KPMG

SHEPPARD AND ENOCH PRATT FOUNDATION, INC.
AND SUBSIDIARIES

Consolidated Financial Statements and Supplementary Information

June 30, 2019 and 2018

(With Independent Auditors' Report Thereon)

SHEPPARD AND ENOCH PRATT FOUNDATION, INC.
AND SUBSIDIARIES

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KPMG LLP
750 East Pratt Street, 18th Floor
Baltimore, MD 21202

Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Sheppard and Enoch Pratt Foundation, Inc. and its subsidiaries (the Company), which comprise the consolidated balance sheets as of June 30, 2019 and 2018, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sheppard and Enoch Pratt Foundation, Inc. and its subsidiaries as of June 30, 2019 and 2018, and the results of their operations, changes in net assets and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in Note 1(u) to the consolidated financial statements, the Company and its subsidiaries adopted Financial Accounting Board Standards Accounting Standards Update No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities* during the year ended June 30, 2019. Our opinion is not modified with respect to this matter.

Other Matters

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

KPMG LLP

October 16, 2019

SHEPPARD AND ENOCH PRATT FOUNDATION, INC.
AND SUBSIDIARIES

Consolidated Balance Sheets

June 30, 2019 and 2018

Assets		**2019**	**2018**
Current assets:			
Cash and cash equivalents	$	36,333,171	57,539,767
Investments limited or restricted as to use		553,333	2,193,109
Accounts receivable, net		34,475,223	31,809,978
Prepaid expenses and other current assets		15,489,857	15,936,785
Total current assets		86,851,584	107,479,639
Investments limited or restricted as to use, less current portion		291,646,562	293,160,015
Notes receivable		1,614,104	1,745,868
Third-party payor settlements receivable		7,610,140	6,722,505
Property and equipment, net		253,085,496	233,229,587
Other assets		2,595,956	2,114,063
Total assets	$	643,403,842	644,451,677
Liabilities and Net Assets			
Current liabilities:			
Current maturities of long-term debt	$	5,760,441	5,620,490
Current portion of obligations under capital leases		683,527	561,029
Accounts payable		11,513,122	9,324,925
Accrued salaries, wages and employee benefits		24,973,393	23,611,871
Self-insurance liabilities		4,354,055	4,353,612
Other accrued expenses		5,097,791	5,030,048
Total current liabilities		52,382,329	48,501,975
Long-term liabilities:			
Long-term debt, less current portion		182,405,780	187,664,834
Obligations under capitalized leases, less current portion		4,613,328	5,296,855
Self-insurance liabilities		9,203,812	7,535,696
Accrued pension liabilities		29,492,211	22,246,566
Other long-term liabilities		3,284,952	3,518,746
Total liabilities		281,382,412	274,764,672
Net assets:			
Without donor restrictions		334,327,185	342,239,494
With donor restrictions		27,694,245	27,447,511
Total net assets		362,021,430	369,687,005
Total liabilities and net assets	$	643,403,842	644,451,677

See accompanying notes to consolidated financial statements.

SHEPPARD AND ENOCH PRATT FOUNDATION, INC.
AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended June 30, 2019 and 2018

		2019	2018
Revenues, gains, and other support:			
Patient service revenue (net of allowances and discounts)	$	153,262,072	151,332,053
Residential and educational service revenue (net of allowances)		170,335,523	162,552,367
Total net service revenue		323,597,595	313,884,420
Less provision for bad debts		1,479,238	3,389,079
Net service revenue less provision for bad debts		322,118,357	310,495,341
Net assets released from restrictions used for operations		743,358	1,189,557
Other revenue		59,316,164	58,866,400
Total revenues, gains, and other support		382,177,879	370,551,298
Expenses:			
Salaries and wages		226,647,417	222,689,158
Employee benefits		46,950,131	48,925,569
Expendable supplies		19,387,936	18,336,325
Purchased services		57,613,275	53,052,331
Interest		3,287,713	3,554,180
Repairs and minor alterations		10,824,681	10,518,490
Depreciation and amortization		19,992,147	18,978,249
Loss on disposal of assets, net		106,137	202,168
Total expenses		384,809,437	376,256,470
Operating loss		(2,631,558)	(5,705,172)
Other income (expense):			
Investment income		2,164,619	2,114,843
Realized (loss) gain on investments, net		(763,811)	5,014,038
Change in unrealized gain on investments, net		3,100,139	3,563,005
Other		230,357	69,377
Total other income		4,731,304	10,761,263
Excess of revenues over expenses		2,099,746	5,056,091
Other changes in net assets:			
Net assets released from restrictions used for purchases of property and equipment		339,862	207,120
Pension liability adjustment		(10,379,663)	8,639,418
Capital grants		27,748	2,551,181
(Decrease) increase in net assets without donor restrictions	$	(7,912,307)	16,453,810

See accompanying notes to consolidated financial statements.

SHEPPARD AND ENOCH PRATT FOUNDATION, INC.
AND SUBSIDIARIES

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2019 and 2018

		2019	2018
Net assets without donor restrictions:			
Excess of revenues over expenses	$	2,099,746	5,056,091
Other changes in net assets:			
Net assets released from restrictions used for purchases of property and equipment		339,862	207,120
Pension liability adjustment		(10,379,663)	8,639,418
Capital grants and other		27,748	2,551,181
(Decrease) increase in net assets without donor restrictions		(7,912,307)	16,453,810
Net assets with donor restrictions:			
Gifts and grants		1,154,373	7,730,594
Investment income		100,481	91,612
Net realized (loss) gain on investments		(25,634)	160,731
Net unrealized gain on investments		100,732	115,623
Net assets released from restrictions for operations		(743,358)	(1,189,557)
Net assets released from restrictions for purchases of property and equipment		(339,862)	(207,120)
Increase in net assets with donor restrictions		246,732	6,701,883
(Decrease) increase in net assets		(7,665,575)	23,155,693
Net assets, beginning of year		369,687,005	346,531,312
Net assets, end of year	$	362,021,430	369,687,005

See accompanying notes to consolidated financial statements.

SHEPPARD AND ENOCH PRATT FOUNDATION, INC.
AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended June 30, 2019 and 2018

	2019	2018
Cash flows from operating activities:		
(Decrease) increase in net assets	$ (7,665,575)	23,155,693
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	19,992,147	18,978,249
Pension liability adjustment	10,379,663	(8,639,418)
Provision for doubtful accounts	1,479,238	3,389,079
Gifts and grants, net	(411,015)	(6,541,037)
Net realized loss (gain) on investments	789,445	(5,174,769)
Net unrealized gain on investments	(3,200,871)	(3,678,628)
Restricted investment income on restricted net assets	(100,481)	(91,612)
Capital grant and loss on disposal of assets	78,389	(2,349,013)
Increase in accounts receivable, net	(4,144,484)	(2,832,890)
Decrease (increase) in prepaid expenses and other current assets	302,750	(3,191,694)
Decrease (increase) in third-party payor settlements receivable	(887,635)	3,032,988
Increase in accounts payable, accrued expenses and other	4,269,428	3,099,941
Increase in self-insurance liabilities	1,668,559	551,991
Decrease in accrued pension liability	(3,134,018)	(1,801,105)
Net cash provided by operating activities	19,415,540	17,907,775
Cash flows from investing activities:		
Purchases of property and equipment	(40,832,614)	(35,962,891)
Decrease (increase) in other assets	(407,193)	642,222
Proceeds from sale of property and equipment	7,962	86,016
Decrease in notes receivable	131,764	131,763
Purchases of alternative investments	(3,643,782)	(6,298,172)
Sales of alternative investments	1,986,317	5,532,388
Establishment of 2017 construction funds	—	(100,000,128)
Decrease in investments limited or restricted as to use, net	7,493,580	10,918,592
Net cash used in investing activities	(35,263,966)	(124,950,210)
Cash flows from financing activities:		
Proceeds from debt	—	178,748,000
Payment of note payable	—	(12,900,000)
Payment of long-term debt principal	(5,125,337)	(83,000,346)
Payment on capital lease obligations	(561,029)	(610,931)
Payment of deferred financing costs	(44,376)	(429,720)
Capital grants and advances	27,748	2,714,181
Gifts and grants, net	344,824	3,783,457
Net cash (used in) provided by financing activities	(5,358,170)	88,304,641
Net decrease in cash and cash equivalents	(21,206,596)	(18,737,794)
Cash and cash equivalents, beginning of year	57,539,767	76,277,561
Cash and cash equivalents, end of year	$ 36,333,171	57,539,767

See accompanying notes to consolidated financial statements.

(1) Summary of Significant Accounting Policies

(a) Organization

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

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

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

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

On December 8, 2017, Foundation formed Sheppard Pratt Properties, LLC. The sole member of the company is Sheppard and Enoch Pratt Foundation, Inc., and its established purpose is to acquire, own, operate, lease and manage properties on behalf of Foundation. During 2018, certain assets and rental activity relating to a warehouse rental property acquired in Elkridge, Maryland was transferred from Investment Company to Sheppard Pratt Properties, LLC.

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

Resources is a for-profit company that was formed for the purpose of providing employee assistance program services to other entities. Resources was inactive as an operating entity for the years ended June 30, 2019 and 2018.

(b) Basis of Presentation

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

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

Net assets without donor restrictions – Net assets that are not subject to donor-imposed stipulations. Board-designated funds are included within this category of net assets.

Net assets with donor restrictions – Net assets whose use by Foundation has been limited by donors to a specific time or purpose. Also included in this category are net assets that have been restricted by donors to be maintained by the Foundation in perpetuity. Generally, donors of assets to be held in perpetuity permit Foundation to use all or part of the income earned on related investments for general or specific purposes.

Revenues are reported as increases in net assets without donor restrictions unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in net assets without donor restrictions. Gains and losses are reported as increases or decreases in net assets without donor restrictions unless their use is restricted by explicit donor stipulation or by law. Contributions with no donor-imposed restrictions are recognized as revenues in the period received as increases in net assets without donor restrictions.

Unconditional promises to give cash and other assets to Foundation with donor-imposed restrictions are reported as increases in net assets at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. When the donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets are reclassified as net assets without donor restrictions and reported in the consolidated statements of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as contributions without donor restrictions in the accompanying consolidated financial statements.

Net assets with donor restrictions are available for the purposes of providing indigent care, health and educational programs and the purchase of property and equipment. The income from net assets with donor restrictions that are restricted in perpetuity is expendable to provide health and educational programs.

(c) Charity Care

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

(d) Cash and Cash Equivalents

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

(e) Allowance for Doubtful Accounts

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

(f) Investments Limited or Restricted as to Use

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

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

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

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

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

(g) Pledges

Pledges, less an allowance for uncollectible amounts, are recorded as receivables in the year the pledge is made unless the pledge carries conditions that have not been met. Conditional pledges are recorded as contributions when the conditions of the pledge have been satisfied. Pledges receivable are recorded at net realizable value, which is calculated using a discount rate of 3% at June 30, 2019 and 2018.

(h) Property and Equipment

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

Gifts of long-lived assets such as land, buildings, or equipment are reported as other changes in net assets without donor restrictions, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

(i) Costs of Borrowing

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

(j) Estimated Self-Insurance Liability Claims

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

(k) Pension Benefits

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

(l) Patient Service Revenue

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

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

(m) Residential and Educational Service Revenue

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

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

(Continued)

(n) Other Operating Revenue

Other operating revenue is primarily comprised of grant revenue, which is recognized when funds are released to cover qualified expenses, and business service revenue, which is recognized when earned.

(o) Impairment of Long-Lived Assets

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

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

In estimating the future cash flows for determining whether an asset is impaired and if expected future cash flows used in measuring assets are impaired, Foundation groups its assets at the lowest level for which there are identifiable cash flows independent of other groups of assets. No impairment charges were recorded during the years ended June 30, 2019 and 2018.

(p) Rental Income

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

(q) Excess of Revenues over Expenses

The consolidated statements of operations include a performance indicator, the excess of revenues over expenses. Changes in net assets without donor restrictions that are excluded from excess of revenues over expenses, consistent with industry practice, include changes in pension liability adjustments, contributions of long-lived assets (including assets acquired using contributions that by donor restriction were to be used for the purposes of acquiring such assets) and grants for capital purposes.

(r) Income Taxes

Foundation and its subsidiaries, except for Resources, have been recognized as tax-exempt organizations under Section 501(a) as organizations described in Section 501(c)(3) of the Internal Revenue Code (IRC) and are not subject to income taxes on related income pursuant to Section 501(a) of the IRC. The operations of Resources, a for-profit company, are not significant to the consolidated financial statements. Foundation accounts for income taxes under ASC Topic 740, *Income Taxes*.

(Continued)

Investment Company recognizes taxable unrelated business income from alternative investment funds held in a combined investment pool. Investment Company will utilize available losses incurred to offset taxable income as allowed under the related tax regulations.

On December 22, 2017, the President signed into law H.R. 1, originally known as the Tax Cuts and Jobs Act. The new law includes several provisions that result in substantial changes to the tax treatment of tax-exempt organizations and their donors. Foundation has reviewed these provisions and the potential impact and concluded the enactment of H.R. 1 did not have a material effect on the operations of the organization.

Under terms of H.R. 1, effective January 1, 2018, non-profit organizations, Foundation and Community Services, were required to report employee parking expenses as qualified transportation fringes under §274(a)(4) and §512(a)(7) of the IRC. The calculated employee parking expense amount is nondeductible, and is now required to be reported as unrelated business taxable income for tax purposes.

(s) Leases

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

(t) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates

(u) New Accounting Pronouncements

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

- Reduces the number of net asset classes presented from three to two: with donor restrictions and without donor restrictions;
- Requires all NFPs to present expenses by their functional and their natural classifications in one location in the financial statements; (note 15)
- Requires NFPs to provide quantitative and qualitative information about management of liquid resources and availability of financial assets to meet cash needs within one year of the balance sheet date. (note 18)

The Company adopted ASU 2016-14 during 2019, which was applied retrospectively. Upon adoption, $23,512,452 of temporarily restricted and $3,935,059 of permanently restricted net assets were combined into one category, net assets with donor restrictions.

The FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU establishes principles for reporting useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts with customers. Particularly, that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for fiscal year 2020. The Company expects to record a decrease in net patient service revenue related to self-pay patients and a corresponding decrease in bad debt expense upon the adoption of the standard.

The FASB issued ASU No. 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made,* which addresses practice issues by helping an entity evaluate whether it should account for a grant (or similar transaction) as a contribution or as an exchange transaction. In an exchange transaction, a resource provider receives '"commensurate value" in return for the resources transferred. The ASU clarifies how an entity determines whether a resource provider is receiving commensurate value. The ASU also clarifies and expands the criteria for determining whether a contribution is conditional. Some grants that are considered exchange transactions under current U.S. GAAP will be accounted for as conditional contributions under the ASU. The adoption of this ASU is effective for the year ended June 30, 2020 and the Company is still assessing the impact.

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

The FASB issued ASU No. 2016-02, *Leases*, which will require lessees to recognize most leases on-balance sheet, increasing their reported assets and liabilities – sometimes very significantly. This update was developed to provide financial statement users with more information about an entity's leasing activities, and will require changes in processes and internal controls. The adoption of ASU 2016-02 is effective fiscal year 2021, and will require application of the new guidance at the beginning of the earliest comparable period presented. The Company is currently assessing the impact of the adoption of ASU No. 2016-02, which is expected to have a material impact on its consolidated balance sheet.

(Continued)

(v) Management's Assessment and Plans

ASU 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern,* 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). Through the date of this report, management determined that there were no conditions or events that raise substantial doubt about the Company's ability to continue as a going concern and the Company will continue to meet its obligations.

(2) Charity Care and Community Services

Foundation maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy and equivalent service statistics. The estimated cost of charity care provided during the years ended June 30, 2019 and 2018 was $4,683,471 and $3,784,810, respectively.

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

(3) Investments Limited or Restricted as to Use

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

		2019	2018
Board designated, without restrictions:			
Portion of pooled investments	$	158,605,919	162,975,810
Other investments		15,763,529	11,415,951
Held by trustees:			
Construction funds		91,663,555	100,664,801
Under self-insurance trusts		5,683,977	4,754,820
Security deposit and collateral		5,598,828	631,669
With donor restrictions:			
Portion of pooled investments		6,365,179	6,388,580
Restricted investments		8,518,908	8,521,493
Total investments limited or restricted as to use		292,199,895	295,353,124
Current portion		553,333	2,193,109
Investments limited or restricted as to use, less current portion	$	291,646,562	293,160,015

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

		2019	2018
Board designated, without restrictions:	$	158,605,919	162,975,810
With donor restrictions		6,365,179	6,388,579
Total	$	164,971,098	169,364,389

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

		2019	2018
Cash and cash equivalents	$	6,937,547	5,724,924
Corporate bonds		12,981,111	12,881,359
Marketable equity securities		7,930	5,933
Mutual and common trust funds		85,992,334	93,593,425
Other (primarily alternative investments under equity method)		59,052,176	57,158,748
Total	$	164,971,098	169,364,389

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

		2019	2018
Cash and cash equivalents	$	8,722,999	4,362,151
Mutual funds		3,634,792	3,375,384
Real estate held for future development, at cost		3,080,215	3,084,139
Other		325,523	594,277
	$	15,763,529	11,415,951

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

		2019	2018
Cash and cash equivalents	$	523,409	587,265
Fixed income investments		5,160,568	4,167,555
	$	5,683,977	4,754,820

(Continued)

A Foundation trustee served as an investment manager for a portion of the investments limited or restricted as to use totaling approximately $13,101,000 as of June 30, 2018. This investment manager did not serve on Foundation's board of trustees during the period ended June 30, 2019.

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

		2019	2018
Investment income, net:			
Without donor restrictions	$	2,164,619	2,114,843
With donor restrictions		100,481	91,612
		2,265,100	2,206,455
Net realized gains (losses) on sales of investments:			
Without donor restrictions		(763,811)	5,014,038
With donor restrictions		(25,634)	160,731
		(789,445)	5,174,769
Net unrealized gains on investments:			
Without donor restrictions		3,100,139	3,563,005
With donor restrictions		100,732	115,623
Total unrealized gains		3,200,871	3,678,628
Total investment gain income		4,676,526	11,059,852
Investment income on other unrestricted investments and cash and cash equivalents		994,173	968,334
Investment income on self-insurance trust assets		11,576	6,852
Total investment income	$	5,682,275	12,035,038

(4) Disclosures about Fair Value of Financial Instruments

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

- Defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, and establishes a framework for measuring fair value;
- Establishes a three-level hierarchy for fair value measurement;
- Requires consideration of Foundation's nonperformance risk when valuing liabilities; and

- Expands disclosures about instruments measured at fair value.

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

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

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

		Level 1	Level 2	Level 3	Total
Assets:					
Cash and cash equivalents	$	112,327,846			112,327,846
Equities:					
Common stocks		11,143,866	—	—	11,143,866
Mutual funds		72,244,285	117,162	—	72,361,447
Other		2,226,402	4,572,667	—	6,799,069
Fixed income:					
Collateralized mortgage obligations		—	422,314	—	422,314
Corporate bonds		—	9,874,490	—	9,874,490
Government issued bonds		—	7,844,875	—	7,844,875
Other financial instruments		—	6,977	—	6,977
Total assets	$	197,942,399	22,838,485	—	220,780,884
Liabilities:					
Interest rate swap	$		24,861		24,861

The table below presents Foundation's investable assets and liabilities as of June 30, 2018, aggregated by the three-level valuation hierarchy:

		Level 1	Level 2	Level 3	Total
Assets:					
Cash and cash equivalents	$	115,513,147	—	—	115,513,147
Equities:					
Common stocks		10,140,939	—	—	10,140,939
Mutual funds		81,245,116	—	—	81,245,116
Other		1,806,983	4,572,667	—	6,379,650
Fixed income:					
Collateralized mortgage obligations		—	574,709	—	574,709
Corporate bonds		—	9,064,222	—	9,064,222
Government issued bonds		—	7,409,983	—	7,409,983
Other financial instruments		—	4,424	—	4,424
Total assets	$	208,706,185	21,626,005	—	230,332,190
Liabilities:					
Interest rate swap	$	—	129,649	—	129,649

Foundation did not have transfers between Levels, or Level 3 measurements.

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

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

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

The carrying amount of cash and cash equivalents, accounts receivable, third-party payor settlements receivable or payable, other current assets, accounts payable and accrued expenses approximates fair value because of the short-term maturity of these instruments. The fair value of Foundation's long-term debt, except for the Series A portion of the 2012 Bonds, is estimated to approximate the carrying amount because interest rates are variable and determined frequently based on prevailing market conditions. The estimated fair value of the Series 2017 Bond at June 30, 2019 and the Series A portion of the 2012 Bonds at June 30, 2018 was approximately $173,365,000 and $177,329,000, respectively. During 2018, Series A and Series B portion of the 2012 Bond were refinanced with the issuance of the Series 2017 Bond. Due to the subjective nature of the terms of the Foundation's notes receivable and capital lease obligations, their fair values cannot be estimated.

(5) Donor Restricted Assets

Donor restricted assets consist of the following at June 30:

		2019	2018
Pledges receivable, net of unamortized discount of $186,000 at June 30, 2019 and $146,000 at June 30, 2018	$	3,057,063	3,125,332
Less allowance for uncollectible pledges		97,000	98,000
Net pledges receivable		2,960,063	3,027,332
Other investments (primarily property)		12,810,158	12,537,438
Portion of pooled investments (note 3)		6,365,179	3,020,595
Restricted cash and investments		5,558,845	4,927,087
	$	27,694,245	23,512,452

The net realizable value of the unconditional pledges receivable at June 30, 2019 was calculated using an average discount rate of 3%. The net present value of pledges receivable and the expected collection period at June 30, 2019 are as follows:

2020	$	114,833
2021		2,887,062
2022		19,231
2023		18,425
2024		17,512
	$	3,057,063

(6) Note Receivable

In conjunction with the land lease described in note 7, Investment Company provided a loan and a line of credit to the Maryland Economic Development Company (MEDCO) to help finance the development of university student housing located on the campus of Foundation. The unsecured term loan of $3.75 million is payable in equal quarterly installments between the initial repayment date (January 2004) and June 30, 2031. MEDCO repaid approximately $132,000 during each of the years ended June 30, 2019 and 2018, which resulted in an outstanding balance of $1,614,104 and $1,745,867 June 30, 2019 and 2018, respectively. The loan bears interest at the rate of 12% per annum. Foundation has included approximately $202,000 and $218,000 of interest income from the loan in investment income during the fiscal years ended June 30, 2019 and 2018, respectively.

(7) Property and Equipment

Property and equipment at June 30 are summarized as follows:

		2019	2018
Land	$	25,020,490	24,682,726
Land improvements		19,222,543	14,761,963
Buildings and building improvements		341,640,528	337,649,336
Furniture and equipment		73,797,595	71,011,568
Vehicles		8,926,474	8,341,644
Construction in progress		45,669,307	19,864,813
		514,276,937	476,312,050
Less accumulated depreciation		261,191,441	243,082,463
	$	253,085,496	233,229,587

Assets under capital lease at June 30, 2019 and 2018 of $9,512,732 and $9,639,233, respectively, were included in buildings and building improvements and furniture and equipment in the table above. Accumulated depreciation of assets under capital leases totaled $6,266,052 and $5,481,545 at June 30, 2019 and 2018, respectively.

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

Depreciation expense for the years ended June 30, 2019 and 2018 was $19,929,971 and $18,917,376, respectively.

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

The payment of ground rent is subordinate to the payment of debt on the MEDCO loan. Based on current cash flow projections, it is anticipated that the full amount of rent accruing will not be paid. Foundation has recorded an allowance for a portion of the unpaid accrued rent, and the related interest on the unpaid rents for fiscal years 2014 through 2019. Partial ground rent payments of approximately $2,095,000 and $2,130,000 were accrued as a receivable at June 30, 2019 and 2018. As of June 30, 2019 and 2018, Foundation has recorded total ground rent receivable in the accompanying consolidated balance sheets of $8,273,638 and $7,708,194, respectively, with a related reserve of $6,178,778 and $5,578,630, respectively.

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

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

Construction in progress includes the project to build the replacement facility in Howard County. In connection with this project, the Foundation has total unspent commitments of approximately $71,000,000 and $9,000,000 as of June 30, 2019 and 2018, respectively. Interest expense, net of investment earnings, capitalized for this project totaled $649,756 and $933,399 for the years ended June 30, 2019 and 2018, respectively.

(8) Other Assets

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

		2019	2018
Workers' compensation excess insurance receivable	$	233,218	275,395
Intangible assets		1,307,000	1,307,000
Cash surrender value of life insurance and other		1,628,588	1,071,843
		3,168,806	2,654,238
Less accumulated amortization		(572,850)	(540,175)
	$	2,595,956	2,114,063

(9) Long-Term Debt and Note Payable

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

		2019	2018
Maryland Health and Higher Educational Facilities Authority (MHHEFA) Revenue Bonds, Series 2017	$	173,365,000	177,329,000
MHHEFA Revenue Bond – 2013		4,627,130	5,046,052
MHHEFA Revenue Bond – 2014		3,542,708	3,672,748
MHHEFA Revenue Bond – 2016		3,062,000	3,446,000
Bank notes		2,090,419	2,148,742
Mortgages on real estate		2,442,617	2,627,002
Other debt		95,642	126,497
		189,225,516	17,067,041
Less deferred financing costs		(1,059,295)	(1,110,717)
Less current portion		(5,760,441)	(5,620,490)
	$	182,405,780	187,664,834

In December 2017, Health System, Physicians, Foundation and Investment Company (Obligated Group) acquired new financing to fund a portion of the construction costs of a new hospital in Elkridge, Maryland and other capital improvements and equipment, to refinance certain outstanding indebtedness, including 2012 Series A and Series B bonds, and to fund transaction related costs. The 2017 Series bond was issued by the Maryland Health and Higher Educational Facilities Authority (MHHEFA) and purchased by a bank in a direct placement loan arrangement.

The 2017 Series bond is a tax- exempt fixed rate bond with an original principal amount of $178,748,000 bearing a fixed interest rate of 2.88% and 2.48% at June 30, 2019 and 2018, respectively. The initial term of the credit facility provided by the direct placement loan arrangement is 15 years, and the final scheduled maturity of the bonds is June 1, 2048. The Series 2017 bonds are secured by a trust indenture and Obligated Group has granted the bank and MHHEFA a security interest in its revenues. The Series 2017 Bonds require Obligated Group to satisfy certain measures of financial performance as long as the bonds are outstanding.

On May 2, 2013, MHHEFA issued a $7,200,000 bank-qualified tax-exempt revenue bond (MHHEFA Revenue Bond - 2013) for the purpose of reimbursing Way Station for certain capital expenditures associated with the acquisition and development of two properties in Frederick, Maryland, a property in Hagerstown, Maryland, and a property in Columbia, Maryland. The bond was purchased by Capital One Bank, and Way Station was scheduled make payments to Capital One over 15 years, at a fixed interest rate of 2.645%. However, the lowering of the corporate tax rate in the Tax Cuts and Jobs Act of 2017 has triggered an adjustment to the interest rate. The new interest rate with the bank is 3.11%. Way Station owed $4,627,130 and $5,046,051 as of June 30, 2019 and 2018, respectively. The tax-exempt loan is secured by a deed of trust covering six of the Company's properties in Frederick, Hagerstown, and Columbia, Maryland. Way Station's ability to obtain additional borrowings is limited without the bank's consent.

On March 4, 2014, MHHEFA issued a $4,430,000 bank-qualified tax-exempt revenue bond (MHHEFA Revenue Bond – 2014) for the purpose of refinancing Family Services existing mortgage debt. The bond was purchased by a bank, and Family Services is required to make payments over 25 years at interest rates ranging from 2.75 to 3.4%. As part of the same transaction, the same bank loaned Family Services $1,683,000 in a taxable term bank note that is amortized over 25 years; however, it is due in 10 years, at fixed interest rates that vary from 4.25% in year one to 5.25% in subsequent years. On February 24, 2015, Family Services received a $676,540 term bank loan, bearing an interest rate of 4.7% with a term of nine years. The tax-exempt and taxable term bank notes are secured by a deed in trust covering the Company's properties, which require Family Services to satisfy certain measures of financial performance as long as the loans are outstanding.

On September 28, 2016, Mosaic borrowed $4,066,000 variable rate debt (MHHEFA Revenue Bond - 2016) via a tax-exempt nonbank qualified direct purchase. The bonds accrue interest at a variable rate at 83% of the 30-Day London Interbank Offered Rate (LIBOR) plus 142 basis points and are being amortized over ten years, which was 3.4% and 3.1% as of June 30, 2019, and 2018, respectively, and have principal payments beginning November 2016 and terminating October 2026. The loan is secured by collateral, including, but not limited to, gross revenue, fixed assets (excluding buildings), and cash accounts. In conjunction with the refinance, Mosaic entered into a 10-year interest rate swap agreement with a third party under which the Company will make monthly payments at a fixed rate of 0.92% in exchange for payments based on LIBOR. The liability of $24,861 and $129,649 as of June 30, 2019 and 2018, respectively, is included in other long-term liabilities.

Community Services have mortgages on multiple properties with a total outstanding balance of $2,442,617 as of June 30, 2019 and $3,251,727 as of June 30, 2018. The interest rates and years of maturity range from 0% to 7.45%, and 2019 to 2037, respectively.

Community Services have other nonmortgage debt, consisting primarily of auto and renovation loans, with a total outstanding balance of $95,642 as of June 30, 2019 and $126,497 as of June 30, 2018. The interest rates range from 0% to 5.9%.

Community Services have combined variable rate lines of credit the amount of $5,000,000. As of June 30, 2019 and 2018, there were no outstanding balances on the lines of credit.

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

2020	$	5,760,441
2021		5,460,144
2022		5,584,646
2023		5,735,829
2024		5,856,210
2025 and thereafter		160,828,246
	$	189,225,516

Interest payments were $5,907,137 and $4,143,587 in 2019 and 2018, respectively.

(10) Other Financial Instruments

During the year ended June 30, 2006, Foundation received a gift annuity from donors. Under the terms of such agreement, Foundation agreed to pay 6% annually of the contributed amount (approximately $1 million) on a quarterly basis over the remaining lives of the donors. Accordingly, as of June 30, 2019 and 2018, the net present value of the estimated remaining payments of approximately $325,522 and $369,661, respectively, have been recorded as an other long-term liability.

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

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

(Continued)

ASC Subtopic 715-30, *Defined Benefit Plans-Pension*, requires Foundation to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its pension plan in the accompanying consolidated balance sheets, with a corresponding adjustment to net assets without donor restrictions. The pension liability adjustment to net assets without donor restrictions represents the change in net unrecognized actuarial losses and unrecognized prior service costs that have not yet been recognized as part of excess of revenues over expenses. Those amounts will be subsequently recognized as a component of net periodic pension cost pursuant to Foundation's historical accounting policy for amortizing such amounts.

The following are deferred pension costs that have not yet been recognized in periodic pension expense but instead are included as a component of net assets without donor restrictions, as of June 30, 2019 and 2018. Unrecognized actuarial losses represent unexpected changes in the projected benefit obligation and plan assets over time, primarily due to changes in assumed discount rates and investment experience. Unrecognized prior service cost is the impact of changes in plan benefits applied retrospectively to employee service previously rendered. Deferred pension costs are amortized into annual pension expense over the average remaining assumed service period for active employees.

		Amounts in net assets without donor restrictions to be recognized during the next fiscal year	Amounts recognized in net assets without donor restrictions at June 30, 2019	Amounts recognized in net assets without donor restrictions at June 30, 2018
Net prior service cost	$	—	—	3,992
Net actuarial loss		4,355,926	52,321,741	41,938,086
Total	$	4,355,926	52,321,741	41,942,078

During 2013, the Plan was amended to permanently allow certain vested terminated participants to take a lump-sum payment of Plan benefits not previously available as a lump-sum in lieu of a deferred monthly benefit. This offer is available to terminating participants with a vested benefit value of less than $25,000. In 2018, the Plan was amended to temporarily allow a one-time opportunity to elect a lump-sum distribution of vested benefit in lieu of monthly payments for vested benefit payouts not to exceed $250,000. As a result of these changes, Foundation made lump-sum payments of approximately $116,983 and $7,979,319 in 2019 and 2018, respectively.

Foundation previously adopted the new RP-2014 Mortality Table with generational improvements using projection scale MP-2014. The Foundation updated its mortality table assumptions to the projection scale MP-2018 and MP-2017 in 2019 and 2018, respectively.

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

		2019	2018
Accumulated benefit obligation at the end of the year	$	227,029,642	204,466,414
Changes in benefit obligations:			
Projected benefit obligation at the beginning of the year	$	220,432,718	234,679,327
Service cost		3,799,732	4,675,073
Interest cost		8,661,017	8,081,882
Actuarial loss		17,717,310	(10,843,582)
Benefits paid		(9,657,350)	(16,159,982)
Projected benefit obligation at the end of the year		240,953,427	220,432,718
Changes in plan assets:			
Fair value of plan assets at beginning of the year		198,186,152	201,992,238
Actual return on plan assets		17,932,414	7,353,896
Contributions to the plan		5,000,000	5,000,000
Benefits paid		(9,657,350)	(16,159,982)
Fair value of plan assets at end of the year		211,461,216	198,186,152
Funded status	$	(29,492,211)	(22,246,566)

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

		2019	2018
Service cost	$	3,799,732	4,675,073
Interest cost		8,661,017	8,081,882
Expected return on plan assets		(13,301,175)	(13,592,310)
Amortization of prior service cost		3,992	29,137
Amortization of net loss		2,702,416	4,005,113
Net pension expense	$	1,865,982	3,198,895

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

	2019	2018
PBO Discount Rate (EOY)	3.69 %	4.35 %
Service Cost Discount Rate (BOY)	4.45	4.19
Interest Cost Discount Rate (BOY)	4.06	3.50
Rate of compensation increase	Age Graded	Age Graded
Expected long-term return on plan assets	6.80	6.80

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

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

(b) Investment Policy and Objectives

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

Foundation monitors the investment managers' performance and ensures adequate diversification by asset class to further mitigate the risks associated with the investment program. Management believes that its assets are invested in accordance with its overall investment policies at June 30, 2019 and 2018.

(c) Plan Assets

Foundation's pension plan weighted average asset allocations at the measurement dates of June 30, 2019 and 2018 by asset category are as follows:

	Target allocation	2019	2018
Equity securities	44 %	44 %	45 %
Debt securities	56	54	53
Cash and cash equivalents	—	2	2
	100 %	100 %	100 %

In accordance with ASC Subtopic 715-20, *Defined Benefit Plans-General-Disclosures*, nonpublic entities are required to report the fair value of each major category of pension plan asset within the fair value hierarchy. ASC Subtopic 820-10, *Fair Value Measurements-Overall*, provides guidance for the fair value hierarchy, which is a valuation technique that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Refer to note 4 for descriptions of each of the three levels within the valuation hierarchy.

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

	Level 1	Level 2	Level 3	Total	Reported at NAV[1]
Assets:					
Cash and cash equivalents	$ 3,721,801	—	—	3,721,801	—
Collective trusts – equity	—	93,690,160		93,690,160	—
Collective trusts – fixed income	—	113,236,213	—	113,236,213	—
Private equity and real estate funds	—	—	—	—	813,042
Total assets	$ 3,721,801	206,926,373	—	210,648,174	813,042

[1] Investments reported at NAV as the practical expedient

The table below presents Foundation's pension plan investable assets as of June 30, 2018 aggregated by the three level valuation hierarchy:

	Level 1	Level 2	Level 3	Total	Reported at NAV[1]
Assets:					
Cash and cash equivalents	$ 3,099,198	—	—	3,099,198	—
Collective trusts – equity	—	88,863,733		88,863,733	—
Collective trusts – fixed income	—	105,173,272	—	105,173,272	—
Private equity and real estate funds	—	—	—	—	1,049,949
Total assets	$ 3,099,198	194,037,005	—	197,136,203	1,049,949

[1] Investments reported at NAV as the practical expedient

The majority of the investments held by the plan are Level 2 securities. There were no significant transfers between levels during the years ended June 30, 2019 and 2018. Foundation has the ability to liquidate the collective trusts on a daily basis.

Foundation's pension plan invests in alternative investments, which are primarily hedge funds of funds and private equity funds. Such investments are carried at their estimated fair value using the practical expedient. Most of the funds have not had changes in the redemption policies during the year ended June 30, 2019, and the policies range primarily from 30 to 90 days. Determination of fair value is performed on a quarterly basis by the general partner(s) of the funds. Because of the inherent uncertainty of valuation, the determined values may differ significantly from the values that would have been used had a ready market for these investments existed.

(d) Contributions

The Foundation expects to contribute $5 million to its pension plan during the year ending June 30, 2020.

(e) Estimated Future Benefit Payments

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

2020	$ 10,536,000
2021	11,250,000
2022	11,723,000
2023	12,296,000
2024	12,786,000
2025–2029	68,792,000

The expected benefits to be paid are based on the same assumptions used to measure Foundation's benefit obligation at June 30, 2019.

Effective July 1, 2006, Foundation elected to not allow employees hired on or after July 1, 2006 to participate in the defined benefit pension plan. Instead, such employees participate in a new employees' thrift plan. The new employee's thrift plan expense was $4,234,969 and $4,158,573 in 2019 and 2018, respectively. The retirement benefits for employees hired on or prior to June 30, 2006 under the defined benefit plan remain unchanged. Foundation may provide a discretionary contribution to the employees' thrift plan. There were no discretionary contributions to the thrift plan in 2019 and 2018.

Foundation maintains a self-insured life, accident and health plan for employees of Health System, Physicians and Way Station, which provides for monthly contributions in amounts sufficient to cover the costs of basic hospital, surgical and diagnostic benefits and administrative expenses. The life, accident, and health plan expense was $15,516,812 in 2019 and $14,403,841 in 2018.

Certain of the subsidiaries maintain various tax sheltered annuity accounts, defined contribution plans or other retirement benefit plans. These subsidiaries have the option to issue discretionary matching contributions to the plans. During the years ended June 30, 2019 and 2018, these subsidiaries contributed $614,221 and $557,117, respectively, to the plans.

(12) Leases

Foundation leases office space under long-term operating leases, which expire at various dates through 2035, some of which require increasing monthly payments expiring over the next several years. The following is a schedule of the future minimum lease payments under operating leases as of June 30, 2019 that have initial or remaining lease terms in excess of one year for each of the years ending June 30:

2020	$	4,629,390
2021		2,914,673
2022		1,945,488
2023		1,585,957
2024		1,339,556
Thereafter		6,367,722
Total minimum lease payments	$	18,782,786

Rent expense was approximately $7,017,661 and $7,302,294 in 2019 and 2018, respectively. Foundation also leases various equipment under short-term leases.

Foundation has various capital leases for buildings and software the majority of which are related to its electronic medical records system and the long-term rental for one of its school locations.

The following is a schedule of future minimum lease payments under capital leases as of June 30, 2019:

2020	$	938,528
2021		972,661
2022		1,008,056
2023		1,044,762
2024		731,137
Thereafter		1,653,226
Total minimum lease payments		6,348,370
Less amount representing interest		1,051,515
Present value of net minimum lease payments		5,296,855
Less obligations under capital leases, current portion		683,527
Obligations under capital leases, less current portion	$	4,613,328

(13) Self-Insurance Programs and Litigation

Foundation is from time to time subject to claims and suits arising in the ordinary course of business. In the opinion of management, the ultimate resolution of pending legal proceedings will not have a material effect on the consolidated financial statements. In this regard, Foundation maintains a self-insurance program for professional liability claims, and a related trust fund has been established for the purpose of setting aside assets based on actuarial funding recommendations. Under the trust agreement, the assets can only be used for the payment of professional and general liability claims, related expenses, and the cost of administering the trust. Certain claims-made based professional and occurrence-based general liability insurance coverages have been purchased to provide protection for claims in excess of the self-insured amounts. The assets of the trust are classified as investments limited as to use in the accompanying consolidated balance sheets in the amount of approximately $523,000 and $587,000 at June 30, 2019 and 2018, respectively. The related claims liabilities of approximately $5,622,000 and $3,730,000 as of June 30, 2019 and 2018, respectively, are recorded on an undiscounted basis and represent estimates for asserted claims and unasserted claims arising from reported incidents and unreported incidents. Management believes that the provision for loss is adequate at June 30, 2018 and 2017; however, the ultimate liability may differ significantly. Management is aware of certain asserted and unasserted legal claims, none of which, in the opinion of management, are expected to result in losses in excess of insurance limits.

Health System and Physicians are also self-insured for general and professional claims and have established a letter of credit arrangement of approximately $1,427,000 in 2019 and $1,458,000 in 2018 in accordance with the requirements of the Maryland Department of Employment and Training.

(Continued)

Also, Foundation is self-insured for workers' compensation claims up to $550,000 for both 2019 and 2018. Investments of approximately $5,200,000 and $4,200,000 at June 30, 2019 and 2018, respectively, are being held in an account at a financial institution to secure the payment of claims. These investments are included in the balance of investments limited or restricted as to use. The related liabilities of approximately $6,062,000 and $5,880,000 as of June 30, 2019 and 2018, respectively, are recorded in the accompanying consolidated balance sheets. Foundation records outstanding losses and loss expenses for workers' compensation liability claims based on the estimates of the amount of reported losses together with a provision for losses incurred but not reported, the recommendations of an independent actuary, and management's judgment using its past experience and industry experience.

Foundation offers employees a self-insured health plan. Foundation maintains an accrual for claims that have been incurred but not reported to the plan administrator. The accrued liability for claims incurred but not reported is based on the historical claim lag period and current payment trends of health insurance claims. The accrued liability for health claims is approximately $1,870,000 and $2,270,000, respectively, as of June 30, 2019 and 2018.

While management believes that the provision for self-insurance claims is adequate, at June 30, 2019 and 2018, the ultimate liabilities may be significantly different from the estimates.

(14) Rate Setting Matters and Business and Credit Concentrations

Foundation provides healthcare services through its inpatient and outpatient care facilities located throughout Maryland. Foundation grants credit to patients and generally does not require collateral or other security in extending credit; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits receivable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid, Blue Cross/Blue Shield, health maintenance organizations (HMOs), and commercial insurance policies).

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

	2019	2018
Medicare	8 %	8 %
Medicaid	46	44
Commercial insurers and HMOs	12	13
Local government	16	16
Blue Cross/Blue Shield	10	10
Self-pay and other	8	9
	100 %	100 %

(Continued)

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

		2019	2018
Medicare	$	9,447,252	9,491,310
Medicaid		8,931,171	8,358,532
Other third-party payors		6,506,333	6,018,604
	$	24,884,756	23,868,446

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

The Foundation is reimbursed for certain services to their Medicare and Medicaid program beneficiaries based upon cost reimbursement methodologies. The Maryland Medicaid program’s inpatient reimbursement methodology is a prospective payment system, which is set at 94% of HSCRC rates. Medicaid outpatient services continue to be reimbursed on a cost report basis. Effective July 1, 2005, the Medicare program changed its reimbursement methodology to a prospective payment system. Health System has received either the final settlement or the notice of final settlement on Medicare cost reports through June 30, 2016 and on Medicaid cost reports for all programs through June 30, 2016. As of June 30, 2019 and 2018, the Company has recorded third-party payor settlements receivable of $7,610,140 and $6,722,504 respectively.

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

During 2019 and 2018, some of Foundation’s prior year third-party cost reports were audited and settled, or tentatively settled, by third-party payors. Adjustments resulting from such audits and management reviews of unaudited years and open claims are reflected as adjustments to revenue in the year the adjustment becomes known. The effect of these adjustments was to increase net patient service revenue by approximately $400,978 and $252,515 during the years ended June 30, 2019 and 2018, respectively. Although certain other prior year cost reports submitted to third-party payors remain subject to audit and retroactive adjustment, management does not expect any material adverse settlements.

Patient accounts receivable are as follows at June 30:

		2019	2018
Patient accounts receivable, net of contractuals	$	22,033,046	21,804,584
Residential and educational accounts receivable, net of contractuals		17,356,992	16,246,606
Less allowance for doubtful accounts		(4,914,815)	(6,241,212)
Patient accounts receivable, net	$	34,475,223	31,809,978

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

		2019	2018
Beginning balance as of July 1	$	6,241,212	6,562,215
Provisions for bad debts		1,479,239	3,389,079
Less writeoffs		(2,805,636)	(3,710,082)
Ending balance as of June 30	$	4,914,815	6,241,212

(15) Functional Expenses

Members of Foundation provide healthcare, educational, and residential and psychiatric rehabilitative services to the communities they serve. Expenses related to providing these services, based on management's estimates of expense allocations, are as follows for the years ended June 30, 2019 and 2018:

	2019									
	Program Services									
	Healthcare Services	Residential Services	Education Services	Rehabilitation and Recovery	Community Treatment	Families and Communities	Community Development	Program Services	Supporting Services	Total
Expenses:										
Salaries and wages	$ 77,806,157	17,005,718	33,201,877	32,942,286	11,387,014	10,357,620	8,981,518	191,682,190	34,965,227	226,647,417
Employee benefits	15,418,415	3,471,179	7,871,439	6,074,399	1,890,749	1,889,699	2,178,687	38,794,567	8,155,564	46,950,131
Expendable supplies	8,969,128	1,909,454	2,196,730	2,674,161	221,900	1,400,136	716,774	18,088,283	1,299,653	19,387,936
Purchased services	16,173,495	1,767,241	4,303,649	10,452,260	1,507,392	3,106,568	2,364,674	39,675,279	17,937,996	57,613,275
Interest	1,066,269	201,468	569,601	174,700	2,154	19,527	21,141	2,054,860	1,232,853	3,287,713
Repairs and minor alterations	4,058,613	873,772	761,530	1,748,554	222,325	170,472	146,251	7,981,517	2,843,164	10,824,681
Depreciation and amortization	7,137,003	1,573,911	2,848,851	2,395,613	402,824	150,056	173,927	14,682,185	5,416,099	20,098,284
	$ 130,629,080	26,802,743	51,753,677	56,461,973	15,634,358	17,094,078	14,582,972	312,958,881	71,850,556	384,809,437

	2018									
	Program Services									
	Healthcare Services	Residential Services	Education Services	Rehabilitation and Recovery	Community Treatment	Families and Communities	Community Development	Program Services	Supporting Services	Total
Expenses:										
Salaries and wages	$ 78,472,279	14,118,201	32,097,992	32,441,469	11,309,263	11,514,972	8,309,370	188,263,546	34,425,612	222,689,158
Employee benefits	17,052,785	3,389,212	8,293,353	6,254,737	1,828,731	2,186,678	2,072,105	41,077,601	7,847,968	48,925,569
Expendable supplies	8,549,168	1,736,067	1,972,962	2,654,772	186,459	958,717	874,156	16,932,301	1,404,024	18,336,325
Purchased services	16,118,895	1,515,894	4,059,806	10,217,922	1,562,280	3,309,694	2,434,329	39,218,820	13,833,511	53,052,331
Interest	1,135,856	203,121	577,780	181,953	2,246	21,292	23,603	2,145,851	1,408,329	3,554,180
Repairs and minor alterations	3,998,702	725,076	793,833	1,627,615	206,037	196,803	138,735	7,686,801	2,831,689	10,518,490
Depreciation and amortization	6,622,725	1,363,649	2,925,812	2,201,554	399,286	219,992	182,885	13,915,903	5,264,514	19,180,417
	$ 131,950,410	23,051,220	50,721,538	55,580,022	15,494,302	18,408,148	14,035,183	309,240,823	67,015,647	376,256,470

(16) Certain Significant Risks and Uncertainties

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

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

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

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

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

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

As a result of recently enacted and pending federal healthcare reform legislation, substantial changes are anticipated in the U.S. healthcare system. Such legislation includes numerous provisions affecting the delivery of healthcare services, the financing of healthcare costs, reimbursement to healthcare providers and the legal obligations of health insurers, providers, and employers. These provisions are currently slated to take effect at specified times over the next decade.

(17) Endowment Net Assets

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

(a) Interpretation of Relevant Law

Foundation has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Foundation classifies its permanently restricted net assets as (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by SPMIFA. In accordance with SPMIFA, Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

(1) The duration and preservation of the fund

(2) The purposes of Foundation and the donor-restricted endowment fund

(3) General economic conditions

(4) The possible effect of inflation and deflation

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

(6) Other resources of Foundation

(7) The investment policies of Foundation

(b) Net Asset Classification by Type of Endowment as of June 30, 2019

		Without donor restrictions	With donor restrictions	Total
Donor-restricted endowment funds	$	—	3,968,378	3,968,378
Board-designated endowment funds		132,600,296	—	132,600,296
	$	132,600,296	3,968,378	136,568,674

Changes in endowment net assets for the year ended June 30, 2019:

		Without donor restrictions	With donor restrictions	Total
Endowment net assets, beginning of year	$	134,319,442	3,935,059	138,254,501
Investment return:				
Investment income		1,661,448	—	1,661,448
Net appreciation (realized and unrealized gains and losses)		1,176,370	15,444	1,191,814
Total investment return		2,837,818	15,444	2,853,262
Contributions		—	17,875	17,875
Appropriation of endowment assets for expenditure		(4,556,964)	—	(4,556,964)
	$	132,600,296	3,968,378	136,568,674

(c) Net Asset Classification by Type of Endowment as of June 30, 2018

		Without donor restrictions	With donor restrictions	Total
Donor-restricted endowment funds	$	—	3,935,059	3,935,059
Board-designated endowment funds		134,319,442	—	134,319,442
	$	134,319,442	3,935,059	138,254,501

(Continued)

Changes in endowment net assets for the year ended June 30, 2018:

		Without donor restrictions	With donor restrictions	Total
Endowment net assets, beginning of year	$	130,641,280	3,909,375	134,550,655
Investment return:				
Investment income		1,595,504	—	1,595,504
Net appreciation (realized and unrealized gains and losses)		6,456,226	8,108	6,464,334
Total investment return		8,051,730	8,108	8,059,838
Contributions		—	17,576	17,576
Appropriation of endowment assets for expenditure		(4,373,568)	—	(4,373,568)
	$	134,319,442	3,935,059	138,254,501

(d) Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or SPMIFA requires Foundation to retain as a fund of perpetual duration as a result of unfavorable market fluctuations. During the years ended June 30, 2019 and 2018, the fair value did not fall below the specified amounts.

(e) Investment Strategies

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

To satisfy its long-term rate-of-return objectives, Foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). Foundation employs a diversified asset allocation structure to achieve its long-term return objectives within prudent risk constraints.

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

(18) Liquidity

Foundation funds its operations through cash and investments. Foundation maintains a policy of structuring its financial assets to be available as its general expenditures, liabilities, and other obligations come due. Cash required to meet operating needs is invested in bank operating accounts. Community Services have access to variable rate lines of credit in the amount of $5,000,000 to support liquidity.

Foundation’s endowment funds consist of donor and board restricted endowments. Donor restricted endowments are restricted for specific purposes and, therefore, are not available for general expenditure. While it is not the intent of Foundation to utilize board restricted endowments to fund operations (other than spending policy), these funds, amounting to approximately $170,000,000, could be available to fund operations if needed. Foundation has an endowment spending rate policy of 4%. Approximately $4,700,000 of appropriations from this endowment will be available within the next 12 months to support liquidity.

The following is a reconciliation of current financial assets as of June 30, 2019 to financial assets available to fund general expenditures for the following fiscal year. General expenditures include all programmatic and supporting operating expenses.

Financial assets at year end:		
Current assets:		
Cash and cash equivalents	$	36,333,171
Investments limited or restricted as to use		553,333
Accounts receivable, net		34,475,223
Prepaid expenses and other current assets		15,489,857
Total current assets		86,851,584
Other:		
Investments		3,807,205
Line of credit		5,000,000
Subtotal		95,658,789
Less assets unavailable for general expenditures within one year:		
Investments limited or restricted as to use		(544,208)
Prepaid expenses		(5,651,009)
Financial assets available to meet cash needs for general expenditures within one year	$	89,463,572

(19) Subsequent Events

Foundation has evaluated all events and transactions from the balance sheet date through October 16, 2019, the date at which the consolidated financial statements were issued, and determined there are no other items to be recognized or disclosed.

SUPPLEMENTARY INFORMATION

Schedule 1

SHEPPARD AND ENOCH PRATT FOUNDATION, INC.
AND SUBSIDIARIES

Consolidating Balance Sheet Information

June 30, 2019

Assets	**Sheppard and Enoch Pratt Foundation, Inc.**	**Sheppard Pratt Health System, Inc.**	**Sheppard Pratt Investment, Inc.**	**Sheppard Pratt Physicians, P.A.**	**Obligated Group combining eliminations**	**Combined Obligated Group subtotal**	**Sheppard Pratt Properties, LLC**	**Eliminations**	**Subtotal**
Current assets:									
Cash and cash equivalents	$ 73,643	17,302,745	—	484,912	—	17,861,300	204,146	—	18,065,446
Investments limited or restricted as to use	118,127	—	—	—	—	118,127	—	—	118,127
Accounts receivable, net	—	27,365,020	—	1,002,815	—	28,367,835	—	—	28,367,835
Due from affiliates	1,149	725,757	2,780,704	308,935	(3,115,267)	701,278	—	—	701,278
Prepaid expenses and other current assets	—	7,298,972	—	1,064,385	—	8,363,357	—	—	8,363,357
Total current assets	192,919	52,692,494	2,780,704	2,861,047	(3,115,267)	55,411,897	204,146	—	55,616,043
Investments limited or restricted as to use, less current portion	16,587,003	148,606,228	134,996,131	—	—	300,189,362	—	(12,637,742)	287,551,620
Interest in net assets of Foundation	—	14,144,833	—	—	(14,144,833)	—	—	—	—
Notes receivable	—	—	1,614,104	—	—	1,614,104	—	—	1,614,104
Third-party payor settlements receivable	—	7,610,140	—	—	—	7,610,140	—	—	7,610,140
Property and equipment, net	—	188,974,775	—	—	—	188,974,775	12,563,442	—	201,538,217
Other assets	—	2,230,437	382,250	—	—	2,612,687	—	(1,192,007)	1,420,680
Total assets	$ 16,779,922	414,258,907	139,773,189	2,861,047	(17,260,100)	556,412,965	12,767,588	(13,829,749)	555,350,804
Liabilities and Net Assets									
Current liabilities:									
Current maturities of long-term debt	$ —	4,104,000	—	—	—	4,104,000	—	—	4,104,000
Current portion of obligations under capital leases	—	683,527	—	—	—	683,527	—	—	683,527
Accounts payable	—	8,843,711	—	143,558	—	8,987,269	40,562	—	9,027,831
Accrued salaries, wages and employee benefits	—	14,656,124	—	2,738,481	—	17,394,605	—	—	17,394,605
Due to affiliates	58,323	3,057,576	6,360,566	28	(3,115,267)	6,361,226	—	—	6,361,226
Self-insurance liabilities	—	3,745,371	—	232,829	—	3,978,200	—	—	3,978,200
Other accrued expenses	(750)	2,444,414	812,328	263,917	—	3,519,909	60,451	—	3,580,360
Total current liabilities	57,573	37,534,723	7,172,894	3,378,813	(3,115,267)	45,028,736	101,013	—	45,129,749
Long-term liabilities:									
Long-term debt, less current portion	—	168,773,447	—	—	—	168,773,447	—	—	168,773,447
Obligations under capitalized leases, less current portion	—	4,613,328	—	—	—	4,613,328	—	—	4,613,328
Self-insurance liabilities	—	8,138,802	—	—	—	8,138,802	—	—	8,138,802
Accrued pension liabilities	—	21,024,172	—	8,468,039	—	29,492,211	—	—	29,492,211
Other long-term liabilities	325,524	—	—	—	—	325,524	1,192,007	(1,192,007)	325,524
Total liabilities	383,097	240,084,472	7,172,894	11,846,852	(3,115,267)	256,372,048	1,293,020	(1,192,007)	256,473,061
Net assets (deficit):									
Without donor restrictions	1,920,086	160,029,602	132,600,295	(8,985,805)	—	285,564,178	11,474,568	(12,637,742)	284,401,004
With donor restrictions	14,476,739	14,144,833	—	—	(14,144,833)	14,476,739	—	—	14,476,739
Total net assets (deficit)	16,396,825	174,174,435	132,600,295	(8,985,805)	(14,144,833)	300,040,917	11,474,568	(12,637,742)	298,877,743
Total liabilities and net assets	$ 16,779,922	414,258,907	139,773,189	2,861,047	(17,260,100)	556,412,965	12,767,588	(13,829,749)	555,350,804

(Continued)

Schedule 1

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

Consolidating Balance Sheet Information

June 30, 2019

Assets		Family Services Inc.	Mosaic Community Services, Inc.	Way Station, Inc.	Consolidating eliminations	Consolidated totals
Current assets:						
Cash and cash equivalents	$	1,914,692	6,109,977	10,243,056	—	36,333,171
Investments limited or restricted as to use		137,848	9,125	288,233	—	553,333
Accounts receivable, net		2,224,365	1,915,161	1,967,862	—	34,475,223
Due from affiliates		1,781	601	—	(703,660)	—
Prepaid expenses and other current assets		235,990	4,860,858	2,029,652	—	15,489,857
Total current assets		4,514,676	12,895,722	14,528,803	(703,660)	86,851,584
Investments limited or restricted as to use, less current portion		—	4,066,943	6,386,844	(6,358,845)	291,646,562
Interest in net assets of Foundation		—	—	—	—	—
Notes receivable		—	—	—	—	1,614,104
Third-party payor settlements receivable		—	—	—	—	7,610,140
Property and equipment, net		9,196,324	20,397,186	21,953,769	—	253,085,496
Other assets		74,900	724,366	376,010	—	2,595,956
Total assets	$	13,785,900	38,084,217	43,245,426	(7,062,505)	643,403,842
Liabilities and Net Assets						
Current liabilities:						
Current maturities of long-term debt	$	219,328	972,001	465,112	—	5,760,441
Current portion of obligations under capital leases		—	—	—	—	683,527
Accounts payable		432,316	1,668,850	384,125	—	11,513,122
Accrued salaries, wages and employee benefits		1,407,285	4,096,833	2,074,670	—	24,973,393
Due to affiliates		244,205	172,357	284,717	(7,062,505)	—
Self-insurance liabilities		—	147,802	228,053	—	4,354,055
Other accrued expenses		482,439	555,112	479,880	—	5,097,791
Total current liabilities		2,785,573	7,612,955	3,916,557	(7,062,505)	52,382,329
Long-term liabilities:						
Long-term debt, less current portion		5,254,802	4,349,518	4,028,013	—	182,405,780
Obligations under capitalized leases, less current portion		—	—	—	—	4,613,328
Self-insurance liabilities		—	380,235	684,775	—	9,203,812
Accrued pension liabilities		—	—	—	—	29,492,211
Other long-term liabilities		106,012	672,802	2,180,614	—	3,284,952
Total liabilities		8,146,387	13,015,510	10,809,959	(7,062,505)	281,382,412
Net assets:						
Without donor restrictions		4,092,571	20,798,288	25,035,322	—	334,327,185
With donor restrictions		1,546,942	4,270,419	7,400,145	—	27,694,245
Total net assets		5,639,513	25,068,707	32,435,467	—	362,021,430
Total liabilities and net assets	$	13,785,900	38,084,217	43,245,426	(7,062,505)	643,403,842

See accompanying independent auditors' report.

Schedule 2

SHEPPARD AND ENOCH PRATT FOUNDATION, INC.
AND SUBSIDIARIES

Consolidating Statement of Operations Information

Year ended June 30, 2019

	Sheppard and Enoch Pratt Foundation, Inc.	Sheppard Pratt Health System, Inc.	Sheppard Pratt Investment, Inc.	Sheppard Pratt Physicians, P.A.	Obligated Group combining eliminations	Combined Obligated Group subtotal	Sheppard Pratt Properties, LLC	Eliminations	Subtotal
Revenues, gains, and other support:									
Patient service revenue (net of allowances and discounts)	$ —	139,162,243	—	14,099,829	—	153,262,072	—	—	153,262,072
Residential and educational service revenue (net of allowances)	—	93,452,778	—	16,150	—	93,468,928	—	—	93,468,928
Total net service revenue	—	232,615,021	—	14,115,979	—	246,731,000	—	—	246,731,000
Less provision for bad debts	—	212,035	—	217,983	—	430,018	—	—	430,018
Net service revenue less provision for bad debts	—	232,402,986	—	13,897,996	—	246,300,982	—	—	246,300,982
Net assets released from restrictions used for operations	—	576,564	—	—	—	576,564	—	—	576,564
Other revenue	17,998	11,355,120	—	15,510,297	(14,733,602)	12,149,813	138,464	—	12,288,277
Total revenues, gains, and other support	17,998	244,334,670	—	29,408,293	(14,733,602)	259,027,359	138,464	—	259,165,823
Expenses:									
Salaries and wages	—	125,822,660	—	28,274,182	—	154,096,842	—	—	154,096,842
Employee benefits	—	28,964,455	—	4,083,951	—	33,048,406	—	—	33,048,406
Expendable supplies	—	12,955,658	—	—	—	12,955,658	69,345	—	13,025,003
Purchased services	3,259	46,193,979	—	5,951,716	(14,899,618)	37,249,336	246,117	—	37,495,453
Interest	—	2,661,587	—	—	—	2,661,587	—	—	2,661,587
Repairs and minor alterations	—	7,720,117	—	—	—	7,720,117	94,022	—	7,814,139
Depreciation and amortization	—	15,141,193	—	—	—	15,141,193	491,780	—	15,632,973
Loss on disposal of assets, net	—	117,175	—	—	—	117,175	—	—	117,175
Total expenses	3,259	239,576,824	—	38,309,849	(14,899,618)	262,990,314	901,264	—	263,891,578
Operating income (loss)	14,739	4,757,846	—	(8,901,556)	166,016	(3,962,955)	(762,800)	—	(4,725,755)
Other income (expense):									
Investment income	—	367,330	1,661,448	—	(166,016)	1,862,762	—	—	1,862,762
Realized gain on investments, net	—	(144,520)	(591,928)	—	—	(736,448)	—	—	(736,448)
Change in unrealized gain on investments, net	—	567,967	2,326,042	—	—	2,894,009	—	—	2,894,009
Other	—	683,314	(557,744)	—	—	125,570	—	—	125,570
Total other income (expense)	—	1,474,091	2,837,818	—	(166,016)	4,145,893	—	—	4,145,893
Excess (deficiency) of revenues over expenses	14,739	6,231,937	2,837,818	(8,901,556)	—	182,938	(762,800)	—	(579,862)
Other changes in net assets:									
Net assets released from restrictions used for purchases of property and equipment	—	11,083	—	—	—	11,083	—	—	11,083
Transfer from (to) affiliates	—	(4,943,097)	(4,556,964)	9,500,061	—	—	—	—	—
Pension liability adjustment	—	(10,379,663)	—	—	—	(10,379,663)	—	—	(10,379,663)
Capital grants	—	—	—	—	—	—	—	—	—
Increase (decrease) in net assets without donor restrictions	$ 14,739	(9,079,740)	(1,719,146)	598,505	—	(10,185,642)	(762,800)	—	(10,948,442)

(Continued)

Schedule 2

SHEPPARD AND ENOCH PRATT FOUNDATION, INC.
AND SUBSIDIARIES

Consolidating Statement of Operations Information

Year ended June 30, 2019

	Family Services Inc.	Mosaic Community Services, Inc.	Way Station, Inc.	Consolidating eliminations	Consolidated totals
Revenues, gains, and other support:					
Patient service revenue (net of allowances and discounts)	$ —	—	—	—	153,262,072
Residential and educational service revenue (net of allowances)	12,817,159	36,701,295	27,348,141	—	170,335,523
Total net service revenue	12,817,159	36,701,295	27,348,141	—	323,597,595
Less provision for bad debts	335,144	562,655	151,421	—	1,479,238
Net service revenue less provision for bad debts	12,482,015	36,138,640	27,196,720	—	322,118,357
Net assets released from restrictions used for operations	23,645	12,087	121,062	10,000	743,358
Other revenue	12,310,071	27,687,111	7,980,028	(949,323)	59,316,164
Total revenues, gains, and other support	24,815,731	63,837,838	35,297,810	(939,323)	382,177,879
Expenses:					
Salaries and wages	13,986,057	35,775,834	22,788,684	—	226,647,417
Employee benefits	2,540,014	7,264,158	4,097,553	—	46,950,131
Expendable supplies	1,760,337	2,966,092	1,636,504	—	19,387,936
Purchased services	4,630,319	13,090,926	3,335,900	(939,323)	57,613,275
Interest	237,425	239,123	149,578	—	3,287,713
Repairs and minor alterations	470,531	1,699,133	840,878	—	10,824,681
Depreciation and amortization	817,951	2,305,296	1,235,927	—	19,992,147
Loss (gain) on disposal of assets, net	5,082	(16,021)	(99)	—	106,137
Total expenses	24,447,716	63,324,541	34,084,925	(939,323)	384,809,437
Operating income (loss)	368,015	513,297	1,212,885	—	(2,631,558)
Other income (expense):					
Investment income	—	108,279	193,578	—	2,164,619
Realized gain on investments, net	—	—	(27,363)	—	(763,811)
Change in unrealized gain on investments, net	—	98,605	107,525	—	3,100,139
Other	—	104,787	—	—	230,357
Total other income	—	311,671	273,740	—	4,731,304
Excess of revenues over expenses	368,015	824,968	1,486,625	—	2,099,746
Other changes in net assets:					
Net assets released from restrictions used for purchases of property and equipment	—	144,585	184,194	—	339,862
Transfer from (to) affiliates	—	—	—	—	—
Pension liability adjustment	—	—	—	—	(10,379,663)
Capital grants	—	27,748	—	—	27,748
Increase (decrease) in net assets without donor restrictions	$ 368,015	997,301	1,670,819	—	(7,912,307)

See accompanying independent auditors' report.

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

Consolidating Statement of Changes in Net Assets Information

Year ended June 30, 2019

	Sheppard and Enoch Pratt Foundation, Inc.	Sheppard Pratt Health System, Inc.	Sheppard Pratt Investment, Inc.	Sheppard Pratt Physicians, P.A.	Obligated Group combining eliminations	Combined Obligated Group subtotal	Sheppard Pratt Properties, LLC	Eliminations	Subtotal
Net assets without donor restrictions:									
Excess (deficiency) of revenues over expenses	$ 14,739	6,231,937	2,837,818	(8,901,556)	—	182,938	(762,800)	—	(579,862)
Other changes in net assets:									
Net assets released from restrictions used for purchases of property and equipment	—	11,083	—	—	—	11,083	—	—	11,083
Transfer from (to) affiliates	—	(4,943,097)	(4,556,964)	9,500,061	—	—	—	—	—
Pension liability adjustment	—	(10,379,663)	—	—	—	(10,379,663)	—	—	(10,379,663)
Capital grants and other	—	—	—	—	—	—	—	—	—
Increase (decrease) in net assets without donor restrictions	14,739	(9,079,740)	(1,719,146)	598,505	—	(10,185,642)	(762,800)	—	(10,948,442)
Net assets with donor restrictions:									
Gifts and grants	774,339	(135,841)	—	—	—	638,498	—	—	638,498
Investment income	79,561	11,596	—	—	—	91,157	—	—	91,157
Net realized gain on investments	(25,634)	—	—	—	—	(25,634)	—	—	(25,634)
Net unrealized gain on investments	100,732	—	—	—	—	100,732	—	—	100,732
Interest in net assets of Foundation	—	315,909	—	—	(315,909)	—	—	—	—
Transfer to affiliates	(597,647)	587,647	—	—	—	(10,000)	—	—	(10,000)
Net assets released from restrictions for operations	—	(576,564)	—	—	—	(576,564)	—	—	(576,564)
Net assets released from restrictions for purchases of property and equipment	—	(11,083)	—	—	—	(11,083)	—	—	(11,083)
Increase (decrease) in net assets with donor restrictions	331,351	191,664	—	—	(315,909)	207,106	—	—	207,106
Increase (decrease) in net assets	346,090	(8,888,076)	(1,719,146)	598,505	(315,909)	(9,978,536)	(762,800)	—	(10,741,336)
Net assets (deficit), beginning of year	16,050,735	183,062,511	134,319,441	(9,584,310)	(13,828,924)	310,019,453	12,237,368	(12,637,742)	309,619,079
Net assets (deficit), end of year	$ 16,396,825	174,174,435	132,600,295	(8,985,805)	(14,144,833)	300,040,917	11,474,568	(12,637,742)	298,877,743

Schedule 3

SHEPPARD AND ENOCH PRATT FOUNDATION, INC.
AND SUBSIDIARIES

Consolidating Statement of Changes in Net Assets Information

Year ended June 30, 2019

	Family Services Inc.	Mosaic Community Services, Inc.	Way Station, Inc.	Consolidating eliminations	Consolidated totals
Net assets without donor restrictions:					
Excess of revenues over expenses	$ 368,015	824,968	1,486,625	—	2,099,746
Other changes in net assets:					
Net assets released from restrictions used for purchases of property and equipment	—	144,585	184,194	—	339,862
Transfer from (to) affiliates	—	—	—	—	—
Pension liability adjustment	—	—	—	—	(10,379,663)
Capital grants and other	—	27,748	—	—	27,748
Increase (decrease) in net assets without donor restrictions	368,015	997,301	1,670,819	—	(7,912,307)
Net assets with donor restrictions:					
Gifts and grants	196,615	—	319,260	—	1,154,373
Investment income	—	9,324	—	—	100,481
Net realized gain on investments	—	—	—	—	(25,634)
Net unrealized gain on investments	—	—	—	—	100,732
Interest in net assets of Foundation	—	—	—	—	—
Transfer from affiliates	—	—	—	10,000	—
Net assets released from restrictions for operations	(23,645)	(12,087)	(121,062)	(10,000)	(743,358)
Net assets released from restrictions for purchases of property and equipment	—	(144,585)	(184,194)	—	(339,862)
Increase (decrease) in net assets with donor restrictions	172,970	(147,348)	14,004	—	246,732
Increase (decrease) in net assets	540,985	849,953	1,684,823	—	(7,665,575)
Net assets, beginning of year	5,098,528	24,218,754	30,750,644	—	369,687,005
Net assets, end of year	$ 5,639,513	25,068,707	32,435,467	—	362,021,430

See accompanying independent auditors' report.