

# **GARRETT REGIONAL MEDICAL CENTER**

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A PROUD AFFILIATE OF



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## **Consolidated Financial Statements**

**Years Ended June 30, 2018 and 2017**

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## **Independent Auditors' Report**

Board of Governors  
Garrett County Memorial Hospital  
Oakland, Maryland

We have audited the accompanying consolidated financial statements of Garrett County Memorial Hospital and subsidiaries, d/b/a Garrett Regional Medical Center, (collectively, the Company), which comprise the consolidated balance sheets as of June 30, 2018 and 2017, and the related consolidated statements of operations and other changes in unrestricted net assets, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### ***Management's Responsibility for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes 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 and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of June 30, 2018 and 2017, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

***Supplementary Schedules***

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating information is presented for purposes of additional analysis rather than to present the financial position, results of operations and cash flows of the individual companies 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 accompanying consolidating 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 accompanying consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated September 26, 2018, on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting and compliance.

*Dixon Hughes Goodman LLP*

**Charleston, West Virginia  
September 26, 2018**

**Garrett Regional Medical Center**  
**Consolidated Balance Sheets**  
**June 30, 2018 and 2017**

	<u>2018</u>	<u>2017</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 7,565,959	\$ 12,448,754
Short-term investments -- <i>Note 2</i>	15,180,958	13,752,625
Patient accounts receivable, net of allowance for doubtful accounts of \$2,680,000 and \$2,507,000 at June 30, 2018 and 2017, respectively -- <i>Note 11</i>	7,404,754	6,319,476
Other amounts receivable	658,052	514,240
Assets whose use is limited by donors and others -- <i>Note 2</i>	179,723	222,968
Inventories	1,344,510	1,261,130
Prepaid expenses	<u>730,185</u>	<u>672,358</u>
Total current assets	<u>33,064,141</u>	<u>35,191,551</u>
Noncurrent assets:		
Property and equipment, net -- <i>Note 4</i>	40,699,773	40,076,273
Insurance recoverable -- <i>Note 10</i>	870,876	599,001
Long-term investments -- <i>Note 2</i>	6,439,950	5,977,531
Investment in affiliates -- <i>Note 3</i>	420,487	352,876
Assets whose use is limited by donors and others, less current portion -- <i>Note 2</i>	389,969	678,943
Assets whose use is limited by board of governors -- <i>Note 2</i>	<u>698,000</u>	<u>698,000</u>
Total noncurrent assets	<u>49,519,055</u>	<u>48,382,624</u>
Total assets	<u>\$ 82,583,196</u>	<u>\$ 83,574,175</u>

See accompanying notes.

**Garrett Regional Medical Center**  
**Consolidated Balance Sheets**  
**June 30, 2018 and 2017**

**(Continued)**

	<u>2018</u>	<u>2017</u>
<b>LIABILITIES AND NET ASSETS</b>		
Current liabilities:		
Accounts payable	\$ 2,059,329	\$ 2,349,834
Accrued salaries and wages	2,994,123	2,826,628
Advances from third parties	461,745	484,507
Current portion of long-term debt -- <i>Note 5</i>	1,186,573	1,177,979
Other current liabilities -- <i>Note 10</i>	<u>477,358</u>	<u>311,044</u>
Total current liabilities	7,179,128	7,149,992
Long-term debt, net of \$45,349 and \$49,104 of unamortized debt issuance costs at June 30, 2018 and 2017, respectively, less current portion -- <i>Note 5</i>	14,098,652	13,795,995
Pension obligation -- <i>Note 7</i>	21,674,875	22,483,975
Other long-term liabilities -- <i>Note 10</i>	<u>1,465,315</u>	<u>1,114,775</u>
Total liabilities	<u>44,417,970</u>	<u>44,544,737</u>
Net assets:		
Unrestricted	37,488,745	38,416,269
Temporarily restricted -- <i>Note 6</i>	638,470	575,808
Permanently restricted -- <i>Note 13</i>	<u>38,011</u>	<u>37,361</u>
Total net assets	<u>38,165,226</u>	<u>39,029,438</u>
Total liabilities and net assets	<u>\$ 82,583,196</u>	<u>\$ 83,574,175</u>

See accompanying notes.

**Garrett Regional Medical Center**  
**Consolidated Statements of Operations and Other Changes in Unrestricted Net Assets**  
**Years Ended June 30, 2018 and 2017**

	<u>2018</u>	<u>2017</u>
Revenue:		
Net patient service revenue -- <i>Note 11</i>		
Patient service revenue		
(net of contractual allowances and discounts)	\$ 56,249,915	\$ 53,807,489
Less: provision for uncollectible accounts	(1,598,755)	(1,874,749)
	<u>54,651,160</u>	51,932,740
Other revenue	679,769	1,190,513
Net assets released from restriction for use in operations -- <i>Note 6</i>	<u>325,759</u>	<u>292,342</u>
Total revenue	<u>55,656,688</u>	<u>53,415,595</u>
Expenses -- <i>Note 12</i> :		
Salaries and wages	22,870,913	21,344,483
Employee benefits -- <i>Note 7</i>	8,780,364	7,119,441
Supplies	10,954,236	10,798,828
Utilities	768,389	666,922
Purchased services	9,633,330	7,283,764
Depreciation and amortization -- <i>Note 4</i>	4,156,131	3,679,721
Interest -- <i>Note 5</i>	157,566	138,491
Other expenses	<u>1,420,097</u>	<u>1,623,917</u>
Total operating expenses	<u>58,741,026</u>	<u>52,655,567</u>
(Loss) gain from operations	<u>(3,084,338)</u>	<u>760,028</u>
Other income (expense):		
Investment income -- <i>Note 2</i>	661,336	723,454
Equity in earnings of affiliates -- <i>Note 3</i>	127,612	87,624
Other	<u>(12,415)</u>	<u>240,493</u>
Total other income	<u>776,533</u>	<u>1,051,571</u>
Excess (deficit) of revenue over expenses	<u>(2,307,805)</u>	1,811,599
Net assets released from restriction for the purchase of property and equipment -- <i>Note 6</i>	76,275	543,954
Pension-related changes other than net periodic pension cost -- <i>Note 7</i>	<u>1,304,006</u>	<u>(5,501,018)</u>
Decrease in unrestricted net assets	<u>\$ (927,524)</u>	<u>\$ (3,145,465)</u>

See accompanying notes.

**Garrett Regional Medical Center**  
**Consolidated Statements of Changes in Net Assets**  
**Years Ended June 30, 2018 and 2017**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total Net Assets</u>
Balance, June 30, 2016	\$ 41,561,734	\$ 895,255	\$ 36,461	\$ 42,493,450
Excess revenue over expenses	1,811,599	-	-	1,811,599
Net assets released from restriction for the purchase of property and equipment -- <i>Note 6</i>	543,954	(543,954)	-	-
Pension-related changes other than net periodic pension cost -- <i>Note 7</i>	(5,501,018)	-	-	(5,501,018)
Contributions	-	516,849	900	517,749
Net assets released from restriction for use in operations -- <i>Note 6</i>	-	(292,342)	-	(292,342)
(Decrease) increase in net assets	<u>(3,145,465)</u>	<u>(319,447)</u>	<u>900</u>	<u>(3,464,012)</u>
Balance, June 30, 2017	38,416,269	575,808	37,361	39,029,438
Deficit of revenue over expenses	<b>(2,307,805)</b>	-	-	<b>(2,307,805)</b>
Net assets released from restriction for the purchase of property and equipment -- <i>Note 6</i>	<b>76,275</b>	<b>(76,275)</b>	-	-
Pension-related changes other than net periodic pension cost -- <i>Note 7</i>	<b>1,304,006</b>	-	-	<b>1,304,006</b>
Contributions	-	<b>464,696</b>	<b>650</b>	<b>465,346</b>
Net assets released from restriction for use in operations -- <i>Note 6</i>	-	<b>(325,759)</b>	-	<b>(325,759)</b>
(Decrease) increase in net assets	<u>(927,524)</u>	<u>62,662</u>	<u>650</u>	<u>(864,212)</u>
Balance, June 30, 2018	<u><b>\$ 37,488,745</b></u>	<u><b>\$ 638,470</b></u>	<u><b>\$ 38,011</b></u>	<u><b>\$ 38,165,226</b></u>

**Garrett Regional Medical Center**  
**Consolidated Statements of Cash Flows**  
**Years Ended June 30, 2018 and 2017**

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:		
Decrease in net assets	\$ (864,212)	\$ (3,464,012)
Adjustments to reconcile decrease in net assets to net cash and cash equivalents provided by operating activities:		
Realized and unrealized gains on investments	(468,526)	(610,571)
Restricted contributions	(465,346)	(517,749)
Depreciation and amortization	4,156,131	3,679,721
Amortization of debt issuance costs	3,755	3,755
Provision for uncollectible accounts	1,598,755	1,874,749
Earnings of affiliate investment	(127,612)	(87,624)
Loss on disposal of property and equipment	24,451	34,815
Pension-related changes other than net periodic pension cost	(1,304,006)	5,501,018
Change in:		
Patient accounts receivable	(2,684,033)	(1,861,566)
Inventories	(87,135)	(43,471)
Investments in trading securities	(1,090,007)	1,396,456
Prepaid expenses	(57,827)	(94,511)
Insurance recoverable	(271,875)	29,642
Other amounts receivable	(143,812)	(158,290)
Accounts payable	(290,505)	(124,209)
Accrued salaries and wages	167,495	250,183
Advances from third parties	(22,762)	(32,892)
Pension obligation	494,906	(131,449)
Other liabilities	516,854	5,131
Net cash and cash equivalents (used in) provided by operating activities	<u>(915,311)</u>	<u>5,649,126</u>
Cash flows from investing activities:		
Purchases of property and equipment	(4,843,500)	(6,442,115)
Proceeds from the sale of property and equipment	39,418	-
Net proceeds from affiliate investment	60,001	60,000
Net cash and cash equivalents used in investing activities	<u>(4,744,081)</u>	<u>(6,382,115)</u>
Cash flows from financing activities:		
Proceeds from the issuance of long-term debt	2,523,882	2,409,594
Repayments of long-term debt	(2,212,631)	(1,170,793)
Proceeds from restricted contributions	465,346	517,749
Net cash and cash equivalents provided by financing activities	<u>776,597</u>	<u>1,756,550</u>
Net (decrease) increase in cash and cash equivalents	<u>(4,882,795)</u>	<u>1,023,561</u>
Cash and cash equivalents, beginning of year	<u>12,448,754</u>	<u>11,425,193</u>
Cash and cash equivalents, end of year	<u>\$ 7,565,959</u>	<u>\$ 12,448,754</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	<u>\$ 119,555</u>	<u>\$ 99,562</u>
Equipment acquired with capital lease	<u>\$ -</u>	<u>\$ 114,288</u>

See accompanying notes.

## **Notes to Consolidated Financial Statements**

### **1. Organization and Summary of Significant Accounting Principles**

#### ***Organization***

Garrett County Memorial Hospital (the Hospital) is an instrumentality of Garrett County, Maryland. The Hospital was organized for charitable purposes and is exempt from income taxes as an instrumentality of Garrett County. In 2003, the Hospital formed and became the sole member of Professional Emergency Physician Services, LLC (PEPS), which is a limited liability company. The purpose of PEPS is to provide professional emergency services solely to the Hospital. In addition, the Hospital owns 100% of the outstanding shares of Garrett Community Health Services (GCHS), which is a for-profit corporation. GCHS had no activity for the years ended June 30, 2017 and 2016. In 2017, the Hospital formed and became sole member of Garrett Anesthesia Services, LLC (GAS) and Specialty Physicians of Garrett County, LLC (SPE). GAS was created to provide anesthesia services to patients undergoing surgical procedures at the Hospital. SPE is designed to facilitate the recruitment of physicians to provide specialty services for the benefit of patients served by the Hospital.

#### ***Principles of consolidation***

The consolidated financial statements include the accounts of Garrett County Memorial Hospital, Professional Emergency Physician Services, LLC, Garrett Anesthesia Services, LLC, Specialty Physicians of Garrett County, LLC, and Garrett Community Health Services, (collectively referred to as the Company and doing business as Garrett Regional Medical Center). All significant intercompany accounts and transactions have been eliminated in consolidation.

#### ***Basis of presentation***

The consolidated financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Contributions, including unconditional promises to give, with no donor-imposed restrictions are recognized in the period received as increases in unrestricted net assets. Contributions with donor-imposed restrictions are reported as increases in temporarily or permanently restricted net assets. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets.

Income and realized net gains (losses) on investments are reported as follows:

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

#### ***Net patient service revenue***

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered, after contractual adjustments. Patient accounts receivable include charges for amounts due from Medicare, Maryland Medical Assistance (Medicaid), Blue Cross, commercial insurers and self-pay patients (see Note 11). Contractual adjustments represent the differences between amounts billed as patient service revenue and amounts contracted with third party payers, and are accrued on an estimated basis in the period in which the related services are rendered and adjusted in future periods as final settlements are determined.

## **Garrett Regional Medical Center Notes to Consolidated Financial Statements**

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Rates charged are based primarily on rates established by the State of Maryland Health Services Cost Review Commission (HSCRC); accordingly, revenue reflects actual charges to patients based on rates in effect during the period in which the services are rendered (see Note 9).

The Company grants credit without collateral to its patients, most of whom are local residents insured under third-party payer agreements (see Note 11). Accounts receivable are reported at their net realizable value from third-party payers, patients, residents and others for services rendered. Allowances are provided for third-party payers based on estimated reimbursement rates. Allowances are also provided for uncollectible accounts based on an estimate of ultimate collectability. Write-off of uncollectible accounts is determined on a case-by-case basis after a review of the circumstances surrounding individual patient accounts.

### ***Allowance for uncollectible accounts***

The provision for uncollectible accounts is based upon management's judgmental assessment of historical and expected net collections considering business and general economic conditions in its service area, trends in healthcare coverage, and other collection indicators. On a relatively continuous basis, management assesses the adequacy of the allowance for uncollectible accounts based upon its review of accounts receivable payer category, payer agreement rate changes and other factors. The results of these assessments are used to make modifications to the provision for uncollectible accounts and to establish an appropriate allowance for uncollectible accounts.

For self-pay patients, the provision is based on an analysis of past experience related to collection rates of self-pay balances. The Company follows established guidelines for placing certain past-due patient balances with external collection agencies.

### ***Charity care***

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

The Hospital 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. Under current accounting standards, the Hospital is required to report the cost of providing charity care. The cost of charity care provided by the Hospital totaled \$2,150,465 and \$2,253,486 for the years ended June 30, 2018 and 2017, respectively. Rates charged by the Hospital for regulated services are determined based on an assessment of direct and indirect cost calculated pursuant to the methodology established by the HSCRC (see Note 9), and therefore the cost of charity services noted above for the Hospital are equivalent to its established rates for those services.

For any charity services rendered by the Company other than the regulated services of the Hospital, the cost of charity care is calculated by applying the estimated total cost-to-charge ratio for the non-Hospital services to the total amount of charges for services provided to patients benefitting from the charity care policies of the Company's non-Hospital affiliates.

The HSCRC established an uncompensated care fund whereby all hospitals were required to contribute 0.75% of revenues to this fund to help provide for the cost associated with uncompensated care for certain Maryland hospitals above the State average, and all Maryland hospitals have the same percentage of uncompensated care in rates. High uncompensated care hospitals receive funds and low uncompensated care hospitals provide funding. The Hospital had net receipts of \$1,173,646 and \$1,231,318 for 2018 and 2017, respectively, related to its participation in the uncompensated care fund mechanism.

### ***Advertising expense***

The Company expenses advertising costs as they are incurred.

**Garrett Regional Medical Center**  
**Notes to Consolidated Financial Statements**

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***Cash and cash equivalents***

Cash and cash equivalents include investments in certain highly liquid debt instruments with original maturities of three months or less when purchased. The Company has cash holdings in commercial banks that routinely exceed the Federal Deposit Insurance Corporation (FDIC) maximum insurance limit of \$250,000. Funds held in excess of the FDIC maximums are collateralized by the deposit institution. The Company has not experienced any losses related to funds held in excess of the FDIC limit.

***Inventories***

Inventories consist primarily of drugs and medical supplies and are carried at the lower of cost (first-in, first-out) or net realizable value.

***Donor-restricted funds***

Donor-restricted funds are used to differentiate resources, the use of which are limited by the donor, from resources on which the donor places no restriction or which arise as a result of the operation of the Hospital for its stated purposes. Restricted funds for care of needy patients and other temporarily restricted net assets are reflected in operating revenue to the extent restrictions have been met; net assets restricted for property and equipment are reclassified to the unrestricted net assets balance when those assets are acquired.

***Assets whose use is limited***

Assets limited as to use primarily consist of cash, certificates of deposit, pledges receivable and investments. Assets limited as to use include donor restricted assets, funds held by trustee and assets designated by the board of governors for future capital improvements, over which the board retains control and may, at its discretion, subsequently use for other purposes.

***Property and equipment***

Property and equipment are stated at cost, except for donated items which are recorded at fair value at the date of donation. Expenditures less than \$1,000 are expensed when incurred. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets. Equipment under capital lease obligations is amortized on a straight-line basis over the shorter period of the lease terms or the estimated useful lives of the equipment. Such amortization is included in depreciation in the accompanying consolidated financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is 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 unrestricted support, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are 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.

***Debt issuance costs***

Costs related to issuance of debt are deferred and amortized using the straight-line method, which approximates the effective interest rate method.

***Investments***

Investments are exposed to certain risks such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, changes in the value of investment securities could occur in the near term and these changes could materially differ from the amounts reported in the accompanying consolidated financial statements. Investments and assets whose use is limited, which are invested in marketable securities, are reported at their fair value, based on quoted market prices provided by the asset managers. Investment income or loss (including interest, dividends, and gains and losses, both real and unrealized, on

## **Garrett Regional Medical Center Notes to Consolidated Financial Statements**

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investment) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law (see Note 2).

### ***Investments in affiliates***

The Hospital maintains certain investments in unconsolidated entities. These investments are accounted for using the equity method (see Note 3).

### ***Excess (deficit) of revenue over expenses***

The accompanying consolidated statements of operations include excess deficit of revenue over expenses. Changes in unrestricted net assets which are excluded from excess (deficit) of revenue over expenses, consistent with industry practice, include unrealized gains and losses on other than trading securities, pension-related changes other than net periodic pension cost, any permanent transfers of assets to and from affiliates for other than goods or services and contributions of long lived assets (including assets required using contributions which by donor restriction were to be used for the purpose of acquiring such assets).

### ***Meaningful use incentive***

Under the provisions of the American Recovery and Reinvestment Act of 2009, incentive payments are available to certain healthcare providers that can demonstrate "meaningful use" of certified electronic health records technology. The Hospital recognized these incentive payments when reasonably assured of the ability to successfully demonstrate compliance with meaningful use criteria. The Hospital recognized approximately \$0 and \$519,622 of these incentive payments in other operating revenue in the accompanying consolidated financial statements for the years ended June 30, 2018 and 2017, respectively.

### ***Estimated malpractice costs***

The costs of professional and general liability insurance include estimates for both reported claims and claims incurred but not reported, based on the evaluation of pending claims and past experience (see Note 10).

### ***Use of estimates***

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

### ***Income taxes***

The Hospital has been recognized by the Internal Revenue Service (IRS) as tax exempt under Section 115 as an instrumentality of a political subdivision of the State of Maryland. GCHS is organized as a for-profit entity and, therefore, is subject to federal and state income taxes. GAS, SPE and PEPS have been treated as disregarded entities for tax purposes.

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

The Hospital had no unrecognized tax benefits or such amounts were immaterial during the periods presented. For tax periods with respect to which no unrelated business income was recognized, no tax return was required. No tax returns were filed for the Hospital during 2018 and 2017.

Management has also considered the impact of unrelated business activities and has concluded that the Hospital is not subject to unrelated business tax or any other taxes that could be imposed by the Internal Revenue Code or

## **Garrett Regional Medical Center Notes to Consolidated Financial Statements**

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state taxing authorities. As such, no provision is made for income taxes and no asset or liability has been recognized for deferred taxes.

### ***Subsequent events***

Management has evaluated the effect subsequent events would have on financial statements through September 26, 2018, which is the date the financial statements were available to be issued.

### ***Recent accounting pronouncements***

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-9, *Revenue from Contracts with Customers*, which provides a principles-based standard for recognizing revenue through a five-step process. This standard is effective for the Company, for fiscal year ending June 30, 2019. Management is currently evaluating the effects the adoption of this standard will have on the Hospital's consolidated financial statements and disclosures.

In November 2015, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 23): Restricted Cash*. The ASU requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash and restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flow. The ASU is effective for fiscal years beginning after December 15, 2017. The ASU should be applied retrospectively to all periods presented.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The amendments in this ASU revise the accounting related to lessee accounting. Under the new guidance, lessees will be required to recognize a lease liability and a right-of-use asset for all leases. The amendments in this ASU are effective for the Company beginning on July 1, 2020, with early adoption permitted, and should be applied through a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements.

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

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

The amendments in ASU 2016-14 are effective for the Company beginning on July 1, 2018.

Management has not yet determined the impact, if any, of adoption of these changes in accounting standards on the consolidated financial statements of the Company.

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**Notes to Consolidated Financial Statements**

**2. Investments and Assets Whose Use is Limited**

Investments and assets limited as to use consist of the following:

	<u>Investments</u>	<u>Assets whose use is limited by donors</u>	<u>Assets whose use is limited by the board of governors</u>	<u>Total</u>
At June 30, 2018:				
Cash and cash equivalents	\$ 196,055	\$ 3,655	\$ -	\$ 199,710
Certificates of deposit	9,046,913	574	698,000	9,745,487
Corporate bonds	1,072,376	10,389	-	1,082,765
Government securities	6,249,201	536	-	6,249,737
Mutual funds	3,585,252	34,733	-	3,619,985
Common stock	1,444,390	13,944	-	1,458,334
Preferred stock	26,721	259	-	26,980
Pledges receivable, net	-	505,602	-	505,602
	<u>21,620,908</u>	<u>569,692</u>	<u>698,000</u>	<u>22,888,600</u>
Less short-term portion	<u>15,180,958</u>	<u>179,723</u>	<u>-</u>	<u>15,360,681</u>
	<u>\$ 6,439,950</u>	<u>\$ 389,969</u>	<u>\$ 698,000</u>	<u>\$ 7,527,919</u>

	<u>Investments</u>	<u>Assets whose use is limited by donors</u>	<u>Assets whose use is limited by the board of governors</u>	<u>Total</u>
At June 30, 2017:				
Cash and cash equivalents	\$ 232,397	\$ 10,851	\$ -	\$ 243,248
Certificates of deposit	13,762,947	114	698,000	14,461,061
Corporate bonds	1,005,524	11,325	-	1,016,849
Government securities	24,475	276	-	24,751
Mutual funds	3,041,502	34,257	-	3,075,759
Common stock	1,636,365	18,374	-	1,654,739
Preferred stock	26,946	304	-	27,250
Pledges receivable, net	-	826,410	-	826,410
	<u>19,730,156</u>	<u>901,911</u>	<u>698,000</u>	<u>21,330,067</u>
Less short-term portion	<u>13,752,625</u>	<u>222,968</u>	<u>-</u>	<u>13,975,593</u>
	<u>\$ 5,977,531</u>	<u>\$ 678,943</u>	<u>\$ 698,000</u>	<u>\$ 7,354,474</u>

Assets whose use is limited include investments and pledges receivable. Board designated funds consist of certificates of deposit at June 30, 2018 and 2017.

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Pledges receivable are recorded net of an allowance for uncollectible pledges of \$40,844 and \$68,980 at June 30, 2018 and 2017, respectively. Pledges are recorded at their net present value and are due as follows at June 30, 2018:

2019	\$	187,338
2020		129,443
2021		78,360
2022		64,616
2023		43,144
After 2023		<u>107,476</u>
		610,377
Present value discount, at 2.65%		(63,931)
Allowance for uncollectible pledges		<u>(40,844)</u>
	\$	<u>505,602</u>

The investment return on the Company's investments and assets limited as to use consists of the following for the years ended June 30:

	<u>2018</u>	<u>2017</u>
Interest and dividends	\$ 192,810	\$ 112,883
Net realized gain	430,099	326,822
Net unrealized gain	<u>38,427</u>	<u>283,749</u>
	<u>\$ 661,336</u>	<u>\$ 723,454</u>

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

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

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

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial asset, including estimates of the timing, amount of expected future cash flows, and the credit standing of the issuer. In some cases, the fair value estimates cannot be substantiated by comparison to

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independent markets. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial asset. Furthermore, the disclosed fair values do not reflect any premium or discount that could result from offering for sale at one time an entire holding of a particular financial asset. Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in the amounts disclosed.

Fair values of the Company's government securities and corporate bonds are based on prices provided by its investment managers, who use a variety of pricing sources to determine market valuations. Each designate specific pricing services or indexes for each sector of the market based upon the provider's experience. The Company's government securities and corporate bonds portfolio is highly liquid, which allows for a high percentage of the portfolio to be priced through pricing services. Fair values of the Company's certificate of deposits are based on cost plus accrued interest, which in the opinion of management approximates fair value. Fair values of marketable equity securities (mutual funds and stock) have been determined by the Company from observable market quotations, when available. Private placement securities and other equity securities where a public quotation is not available are valued by using broker quotes.

The following table presents the Company's fair value hierarchy for assets measured at fair value on a recurring basis as of June 30, 2018:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Cash and cash equivalents	\$ 199,710	\$ -	\$ 199,710
Certificates of deposit	9,745,487	-	9,745,487
Corporate bonds	-	1,082,765	1,082,765
Government securities	-	6,249,737	6,249,737
Mutual funds	3,619,985	-	3,619,985
Common stock	1,458,334	-	1,458,334
Preferred stock	<u>26,980</u>	<u>-</u>	<u>26,980</u>
	<u>\$ 15,050,496</u>	<u>\$ 7,332,502</u>	<u>\$ 22,382,998</u>

The following table presents the Company's fair value hierarchy for assets measured at fair value on a recurring basis as of June 30, 2017:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Cash and cash equivalents	\$ 243,248	\$ -	\$ 243,248
Certificates of deposit	14,461,061	-	14,461,061
Corporate bonds	-	1,016,849	1,016,849
Government securities	-	24,751	24,751
Mutual funds	3,075,759	-	3,075,759
Common stock	1,654,739	-	1,654,739
Preferred stock	<u>27,250</u>	<u>-</u>	<u>27,250</u>
	<u>\$ 19,462,057</u>	<u>\$ 1,041,600</u>	<u>\$ 20,503,657</u>

The tables above do not include pledges receivables of \$505,602 and \$826,410 at June 30, 2018 and 2017, respectively. During 2018, the Company transferred approximately \$6,200,000 of financial instruments classified as Level 1 to purchase government securities. There were no transfers among the fair value levels during 2017.

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**Notes to Consolidated Financial Statements**

**3. Investments in Affiliates**

The Hospital maintains investments in joint ventures at June 30 as follows:

<u>Joint Venture</u>	<u>Type of organization</u>	<u>Business purpose</u>	<u>Percentage ownership</u>	
			<u>2017</u>	<u>2016</u>
Oakland MRI Center, LLC (OMRI)	For-profit	MRI and Dexa scan services	50%	50%
Freestate Healthcare Insurance Company, Ltd. (Freestate)	For-profit	Malpractice and professional liability insurance	20%	20%

In April 2004, the Hospital formed OMRI with Premier Imaging, LLC. The purpose of this joint venture is to provide MRI and Dexa Scan services to the local and surrounding communities. The Hospital made an initial capital contribution of \$162,000 in 2005. OMRI began operations in January 2006.

In December 2004, the Hospital joined Freestate along with seven other community hospitals from Maryland. Freestate is a Cayman Islands corporation formed for the purpose of providing insurance coverage to its members, their affiliates and their respective employees (see Note 10). The Hospital contributed \$15,000 of equity to Freestate during 2005.

The Hospital's investment balance and income in earnings of these joint ventures as of and for the year ended June 30 are as follows:

	<u>Investment balance</u>		<u>Income in earnings</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
OMRI	\$ 399,945	\$ 332,334	\$ 127,612	\$ 87,624
Freestate	<u>20,542</u>	<u>20,542</u>	<u>-</u>	<u>-</u>
	<u>\$ 420,487</u>	<u>\$ 352,876</u>	<u>\$ 127,612</u>	<u>\$ 87,624</u>

Summary combined financial information (unaudited) for these joint ventures as of and for the year ended June 30 is as follows:

	<u>2018</u>	<u>2017</u>
Current assets	\$ 36,214,417	\$ 29,535,970
Noncurrent assets	<u>14,200,436</u>	<u>18,057,263</u>
Total assets	<u>\$ 50,414,853</u>	<u>\$ 47,593,233</u>
Current liabilities	\$ 280,319	\$ 279,290
Noncurrent liabilities	49,231,932	46,546,563
Net worth	<u>902,602</u>	<u>767,380</u>
Total liabilities and net worth	<u>\$ 50,414,853</u>	<u>\$ 47,593,233</u>
Total operating revenue	\$ 7,455,125	\$ 7,608,603
Total operating expense	<u>7,212,330</u>	<u>7,442,465</u>
Net income	<u>\$ 242,795</u>	<u>\$ 166,138</u>

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**4. Property and Equipment**

Property and equipment and their related estimated useful lives as of June 30 are summarized as follows:

	<u>Estimated Useful life</u>	<u>2018</u>	<u>2017</u>
Land improvements	10 – 40 years	\$ 988,829	\$ 883,108
Buildings and improvements	15 – 40 years	46,387,142	42,337,826
Fixed equipment	5 – 20 years	5,735,014	5,074,051
Movable equipment	3 – 20 years	21,453,583	20,587,631
Equipment under capital lease	lease term	<u>138,282</u>	<u>138,282</u>
		<b>74,702,850</b>	69,020,898
Less accumulated depreciation and amortization		<u>(35,664,084)</u>	<u>(32,434,106)</u>
		<b>39,038,766</b>	36,586,792
Land		1,259,605	1,208,170
Construction in progress		<u>401,402</u>	<u>2,281,311</u>
		<b><u>\$ 40,669,773</u></b>	<b><u>\$ 40,076,273</u></b>

Depreciation and amortization expense for the years ended June 30, 2018 and 2017 was \$4,156,131 and \$3,679,721, respectively.

**5. Long-Term Debt**

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

	<u>2018</u>	<u>2017</u>
Series 2015 bonds	\$ 4,333,290	\$ 3,181,146
Series 2014 bonds	7,999,999	8,666,666
USDA bonds	2,293,672	2,371,899
Series 2004 bonds	591,767	666,810
Capital lease obligations	<u>111,846</u>	<u>136,557</u>
	<b>15,330,574</b>	15,023,078
Less unamortized debt issuance cost	<u>(45,349)</u>	<u>(49,104)</u>
	<b>15,284,785</b>	14,973,974
Less current portion	<u>(1,186,573)</u>	<u>(1,177,979)</u>
	<b><u>\$ 14,098,652</u></b>	<b><u>\$ 13,795,995</u></b>

**Series 2015 Bonds**

On December 23, 2015, the Garrett County (the County) issued the Garrett County Memorial Hospital Refunding Bonds, Series 2015 (Series 2015 Bonds), on behalf of the Hospital for the purpose of renovating various areas of the Hospital. The Series 2015 Bonds represent a supplemental loan agreement between the Hospital and the County for amounts that are equal to the loan principal of the County's Series 2015 Bonds. Series 2015 Bonds incur interest at a fixed interest rate of 3.53% per annum. Interest accrues based on the average outstanding principal

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balance and is paid semi-annually. Annual principal payments are due on the anniversary date of issuance based on a twenty-five year amortization period. On December 23, 2030, the Series 2015 Bonds mature and all outstanding principal balances and interest are due.

***Series 2014 Bonds***

On November 26, 2014, the County issued the Garrett County Memorial Hospital Refunding Bonds, Series 2014 (Series 2014 Bonds), on behalf of the Hospital for the purpose of renovating and constructing a new wing of the Hospital. The Series 2014 Bonds represent a supplemental loan agreement between the Hospital and the County for amounts that are equal to the loan principal of the County's Series 2014 Bonds. Series 2014 Bonds incur interest at a fixed interest rate of 3.53% per annum. Interest accrues based on the average outstanding principal balance and is paid semi-annually. Annual principal payments are due on the anniversary date of issuance based on a twenty-five year amortization period. On November 26, 2029, the Series 2014 Bonds mature and all outstanding principal balances and interest are due.

***United States Department of Agriculture (USDA) Bonds***

In June 2007, the County issued the Garrett County Memorial Hospital Refunding Bonds, Series 2007 (Series 2007 Bonds), on behalf of the Hospital for the purpose of providing funding for the Hospital's Emergency Room/Same Day Surgery/Admissions construction and renovation project. The Series 2007 Bonds represent a supplemental loan agreement between the Hospital and the County for amounts that are equal to the loan principal of the Garrett County Series 2007 Bonds. The funds were provided to the County from the USDA. Funding from the Series 2007 Bonds was also used to refinance other outstanding indebtedness.

The Series 2007 Bonds bear interest at an average rate of approximately 4.13%. Bond principal and interest payments are made in monthly installments to a trustee to meet the payment schedule stipulated in the loan agreement. The Series 2007 Bonds mature June 28, 2037.

***Series 2004 Bonds***

In November 2004, the County issued County Commissioners of Garret County Hospital Refunding Bonds, Series 2004 (Series 2004 Bonds), on behalf the Hospital for the purpose of refunding a portion of other outstanding indebtedness. The Series 2004 Bonds represent a supplemental loan agreement between the Hospital and the County for amounts that are equal to the loan principal of the County's Series 2004 Bonds.

The Series 2004 Bonds incur interest at a rate of 4.12% per annum. Bond principal and interest payments are made in semiannual installments to a trustee to meet the payment schedule stipulated in the loan agreement. The Series 2004 Bonds matures on November 19, 2024.

Aggregate maturities of all long-term debt (including capital leases) as of June 30, 2018 are as follows:

2019	\$	1,186,573
2020		1,195,660
2021		1,205,288
2022		1,206,437
2023		1,189,307
Thereafter		<u>9,347,309</u>
	\$	<u>15,330,574</u>

The Company is subject to certain restrictive covenants defined in various agreements with lenders. In the opinion of management, the Company was in compliance with applicable restrictive covenants as of June 30, 2018 and 2017.

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**Capital Leases**

The Company periodically enters into various leases for equipment that meet the criteria for capitalization under current accounting standards.

**6. Temporarily Restricted Net Assets**

Temporarily restricted net assets of \$638,470 and \$575,808 at June 30, 2017 and 2016, respectively, are restricted primarily for property replacement, expansion, and health care clinical services. Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors as follows during the years ended June 30:

	<u>2018</u>	<u>2017</u>
Health care clinical services	\$ 325,759	\$ 292,342
Plant replacement and expansion	<u>76,275</u>	<u>543,954</u>
	<u>\$ 402,034</u>	<u>\$ 836,296</u>

**7. Pension Plan**

The Hospital has a noncontributory defined benefit pension plan (the Plan) covering all employees of the Hospital who work at least twenty hours per week. Benefits are based on the participants' credited service and average monthly earnings. The Hospital's funding policy is to contribute an amount annually that is equal to the normal cost plus interest on the unfunded accrued liability. The Internal Revenue Service classifies the Plan as a government plan, and the Plan, as such, is exempt from the requirements of the Employee Retirement Income Security Act of 1974. The Hospital uses a June 30 measurement date for the Plan. The Hospital intends to contribute approximately \$1,300,000 to \$1,400,000 for fiscal year 2018. The assumption changes increasing the discount rate and rate of compensation increase for 2018 compared to 2017 resulted in a reduction in the net loss included in unrestricted net assets of \$2,014,000.

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

	<u>2018</u>	<u>2017</u>
Projected benefit obligation at beginning of year	\$ 48,108,636	\$ 42,255,338
Service cost	1,357,653	1,239,709
Interest	1,658,867	1,360,776
Assumption change	(700,500)	6,555,668
Benefits paid	<u>(1,750,704)</u>	<u>(3,302,855)</u>
Projected benefit obligation at end of year	<u>\$ 48,673,952</u>	<u>\$ 48,108,636</u>

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

	<u>2018</u>	<u>2017</u>
Fair value of Plan assets at beginning of year	\$ 25,624,661	\$ 25,140,932
Actual return on Plan assets	1,492,050	2,164,046
Employer contribution	1,633,070	1,622,538
Benefits paid	<u>(1,750,704)</u>	<u>(3,302,855)</u>
Fair value of Plan assets at end of year	<u>\$ 26,999,077</u>	<u>\$ 25,624,661</u>
Funded status	<u>\$ (21,674,875)</u>	<u>\$ (22,483,975)</u>
Net loss included in unrestricted net assets	<u>\$ 19,527,308</u>	<u>\$ 20,831,314</u>
Accumulated benefit obligation	<u>\$ 43,816,772</u>	<u>\$ 43,372,694</u>

The components of the net periodic benefit cost consist of the following for the years ended June 30:

	<u>2018</u>	<u>2017</u>
Service cost	\$ 1,357,653	\$ 1,239,709
Interest cost	1,658,867	1,360,776
Expected return on assets held in the plan	(1,781,338)	(2,010,026)
Amortization of net loss	<u>892,794</u>	<u>900,630</u>
	<u>\$ 2,127,976</u>	<u>\$ 1,491,089</u>

The assumptions used in the accounting for the benefit obligation are as follows at June 30:

	<u>2018</u>	<u>2017</u>
Discount rate	4.17%	3.86%
Rate of compensation increase	3.00%	2.86%

The weighted average assumptions used in the accounting for the net periodic benefit cost are as follows for the years ended June 30:

	<u>2018</u>	<u>2017</u>
Discount rate	4.17%	3.86%
Rate of compensation increase	3.00%	2.86%
Expected long-term return on plan assets	7.00%	7.00%

The Hospital's weighted average asset allocations for Plan assets are as follows at June 30:

	<u>2018</u>	<u>2017</u>
Equity securities	56%	59%
Fixed maturity securities	40%	40%
Other	<u>4%</u>	<u>1%</u>
Total plan assets	<u>100%</u>	<u>100%</u>

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Plan assets are invested in accordance with the investment policy statement objectives in an attempt to maximize return with reasonable and prudent levels of risk. This structure includes various asset classes, investment management styles, asset allocation and acceptable ranges that, in total, are expected to produce a sufficient level of overall diversification and total investment return. The Hospital periodically reviews performance to test progress toward attainment of longer-term targets, compare results to appropriate indices and peer groups, and assess overall investment risk levels. The target weighted-average asset allocation of pension investments is 55% equity securities, 40% debt securities and 5% other. Fixed maturity securities primarily include corporate bonds. Equity securities primarily include investments in large-cap and mid-cap companies and common stock which are valued by observable market quotations.

The fair values of the Hospital's Plan assets as June 30, 2018 by asset category are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Cash and Cash Equivalents	\$ 956,011	\$ -	\$ 956,011
Fixed Income:			
Corporate Bonds	-	7,670,604	7,670,604
Municipal Bonds	-	1,962,205	1,962,205
Mutual Funds	949,266	-	949,266
Equity Securities:			
Mutual Funds	4,314,136	-	4,314,136
Common Stocks	7,300,871	-	7,300,871
Exchange Traded Funds	<u>3,845,984</u>	-	<u>3,845,984</u>
	<u>\$ 17,366,268</u>	<u>\$ 9,632,809</u>	<u>\$ 26,999,077</u>

The fair values of the Hospital's Plan assets as of June 30, 2017 by asset category are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Cash and Cash Equivalents	\$ 423,093	\$ -	\$ 423,093
Fixed Income:			
Corporate Bonds	-	6,637,699	6,637,699
Municipal Bonds	-	1,926,148	1,926,148
Mutual Funds	1,306,431	-	1,306,431
Equity Securities:			
Mutual Funds	4,915,306	-	4,915,306
Common Stocks	6,383,508	-	6,383,508
Exchange Traded Funds	<u>4,032,476</u>	-	<u>4,032,476</u>
	<u>\$ 17,060,814</u>	<u>\$ 8,563,847</u>	<u>\$ 26,624,661</u>

There were no transfers between or among the fair value levels during 2018 and 2017.

The following benefit payments, which reflect expended future service, as appropriate, are expected to be paid:

2019	\$ 1,927,844
2020	1,959,575
2021	1,960,429
2022	1,962,520
2023	1,969,381
2024	1,970,290
2025 - 2029	<u>11,094,813</u>
	<u>\$ 22,844,852</u>

## **8. Certain Significant Risks and Uncertainties**

The Hospital provides general acute health care services in Garrett County, Maryland. The Company and other health care providers in Maryland are subject to certain inherent risks, including the following:

- Dependence on revenues derived from reimbursement by the federal Medicare and state Medicaid programs (*see Note 11*);
- Regulation of hospital rates by the State of Maryland Health Services Cost Review Commission (*see Note 9*);
- Government regulation, government budgetary constraints and proposed legislative and regulatory changes; and
- Lawsuits alleging malpractice and related claims (*see Note 10*).

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

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

The healthcare industry is subject to numerous laws and regulation from federal, state and local governments, and the government has increased enforcement of Medicare and Medicaid anti-fraud and abuse laws, as well as physician self-referral laws and regulations. The Company'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.

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

The Company is subject to certain legal proceedings and claims arising in the ordinary course of business. After consultation with legal counsel, it is management's opinion that the ultimate resolution of these claims will not have a material adverse effect on the Company's financial position.

## **9. Maryland Health Services Cost Review Commission**

The Hospital's rate structure applicable to regulated services is subject to review and approval by the Maryland HSCRC. Effective July 1, 2016, the Hospital entered into a Global Budget Revenue (GBR) agreement with the HSCRC. The GBR agreement will renew each year for a one-year period unless it is cancelled by the HSCRC or by the Hospital. The GBR agreement provides the Hospital with a fixed revenue amount (CAP) under which it must operate each year. The CAP is adjusted annually for inflation, change in the Hospital's payer mix and uncompensated care, change in population and quality incentives. Approximately 95% of the gross patient revenue of the Hospital is subject to the GBR system.

The rate variances, plus penalties where applicable, are applied to decreases (in the case of overcharges) or increases (in the case of undercharges) prospectively in future approved rates on an annual basis. Under GBR, the Hospital has the ability (within limits) to adjust rates to charge patients more or less than the gross patient service revenue approved for each year.

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The Hospital's policy is to accrue revenue based on actual charges for services to patients in the year in which the services are performed and billed.

The Commission has jurisdiction over hospital reimbursement in Maryland by agreement with the Centers for Medicare and Medicaid Services (CMS). This agreement is based on a waiver from the Medicare Prospective Payment System reimbursement principles granted under Section 1814(b) of the Social Security Act. On January 10, 2015 Maryland's All-Payer Hospital System Modernization was approved by CMS. This is a five-year demonstration where Maryland agreed to permanently shift away from its former statutory waiver, which is based on Medicare payment per inpatient admission, in exchange for the new CMS model based on Medicare per capita total hospital cost growth.

## **10. Insurance**

### ***Malpractice insurance***

The Company is involved in litigation arising in the normal course of business. Claims alleging malpractice have been asserted against the Company and are currently in various stages of litigation. Additional claims may be asserted against the Company arising from services provided through June 30, 2018. Management believes that no material loss will result from any pending or threatened litigation or from incidents incurred but not reported. However, the ultimate outcome is unknown.

In accordance with current accounting standards, the Company reports gross insurance recoveries separately from the related claims liability for professional liability claims already reported to its insurance carrier. As of June 30, 2018 and 2017, the Company recorded insurance recoverable and professional claim liability of \$870,876 and \$599,001, respectively, as both an asset and other long-term liability in the accompanying consolidated financial statements.

An estimated liability for incurred but not reported professional liability claims has been recorded in the amount of approximately \$421,000 and \$383,000 for the years ended June 30, 2018 and 2017, respectively. These amounts are included in other long-term liabilities in the accompanying consolidated financial statements. Management believes this accrual is adequate to provide for all professional liability claims that have been incurred through June 30, 2018, but not reported to its insurance carrier.

Effective March 1, 2005, the Hospital became a shareholder of the newly formed Freestate Healthcare Insurance Company, Ltd. (Freestate), a captive insurance company formed in the Cayman Islands by eight Maryland hospitals. The Hospital became a shareholder of Freestate when the Hospital's insurance company decided not to continue to write insurance policies for hospitals within the State of Maryland effective March 1, 2005. The Hospital believes that becoming a shareholder of the captive insurance company provides the best long-term solution to providing insurance coverage that is cost effective and predictable. Freestate provides insurance coverage on a claims-made basis to its owners for professional liability claims and comprehensive general liability of \$1,000,000 for each and every claim. Freestate has entered into reinsurance and excess policy agreements with independent insurance companies to limit its losses for professional liability and comprehensive general liability claims. Freestate has \$2,000,000 of additional insurance in the aggregate through such reinsurance arrangements which is applicable to the Hospital. Retrospective premium assessments and credits are calculated based on the aggregate experience of all named insureds under the policy. Each named insured's assessment or credit is based on the percentage of their actual exposure to the actual exposure of all named insureds. If the financial condition of Freestate were to materially deteriorate in the future, and Freestate was unable to pay its claim obligations, the payment of such claims would be the responsibility of the member hospitals. The estimated cost of claims is actuarially determined based upon past experience and discounted using a discount rate of 3.5% in 2018 and 2017. Effective September 1, 2016, coverage was expanded to include the operations of GAS and SPE.

PEPS' malpractice insurance is provided by a commercial insurance carrier. The policy provides coverage of \$1,000,000 for each event, with a physician aggregate of \$3,000,000 and a \$5,000,000 policy aggregate.

**Garrett Regional Medical Center**  
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***Health insurance***

The Company is self-insured for employee health claims. Under the self-insurance plan, the Company has accrued a liability of \$376,023 and \$243,027 for the years ended June 30, 2018 and 2017 for incurred but not reported claims. These amounts are included in other current liabilities in the accompanying consolidated financial statements. Management believes that the accruals are adequate to provide for all employee health claims that have been incurred for the years ended June 30, 2018 and 2017.

**11. Business and Credit Concentrations**

The Company provides health care services through its inpatient and outpatient care facilities located in Oakland, Maryland. The Company grants credit to patients, substantially all of whom are local residents. The Company 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, managed care organizations (MCOs) and commercial insurance policies).

At June 30, the Company had patient accounts receivable, net of contractual allowances from third-party payers and others, as follows:

	<u>2018</u>	<u>2017</u>
Self-pay and others	\$ 2,335,161	\$ 2,170,628
Medicare	3,250,627	2,701,393
Commercial insurance and MCOs	2,123,997	1,941,503
Medicaid	1,454,930	1,416,021
Blue Cross	<u>919,965</u>	<u>597,058</u>
	<b>10,084,680</b>	8,826,602
Allowance for doubtful accounts	<u>(2,679,926)</u>	<u>(2,507,126)</u>
	<b><u>\$ 7,404,754</u></b>	<b><u>\$ 6,319,476</u></b>

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

	<u>2018</u>	<u>2017</u>
Medicare	51%	48%
Commercial insurance and MCOs	18%	18%
Blue Cross	10%	11%
Medicaid	19%	20%
Self-pay and others	<u>2%</u>	<u>3%</u>
	<b><u>100%</u></b>	<b><u>100%</u></b>

**Garrett Regional Medical Center**  
**Notes to Consolidated Financial Statements**

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**12. Functional Expenses**

The Company provides general health care services to residents within its geographic location. Expenses related to providing these services, based on management's estimates of expense allocations, are as follows for the years ended June 30:

	<u>2018</u>	<u>2017</u>
Health care services	\$ 49,518,940	\$ 44,361,512
General and administrative	<u>9,222,086</u>	<u>8,294,055</u>
	<u>\$ 58,741,026</u>	<u>\$ 52,655,567</u>

**13. Endowment**

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

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

The Board of Governors of the Company has interpreted the Maryland State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Company classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets (if any) 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, the Company considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

5. The duration and preservation of the fund
6. The purposes of the Company and the donor-restricted endowment fund
7. General economic conditions
8. The possible effect of inflation and deflation
9. The expected total return from income and the appreciation of investments
10. Other resources of the Company
11. The investment policies of the Company

From time to time, the fair value of assets associated with the endowment fund may fall below the level that the donor or SPMIFA required the Company to retain as a fund of perpetual duration. There were no such deficiencies as of June 30, 2018 or 2017.

The Company has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity. Under this policy,

**Garrett Regional Medical Center**  
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as approved by the Board of Governors, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the Lehman Intermediate Government/Corporate Bond index while assuming a moderate level of investment risk. The Company expects its endowment funds, over time, to provide an average rate of return of approximately 8% percent annually. Actual returns in any given year may vary from this amount.

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

The endowment's net asset composition and the changes therein were as follows:

	2018			2017		
	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Endowment Total</u>	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Endowment Total</u>
Beginning balance	\$ 18,290	\$ 37,361	\$ 55,651	\$ 14,627	\$ 36,461	\$ 51,088
Interest and dividends	2,488	-	2,488	3,663	-	3,663
Contributions	-	650	650	-	900	900
Ending Balance	<u>\$ 20,778</u>	<u>\$ 38,011</u>	<u>\$ 58,789</u>	<u>\$ 18,290</u>	<u>\$ 37,361</u>	<u>\$ 55,651</u>

***Other Financial Information***



## **Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed In Accordance with Government Auditing Standards**

The Board of Governors  
Garrett County Memorial Hospital  
Oakland, Maryland

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Garrett County Memorial Hospital and subsidiaries, d/b/a Garrett Regional Medical Center, (collectively, the Company), which comprise the consolidated balance sheet as of June 30, 2018, and the related consolidated statements of operations and other changes in unrestricted net assets, changes in net assets and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated September 26, 2018.

### ***Internal Control Over Financial Reporting***

In planning and performing our audit of the consolidated financial statements, we considered the Company's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

### ***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether the Company's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

***Purposes of this Report***

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Dixon Hughes Goodman LLP*

**Charleston, West Virginia  
September 26, 2018**

**Garrett Regional Medical Center  
Consolidating Balance Sheets  
June 30, 2018**

	Garrett County Memorial Hospital	Professional Emergency Physician Services, LLC	Garrett Anesthesia Services, LLC	Specialty Physicians of Garrett County, LLC	Elimination Entries	Consolidated
<b>ASSETS</b>						
Current assets:						
Cash and cash equivalents	\$ 7,279,050	\$ 65,807	\$ 98,873	\$ 122,229	\$ -	\$ 7,565,959
Short-term investments	15,180,958	-	-	-	-	15,180,958
Patient accounts receivable, net	6,918,146	146,994	203,557	136,057	-	7,404,754
Other amounts receivable	657,689	363	-	-	-	658,052
Assets whose use is limited by donors	179,723	-	-	-	-	179,723
Inventories	1,344,510	-	-	-	-	1,344,510
Prepaid expenses	655,009	59,437	9,558	6,181	-	730,185
Due from affiliates	9,450,345	-	-	-	(9,450,345)	-
Total current assets	41,665,430	272,601	311,988	264,467	(9,450,345)	33,064,141
Noncurrent assets:						
Property and equipment	40,442,171	-	-	257,602	-	40,699,773
Insurance recoverable	870,876	-	-	-	-	870,876
Long-term investments	6,439,950	-	-	-	-	6,439,950
Investment in affiliates	420,487	-	-	-	-	420,487
Assets whose use is limited by donors, less current portion	389,969	-	-	-	-	389,969
Assets whose use is limited by board of governors	698,000	-	-	-	-	698,000
Deferred financing costs, net	-	-	-	-	-	-
Total noncurrent assets	49,261,453	-	-	257,602	-	49,519,055
Total assets	<u>\$ 90,926,883</u>	<u>\$ 272,601</u>	<u>\$ 311,988</u>	<u>\$ 522,069</u>	<u>\$ (9,450,345)</u>	<u>\$ 82,583,196</u>
<b>LIABILITIES AND NET ASSETS</b>						
Current liabilities:						
Accounts payable	\$ 1,913,646	\$ 77,586	\$ 50,952	\$ 17,145	\$ -	\$ 2,059,329
Accrued salaries and wages	2,602,457	149,036	113,151	129,479	-	2,994,123
Due to affiliates	-	3,019,347	4,352,241	2,078,757	(9,450,345)	-
Advances from third parties	461,745	-	-	-	-	461,745
Current portion of long-term debt	1,185,954	-	-	619	-	1,186,573
Other current liabilities	451,877	1,201	-	24,280	-	477,358
Total current liabilities	6,615,679	3,247,170	4,516,344	2,250,280	(9,450,345)	7,179,128
Long-term debt, net of unamortized debt issuance costs, less current portion						
	14,095,637	-	-	3,015	-	14,098,652
Pension obligation	21,674,875	-	-	-	-	21,674,875
Other long-term liabilities	1,323,273	142,042	-	-	-	1,465,315
Total liabilities	43,709,464	3,389,212	4,516,344	2,253,295	(9,450,345)	44,417,970
Net assets (deficit):						
Unrestricted	46,540,938	(3,116,611)	(4,204,356)	(1,731,226)	-	37,488,745
Temporarily restricted	638,470	-	-	-	-	638,470
Permanently restricted	38,011	-	-	-	-	38,011
Total net assets (deficit)	47,217,419	(3,116,611)	(4,204,356)	(1,731,226)	-	38,165,226
Total liabilities and net assets	<u>\$ 90,926,883</u>	<u>\$ 272,601</u>	<u>\$ 311,988</u>	<u>\$ 522,069</u>	<u>\$ (9,450,345)</u>	<u>\$ 82,583,196</u>

**Garrett Regional Medical Center  
Consolidating Statements of Operations  
Year Ended June 30, 2018**

	Garrett County Memorial Hospital	Professional Emergency Physician Services, LLC	Garrett Anesthesia Services, LLC	Specialty Physicians of Garrett County, LLC	Elimination Entries	Consolidated
Revenue:						
Net patient service revenue						
Patient service revenue (net of contractual allowances and discounts)	\$ 51,444,857	\$ 1,985,294	\$ 1,421,592	\$ 1,398,172	\$ -	\$ 56,249,915
Less: provision for uncollectible accounts	(1,249,072)	(242,690)	(56,895)	(50,098)	-	(1,598,755)
	50,195,785	1,742,604	1,364,697	1,348,074	-	54,651,160
Other revenue	1,020,245	764	-	61,518	(402,758)	679,769
Net assets released from restriction for use in operations	325,759	-	-	-	-	325,759
Total revenue	51,541,789	1,743,368	1,364,697	1,409,592	(402,758)	55,656,688
Expenses:						
Salaries and wages	19,017,530	1,340,965	1,494,479	1,051,804	(33,865)	22,870,913
Employee benefits	8,107,025	229,904	225,313	218,122	-	8,780,364
Supplies	10,790,459	219	3,141	160,417	-	10,954,236
Utilities	751,718	3,080	3,184	10,407	-	768,389
Purchased services	7,134,068	868,317	1,454,384	176,561	-	9,633,330
Depreciation and amortization	4,092,356	-	-	63,775	-	4,156,131
Interest	156,231	-	-	1,335	-	157,566
Management fees	-	160,618	46,913	161,362	(368,893)	-
Other expenses	1,100,875	69,200	136,683	113,339	-	1,420,097
Total expenses	51,150,262	2,672,303	3,364,097	1,957,122	(402,758)	58,741,026
Gain (loss) from operations	391,527	(928,935)	(1,999,400)	(547,530)	-	(3,084,338)
Other income (expense):						
Investment income	661,271	65	-	-	-	661,336
Equity in earnings of affiliates	127,612	-	-	-	-	127,612
Other	(12,415)	-	-	-	-	(12,415)
Total other income	776,468	65	-	-	-	776,533
Excess (deficit) revenue over expenses	<u>\$ 1,167,995</u>	<u>\$ (928,870)</u>	<u>\$ (1,999,400)</u>	<u>\$ (547,530)</u>	<u>\$ -</u>	<u>\$ (2,307,805)</u>

**DHG**