates, within certain limits, to achieve the overall revenue budget for the Health System at year-end. Any overcharge or undercharge vs. the revenue budget is prospectively added to the subsequent year's budget. While the TPR cap does not adjust for changes in volume or service mix, the TPR cap is adjusted annually for inflation, and for changes in payor mix, market share, and uncompensated care. The HSCRC also may impose various revenue adjustments that could be significant in the future.

WMHS operated under the TPR agreement for six years, under two three-year TPR contracts.

In 2014, most Maryland hospitals that were not under the TPR agreements were put on a Global Budget Revenue Agreement (GBR) that was modeled after the TPR agreement with some minor differences. Effective July 1, 2016, the HSCRC transitioned TPR hospitals away from the TPR agreement to the GBR agreement for consistency with all hospitals. There were a few components of the TPR agreement that were important to TPR hospitals that were incorporated into WMHS's GBR agreement related to market share and population growth. The agreement is a one-year agreement with an automatic renewal each year unless either party terminates it with notice.

2. Summary of Significant Accounting Policies (continued)

Explicit price concessions, which represent the difference between amounts billed as patient service revenue and amounts paid by third-party payors, are accrued in the period in which the related services are rendered. Because the Health System does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue. These amounts also represent an explicit price concession. There are also implicit price concessions accrued for amounts expected to become bad debt.

The Maryland Medicaid program is administered primarily through independent licensed managed care organizations. The state of Maryland has contracts with these independent managed care organizations to manage the care to eligible participants. Amounts due from the Medicaid program in Maryland are primarily due from the independent managed care organizations.

Patient receivable include charges for amounts due from all patients less price concessions relating to allowances for the excess of established charges over the payments to be received on behalf of patients covered by Medicare, Medicaid and other insurers. The provision for price concessions is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in health care coverage, and other collection indicators. Periodically throughout the year, management assesses the adequacy of the price concessions based upon historical experience of self-pay accounts receivable, including those balances after insurance payments and not covered by insurance.

The Health System's revenues generally relate to contracts with patients in which our performance obligations are to provide health care services to the patients. These revenues are based upon the estimated amounts that management expects to be entitled to receive from patients and third-party payors. Refer to Note 3 for additional information regarding the recognition of revenues in accordance with generally accepted accounting principles.

Excess of Revenues Over Expenses

The consolidated statement of operations includes the performance indicator, excess of revenues over expenses. Changes in net assets without donor restrictions, which are excluded from excess of revenues over expenses, include unrealized gains and losses on other than trading securities, change in funded status of the pension plan, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions, which by donor restriction were to be used for the purposes of acquiring such assets).

2. Summary of Significant Accounting Policies (continued)

Charity Care

The Health System, as an integral part of its mission, accepts and treats all patients without regard to their ability to pay. A patient is classified as a charity patient in accordance with established criteria. Charity care is the recognition of services rendered for which no payment is expected.

Donations

Unconditional donations are included in income when pledged or received. Donations restricted as to use by the donor are reflected as additions to temporarily or permanently restricted net assets.

Expenditures of temporarily restricted net assets are transferred to net assets without donor restrictions, if for capital additions, or reported as other revenue if for operating purposes.

Income Taxes

The Health System and substantially all of its affiliates are tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code (IRC) and are not subject to income taxes except to the extent they have taxable income from activities that are not related to their exempt purpose. No provision for income taxes was required to be made in the consolidated financial statements for these entities.

Johnson Heights is a general partnership and Haystack Imaging is a limited liability company and both are not directly subject to income taxes. The results of their operations are included in the tax returns of their partners. Haystack Consolidated and MMCS are taxable for-profit entities, which recognized an immaterial amount of taxable income during 2019 and 2018. There is a full valuation allowance against their deferred tax costs.

The Health System and affiliates account for tax provisions in accordance with Financial Accounting Standards Board (FASB) ASC Subtopic 740-10, *Income Taxes – Overall*, which creates a single model to address uncertainty in tax positions and clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. Under the requirements of ASC Subtopic 740-10, an entity could be required to record an obligation as the result of a tax position it has historically taken on various tax exposure items. The Health System and affiliates have determined that they did not have any uncertain tax positions as of January 31, 2020 or June 30, 2019.

2. Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes and supplementary information.

Actual results could differ from those estimates.

Western Maryland Health System Foundation

The Foundation is controlled by the Health System, and thus its assets, liabilities, net assets, and results of operations are consolidated within the Health System's financial statements.

Beneficial Interest in Trustee-Held Assets

The Health System records a beneficial interest in several trusts (the assets of which are to be held in perpetuity) for which a portion of the income is to be distributed to the Health System. These changes in the fair value of the trusts are recorded as unrealized gains/losses in permanently restricted net assets.

Trivergent Health Alliance MSO

On July 6, 2014, Western Maryland Health System Corporation, Frederick Regional Health System, and Meritus Health, three regional nonprofit health systems, formed Trivergent Health Alliance, LLC (Trivergent or the Alliance). The three key objectives of the Alliance are to improve the health of the population served by the three hospitals, improve the quality of care rendered by the hospitals, and reduce the cost of health care provided as embodied in the Management Services Organization (MSO). A subsidiary, Trivergent Health Alliance MSO, LLC, was created to oversee six key service lines for the three hospitals: supply chain, revenue cycle, laboratory, pharmacy, information systems, and human resources. During 2018, the decision was made that the Health System would not be renewing its agreement with Trivergent that expired June 30, 2019. The decision was also made to transfer the Trivergent employees working at WMHS back to WMHS on January 1, 2019. Therefore, the salary expense for these employees was recorded for half the fiscal year as a purchased service and as a salary expense for the other half of fiscal year 2019.

2. Summary of Significant Accounting Policies (continued)

After June 30, 2019, the Health System continued to lease a limited number of services from Trivergent even though WMHS was no longer a Trivergent member. Therefore, the Health System incurred $84 and $13,285 in expenses related to Trivergent during the period ended January 31, 2020, and year ended June 30, 2019, respectively. These amounts were recorded in the purchased services caption on the consolidated statement of operations.

WMHS's investment in Trivergent was terminated after Trivergent's year-end audit was completed in October 2019. At that time, any monies due/owing WMHS were settled. WMHS recorded an investment loss of $286, reflected in the financial statements ended January 31, 2020.

Pension Plan

For employees hired prior to July 1, 2011, the Health System has a noncontributory defined benefit pension plan covering substantially all of its employees upon their retirement. Since 2008, the benefits are based on age, years of service, and career average pay. Grandfathered employees prior to 2008 are based on age, years of service, and final average pay based on their five highest paid years of their last ten years of service. Effective July 1, 2011, employees hired or rehired will not participate in the plan. These employees will participate in a defined contribution plan that has been developed. Effective January 1, 2018, a freeze was placed on benefit accruals in the WMHS Retirement Plan for all employees except those specified in the plan amendment with certain levels of years of service and/or age. Those employees whose benefits were frozen are now also participating in the defined contribution plan.

For the defined benefit pension plan, the Health System records annual amounts relating to its pension plan based on calculations that incorporate various actuarial and other assumptions, including discount rates, mortality, assumed rates of return, compensation increases, turnover rates, and health care cost trend rates. The Health System reviews its assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends when it is appropriate to do so. The Health System believes that the assumptions utilized in recording its obligations under its plans are reasonable based on its experience and market conditions.

New Accounting Pronouncements

Recent accounting pronouncements pending adoption are either not applicable or are not expected to have a material impact on WMHS's consolidated balance sheets, statements of operations and changes in net assets, or cash flows.

2. Summary of Significant Accounting Policies (continued)

In February 2016, Accounting Standards Update No. (ASU) 2016-02 was issued to codify ASC 842, *Leases*. Under the new standard, assets and liabilities arising from most leases are recognized on the balance sheet and enhanced disclosures on key quantitative and qualitative information about leasing arrangements are required. Leases are classified as either operating or financing, and the lease classification determines whether expense is recognized on a straight-line basis (operating leases) or based on an effective interest method (finance leases). The new standard was effective for interim and annual periods on January 1, 2019. WMHS therefore adopted the standard for the fiscal year beginning on July 1, 2019. WMHS did not apply the transitional package of practical expedients allowed by the standard relating to the identification, classification, and initial direct costs of leases commencing before the effective date and did not elect the hindsight traditional practical expedient. WMHS has made accounting policy elections not to apply recognition requirements of the guidance to short-term leases and to use the risk-free discount rate for operating leases.

Management's Assessment and Plans

The Health System adopted ASU 2014-05, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, 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 raised substantial doubt about the Health System's ability to continue as a going concern and the Health System will continue to meet its obligations through June 4, 2021.

(Dollars in Thousands)

3. Net Patient Service Revenue, Accounts Receivable, Implicit and Explicit Price Concessions, and Business Concentrations

Net accounts receivable at the period ended January 31, 2020, and the year ended June 30, 2019, consisted of the following payors:

	2020	2019
Medicare	**43%**	41%
Medicaid	**16**	17
Blue Cross	**8**	8
Self-pay	**11**	15
Other	**22**	19
	100%	100%

The Health System's revenues generally relate to contracts with patients in which its performance obligations are to provide health care services to the patients. Revenues are recorded during the period the obligations to provide health care services are satisfied. Performance obligations for revenues are recognized based on charges incurred in relation to total expected charges. The Health System has agreements with third-party payors that provide for payments to the Health System for patient services at amounts different from its established rates. Management continually reviews the contractual estimation process to incorporate updates to laws and regulations and any changes in managed care contractual terms resulting from contract renegotiations and renewals.

The Health System's revenues are based upon the estimated amounts that management expects to be entitled to receive from patients and third-party payors. Estimates of explicit price concessions, formerly contractual allowances, under state-run programs are based upon the payment terms specified therein for regulated revenue and those under managed care and commercial insurance plans are based upon the payment terms specified in the related contractual agreements for unregulated revenue. Revenues related to uninsured patients and uninsured co-payment and deductible amounts for patients who have health care coverage may have discounts applied (uninsured discounts and contractual discounts). Management also records estimated implicit price concessions (based primarily on historical collection experience) related to uninsured accounts to record self-pay revenues at the estimated amounts that it expects to collect.

3. Net Patient Service Revenue, Accounts Receivable, Implicit and Explicit Price Concessions, and Business Concentrations (continued)

Additionally, the Health System'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. Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreements with the payor, correspondence from the payor, and the Health System's historical settlement activity, including an assessment to ensure it is probable a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known, or as years are settled or are no longer subject to such audits, reviews, and investigations.

The Health System 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 Health System's expectation that the period between the time the service is provided to a patient and the time that the patient or third-party payor pays for that service will be one year or less.

The estimates for implicit price concessions are based upon management's assessment of historical write-offs and expected net collections; business and economic conditions; trends in federal, state, and private employer health care coverage; and other collection indicators. Management relies on the results of detailed reviews of historical write-offs and collections at facilities that represent a majority of the Health System's revenues and patient receivable as a primary source of information in estimating the collectibility of patient receivables.

(Dollars in Thousands)

4. Investments

Investments, which include funds on deposit with trustees, board designated investments, investments restricted by donor or grantor, and other long-term investments, consist of the following as of January 31, 2020 and June 30, 2019:

	2020	2019
U.S. government obligations	**$ 7,414**	$ 25,548
Money market funds	**9,743**	26,089
Corporate stocks and other	**83,576**	81,186
Fixed-income securities	**7,010**	29,109
	$ 107,743	$ 161,932

Investments have been classified on the accompanying consolidated balance sheets as follows as of January 31, 2020 and June 30, 2019:

	2020	2019
Investments	**$ 90,251**	$ 128,939
Funds on deposit with trustee	**18**	18,089
Board designated investments	**6,936**	7,858
Other long-term investments	**234**	225
Investments restricted by donor or grantor	**10,304**	6,821
	$ 107,743	$ 161,932

Investment income and gains for assets limited as to use, cash equivalents, and other investments comprise the following for the period ended January 31, 2020, and the year ended June 30, 2019:

	2020	2019
Income		
Investment income	**$ (700)**	$ (543)
Realized gains on trading investment portfolio	**26,724**	2,266
Unrealized (losses) gains on trading investment portfolio	**(18,054)**	8,634
	$ 7,970	$ 10,357

(Dollars in Thousands)

5. Property and Equipment

Property and equipment and estimated useful lives (in years) are summarized as follows as of January 31, 2020 and June 30, 2019:

	2020	2019
Land and land improvements (2–25 years)	**$ 15,046**	$ 15,046
Buildings and improvements (5–40 years)	**330,403**	331,217
Equipment (3–20 years)	**231,004**	223,891
Construction-in-progress	**4,133**	2,202
	580,586	572,356
Less accumulated depreciation	**339,469**	325,758
Property and equipment, net	**$ 241,117**	$ 246,598

Depreciation expense during the period ended January 31, 2020, was $15,615. Depreciation expense for the year ended June 30, 2019, was $25,052.

6. Investments in Affiliates

Investments in affiliates and equity in income (loss) of affiliates are as follows as of and for the period ended January 31, 2020, and the year ended June 30, 2019:

			Investment		Equity in Income (Loss)	
Name	**Interest**	**Business**	**2020**	**2019**	**2020**	**2019**
Maryland Physicians Care, Inc.	25.00%	State of Maryland Medicaid managed care	**$ 31,068**	$ 31,159	**$ (73)**	$ 1,534
Other affiliates	0.14% to 40.70%	Supply purchasing, MSO, and imaging services	**9,702**	6,876	**(261)**	(1)
			$ 40,770	$ 38,035	**$ (334)**	$ 1,533

(Dollars in Thousands)

6. Investments in Affiliates (continued)

Maryland Physicians Care, Inc. had the following summary financial information as of and for the period ended January 31, 2020, and the year ended June 30, 2019:

	2020	2019
Total assets	**$ 341,437**	$ 357,263
Total liabilities	**217,167**	232,629
Net assets	**$ 124,270**	$ 124,634
Total revenues	**$ 705,311**	$ 1,107,454
Total expenses, net	**705,605**	1,100,804
Net income	**$ (294)**	$ 6,650

7. Long-Term Debt

Long-term debt consists of the following as of January 31, 2020 and June 30, 2019:

	2020	2019
Maryland Health and Higher Educational Facilities Authority (MHHEFA) Series 2014 Revenue Bonds, interest rate 4.00% to 5.25%	**$ 184,860**	$ 197,860
Capital leases	**177**	330
Net unamortized bond premium	**18,441**	20,594
Long-term debt	**203,478**	218,784
Less current portion of long-term debt	**13,827**	13,263
Less unamortized financing fees	**1,792**	1,860
Long-term debt less current portion	**$ 187,859**	$ 203,661

(Dollars in Thousands)

7. Long-Term Debt (continued)

Scheduled principal repayments on long-term debt for the years ending December 31 are as follows:

2020 (11 months)	$ 13,650
2021	14,335
2022	11,675
2023	12,200
2024	12,750
Thereafter	120,250
Total	$ 184,860

In November 2014, MHHEFA issued $236,170 in bonds (Series 2014 Bonds) on behalf of the Health System. As security for WMHS obligations, the Bond Authority has been granted a lien, claim on, and a security interest in all of the receipts of WMHS. The lien, claim, and security interest continuously applies for the entire term of the Agreement. The Series 2014 Bonds were issued as $171,035 of serial bonds maturing 2015 through 2035 and $65,135 of term bonds maturing in 2034. The Series 2014 Bonds maturing on or after July 2025 are subject to redemption at the option of MHHEFA prior to maturity, beginning July 2024. The Series 2014 Bonds were issued at fixed rates.

Principal payments on the Series 2014 revenue bonds commenced on July 1, 2015, and are due annually through July 1, 2035. Interest payments are due semiannually commencing July 1, 2015. Interest on the Series 2014 bonds accrues at a rate of 4.00% to 5.25% per annum. The financing document contains quantitative and qualitative covenants (measured quarterly). The quantitative covenants include a debt service coverage ratio, a days cash on hand requirement, current ratio requirement, a net days in accounts receivable requirement, and restrictions on operating losses and revenue over expenses.

8. Charity Care

The Health System utilizes a cost to charge ratio methodology to convert charity care to cost. Costs incurred are estimated based on the ratio of total operating expenses to gross charges applied to charity care charges. The amount of charges forgone for services and supplies furnished under the Health System's Charity Care policy aggregated approximately $9,821 and $10,861 for the period ended January 31, 2020, and the year ended June 30, 2019, respectively. The total direct and indirect costs to provide the care amounted to approximately $7,798 and $8,558 for the period ended January 31, 2020, and the year ended June 30, 2019, respectively.

9. Retirement Plans

The WMHS Retirement Plan (the Plan) is a noncontributory defined benefit plan that covers substantially all full-time employees who meet certain age and service requirements. The Plan's funding policy is to contribute, annually, the pension costs as determined by the Plan's actuary, subject to adjustment for full funding limitations as defined by the IRC.

The Health System's investment policy, established by the Investment Committee of the Finance Committee and approved by the Health System's Board of Directors, is to ensure current and future benefit obligations are adequately funded in a cost-effective manner. The investment guidelines are based on a time horizon of greater than five years. In establishing the risk tolerances, the ability to withstand short- and intermediate-term variability with some interim fluctuations in market value and rates of return may be tolerated in order to achieve the longer-term objectives.

The measurement date of the Plan is January 31.

(Dollars in Thousands)

9. Retirement Plans (continued)

The components of the Plan's funded status, net periodic benefit costs, and actuarial assumptions used in accounting for defined benefit plans for the period ended January 31, 2020, and the year ended June 30, 2019, are as follows:

	2020	2019
Change in projected benefit obligation		
Projected benefit obligation at beginning of year	**$ 327,398**	$ 290,370
Service cost	**1,260**	2,275
Interest cost	**5,922**	11,457
Assumptions	**37,902**	34,074
Actuarial (loss) gain	**(577)**	1,255
Special termination benefits	**5,038**	–
Benefits paid	**(8,666)**	(12,033)
Projected benefit obligation at end of year	**368,277**	327,398
Change in plan assets		
Plan assets at fair value at beginning of year	**255,438**	241,207
Actual return	**18,179**	14,264
Employer contributions	**6,000**	12,000
Benefits paid	**(8,666)**	(12,033)
Fair value of plan assets at end of year	**270,951**	255,438
Funded status at end of year	**$ (97,326)**	$ (71,960)

	2020	2019
Amounts recognized in unrestricted net assets		
Net prior service costs	**$ (186)**	$ (216)
Net actuarial loss	**146,319**	123,521
Amounts recognized in unrestricted net assets	**$ 146,133**	$ 123,305

(Dollars in Thousands)

9. Retirement Plans (continued)

	2020	2019
Components of net periodic benefit costs		
Service cost	**$ 1,260**	$ 2,275
Interest cost	**5,922**	11,457
Expected return on plan assets	**(9,373)**	(15,081)
Recognized prior service cost	**(29)**	(49)
Recognized net loss	**5,721**	6,828
Special termination benefits	**5,038**	–
Net periodic pension cost	**$ 8,539**	$ 5,430

Deferred pension costs, which have not yet been recognized in periodic pension expense but are accrued in unrestricted net assets, are $146,133 and $123,305 at January 31, 2020 and June 30, 2019, respectively. Deferred pension costs represents unrecognized actuarial losses or unexpected changes in the projected benefit obligation and plan assets over time primarily due to changes in assumed discount rates and investment experience, and unrecognized prior service costs, which is the impact of changes in plan benefits applied retrospectively to employee service previously rendered. The amount of deferred pension costs expected to be recognized as a component of net period pension costs during the upcoming 12 months is $11,830.

	2020	2019
Weighted average assumptions – benefit obligations:		
Discount rate	**2.74%**	3.29%
Salary scale	**2.50**	2.50
Return on assets	**6.25**	6.25
Weighted average assumptions – net periodic expense:		
Discount rate	**3.29% and 2.94%**	4.01%
Salary scale	**2.50**	2.50
Return on assets	**6.25**	7.00

The accumulated benefit obligation for the defined benefit pension plan was $367,238 and $324,002 at January 31, 2020 and June 30, 2019, respectively.

(Dollars in Thousands)

9. Retirement Plans (continued)

The Health System's pension plan weighted average asset allocations at the measurement dates of January 31, 2020 and June 30, 2019, by asset category, are as follows:

	Percentage of Plan Assets		
	Target Allocation	**2020**	**2019**
Asset class:			
Equities	60%	**72%**	72%
Fixed income	40	**28**	28

The Health System expects to contribute $12,000 to the Plan by December 31, 2020.

The following benefit payments, which reflect expected future employee service, as appropriate, are expected to be paid in the following fiscal years ending December 31:

2020 (11 months)	$ 13,368
2021	15,300
2022	15,844
2023	16,351
2024	17,092
2025–2029	92,300

The expected benefits to be paid are based on the same assumptions used to measure the Health System's benefit obligation as of January 31, 2020.

In the second quarter of fiscal year 2018, lump-sum payments of a participant's accrued benefits were offered to terminated vested participants with balances of $75 or less. This resulted in a payout of $6,832 and a net decrease in the pension benefits in excess of pension assets.

9. Retirement Plans (continued)

Effective July 1, 2011, employees hired or rehired will not participate in the Plan. These employees will participate in the Health System sponsored defined contributions plan whereby the Health System will make a contribution on behalf of the employee into a retirement account in the name of the employee. The contribution amount is based on several factors, including years of service and salary levels. Effective January 1, 2018, a freeze was placed on benefit accruals in the Plan for all participants except those specified in the plan amendment with certain levels of years of service and/or age. Those participants whose benefits were frozen are now also participating in the defined contribution plan. The Health System recorded expense related to the employees in the defined contribution plan of $3,092 and $4,881 for the period ended January 31, 2020, and the year ended June 30, 2019, respectively. All Health System employees are eligible to contribute a portion of their compensation to the defined contribution plan.

The Health System will match the employee contribution of the employee compensation at some level based on several factors. The Health System's expense related to the matching component of the Plan for the period ended January 31, 2020, and the year ended June 30, 2019, was $1,505 and $2,364, respectively, and is included in employee benefits on the accompanying consolidated statements of operations.

The Plan was amended on September 30, 2019, as the Plan Sponsor initiated a lump-sum window during the fiscal year that allowed plan participants who met certain specific requirements to participate in an Early Retirement Incentive Plan (ERIP). Those participants who elected to participate in the ERIP received enhanced pension benefits. The increase to the plan liability is classified as a special termination benefit due to the nature of the benefits and timing of receipt of those benefits. Total cost of these special termination benefits to the Health System for the period ended January 31, 2020, was $5,038.

10. Self-Insurance Programs

General and Professional Liability (GLPL)

On December 14, 2004, the Health System formed a new wholly owned insurance subsidiary, WMIC, an exempted company under the Companies Law of the Cayman Islands, to provide GLPL insurance to the Health System and certain affiliates. Effective January 1, 2005, this subsidiary insures the Health System for its GLPL risks under a claims-made policy with $1,000 per claim and a $4,000 annual policy aggregate with up to a limit of $30,000 and have been reinsured with CNA as a primary layer for the first $15,000 and with Sompo for a secondary layer of $15,000. Both firms are highly rated independent third-party insurance companies. In addition, the Health System's retained self-insurance risk under these policies is $1,000 per claim.

Management's estimate of the liability for GLPL claims, including incurred but not reported claims, is principally based on actuarial estimates performed by an independent third-party actuary. The Health System's estimated liability for GLPL claims, including incurred but not reported claims, totaled $13,181 and $12,009 as of January 31, 2020 and June 30, 2019, respectively. These amounts are included in other noncurrent liabilities in the accompanying consolidated financial statements. While management believes that this liability is adequate as of January 31, 2020, the ultimate liability may exceed the amount recorded. Additionally, the Health System has recorded an additional insurance recoveries receivable of $5,448 and $5,076 as of January 31, 2020 and June 30, 2019, respectively, included in other noncurrent assets.

Workers' Compensation Insurance

In the period ended January 31, 2020, and the year ended June 30, 2019, the Health System participated in a self-insured plan for workers' compensation claims. Stop-loss coverage has been purchased through a commercial carrier for claims in excess of $500.

The Health System has accrued a liability recorded in accrued salaries and benefits of $2,948 and $2,429 as of January 31, 2020 and June 30, 2019, respectively, for known and incurred but not reported claims. Management believes this accrual is adequate to provide for all workers' compensation claims that have been incurred through January 31, 2020. Additionally, there are no significant insurance recoveries related to workers' compensation as of January 31, 2020 or June 30, 2019.

(Dollars in Thousands)

10. Self-Insurance Programs (continued)

Health Insurance

The Health System is self-insured for employee health claims. Under these self-insurance plans, the Health System has accrued a liability for salaries and benefits of $2,128 and $1,965 as of January 31, 2020 and June 30, 2019, respectively, for known claims and incurred but not reported claims. Management believes this accrual is adequate to provide for all employee health claims that may have been incurred through January 31, 2020. There were $596 and $933 in insurance recoveries in the period ended January 31, 2020, and the year ended June 30, 2019, respectively, related to employee health insurance claims that exceeded the $300 threshold.

11. Lease Commitments

WMHS has operating and finance leases for corporate offices, physician offices, and various equipment types, among others. These lease arrangements have remaining lease terms of 1 year to 25 years, some of which include options to extend the leases to several periods, and some of which include options to terminate the leases within one year. The components of lease expense were as follows:

	Period Ended January 31, 2020
Finance lease cost:	
Depreciation of right-of-use assets	$ 146
Interest on lease liabilities	2
Total finance lease cost	148
Operating lease cost	495
Short-term/variable lease cost	541
Total	$ 1,184

(Dollars in Thousands)

11. Lease Commitments (continued)

Supplemental balance sheet information related to leases was as follows:

	Period Ended January 31, 2020
Operating leases	
Operating lease right-of-use assets	$ 4,419
Other current liabilities	$ 1,874
Operating lease liabilities	2,544
Total operating lease liabilities	$ 4,418
Finance leases	
Property, buildings, and equipment, net	$ 167
Other current liabilities	$ 177
Operating noncurrent liabilities	–
Total finance lease liabilities	$ 177
Weighted average remaining lease term	
Operating leases	3.2 years
Finance leases	0.67 years
Weighted average discount rate	
Operating leases	1.76%
Finance leases	2.86

(Dollars in Thousands)

11. Lease Commitments (continued)

Cash flows in 2020 were materially consistent with expenses. Undiscounted maturities of future lease labilities were as follows:

	Operating Leases	Finance Leases
For the year ended December 31:		
2020 (11 months)	$ 1,777	$ 179
2021	1,059	–
2022	890	–
2023	566	–
2024	255	–
Thereafter	–	–
Total undiscounted maturities of lease liabilities	4,547	179
Less discount on lease liabilities	(128)	(2)
Total lease liabilities	$ 4,419	$ 177

12. Net Assets With Donor Restrictions

Temporarily and permanently restricted net assets as of January 31, 2020 and June 30, 2019, are available for the following purposes:

	2020	2019
Temporary restrictions:		
Specific support of health care services	**$ 10,026**	$ 6,561
Permanent restrictions:		
Trustee-held assets to be held in perpetuity, the income from which primarily is expendable to support health care services	**2,519**	2,457
Total net assets with donor restrictions	**$ 12,545**	$ 9,018

13. Fair Value of Financial Instruments

Fair Value of Financial Instruments

The following methods and assumptions were used by the Health System in estimating the fair value of its financial instruments:

Cash and cash equivalents, investments, funds on deposit with trustee, board designated investments, patient accounts receivable, other assets, accounts payable and accrued liabilities, payable to third-party payors, and other long-term liabilities – The carrying amounts reported on the consolidated balance sheets approximate the related fair values.

The fair value of a financial instrument is the amount 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.

Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the Health System's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Health System based on the best information available in the circumstances.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents, accounts receivable, due from affiliates, other assets, line of credit, accounts payable, advances from third-party payors, due to affiliates, and accrued expenses – The carrying amounts, at face value or cost plus accrued interest, approximate fair value because of the short maturity of these instruments.

Board designated and other investments – Equity and debt securities classified as trading are measured using quoted market prices at the reporting date multiplied by the quantity held.

13. Fair Value of Financial Instruments (continued)

Long-Term Debt

The Series 2014 Bonds bear interest at fixed rates and, accordingly, had a carrying amount of $203,301 and $218,454 and a fair value of $209,097 and $219,881 as of January 31, 2020 and June 30, 2019, respectively.

The fair value of the Health System's long-term debt is measured using quoted offered-side prices when quoted market prices are available. If quoted market prices are not available, the fair value is determined by discounting the future cash flows of each instrument at rates that reflect, among other things, market interest rates and the Health System's credit standing. In determining an appropriate spread to reflect its credit standing, the Health System considers credit default swap spreads, bond yields of other long-term debt offered by the Health System, and interest rates currently offered for similar debt instruments of comparable maturities by the Health System's bankers as well as other banks that regularly compete to provide financing to the Health System.

Fair Value Hierarchy

The Health System adopted ASC Topic 820, *Fair Value Measurement*, on July 1, 2008, for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Health System has the ability to access at the measurement date.

- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

- Level 3 inputs are unobservable inputs for the asset or liability.

(Dollars in Thousands)

13. Fair Value of Financial Instruments (continued)

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The table below presents assets that are measured at fair value as of January 31, 2020, aggregated by the three-level valuation hierarchy:

	2020			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
U.S. government obligations	**$ 6,826**	**$ 588**	**$ –**	**$ 7,414**
Money market funds	**9,743**	**–**	**–**	**9,743**
Corporate stocks and other	**83,576**	**–**	**–**	**83,576**
Fixed-income securities	**25**	**6,985**	**–**	**7,010**
Total assets	**$ 100,170**	**$ 7,573**	**$ –**	**$ 107,743**

The table below presents assets that are measured at fair value as of June 30, 2019, aggregated by the three-level valuation hierarchy:

	2019			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
U.S. government obligations	$ 25,086	$ 462	$ –	$ 25,548
Money market funds	26,089	–	–	26,089
Corporate stocks and other	81,186	–	–	81,186
Fixed-income securities	1,019	28,090	–	29,109
Total assets	$ 133,380	$ 28,552	$ –	$ 161,932

(Dollars in Thousands)

13. Fair Value of Financial Instruments (continued)

The table below presents the pension plan's investable assets as of January 31, 2020, aggregated by the three-level valuation hierarchy:

	2020			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Money market funds	**$ 25,192**	**$ –**	**$ –**	**$ 25,192**
Mutual funds	**226,685**	**–**	**–**	**226,685**
Fixed-income securities	**5,621**	**2,517**	**64**	**8,202**
Other funds	**123**	**3,732**	**7,017**	**10,872**
Total assets	**$ 257,621**	**$ 6,249**	**$ 7,081**	**$ 270,951**

The table below presents the pension plan's investable assets as of June 30, 2019, aggregated by the three-level valuation hierarchy:

	2019			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Mutual funds	$ 67,111	$ –	$ –	$ 67,111
Fixed-income securities	–	40,432	–	40,432
Other funds	6,548	141,347	–	147,895
Total assets	$ 73,659	$ 181,779	$ –	$ 255,438

14. Commitments and Contingencies

Litigation

From time to time, the Health System and its subsidiaries are involved in litigation and regulatory investigations arising in the course of business. After consultation with legal counsel, management believes that these matters will be resolved without a significant adverse effect on the Health System's future consolidated financial position or results from operations.

14. Commitments and Contingencies (continued)

During fiscal 2018, WMHS became aware of a matter regarding compliance with Medicare billing rules in connection with its Home Health Care services. As a result of that matter, WMHS was asked to pay back amounts related to services provided during the period January 1, 2015 through November 21, 2016. WMHS has appealed that request and the matter is currently pending before an Administrative Law Judge. WMHS had recorded a reserve related to this matter of $1,035 within accounts payable and accrued liabilities as of June 30, 2018. However, during fiscal year 2019, an analysis was performed to determine a more accurate amount of this liability by examining the actual claims affected in a three-year period for which Medicare had not already withdrawn the payments. At that time, it was determined that the liability be decreased to $387. That amount is what remains in the reserve as of January 31, 2020.

Other Matters

The Health System has contracts with various physician groups to provide certain emergency, anesthesia, and hospitalists services. Those contracts include certain income guarantee levels, which eliminate as volumes related to services provided increase. The Health System incurred $2,090 and $2,907 related to the guarantee provisions of the contracts in the period ended January 31, 2020, and the year ended June 30, 2019, respectively.

15. Regulation and Reimbursement

The Health System provides health care services primarily through one general acute care hospital. The Health System and other health care providers in Maryland 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 HSCRC;
- Government regulation, government budgetary constraints, and proposed legislative and regulatory changes; and
- Lawsuits alleging malpractice and related claims.

15. Regulation and Reimbursement (continued)

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

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

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

The current rate of reimbursement for services to patients under the Medicare and Medicaid programs is based on an agreement between the Centers for Medicare & Medicaid Services (CMS) and the HSCRC. This agreement is based upon a waiver from Medicare prospective pay system reimbursement principles granted to the state of Maryland under Section 1814(b) of the Social Security Act and will continue as long as all third-party payors elect to be reimbursed in Maryland under this program and the rate of increase for costs per hospital inpatient admission in Maryland is below the national average.

Under GBR, a prospective, fixed revenue budget is established by the HSCRC for the upcoming year. This fixed revenue budget incorporates all payors and is not adjusted for changes in volume, case mix, or mix of inpatient services that occur during the year. The GBR revenue budget is adjusted annually for inflation and for population in a hospital's service area.

Consistent with the objectives of health care reform, the GBR model eliminates "payment for volume" and is designed to encourage hospitals to operate efficiently by reducing utilization and managing patients in the most appropriate care delivery setting. GBR does not include physician services or other kinds of unregulated services (i.e., freestanding ambulatory centers) that fall outside of the jurisdiction of the HSCRC. The GBR agreement allows the Health System to adjust unit rates, within certain limits, to achieve the overall revenue budget for the Health System at year-end. Any overcharge or undercharge vs. the revenue budget is prospectively added to the subsequent year's budget.

15. Regulation and Reimbursement (continued)

Effective July 1, 2013, the Health System and the HSCRC agreed to a three-year TPR contract. Effective July 1, 2016, the TPR agreement was converted to a GBR agreement that is for one year with an automatic renewal each year unless either party terminates it with notice.

In January 2014, CMS approved a new waiver for Maryland for a five-year period beginning January 1, 2014, for inpatient and outpatient hospital services. The new All-Payer waiver ties hospital per capita revenue growth to the state's economic growth of 3.58%. CMS can require the state to submit a corrective action plan if targets for a given performance year are not met. The new waiver also imposes quality measures and encourages population health.

In January 2019, Medicare approved a new ten-year waiver for Maryland under a Total Cost of Care All-Payer Model (the Model). The Model began in January 2019 and builds upon the successes of the All-Payer Model. Maryland hospitals must progressively transform care delivery across the heath system to improve health and quality of care. The Model remains in place as long as Maryland meets the Model performance requirements, which include the state's growth in Medicare spending remaining lower than the national growth rate and increasing no more than 3.58% per year.

The Model encourages continued care redesign, focuses on improving chronic care and population health, and includes aggressive quality of care goals and a range of population health goals.

The HSCRC will utilize a Medicare Performance Adjustment that incorporates attribution, episode, and/or geographic measures with Total Cost of Care for Medicare into hospital value-based payments to provide a level of direct hospital accountability within the All-Payer Model. For rate year 2020 and rate year 2021, the revenue at risk is 0.5% and 1.0% of Medicare hospital revenue, respectively.

(Dollars in Thousands)

16. Noncontrolling Interest

Effective June 30, 2012, the Health System adopted accounting guidance that requires a not-for-profit reporting entity to account for and present noncontrolling interests in a consolidated subsidiary as a separate component of the appropriate class of consolidated net assets. The reconciliation of noncontrolling interest reported in unrestricted net assets is as follows:

	WMHS Corporation	Noncontrolling Interest	Net Assets Without Donor Restrictions
Balance at June 30, 2018	$ 207,006	$ 1,473	$ 208,479
Operating income	8,843	2,059	10,902
Nonoperating income	11,971	–	11,971
Excess of revenues over expenses	20,814	2,059	22,873
Change in funded status of pension plan	(29,367)	–	(29,367)
Net assets released for purchase of property and equipment	132	–	132
Distributions to noncontrolling interest in consolidated subsidiaries	–	(1,970)	(1,970)
Change in net assets	(8,421)	89	(8,332)
Balance at June 30, 2019	198,585	1,562	200,147
Operating income	**4,663**	**1,192**	**5,855**
Nonoperating income	**2,675**	**–**	**2,675**
Excess of revenues over expenses	**7,338**	**1,192**	**8,530**
Change in funded status of pension plan	**(22,828)**	**–**	**(22,828)**
Captive dividend	**(3,000)**	**–**	**(3,000)**
Net assets released for purchase of property and equipment	**157**	**–**	**157**
Distributions to noncontrolling interest in consolidated subsidiaries	**–**	**(1,205)**	**(1,205)**
Change in net assets	**(18,333)**	**(13)**	**(18,346)**
Balance at January 31, 2020	**$ 180,252**	**$ 1,549**	**$ 181,801**

(Dollars in Thousands)

17. Functional Expenses

The Health System considers health care services and general and administrative to be its primary functional categories for purposes of expense classification. The Health System's operating expenses by functional classification are as follows for the period ended January 31, 2020, and the year ended June 30, 2019:

	2020	2019
Health care services:		
Salaries and wages	**$ 72,277**	$ 113,141
Employee benefits	**21,818**	34,415
Professional fees	**11,932**	20,103
Purchased services	**13,526**	32,810
Supplies	**30,445**	49,023
Utilities	**2,354**	3,842
Insurance	**2,637**	1,933
Interest	**3,051**	9,090
Depreciation and amortization	**14,052**	22,475
Other	**3,712**	6,213
Total health care services	**175,804**	293,045
General and administrative:		
Salaries and wages	**8,389**	13,557
Employee benefits	**2,533**	4,124
Professional fees	**1,385**	2,409
Purchased services	**1,570**	3,931
Supplies	**3,534**	5,874
Utilities	**273**	460
Insurance	**306**	232
Interest	**354**	1,089
Depreciation and amortization	**1,631**	2,693
Other	**436**	940
Total general and administrative	**20,411**	35,309
Total expenses	**$ 196,215**	$ 328,354

(Dollars in Thousands)

18. Liquidity and Availability

As part of its liquidity management, the Health System structures its financial assets to be available to satisfy general operating expenses, current liabilities, and other obligations as they come due. Financial assets available for general expenditures within one year of January 31, 2020, include the following:

	2020
Cash and cash equivalents	$ 90,322
Investments	70,780
Patient receivables	44,641
Total available within one year	$ 205,743

The Health System has assets whose use is limited and held by trustees and assets held for donor-restricted purposes. These assets are not included in the amounts above.

The Health System invests in accordance with the investment policy. The asset allocation of the investment portfolio is broadly diversified in domestic and global equities and fixed income investment strategies to maximize the Health System's ability to meet long-term investment objectives at established risk levels while maintaining liquidity levels designed to meet portfolio management.

The Health System's most restrictive bond covenant requires the obligated group to maintain unrestricted cash and marketable securities on hand to meet 45 days of normal operating expenses, which would be $24,582 as of January 31, 2020.

19. Subsequent Events

On February 1, 2020, UPMC and the Health System (now referred to as UPMC Western Maryland) and its subsidiaries executed an Integration and Affiliation Agreement (the Agreement) providing for an affiliation. Pursuant to the Agreement, UPMC will provide the Health System with a total investment of $90,000 over a five-year period that will support investment in capital, expansion of ambulatory programs, commitment for information technology, physician recruitment and retention packages, and other program enhancements.

19. Subsequent Events (continued)

UPMC is one of the world's leading integrated delivery and financing systems. UPMC is based in Pittsburgh, Pennsylvania, and primarily serves residents across the commonwealth of Pennsylvania, as well as other locations both nationally and internationally. The transaction is intended to preserve and enhance the mission of the Health System and to enhance its ability to provide high-quality health services to the Health System's primary service area, including counties in both Maryland and West Virginia. On the date of affiliation, the articles of incorporation and bylaws of the Health System were amended such that UPMC became the sole corporate member.

On February 3, 2020, UPMC extinguished all of the Health System's outstanding revenue bonds totaling approximately $202,000. On February 4 and 5, 2020, UPMC Western Maryland transferred $174,000 of cash and investments to UPMC.

In March 2020, UPMC Western Maryland sold Frostburg Nursing and Rehabilitation Center to Axis Healthcare Group for $9,500.

Since the beginning of January 2020, there has been a global outbreak of a coronavirus (COVID-19), which the World Health Organization has declared a Public Health Emergency of International Concern. In March 2020, the impact of COVID-19 began to have a significant impact on the United States of America. The pandemic has adversely impacted UPMC Western Maryland's business by causing a temporary decrease in or diversion of patients. Further disruptions may arise in the form of delays in supply chain, delays in reimbursement by governmental or private payors, or staffing shortages in health system facilities. The full potential impact on operations is inherently difficult to predict. However, due to the fact that the Health System operates in the state of Maryland and is under the authority of the Health Services Cost Review Commission and operates under the Global Budget Revenue system, the revenue impact of reduced volumes due to a pandemic, epidemic, or widespread outbreak of an infectious disease would likely not be as adverse as in other states that operate under fee for service. The Global Budget Revenue recognized might be delayed, but should eventually be recorded. However, given the fluidity of this situation, it is too early to make a reliable estimate of the ultimate financial effects of COVID-19.

19. Subsequent Events (continued)

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) provides for deferred payment of the employer portion of social security taxes between March 27, 2020 and December 31, 2020, with 50% of the deferred amount due December 31, 2021, and the remaining 50% due December 31, 2022. UPMC Western Maryland began deferring the employer portion of social security taxes in mid-April 2020.

The CARES Act provides, among other sources, $100 billion in relief funds to hospitals and other healthcare providers on the front lines of the COVID-19 response. This funding is to be used to support healthcare related expenses or lost revenue attributable to COVID-19. Beginning April 2020, through the date of the issuance of this report, The Health System received $13,200 in funding for which management is continuing to evaluate the accounting and operational impact to the Health System. These government payments are currently expected to be recognized in our operations as revenue during 2020, subject to complying with certain terms and conditions.

In order to increase cash flow to providers of services and suppliers impacted by the COVID-19 pandemic, CMS has expanded the current Accelerated and Advance Program. Beginning in April 2020 through the date of issuance, the Health System received $76,800 in advance funding. Continued claims submissions and reimbursements will occur after this issuance of the accelerated/advanced payment for 120 days, at which time a recoupment process will begin, and every new claim submitted to CMS will be offset to repay the accelerated/advanced payment.

Management evaluated all events and transactions that occurred after January 31, 2020 and through June 4, 2020. The Health System did not have any material subsequent events during this period outside of what is disclosed in this footnote.

Supplementary Information

Western Maryland Health System Corporation

Consolidating Balance Sheet

January 31, 2020
(Dollars in Thousands)

	Western Maryland Health System Corporation	Frostburg Nursing & Rehabilitation Center	Haystack Consolidated Services, Inc.	Western Maryland Health System Foundation Inc.	Eliminations	Consolidated
Assets						
Current assets:						
Cash and cash equivalents	$ 89,833	$ 762	$ –	$ (273)	$ –	$ 90,322
Investments	70,780	–	–	–	–	70,780
Funds on deposit with trustee	18	–	–	–	–	18
Accounts receivable, net	43,907	734	–	–	–	44,641
Pledge receivable, net	–	–	–	49	–	49
Other receivables, net	3,912	–	–	12	(1,703)	2,221
Inventories and other current assets	16,980	3,547	1,212	–	(10,073)	11,666
Total current assets	225,430	5,043	1,212	(212)	(11,776)	219,697
Investments	12,818	–	–	6,653	–	19,471
Board designated investments	6,936	–	–	–	–	6,936
Other long-term investments	74	–	–	160	–	234
Investments restricted by donor or grantor	787	–	–	9,517	–	10,304
Beneficial interest in trustee-held foundation assets	–	–	–	2,191	–	2,191
Property and equipment, net	240,480	637	–	–	–	241,117
Investments in affiliates	40,770	–	–	–	–	40,770
Other assets	10,594	–	–	–	–	10,594
Total assets	$ 537,889	$ 5,680	$ 1,212	$ 18,309	$ (11,776)	$ 551,314

Western Maryland Health System Corporation

Consolidating Balance Sheet (continued)

January 31, 2020
(Dollars in Thousands)

	Western Maryland Health System Corporation	Frostburg Nursing & Rehabilitation Center	Haystack Consolidated Services, Inc.	Western Maryland Health System Foundation Inc.	Eliminations	Consolidated
Liabilities and net assets						
Current liabilities:						
Current portion of long-term debt	$ 13,827	$ –	$ –	$ –	$ –	$ 13,827
Accounts payable and accrued liabilities	17,051	5,447	1	1,703	(11,776)	12,426
Accrued bond interest payable	794	–	–	–	–	794
Accrued salaries and benefits	20,473	364	–	–	–	20,837
Payable to third-party payors	5,951	61	–	–	–	6,012
Deferred revenue	525	–	–	–	–	525
Total current liabilities	58,621	5,872	1	1,703	(11,776)	54,421
Long-term debt, net of current portion	187,859	–	–	–	–	187,859
Pension benefits in excess of pension assets	97,326	–	–	–	–	97,326
Other liabilities	17,362	–	–	–	–	17,362
Total liabilities	361,168	5,872	1	1,703	(11,776)	356,968
Net assets:						
Net assets without donor restrictions	174,384	(192)	1,211	4,849	–	180,252
Net assets with donor restrictions	788	–	–	11,757	–	12,545
Total parent net assets	175,172	(192)	1,211	16,606	–	192,797
Noncontrolling interest in consolidated subsidiaries	1,549	–	–	–	–	1,549
Total net assets	176,721	(192)	1,211	16,606	–	194,346
Total liabilities and net assets	$ 537,889	$ 5,680	$ 1,212	$ 18,309	$ (11,776)	$ 551,314

See accompanying report of independent auditors.

Western Maryland Health System Corporation

Consolidating Statement of Operations

Period Ended January 31, 2020
(Dollars in Thousands)

	Western Maryland Health System Corporation	Frostburg Nursing & Rehabilitation Center	Haystack Consolidated Services, Inc.	Western Maryland Health System Foundation Inc.	Eliminations	Consolidated
Unrestricted revenues and other support:						
Patient service revenue	$ 195,635	$ 3,589	$ –	$ –	$ –	$ 199,224
Other revenue	3,031	104	–	3,000	(3,289)	2,846
Total revenues and other support	198,666	3,693	–	3,000	(3,289)	202,070
Expenses:						
Salaries and wages	78,023	2,643	–	–	–	80,666
Employee benefits	23,671	680	–	–	–	24,351
Professional fees	13,281	36	–	–	–	13,317
Purchased services	14,635	462	–	269	(270)	15,096
Supplies	33,706	273	–	16	(16)	33,979
Utilities	2,495	132	–	–	–	2,627
Insurance	2,940	3	–	–	–	2,943
Interest	3,405	–	–	–	–	3,405
Depreciation and amortization	15,618	65	–	–	–	15,683
Other	6,564	384	–	203	(3,003)	4,148
Total expenses	194,338	4,678	–	488	(3,289)	196,215
Operating income (loss)	4,328	(985)	–	2,512	–	5,855
Nonoperating income:						
Equity in (loss) of affiliates	(334)	–	–	–	–	(334)
Investment income	25,889	(59)	7	187	–	26,024
Unrealized (loss) gains on trading portfolio	(18,261)	–	(8)	215	–	(18,054)
Other	(4,987)	–	–	26	–	(4,961)
Total nonoperating income (loss)	2,307	(59)	(1)	428	–	2,675
Excess (deficiency) of revenues over (under) expenses	$ 6,635	$ (1,044)	$ (1)	$ 2,940	$ –	$ 8,530

See accompanying report of independent auditors.

Western Maryland Health System Corporation

Consolidating Statement of Changes in Net Assets

Period Ended January 31, 2020
(Dollars in Thousands)

	Western Maryland Health System Corporation	Frostburg Nursing & Rehabilitation Center	Haystack Consolidated Services, Inc.	Western Maryland Health System Foundation Inc.	Consolidated
Net assets without donor restrictions					
Balance at June 30, 2019	$ 193,173	$ 852	$ 1,212	$ 4,910	$ 200,147
Excess of revenues over expenses	6,635	(1,044)	(1)	2,940	8,530
Change in funded status of pension plan	(22,828)	–	–	–	(22,828)
Captive dividend	(3,000)	–	–	–	(3,000)
Net assets released for purchase of property and equipment	157	–	–	–	157
Distributions to noncontrolling interest in consolidated interest	(1,205)	–	–	–	(1,205)
Balance at January 31, 2020	172,932	(192)	1,211	7,850	181,801
Net assets with donor restrictions					
Balance at June 30, 2019	594	–	–	8,424	9,018
Investment gain	–	–	–	523	523
Donations	2,859	–	–	3,249	6,108
Grants	443	–	–	–	443
Net assets released for operations	(2,966)	–	–	(179)	(3,145)
Net assets released for purchase of property and equipment	(157)	–	–	–	(157)
Unrealized gains on investments	15	–	–	(307)	(292)
Change in beneficial interest of trustee-held foundation assets	–	–	–	47	47
Balance at January 31, 2020	788	–	–	11,757	12,545
Net assets at January 31, 2020	$ 173,720	$ (192)	$ 1,211	$ 19,607	$ 194,346

See accompanying report of independent auditors.

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. For more information about our organization, please visit ey.com.

ey.com