Consolidated Financial Statements and Supplementary Information

Frederick Regional Health System, Inc. and Subsidiaries
Years Ended June 30, 2018 and 2017
With Report of Independent Auditors

Ernst & Young LLP

Building a better working world

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Consolidated Financial Statements
and Supplementary Information

Years Ended June 30, 2018 and 2017

Contents

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Report of Independent Auditors

The Board of Directors
Frederick Regional Health System, Inc. and Subsidiaries

We have audited the accompanying consolidated financial statements of Frederick Regional Health System, Inc. and Subsidiaries, which comprise the consolidated balance sheets as of June 30, 2018 and 2017, 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 financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Monocacy Insurance, Ltd., a wholly owned subsidiary, which statements reflect total assets of $17,643,829 and $17,151,561 as of June 30, 2018 and 2017, respectively, and net loss after elimination of intercompany revenues of $3,273,203 and $3,007,016, respectively, for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Monocacy Insurance, Ltd., is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

Opinion

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Frederick Regional Health System, Inc. and subsidiaries at June 30, 2018 and 2017, and the consolidated results of their operations, changes in their net assets, and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying supplementary information is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the 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. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Ernst & Young LLP

October 10, 2018

Frederick Regional Health System, Inc. and Subsidiaries

Consolidated Balance Sheets

(In Thousands)

	June 30 2018	June 30 2017
Assets		
Current assets:		
Cash and cash equivalents	**$ 32,772**	$ 26,610
Patient receivables, net	**49,211**	47,039
Other receivables	**2,017**	3,046
Inventory	**5,779**	5,749
Prepaid expenses	**2,592**	2,995
Assets limited as to use	**3,267**	9,163
Promises to give, net	**981**	1,272
Total current assets	**96,619**	95,874
Net property and equipment	**237,197**	247,592
Other assets:		
Assets limited as to use	**1,294**	1,708
Investments – donor restricted	**2,729**	2,429
Promises to give, net	**4,559**	4,823
Long-term investments	**161,254**	150,554
Other investments	**12,566**	12,006
Other assets	**7,087**	6,812
Total other assets	**189,489**	178,332
Total assets	**$ 523,305**	$ 521,798

	June 30	
	2018	**2017**
Liabilities and net assets		
Current liabilities:		
Current maturities of long-term debt, line of credit, and capital lease obligations	**$ 5,013**	$ 11,861
Accounts payable	**26,570**	32,127
Accrued expenses	**24,327**	20,933
Advances from third-party payors	**8,027**	7,719
Other current liabilities	**2,909**	2,596
Total current liabilities	**66,846**	75,236
Long-term liabilities, net of current portion:		
Long-term debt and capital lease obligations	**174,573**	182,112
Interest rate swap contract	**6,706**	9,559
Accrued pension expense	**14,475**	18,747
Other long-term liabilities	**21,500**	22,220
Total long-term liabilities, net of current portion	**217,254**	232,638
Total liabilities	**284,100**	307,874
Net assets:		
Unrestricted	**230,938**	205,402
Temporarily restricted	**7,291**	7,546
Permanently restricted	**976**	976
Total net assets	**239,205**	213,924
Total liabilities and net assets	**$ 523,305**	$ 521,798

See accompanying notes.

Frederick Regional Health System, Inc. and Subsidiaries

Consolidated Statements of Operations

(In Thousands)

	Year Ended June 30	
	2018	**2017**
Unrestricted revenue and other support:		
Net patient service revenue	**$ 417,855**	$ 397,260
Provision for bad debts	**(11,873)**	(10,506)
Net patient service revenue less provision for bad debts	**405,982**	386,754
Other operating revenue	**9,581**	7,898
Gifts, bequests, and contributions	**3,323**	2,722
Net assets released from restrictions	**208**	100
Total unrestricted revenue and other support	**419,094**	397,474
Operating expenses:		
Salaries and wages	**158,792**	145,378
Employee benefits	**33,661**	33,567
Professional fees	**16,144**	15,899
Cost of goods sold	**61,541**	60,495
Supplies	**11,221**	10,557
Contract services	**75,544**	76,812
Other	**13,269**	14,128
Utilities	**4,525**	4,174
Insurance	**3,436**	3,428
Depreciation and amortization	**25,128**	23,791
Interest	**5,224**	4,391
Total operating expenses	**408,485**	392,620
Operating income	**10,609**	4,854
Other income, net:		
Gain on sale of assets	**13**	31
Loss on extinguishment of debt	**–**	(122)
Investment gain, net	**7,774**	6,604
Change in unrealized (losses) gains on trading securities, net	**(1,272)**	3,232
Realized and unrealized gains on interest rate swap contact, net	**1,271**	2,505
Periodic pension expense	**(2,038)**	(2,859)
Pension settlement expense	**(3,544)**	(3,911)
Other nonoperating loss, net	**(205)**	(426)
Total other income, net	**1,999**	5,054
Excess of unrestricted revenue and other support over expenses	**12,608**	9,908
Other changes in unrestricted net assets:		
Pension adjustment	**10,633**	9,503
Released from restriction used to purchase capital	**2,295**	6,344
Total other changes in unrestricted net assets	**12,928**	15,847
Increase in unrestricted net assets	**$ 25,536**	$ 25,755

See accompanying notes.

Frederick Regional Health System, Inc. and Subsidiaries

Consolidated Statements of Changes in Net Assets
(In Thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Net assets, June 30, 2016	$ 179,647	$ 12,297	$ 976	$ 192,920
Excess of unrestricted revenue and other support over expenses	9,908	–	–	9,908
Pension adjustment	9,503	–	–	9,503
Released from restriction used to purchase capital	6,344	(6,344)	–	–
Assets released from restrictions	–	(100)	–	(100)
Restricted gifts, bequests, and contributions	–	1,693	–	1,693
Changes in net assets	25,755	(4,751)	–	21,004
Net assets, June 30, 2017	205,402	7,546	976	213,924
Excess of unrestricted revenue and other support over expenses	**12,608**	**–**	**–**	**12,608**
Pension adjustment	**10,633**	**–**	**–**	**10,633**
Released from restriction used to purchase capital	**2,295**	**(2,295)**	**–**	**–**
Assets released from restrictions	**–**	**(208)**	**–**	**(208)**
Restricted gifts, bequests, and contributions	**–**	**2,248**	**–**	**2,248**
Changes in net assets	**25,536**	**(255)**	**–**	**25,281**
Net assets, June 30, 2018	**$ 230,938**	**$ 7,291**	**$ 976**	**$ 239,205**

See accompanying notes.

Frederick Regional Health System, Inc. and Subsidiaries

Consolidated Statements of Cash Flows
(In Thousands)

	Year Ended June 30	
	2018	**2017**
Operating activities		
Changes in net assets	**$ 25,281**	$ 21,004
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Loss on the refunding of debt	**–**	122
Depreciation of property and equipment	**25,128**	23,791
Amortization of original issue discount, premium, and bond issue costs	**(70)**	(73)
Loss on joint ventures and Premier noncash component	**1,233**	1,983
Gain on sale of property and equipment	**(7)**	(13)
Change in unrealized losses (gains) on trading securities, net	**1,272**	(5,827)
Proceeds from realized gains on investments – trading	**(7,776)**	(7,011)
Increase in investments – trading	**(4,496)**	(2,357)
Proceeds from restricted contributions	**(300)**	(6,444)
Realized and unrealized gains in interest rate swap, net	**(1,271)**	(2,505)
Changes in operating assets and liabilities:		
Receivables, patient, and other	**(1,143)**	907
Other assets	**(274)**	(727)
Inventories and prepaids	**373**	639
Pledges receivable	**555**	322
Accounts payable	**(5,557)**	583
Accrued expenses	**3,394**	1,245
Accrued pension expense	**(4,272)**	(6,140)
Advances from third-party payors	**308**	(1,263)
Other short-term liabilities	**313**	659
Other long-term liabilities	**(720)**	2,853
Net cash provided by operating activities	**31,971**	21,748
Investing activities		
Decrease (increase) in assets limited as to use, non-trading, net	**6,310**	(7,367)
Realized losses on interest rate swap contract	**(1,582)**	(1,994)
Increase in other investments	**(1,793)**	(1,497)
Purchases of property and equipment	**(15,416)**	(54,687)
Net proceeds from sale of assets	**689**	–
Net cash used in investing activities	**(11,792)**	(65,545)
Fundraising and financing activities		
Proceeds from restricted contributions	**300**	6,444
Repayments of long-term debt	**(14,080)**	(65,251)
Deferred financing costs paid	**(237)**	(356)
Proceeds from borrowing	**–**	95,045
Net cash (used in) provided by fundraising and financing activities	**(14,017)**	35,882
Net increase (decrease) in cash and cash equivalents	**6,162**	(7,915)
Cash and cash equivalents at the beginning of the year	**26,610**	34,525
Cash and cash equivalents at the end of the year	**$ 32,772**	$ 26,610
Supplemental disclosures		
Property and equipment acquired under capital lease	$ –	$ –
Cash paid for interest	**$ 5,657**	$ 5,199

See accompanying notes.

1. Organization and Mission

Frederick Regional Health System, Inc. (the System) is a not-for-profit parent corporation formed on June 23, 2011, exempt from income tax under Section 501(a) of the Internal Revenue Code (the Code) as an organization described in Section 501(c)(3) whereby only unrelated business income as defined by Section 512(a)(1) of the Code is subject to federal income tax. The System has received a determination letter from the Internal Revenue Service (IRS) stating that it is exempt from federal income taxes under Section 501(c) of the Code.

Frederick Memorial Hospital, Inc. (FMH) is a not-for-profit hospital, exempt from federal income tax under Section 501(a) of the Code as an organization described in Section 501(c)(3) whereby only unrelated business income as defined by Section 512(a)(1) of the Code is subject to federal income tax. FMH is located in Frederick, Maryland, and provides health care services primarily to residents of Frederick County. FMH has received a determination letter from the IRS stating that it is exempt from federal income taxes under Section 501(c) of the Code.

Monocacy Insurance, Ltd. (MIL) is a Cayman Islands-domiciled single-parent captive incorporated on May 24, 2011, and holds an Unrestricted Class B insurance license issued under Section 7(2) of the Cayman Island Insurance Law. MIL directly provides primary medical professional liability and primary general liability coverage to the System.

Monocacy Health Partners, LLC (MHP) serves as a physician enterprise, providing governance, management, and support functions for employed physicians. MHP is a not-for-profit corporation, formed on June 23, 2011, and operational as of October 1, 2013, exempt from income tax under Section 501(a) of the Code as an organization described in Section 501(c)(3) whereby only unrelated business income as defined by Section 512(a)(1) of the Code is subject to federal income tax. MHP has received a determination letter from the IRS stating that it is exempt from federal income taxes under Section 501(c) of the Code.

Frederick Health Services Corporation (FHSC) is a Maryland for-profit corporation, all of the stock of which is owned by the System. FHSC is subject to federal and state income taxes. No provision for income taxes has been recorded for 2018 or 2017 due to the availability of net operating loss carryforwards. FHSC recorded a net deferred tax asset of $411 and $613 as of June 30, 2018 and 2017, respectively, which is presented in other assets on the consolidated balance sheet.

1. Organization and Mission (continued)

On March 25, 2014, Frederick Integrated Healthcare Network, LLC (FIHN) was formed and is operated exclusively as a charitable organization for charitable, scientific, and educational purposes within the meaning of Section 501(c)(3) of the Code and the Regulations thereunder as they now exist or as they may hereafter be amended. FIHN was formed to maintain and operate a program of clinical integration and an accountable care organization among health care providers. FIHN is a single-member LLC and a disregarded entity of FRHS for income tax purposes.

The Obligated Group for repayment of the Maryland Health and Higher Educational Facilities Authority (MHHEFA) Series 2012A, Series 2017A, and 2017B Bonds includes FMH, MHP, and FRHS.

On July 7, 2014, Frederick Memorial Hospital, Meritus Health, and Western Maryland Health System established Trivergent Health Alliance (THA), the parent company to Trivergent Health Alliance MSO (MSO). MSO is a managed services organization that provides regional health care services. The purpose of MSO is to increase operational efficiencies, reduce costs, and enhance the quality of care by focusing efforts in the following areas: human resources, information technology, laboratory services, materials management, pharmacy services, and revenue cycle. The information technology area returned to the three individual hospitals during December 2017 and is no longer provided by THA. FMH contributed working capital of $100 to THA and $900 to the MSO for a 33% ownership interest, which is presented in other assets on the consolidated balance sheets. Upon establishment of the MSO, all employees within the six service areas transferred employment from FMH to the MSO. The related cost to purchase the service from the MSO is recorded on the consolidated statement of operations within contract services for the years ended June 30, 2018 and 2017. The System paid a total of $32,377 and $35,229 to the MSO during the years ended June 30, 2018 and 2017, respectively.

2. Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts and transactions of the System and its wholly owned subsidiaries: FMH, MIL, FHSC, MHP, and FIHN.

2. Significant Accounting Policies (continued)

FMH has two wholly owned subsidiaries: Hospice of Frederick County, Inc. (HFC) and Emmitsburg Properties, LLC, both of which have been consolidated with FMH into the System in the accompanying consolidated financial statements. HFC, an independent 501(c)(3) organization controlled by FMH, operates as a fundraising organization for the benefit of hospice services and operates the Kline Hospice House. Emmitsburg Properties, LLC is inactive with no transactions or balances in the accompanying consolidated financial statements.

FHSC has three wholly owned subsidiaries: Rosehill of Frederick, LLC and Corporate Occupational Health Solutions, LLC, which are for-profit limited liability companies, and Frederick Surgical Services Corporation, all of which have been consolidated with FHSC into the System in the accompanying consolidated financial statements.

The accompanying consolidated financial statements include the accounts of the System and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP). Certain prior year balances have been reclassified to conform to the current year's presentation.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported 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. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets if restricted for capital or reported in the statements of operations as net assets released from restrictions if restricted for operating purposes. Donations received with no restrictions and donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated statements of operations as other operating revenues.

2. Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less. Those money market funds that are classified as long-term investments are excluded from cash and cash equivalents.

Patient Receivables and Allowances

The System's policy is to write off all patient accounts that have been identified as uncollectible. An allowance for doubtful accounts is recorded for accounts not yet written off that are anticipated to become uncollectible. Insurance coverage and credit information is obtained from patients when available. No collateral is obtained for accounts receivable.

When determining the allowance, the System considers the collectibility of accounts based on past experience, taking into account contractually due amounts from third-party payors and current collection trends on third-party and self-pay receivables. Self-pay receivables include both patients without insurance and patients with deductible and co-payment balances due for which third-party coverage exists for part of the bill. Credit risks are assessed based on historical write-offs, net of recoveries, as well as an analysis of the aged accounts receivable balances with allowances generally increasing as the receivable ages. The analysis of receivables is performed monthly, and the allowances are adjusted accordingly.

Inventory

Inventory is stated at the lower of cost or net realizable value. Cost is determined using the first-in, first-out method.

Cost of Goods Sold

Cost of goods sold consists primarily of drugs, medical supplies, and surgical implants used in the care and treatment of patients.

2. Significant Accounting Policies (continued)

Investments and Assets Limited as to Use

The fair values of individual investments are based on quoted market prices of individual securities or investments or estimated amounts using quoted market prices of similar investments. Private equity investments and hedge funds are carried at cost. Realized and unrealized investment returns from all unrestricted investments and assets limited as to use are included in the consolidated statements of operations as part of nonoperating gains and losses. Investment income (loss) on investments of temporarily and permanently restricted assets is added to or deducted from the appropriate restricted fund balance if the income is restricted. The cost of securities sold is based on the specific-identification method. Investments are classified as either current or noncurrent based on maturity dates and availability for current operations.

Substantially all of the System's investment portfolio (excluding certain assets limited as to use) is classified as trading, with unrealized gains and losses included in excess of unrestricted revenue and other support over expenses. Certain trusteed assets that are included in assets limited as to use are classified as other than trading. These assets primarily consist of funds held for payment of principal and interest on bonds and deferred compensation trusts.

Investment Risk and Uncertainties

The System invests in professionally managed portfolios that contain corporate bonds, U.S. government obligations, municipal obligations, asset-backed securities, marketable equity securities, hedge funds, money market funds, private equity, and alternative investments. Such investments are exposed to various risks, such as interest rate, market, and credit. Due to the level of risk associated with such investments and the level of uncertainty related to changes in the value of such investments, it is at least reasonably possible that changes in risks in the near term would materially affect investment balances and the amounts reported in the consolidated financial statements.

Property and Equipment

Property and equipment are carried at historical cost. Items acquired by gift are recorded at fair value at the time of acquisition. Depreciation is recorded using the straight-line method over the estimated useful lives of the depreciable assets. Leasehold improvements are amortized using the straight-line method over the shorter of the lease term or the estimated useful lives of the assets.

2. Significant Accounting Policies (continued)

Valuation of Long-Lived Assets

The System accounts for the valuation of long-lived assets under Accounting Standards Codification (ASC) 360-10-45, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This guidance requires that long-lived assets and certain identifiable intangible assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Recoverability of the long-lived asset is measured by a comparison of the carrying amount of the asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Assets to be disposed of are reportable at the lower of the carrying amount or fair value, less costs to sell.

Debt Issuance Costs

Debt issuance costs related to the Series 2012 and Series 2017 MHHEFA Bonds are being amortized over the life of the debt using the effective-interest method and are netted in long-term debt in the consolidated balance sheets.

Patient Service Revenue and Allowances

The System has agreements with third-party payors that provide for payments to the System for patient services at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated adjustments under reimbursement agreements with third-party payors. Estimated adjustments are accrued in the period the related services are rendered and are adjusted in future periods as final settlements are determined.

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

2. Significant Accounting Policies (continued)

Other Operating Revenue

During fiscal year 2018, FIHN received approximately $5,100 in Medicare shared savings from the Centers for Medicare and Medicaid Services (CMS), of which approximately $3,400 was recorded in other operating revenue on a consolidated basis at FRHS and the remaining $1,700 was distributed to providers participating in the accountable care organization (ACO) and not employed by FRHS.

Performance Indicator

The performance indicator is the excess of unrestricted revenue and other support over expenses. Changes in unrestricted net assets, consistent with industry practice, include pension adjustments and net assets released from restriction for capital purposes.

Fair Value of Financial Instruments

The carrying amounts reported on the accompanying consolidated balance sheets for cash and cash equivalents, other receivables, accounts payable, accrued expenses, and advances from third-party payors approximate their fair values. The fair values of the System's notes receivable, revenue bond notes, and other long-term debt approximate the carrying amounts, based on loans with similar terms and average maturities.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure 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.

2. Significant Accounting Policies (continued)

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This guidance is intended to improve and converge with international standards the financial reporting requirements for revenue from contracts with customers. It will be effective for fiscal year 2019, and early adoption is permitted beginning in fiscal year 2018. The System has determined the adoption of this ASU will not have a material impact on the System's consolidated results of operations, financial position, and cash flows.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which requires various changes to the measurement and disclosure of equity investments. For the System, the most relevant change under ASU 2016-01 is that certain private equity and hedge fund investments that are currently accounted for using the cost method will be measured at fair value beginning in the first quarter of fiscal 2019. Any changes in the fair value of these securities will be recognized in net income during each reporting period. The System is currently evaluating the impact of its adoption on the accompanying consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*. This ASU amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets. It will be effective for fiscal year 2020, and early adoption is permitted beginning in fiscal year 2019. The System is currently assessing the potential impact this ASU will have on the System's consolidated results of operations, financial position, and cash flows.

In March 2017, FASB issued ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The ASU amends ASC 715, *Compensation – Retirement Benefits*, to require employers that present a measure of operating income in their statement of income to include only the service cost component of net periodic pension cost and net periodic postretirement benefit cost in operating expenses (together with other employee compensation costs). The other components of net benefit cost, including amortization of prior service cost/credit, and settlement and curtailment effects, are to be included in nonoperating expenses. The ASU is effective for fiscal years beginning after December 15, 2017, for public business entities, and early adoption is permitted. The System adopted this standard in fiscal year 2018 on a retrospective basis, resulting in a $5,582 and $6,770 increase in operating income and decrease in other income for fiscal years 2018 and 2017, respectively.

(Dollars in Thousands)

3. Patient Receivables and Patient Service Revenue

Patient receivables consist of the following at June 30:

	2018	2017
Gross patient receivables	**$ 69,029**	$ 65,570
Less estimated uncollectible accounts and contractual allowances	**(19,818)**	(18,531)
Net patient receivables	**$ 49,211**	$ 47,039

Patient service revenue consists of the following for the years ended June 30:

	2018	2017
Inpatient charges	**$ 239,541**	$ 226,245
Outpatient charges	**280,584**	276,976
Gross charges	**520,125**	503,221
Less contractual and other allowances	**(94,856)**	(97,726)
Less charity care	**(7,414)**	(8,235)
Net patient service revenue	**417,855**	397,260
Less provision for bad debts	**(11,873)**	(10,506)
Net patient service revenue less provision for bad debts	**$ 405,982**	$ 386,754

The System provides care to patients who meet certain criteria under its charity care policy. The System charges at its established rates but waives all or a portion of reimbursement. Because the System does not pursue collection of amounts determined to qualify as charity care, these revenues are not reported as net patient service revenue. Using the cost to charge ratio to approximate cost, charity care provided for the years ended June 30, 2018 and 2017, was $5,664 and $6,065, respectively. The state of Maryland rate system includes components within the rates to partially compensate hospitals for uncompensated care.

(Dollars in Thousands)

4. Assets Limited as to Use

A summary of assets that are limited as to use substantially for debt service and deferred compensation trusts at June 30 is as follows:

	2018	2017
Current:		
Principal, interest, and other – bonds	**$ 3,074**	$ 3,104
Construction funds	**99**	6,008
Loss escrow account	**94**	51
	$ 3,267	$ 9,163
Noncurrent:		
Deferred compensation trusts	**$ 1,294**	$ 1,708
	$ 1,294	$ 1,708

The assets that are limited as to use consist of the following at June 30:

	2018	2017
Current:		
Cash and money market accounts	**$ 3,173**	$ 9,112
Mutual funds	**94**	51
	$ 3,267	$ 9,163
Noncurrent:		
Corporate or other bonds	**$ 35**	$ 199
Mutual funds	**1,259**	1,509
	$ 1,294	$ 1,708

The noncurrent assets limited as to use mutual funds are primarily invested in equities and bonds chosen by deferred compensation plan participants.

(Dollars in Thousands)

5. Promises to Give

Promises to give are discounted and are due as follows at June 30:

	2018	2017
Less than one year	**$ 1,154**	$ 1,496
One to five years	**3,729**	3,825
More than five years	**2,736**	3,151
	7,619	8,472
Less discounting and allowance for uncollectible promises	**2,079**	2,377
Total promises to give, net	**5,540**	6,095
Less current portion of promises to give, net	**981**	1,272
	$ 4,559	$ 4,823

Promises to give include $1,225 and $1,039 for the years ended June 30, 2018 and 2017, respectively, related to charitable remainder trusts. This net amount represents the excess of the fair value of the related trust accounts over the net present value of the annuities to be paid out of the trust to the named beneficiaries over their estimated life expectancy.

6. Investments

Long-term investments represent unrestricted investments and unrestricted income earned on unrestricted, temporarily restricted, and permanently restricted investments.

Donor-restricted investments are designated by the donors for expenses relating to capital projects, replacement or improvement of existing assets, or to cover the cost of services rendered as charity care and other programs.

(Dollars in Thousands)

6. Investments (continued)

Long-term and donor-restricted investments consist of the following at June 30:

	2018		2017	
	Cost	**Fair Value**	**Cost**	**Fair Value**
Cash and cash equivalents	**$ 9,076**	**$ 9,059**	$ 6,616	$ 6,616
U.S. government obligations	**4,404**	**4,336**	4,383	4,389
Corporate obligations	**5,040**	**4,886**	4,900	4,967
Mortgage-backed securities	**4,128**	**4,039**	3,849	3,854
Equity securities	**33,150**	**41,144**	29,487	37,231
Mutual funds	**75,223**	**76,945**	74,973	77,467
	$ 131,021	**$ 140,409**	$ 124,208	$ 134,524

Fair value of investments carried at cost at June 30 is as follows:

	2018		2017	
	Cost	**Fair Value**	**Cost**	**Fair Value**
Private equity investments	**$ 5,524**	**$ 5,759**	$ 4,379	$ 4,746
Hedge funds	**18,050**	**20,202**	14,080	14,384
	$ 23,574	**$ 25,961**	$ 18,459	$ 19,130

The System is invested in hedge funds that are accounted for at historic cost. The historic cost of these investments is $18,050 at June 30, 2018. The estimated fair value of these investments is primarily based on financial data supplied by the underlying investee fund. The estimated fair value of these investments is $20,202 at June 30, 2018.

Investments are allocated as follows at June 30:

	2018	**2017**
Investment allocation:		
Unrestricted long-term investments	**$ 161,254**	$ 150,554
Donor-restricted investments	**2,729**	2,429
	$ 163,983	$ 152,983

(Dollars in Thousands)

6. Investments (continued)

Investment income, including income from short-term investments, for the years ended June 30 is as follows:

	2018	2017
Unrestricted:		
Net realized gains	**$ 6,470**	$ 8,274
Interest and dividends, net of investment expense	**3,047**	1,621
Loss from joint ventures	**(1,743)**	(3,291)
	$ 7,774	$ 6,604

Investment expense was $416 and $380 for the fiscal years ended June 30, 2018 and 2017, respectively.

Other investments consist of the following at June 30:

	Carrying Value		Income (Loss)	
	2018	2017	2018	2017
Premier Class B	**$ 4,944**	$ 3,901	**$ –**	$ –
Joint ventures	**7,622**	8,105	**(1,743)**	(3,291)
	$ 12,566	$ 12,006	**$ (1,743)**	$ (3,291)

(Dollars in Thousands)

6. Investments (continued)

Investments in joint ventures are accounted for using the equity method, unless otherwise noted, at June 30 and are as follows:

	Entity	Interest %	2018	2017
Colonial Regional Alliance	FMH	14.3%	**$ –**	$ 5
Carroll Occupational Health, LLC	FHSC	25.0	**108**	158
Comp Claim Management, LLC	FHSC	50.0	**24**	40
Premier Purchasing Partners (cost method)	FMH	–	**392**	392
Mt. Airy Health Services, LLC	FMH	50.0	**702**	702
Mt. Airy Med-Services, LLC	FHSC	50.0	**4,278**	4,417
Mt. Airy Plaza, LLC	FHSC	50.0	**(166)**	(44)
Trivergent Health Alliance	FMH	33.3	**100**	100
Trivergent Health Alliance MSO	FMH	33.3	**900**	900
Advanced Health Collaborative	FRHS	–	**42**	42
Hopkins Health Advantage, Inc.	FMH	6.0	**495**	184
Behavioral Health Partners of Frederick, Inc.	FMH	50.0	**–**	239
Frederick Surgical Center, LLC	FHSC	36.2	**447**	860
MNR of Frederick, LLC	FHSC	22.5	**300**	110
			$ 7,622	$ 8,105

The fair value of these joint ventures is not readily determinable.

Group Purchasing Organization Initial Public Offering

The System has participated and owned equity in Premier Limited Partnership (Premier), which has served as a group purchasing organization for many years. This participation provides purchasing contract rates and rebates the System would not be able to obtain on its own. The System accounts for its investment in Premier on the cost method of accounting.

6. Investments (continued)

During the year ended June 30, 2014, Premier restructured from a privately held company to a public company and completed an initial public offering (IPO) of its equity securities. Several financial transactions occurred with those holding equity in Premier before the IPO, including the System. As a result, the System received a cash payment of approximately $1.1 million in exchange for 16% of its previous ownership in Premier. In addition, in exchange for the extension of the group purchasing contract, the System received partial ownership of the new public company (the Class B units).

During the year ended June 30, 2014, the System received 233,669 Class B units that are earned in seven separate tranches over an 85-month period ending October 31, 2020. The opportunity will exist in the future for these Class B units to be converted to the Premier public company stock.

Prior to vesting, the Class B units may be transferred or sold with the approval of Premier. The System recognized $1,043 and $1,081 related to the vesting of 33,381 and 33,381 Class B units for the years ended June 30, 2018 and 2017, respectively. These amounts are recorded as an investment on the accompanying consolidated balance sheets and were recognized as a reduction of supplies expense in the accompanying consolidated statements of operations, as the value of the Class B shares is tied to the group purchasing contract and is considered a vendor incentive.

7. Fair Value Measurements

Assets and liabilities recorded at fair value in the accompanying consolidated balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value.

FASB guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability (i.e., the exit price) in an orderly transaction between market participants at the measurement date, emphasizing that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, the FASB establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

7. Fair Value Measurements (continued)

The level inputs, as defined by FASB guidance for fair value measurements and disclosures, are as follows:

- Level 1 – Inputs utilize unadjusted quoted prices in active markets for identical assets or liabilities that the System has the ability to access at the measurement date.

- Level 2 – Inputs are inputs other than quoted prices included in Level 1 that are observable for the assets or liabilities, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the assets or liabilities (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals.

- Level 3 – Inputs are unobservable inputs for the assets or liabilities, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

(Dollars in Thousands)

7. Fair Value Measurements (continued)

The determination of the fair value level within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The System's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the assets or liabilities. The following tables present the System's assets and liabilities measured at fair value on a recurring basis, aggregated by the level in the fair value hierarchy within which those measurements fall, as of June 30:

		Fair Value Measurements at Reporting Date Using		
	Fair Value at June 30, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents	$ 45,003	$ 45,003	$ –	$ –
Equity securities	41,145	41,145	–	–
U.S. government obligations	4,120	–	4,120	–
Agency securities	216	–	216	–
Corporate and other bonds	4,921	–	4,921	–
Mutual funds	78,298	78,298	–	–
Mortgage-backed securities	4,039	–	4,039	–
Private equity investments	5,759	–	–	5,759
Hedge funds	20,202	–	–	20,202
Contributions receivable	5,540	–	–	5,540
Total assets	$ 209,243	$ 164,446	$ 13,296	$ 31,501
Liabilities				
Interest rate swap liability	$ (6,706)	$ –	$ (6,706)	$ –
Total liabilities	$ (6,706)	$ –	$ (6,706)	$ –

(Dollars in Thousands)

7. Fair Value Measurements (continued)

	Fair Value at June 30, 2017	Fair Value Measurements at Reporting Date Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents	$ 42,339	$ 42,339	$ –	$ –
Equity securities	37,231	37,231	–	–
U.S. government obligations	4,195	–	4,195	–
Agency securities	193	–	193	–
Corporate and other bonds	5,167	–	5,167	–
Mutual funds	79,026	79,026	–	–
Mortgage-backed securities	3,854	–	3,854	–
Private equity investments	4,746	–	–	4,746
Hedge funds	14,384	–	–	14,384
Contributions receivable	6,095	–	–	6,095
Total assets	$ 197,230	$ 158,596	$ 13,409	$ 25,225
Liabilities				
Interest rate swap liability	$ (9,559)	$ –	$ (9,559)	$ –
Total liabilities	$ (9,559)	$ –	$ (9,559)	$ –

The fair value of the System's trading securities is determined by third-party service providers utilizing various methods dependent upon the specific type of investment. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Where significant inputs, including benchmark yields, broker-dealer quotes, issuer spreads, bids, offers, the London Interbank Offered Rate (LIBOR) curve, and measures of volatility, are used by these third-party dealers or independent pricing services to determine fair values, the securities are classified within Level 2. Private equity investments and hedge funds are carried at cost.

7. Fair Value Measurements (continued)

Assets utilizing Level 1 inputs include exchange-traded equity securities and equity and fixed-income mutual funds. Assets and liabilities utilizing Level 2 inputs include U.S. government securities, corporate bonds, mortgage-backed securities, and interest rate swaps. Assets utilizing Level 3 inputs are contributions receivable, private equity investments, and hedge funds.

Interest Rate Swap

The System entered into an interest rate swap agreement in conjunction with the issuance of variable rate bonds. The swap contract is valued using models based on readily observable market parameters for all substantial terms of the contract. The fair market value of the swap agreement is included as interest rate swap contract in the accompanying consolidated balance sheets. The fair market value calculation includes a credit valuation adjustment as required of $360 and $547, reducing the interest rate swap agreement liability position on June 30, 2018 and 2017, respectively. The change in the fair market value of the swap agreement is included in excess of unrestricted revenue and other support over expenses, as the swap is not designated as an effective hedge.

Credit exposure associated with nonperformance by the counterparty to the derivative instrument is generally limited to the uncollateralized fair value of the asset related to instruments recognized in the balance sheets.

Other

Assets utilizing Level 3 inputs are contributions receivable, private equity investments, and hedge funds. Contributions receivable are recorded net of an allowance for uncollectible pledges and discounted to net present value. The present value of estimated future cash flows using a discount rate commensurate with the risks involved is an appropriate measure of fair value for unconditional promises to give cash and is considered Level 3. The fair value of the System's private equity and hedge fund investments is determined by third-party service providers utilizing various methods dependent upon the specific type of investment.

(Dollars in Thousands)

7. Fair Value Measurements (continued)

The following table provides a reconciliation of the beginning and ending balances of items measured at fair value on a recurring basis in the previous table that used significant unobservable inputs (Level 3):

	Year Ended June 30	
	2018	**2017**
Contributions receivable		
Beginning balance, July 1	**$ 6,095**	$ 6,417
New pledges	**1,397**	1,959
Collections on pledges	**(2,219)**	(1,401)
Write-off of pledges	**(216)**	(1,002)
Changes in reserves and discounting factor	**483**	122
Ending balance, June 30	**$ 5,540**	$ 6,095
Private equity investments		
Beginning balance, July 1	**$ 4,746**	$ 3,982
Purchases	**2,190**	1,959
Losses	**(133)**	(307)
Return of capital	**(1,044)**	(888)
Ending balance, June 30	**$ 5,759**	$ 4,746
Hedge funds		
Beginning balance, July 1	**$ 14,384**	$ –
Purchases	**4,000**	14,050
Gains	**1,818**	334
Ending balance, June 30	**$ 20,202**	$ 14,384

(Dollars in Thousands)

8. Property and Equipment

Property and equipment consist of the following at June 30:

	Estimated Useful Lives	2018	2017
Land	–	**$ 6,013**	$ 6,013
Land improvements	8–20 years	**2,927**	2,190
Buildings	20–40 years	**256,701**	239,102
Fixed equipment	10–20 years	**23,468**	17,239
Movable equipment	3–20 years	**235,746**	218,487
Leasehold improvements	5–20 years	**32,700**	29,878
		557,555	512,909
Less accumulated depreciation		**329,624**	307,604
		227,931	205,305
Construction in process, renovations, and deposits		**9,266**	42,287
		$ 237,197	$ 247,592

Construction in progress consists of the System's building construction and renovations. As these projects are completed, the related assets are transferred out of construction in progress and into the appropriate asset category and are depreciated over the applicable useful lives.

Capitalized computer software, net of accumulated amortization, as of June 30, 2018 and 2017, was $2,850 and $3,224, respectively. Amortization of computer software was $2,773 and $3,165 for fiscal years 2018 and 2017, respectively.

The net book value of assets under capital lease arrangements totaled $2,316 and $3,213 as of June 30, 2018 and 2017, respectively. Depreciation expense related to assets under capital lease arrangements was $897 and $1,342 for the fiscal years ended June 30, 2018 and 2017, respectively.

(Dollars in Thousands)

9. Long-Term Debt

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

	2018	2017
MHHEFA Series 2012A Bonds	**$ 94,906**	$ 95,996
MHHEFA Series 2017A Bonds	**26,780**	29,000
MHHEFA Series 2017B Bonds	**57,490**	60,645
Line of credit	**–**	7,000
Capital lease obligations	**1,991**	2,769
Deferred finance costs	**(1,581)**	(1,437)
	179,586	193,973
Less current maturities	**5,013**	11,861
	$ 174,573	$ 182,112

Series 2012A MHHEFA Revenue Bonds

In December 2012, the System obtained a loan of $96,240 in MHHEFA Revenue Bonds, Frederick Memorial Hospital Issue, Series 2012A. The MHHEFA Series 2012A Bonds were issued to refund all of the MHHEFA Series 2002 Bonds and to finance a portion of certain construction and equipment costs of the System. The Series 2012A Bonds were issued with a premium of $3,990, which is being amortized over the life of the bonds. The accumulated amortization was $890 at June 30, 2018. The annual interest rate on the bond loan ranges between 3% and 5% over the term of the bond. Interest is payable semiannually on each January 1 and July 1, through July 1, 2038.

Series 2012A Bonds maturing on or after July 1, 2023, are subject to redemption prior to maturity beginning on July 1, 2022, at the option of the authority at the principal amount of the Series 2012A Bonds to be redeemed plus accrued interest thereon to the date set for redemption.

Under the provisions of the bond agreement, the System has granted to the authority a security interest in all receipts now owned and hereafter acquired. The Series 2012A Bonds are secured ratably with the Series 2017A and 2017B Bonds. The fair value of the Series 2012A MHHEFA Revenue Bonds is estimated based on quoted prices in active markets for identical assets. The fair value of the 2012A Bonds as of June 30, 2018, is estimated at $93,878.

9. Long-Term Debt (continued)

There is no debt service reserve requirement associated with the Series 2012A Bonds.

The bond agreement contains certain financial covenants.

Series 2017A MHHEFA Revenue Bonds

In June 2017, the System obtained a loan of $29,000 in MHHEFA Revenue Bonds, Frederick Memorial Hospital Issue, Series 2017A. Upon settlement of the bonds, MHHEFA and the obligated group entered into a financing agreement with BB&T Community Holdings Co. (BB&T) whereby BB&T became the initial purchaser of the Series 2017A Bonds. The interest rate on the bonds is based on an index floating rate determined by BB&T equal to the applicable percentage of LIBOR plus the applicable spread plus any Tax Equity and Fiscal Responsibility Act (TEFRA) adjustment. The average interest rate on the bond loan is 1.97% for the year ended June 30, 2018. The carrying value of the 2017A Bonds approximates fair value.

The proceeds of the Series 2017A Bonds were used for completion of the 2017 project, which consists of the construction of the James M. Stockman Cancer Institute, renovations to a building used as a business center, and renovations to the sterile processing department.

Series 2017A Bonds are subject to redemption at the option of the authority at the principal amount of the Series 2017A Bonds to be redeemed plus accrued interest to the date set for redemption. The Series 2017A Bonds, which mature on July 1, 2042, are secured ratably with the Series 2017B Bonds. The System is required to make annual payments to BB&T sufficient to meet the annual debt service requirements for the succeeding year. Annual sinking fund installments for the Series 2017A Bonds range from $7,085 on July 1, 2039 to $5,195 on July 1, 2042.

After experiencing an increase to the effective interest rate due to the reduction of the maximum marginal tax rate of BB&T, on January 1, 2018, amendments to the financing agreement between MHHEFA, the System, and BB&T were executed that changed the definition of the applicable percentage of LIBOR and the applicable spread in the calculation of the index floating rate on the Series 2017A and 2017B Bonds. Effective April 1, 2018, these amendments resulted in a reduction of the index floating rate and interest expense related to this debt going forward.

9. Long-Term Debt (continued)

Series 2017B MHHEFA Revenue Bonds

In June 2017, the System obtained a loan of $60,645 in MHHEFA Revenue Bonds, Frederick Memorial Hospital Issue, Series 2017B. Upon settlement of the bonds, MHHEFA and the obligated group entered into a financing agreement with BB&T whereby BB&T became the initial purchaser of the Series 2017B Bonds. The interest rate on the bonds is based on an index floating rate determined by BB&T equal to the applicable percentage of LIBOR plus the applicable spread plus the TEFRA adjustment, if any. The average interest rate on the bond loan is 1.94% for the year ended June 30, 2018. The carrying value of the 2017B Bonds approximates fair value.

The proceeds of the Series 2017B Bonds were used to pay financing costs and for the refunding of the Series 2012B Bonds.

Series 2017B Bonds are subject to redemption at the option of the authority at the principal amount of the Series 2017B Bonds to be redeemed plus accrued interest to the date set for redemption. The Series 2017B Bonds, which mature on July 1, 2035, are secured ratably with the Series 2017A Bonds. The System is required to make annual payments to BB&T sufficient to meet the annual debt service requirements for the succeeding year. Annual sinking fund installments for the Series 2017B Bonds range from $3,155 on July 1, 2017 to $2,090 on July 1, 2035.

(Dollars in Thousands)

9. Long-Term Debt (continued)

Capital Lease Obligations

As of June 30, 2018, the System has entered into certain capital lease obligations to secure major medical equipment. Future payments under these obligations are as follows:

Years ending June 30:	
2019	$ 814
2020	814
2021	430
Total payments	2,058
Less interest payments	67
Total lease obligations, principal	1,991
Less current portion	773
Long-term obligations under capital leases	$ 1,218

Debt service requirements on long-term debt and capital lease obligations, excluding original issue premium and deferred financing costs at June 30, 2018, of $3,100 and $1,581, respectively, are as follows:

	Principal
Years ending June 30:	
2019	$ 5,013
2020	5,223
2021	5,056
2022	4,875
2023	5,015
Thereafter	152,885
	$ 178,067

9. Long-Term Debt (continued)

On September 9, 2013, the System entered into a $20,000 revolving line of credit with a lending institution for the purpose of funding short-term working capital needs. The line of credit bears a variable interest rate of one-month LIBOR plus 1.5% per annum, adjusted monthly. All outstanding principal and interest must be repaid within two years of closing. There must not be any outstanding principal balance for at least 30 consecutive days during each year the line of credit is available (clean-up period). A $5,000 draw was taken upon closing. The outstanding balance on this line of credit was $0 and $7,000 as of June 30, 2018 and 2017, respectively. The line-of-credit agreement was amended on November 4, 2015, extending the maturity date to December 1, 2017, and decreased the revolving loan commitment from $20,000 to $15,000. A second amendment was made on November 30, 2017, extending the maturity date to January 31, 2020, and eliminating clean-up period requirements.

10. Interest Rate Swap Contract

The System records its derivatives as assets or liabilities at fair value. A derivative is typically defined as an instrument, whose value is derived from an underlying instrument, index or rate, has a notional amount, requires little or no initial investment, and can be net settled. The System participates in an interest rate swap contract that is considered a derivative financial instrument.

The System has an interest rate swap contract with a third party with a notional amount of $57,110 on June 30, 2018, which reduces annually by an amount equal to the sinking fund installment due on bonds until maturity on July 1, 2035. The System is exposed to credit loss in the event of nonperformance by the counterparty to the interest rate swap contract. However, the System does not anticipate nonperformance by the counterparty. Under the swap contract, the System pays interest at a fixed rate of 3.0804% per annum and receives interest at a variable rate equal to 67% of the one-month LIBOR (2.0903%) as of June 30, 2018. The swap contract requires payments to be made or received monthly. The fair value of the swap contract was a liability of $6,706 and $9,559 at June 30, 2018 and 2017, respectively.

The System accrued net payments under its interest rate swap program of $1,583 and $1,994 during fiscal years 2018 and 2017, respectively. These amounts are included within realized and unrealized losses on interest rate swap contract, net, in the accompanying consolidated statements of operations and investing activities in the accompanying consolidated statements of cash flows.

10. Interest Rate Swap Contract (continued)

The interest rate swap contract is not designated as an effective cash flow hedge. The System's objectives of entering into the interest rate swap contract include limiting or hedging variable interest rate payments to achieve lower overall borrowing costs than a comparable unhedged fixed rate borrowing, to alter the pattern of debt service payments, and to improve asset/liability matching. Changes in the fair value of the derivative financial instrument are recognized in realized and unrealized losses on interest rate swap contract, net, in the accompanying consolidated statements of operations and investing activities in the accompanying consolidated statements of cash flows. The carrying value of the System's derivative financial instrument approximates fair value. The interest rate swap contract is valued using models based on readily observable market parameters for all substantial terms of the contract.

Credit exposure associated with nonperformance by the counterparties to derivative instruments is generally limited to the uncollateralized fair value of the asset related to instruments recognized in the consolidated balance sheets. The System attempts to mitigate the risk of nonperformance by selecting counterparties with high credit ratings and monitoring their creditworthiness.

The System's derivative agreements do not contain any credit support provisions that require it to post collateral if there are declines in the derivative value or its credit rating.

	Fair Value	
Balance Sheet Location	**2018**	**2017**
Asset derivatives		
Derivatives not designated as hedging instruments:		
Interest rate contracts	**$ –**	$ –
Liability derivatives		
Interest rate swap contract	**$ 6,706**	$ 9,559
Total derivatives not designated as hedging instruments	**$ 6,706**	$ 9,559

(Dollars in Thousands)

10. Interest Rate Swap Contract (continued)

A summary of the effect of the non-hedging derivatives on the System's consolidated statement of operations for the year ended June 30, 2018, is as follows:

Type of Non-hedging Derivatives	**Statement of Operations Location of (Loss) Gain Recognized**	**Derivative (Loss) Gain Recognized**
Interest rate swap contract – realized loss	Other loss	**$ (1,583)**
Interest rate swap contract – unrealized gain	Other gain	**2,854**
Total		**$ 1,271**

A summary of the effect of the nonhedging derivatives on the System's consolidated statement of operations for the year ended June 30, 2017, is as follows:

Type of Non-hedging Derivatives	**Statement of Operations Location of (Loss) Gain Recognized**	**Derivative (Loss) Gain Recognized**
Interest rate swap contract – realized loss	Other loss	$ (1,994)
Interest rate swap contract – unrealized gain	Other gain	4,499
Total		$ 2,505

11. Employee Benefit Plans

The System has a defined benefit pension plan (the Plan) that was curtailed on June 30, 2007. The System uses a measurement date of June 30 to determine plan assets and benefit obligations. The curtailment is such that participants will no longer accrue benefits under the Plan and no new participants will be accepted. Current participant accounts will not receive any service credits or increases in benefits for post-curtailment compensation increases beyond June 30, 2007; however, the System will make annual contributions to the Plan in accordance with actuarially determined amounts to meet future accumulated benefit obligations under the frozen Plan.

Effective July 1, 2017, the Plan was amended to allow plan participants, who terminated employment prior to June 1, 2017, and have an actuarially equivalent lump-sum payment as of December 1, 2017, of $75 or less, to elect a distribution in the form of an annuity or lump-sum payment. The number of plan participants that chose the lump-sum distribution election was 152, which resulted in a reduction of approximately $4,800 in plan assets and benefit obligation.

A single premium guaranteed annuity contract was purchased on August 16, 2017, for 121 retired participants and beneficiaries in pay status receiving monthly annuity payments of less than $800 dollars. This reduced the plan assets and benefit obligation by approximately $10,106 and transferred this benefit obligation from the Plan to the insurer. The settlement expense in the period as a result of both the lump-sum payment and annuity contract purchase was $3,544.

(Dollars in Thousands)

11. Employee Benefit Plans (continued)

Effective July 1, 2007, a modified defined contribution plan (403b) was implemented, as described below.

The following provides a reconciliation of the changes in fair value of the Plan's assets and projected benefit obligations and the Plan's funded status based on a June 30, 2018 and 2017, measurement date:

	2018	**2017**
Accumulated benefit obligation	**$ 51,808**	$ 71,678
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	**$ 71,678**	$ 87,362
Service cost	**778**	599
Interest cost	**2,272**	2,681
Actuarial gain	**(4,360)**	(4,675)
Benefits paid and administrative expenses	**(1,989)**	(2,458)
Settlement payments	**(14,911)**	(12,908)
Settlement (gain) loss	**(1,660)**	1,077
Projected benefit obligation at end of year	**51,808**	71,678
Change in plan assets:		
Fair value of plan assets at beginning of year	**52,931**	62,475
Actual return on plan assets	**1,302**	1,821
Employer contribution	**–**	4,000
Benefits paid	**(1,152)**	(1,902)
Administrative expenses	**(837)**	(555)
Settlement payments	**(14,911)**	(12,908)
Fair value of plan assets at end of year	**37,333**	52,931
Funded status	**(14,475)**	(18,747)
Net amount recognized	**$ (14,475)**	$ (18,747)

(Dollars in Thousands)

11. Employee Benefit Plans (continued)

The discount rate actuarial assumption was changed from 3.85% to 4.17%, resulting in a $2,600 decrease in the projected benefit obligation as of June 30, 2018.

Net amounts recognized in unrestricted net assets that have not been recognized in net periodic benefit cost are as follows:

	June 30	
	2018	**2017**
Net actuarial loss	**$ 6,292**	$ 16,874
Prior service cost	**82**	133
Total recognized in unrestricted net assets	**$ 6,374**	$ 17,007

The following table sets forth the weighted average assumptions used to determine benefit obligations:

	June 30	
	2018	**2017**
Discount rate	**4.17%**	3.85%
Rate of compensation increase	**N/A**	N/A

The following table sets forth the weighted average assumptions used to determine net periodic benefit cost:

	Year Ended June 30	
	2018	**2017**
Discount rate	**3.85%**	3.59%
Expected return on plan assets	**3.75%**	3.75%
Rate of compensation increase	**N/A**	N/A

(Dollars in Thousands)

11. Employee Benefit Plans (continued)

Net periodic pension cost included the following components:

	2018	2017
Service costs	**$ 778**	$ 599
Interest cost	**2,272**	2,681
Expected return on plan assets	**(1,561)**	(2,291)
Amortization of prior service cost	**52**	52
Amortization of net loss	**1,275**	2,417
Settlement	**3,544**	3,906
Net periodic pension cost	**$ 6,360**	$ 7,364

The estimated net loss that is expected to be amortized from other changes in unrestricted net assets into net periodic benefit cost for the year ending June 30, 2019, is $228.

The System determines the expected long-term rate of return on plan assets by taking into consideration the historical returns of various asset classes and the types of investments the Plan is expected to hold.

The Plan's asset allocation as of the measurement date presented as a percentage of total plan assets was as follows:

	2018	2017
Equity securities	**26%**	27%
Debt securities	**59**	60
Cash	**1**	3
Hedge funds	**14**	10
Total	**100%**	100%

The Plan's assets are recorded at fair value and are categorized based upon the level of judgment associated with the inputs used to measure their fair value.

11. Employee Benefit Plans (continued)

FASB guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability (i.e., the exit price) in an orderly transaction between market participants at the measurement date, emphasizing that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, the FASB establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy). The level inputs, as defined by FASB guidance for fair value measurements and disclosures, are as follows:

- Level 1 – Inputs utilize unadjusted quoted prices in active markets for identical assets or liabilities that the System has the ability to access at the measurement date.

- Level 2 – Inputs are inputs other than quoted prices included in Level 1 that are observable for the assets or liabilities, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the assets or liabilities (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals.

- Level 3 – Inputs are unobservable inputs for the assets or liabilities, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

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

(Dollars in Thousands)

11. Employee Benefit Plans (continued)

The System's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the assets or liabilities. The following tables present the Plan's assets and liabilities measured at fair value on a recurring basis, aggregated by the level in the fair value hierarchy within which those measurements fall, as of June 30:

		Fair Value Measurements at Reporting Date Using		
	Fair Value at June 30 2018	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**
Assets				
Cash and cash equivalents	**$ 744**	**$ 744**	**$ –**	**$ –**
Equity securities	**9,583**	**9,583**	**–**	**–**
Fixed income mutual funds	**22,132**	**22,132**	**–**	**–**
Hedge funds and other alternative	**4,874**	**–**	**–**	**4,874**
Total assets	**$ 37,333**	**$ 32,459**	**$ –**	**$ 4,874**

(Dollars in Thousands)

11. Employee Benefit Plans (continued)

	Fair Value at June 30 2017	Fair Value Measurements at Reporting Date Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents	$ 1,581	$ 1,581	$ –	$ –
Equity securities	14,079	14,079	–	–
Fixed income mutual funds	32,397	32,397	–	–
Hedge funds and other alternative	4,874	–	–	4,874
Total assets	$ 52,931	$ 48,057	$ –	$ 4,874

The following table provides a reconciliation of the beginning and ending balances of items measured at fair value on a recurring basis in the previous table that used significant unobservable inputs (Level 3):

	Hedge Funds	Total
Balance at June 30, 2016	$ 6,179	$ 6,179
Purchases	4,770	4,770
Settlements	(6,239)	(6,239)
Losses, net	164	164
Balance at June 30, 2017	4,874	4,874
Purchases	–	–
Settlements	–	–
Gains, net	–	–
Balance at June 30, 2018	**$ 4,874**	**$ 4,874**

11. Employee Benefit Plans (continued)

The fair value of the Plan's trading securities is determined by third-party service providers utilizing various methods dependent upon the specific type of investment. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Assets utilizing Level 1 inputs include exchange-traded equity securities and equity and fixed income mutual funds. Assets utilizing Level 3 inputs are hedge funds.

The hedge funds are accounted for at fair value, which has been estimated using the net asset value per share of the fund as of June 30, 2018.

Assets of the Plan are invested in a manner consistent with fiduciary standards of the Employee Retirement Income Security Act of 1974, namely: (a) the safeguards and diversity to which a prudent investor would adhere must be present and (b) all transactions undertaken on behalf of the Plan must be for the sole interest of plan participants and beneficiaries to provide benefits in a prudent manner. Investment objectives of the Plan also include the following:

- Achieve an annualized total return that equals or exceeds the actuarial target
- Preserve the value of the Plan's assets
- Diversify assets sufficiently and, in accordance with modern portfolio theory, avoid large specific risks (losses) and minimize the volatility of the portfolio
- Provide sufficient liquidity to plan benefit payment outflows and meet the Plan's requirements

The strategic target asset allocation for the Plan is 20% in equities, 62% in fixed income securities, 10% in hedge funds, 5% real estate, and 3% in cash.

(Dollars in Thousands)

11. Employee Benefit Plans (continued)

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

2019	$	1,203
2020		1,463
2021		1,739
2022		1,974
2023		2,189
2024–2028		13,370

The System also has a tax-deferred annuity savings (403(b)) plan available to substantially all employees. In conjunction with the curtailment of the defined benefit pension plan, the System modified the (403(b)) plan effective July 1, 2007. Effective January 1, 2018, the plan was amended such that all new hires will be automatically enrolled in the 403(b) plan at 3% of employee earnings, which will be automatically increased 1% annually up to 10%. Employees can opt out of this automatic enrollment and annual increase. The System will match 100% on employee contributions up to 5.0% of employee earnings. Base contributions continue for employees with 5 to 10 years of service at 0.5% and 1.0% for employees with over 10 years of service. The System's contribution for base matching and transition credits totaled $6,407 and $4,993 for fiscal years 2018 and 2017, respectively.

In December 2005, the System adopted two nonqualified deferred compensation plans with an effective date of December 15, 2004, for certain members of executive management. Under these plans, participating employees may contribute amounts from their compensation to the plan and may receive a discretionary employer contribution. Employees are fully vested in all employee contributions to the plans. Vesting in employer contributions occurs in accordance with the underlying plan documents. All assets of the plans are held in separate trusts. Total contributions by the System to the plans were $449 and $438 for the years ended June 30, 2018 and 2017, respectively.

(Dollars in Thousands)

12. Concentration of Credit Risk

The System has funds on deposit with financial institutions in excess of amounts insured by the Federal Deposit Insurance Corporation. The System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors (in percentages) at June 30 was as follows:

	2018	2017
Medicare	**29%**	27%
Medicaid	**18**	20
Blue Cross	**13**	14
HMOs and PPOs	**17**	19
Commercial insurance and other third-party payors	**7**	5
Patients	**16**	15
	100%	100%

13. Functional Expenses

The System and its subsidiaries provide general health care services to residents within its geographic location. Expenses related to providing these services are as follows:

	2018	2017
Health care services	**$ 352,584**	$ 342,706
General and administrative	**55,901**	49,914
	$ 408,485	$ 392,620

(Dollars in Thousands)

14. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes or periods at June 30:

	2018	2017
Health care services:		
Buildings and equipment	**$ 5,075**	$ 5,750
Restricted by time only	**1,294**	1,093
Education programs	**510**	336
Indigent care and research	**412**	367
	$ 7,291	$ 7,546

Permanently restricted net assets consist of investments to be held in perpetuity, the income from which is expendable for:

	2018	2017
General health care services (reported as other operating revenue)	**$ 971**	$ 971
Specific health care services (reported as net assets released from restrictions)	**5**	5
	$ 976	$ 976

During 2018 and 2017, net assets were released from donor restrictions by incurring expenses or capital expenditures satisfying the restricted purposes in the amounts of $2,503 and $6,444, respectively.

15. Contingencies

The System has been named as a defendant in various legal proceedings arising from the performance of its normal activities. In the opinion of management, after consultation with legal counsel and after consideration of applicable insurance, the amount of the System's ultimate liability under all current legal proceedings will not have a material adverse effect on its consolidated financial position or results of operations.

15. Contingencies (continued)

The System is partially self-insured against employee medical claims. Expenses include claims paid and a provision for claims incurred but not reported. As of June 30, 2018 and 2017, the System has recorded a liability for claims incurred but not reported of $1,685 and $1,755, respectively. The program has an annual aggregate stop-loss provision of $500 per employee.

On July 1, 2011, MIL, a single-parent captive, was created to provide a flexible risk financing structure to meet the needs of the System's organization. As of June 30, 2012, MIL provides FMH with Primary Medical Professional Liability and Primary General Liability coverage with policy limits of liability of $1,000 each and every medical incident with a $3,000 annual aggregate for the 2011/2012 policy year and with a $5,000 annual aggregate for the 2012/2013 policy year onwards. The MIL Primary Policy coverage form is mature claims-made with a retroactive date of July 1, 2005. The policy funding is retrospectively rated.

MIL has also issued an Excess Umbrella Liability mature claims-made policy with a retroactive date of July 1, 2005. This policy is structured on a "dualtower" design. The Excess Medical Professional Liability Tower follows the form of the underlying Primary Medical Professional Liability coverage providing $20,000 limits of liability ($10,000 prior to July 1, 2016). The Umbrella Liability Tower provides $20,000 limits of liability ($10,000 prior to July 1, 2016) excess of scheduled underlying coverages. The "dualtowers" are 100% reinsured with a commercial carrier with an AM Best rating of A- or better.

Effective June 30, 2012, MIL assumed Professional Liability and Comprehensive General Liability coverage previously included under FMH's self-insured plan, for incidents occurring between July 1, 2005 and June 30, 2011, that were reported to FMH prior to June 30, 2011. The policy provides limits of liability of $1,000 each and every medical incident for the hospital professional liability and $1,000 each and every medical incident for comprehensive general liability. The policy is subject to a $3,000 annual aggregate for the hospital professional liability and comprehensive general liability combined, which applies to each covered year separately on a claims-made basis.

Effective June 30, 2012, MIL further assumed Professional Liability and Comprehensive General Liability coverage previously included under another FMH self-insurance plan, for incidents occurring between July 1, 1999 and June 30, 2001, with a limit of liability of $100 per claim.

15. Contingencies (continued)

The Primary Medical Professional and Primary General Liability policy is 100% MIL retained risk. The Excess Umbrella Liability coverage is fully reinsured with a commercial carrier with an AM Best rating of A- or better.

Effective September 1, 2017, MIL issued a Cyber Deductible Liability Policy to the System at a per claim limit of liability of $100 and an annual aggregate limit of $200. The policy funding is retrospectively rated.

There are known claims and incidents that could result in the assertion of additional claims, as well as claims from unknown incidents that could be asserted arising from services provided to patients. The System maintains reserves, including excess coverage, in the amount of $15,186 and $15,351 at June 30, 2018 and 2017, respectively, and a related reinsurance receivable of $6,605 and $6,105 at June 30, 2018 and 2017, respectively. The System employs an independent actuary to estimate the ultimate settlement of such claims.

These reserves are recorded on an undiscounted basis at June 30, 2018 and 2017. In management's opinion, the amounts recorded provide an adequate reserve for loss contingencies. However, changes in circumstances affecting professional liability claims could cause these estimates to change by material amounts in the short term.

(Dollars in Thousands)

16. Commitments

Operating Leases

The System and its subsidiaries lease facilities under various operating leases, the last of which expires in 2030. The System has various options to renew the leases. The System also leases equipment under various operating leases. Rent expense under all operating leases was $4,489 and $5,304 for 2018 and 2017, respectively. Future minimum payments under noncancelable operating leases are as follows:

Years ending June 30:		
2019	$	3,428
2020		3,330
2021		3,136
2022		3,188
2023		3,158
Thereafter		17,462
	$	33,702

Workers' Compensation

The System is self-insured against workers' compensation claims, currently up to $600 per occurrence. Excess insurance attaches at $600 and has unlimited liability above this amount. Expenses include claims paid, reserves on known claims, and reserves on unreported claims (incurred but not reported).

Letter of Credit

The System has a letter of credit issued by a lending institution in the amount of $1,046. This letter of credit is renewed on an annual basis and is required by the state of Maryland as collateral for unemployment benefits.

17. Regulatory Environment

Medicare and Medicaid

The Medicare and Medicaid reimbursement programs represent a substantial portion of the System's revenues. The System's operations are subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation and government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse.

Over the past several years, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of fines and penalties, as well as repayments for patient services previously billed. Compliance with fraud and abuse standards and other government regulations can be subject to future government review and interpretation.

Also, future changes in federal and state reimbursement funding mechanisms and related government budgeting constraints could have an adverse effect on the System.

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

State of Maryland Health Services Cost Review Commission

Certain hospital charges are subject to review and approval by the Maryland Health Services Cost Review Commission (HSCRC or the Commission). Hospital management has filed the required forms with the Commission and believes the hospital to be in compliance with the Commission's requirements.

17. Regulatory Environment (continued)

Through June 2018, the current rate of reimbursement for principally all inpatient services and certain other services to patients under the Medicare and Medicaid programs is based on an agreement between CMS and the Commission. This agreement is based upon a waiver from Medicare prospective payment system reimbursement principles granted to the state of Maryland under Section 1814(b) of the Social Security Act. As of January 2014, CMS approved a modernized waiver that will be in place as long as Maryland hospitals commit to achieving significant quality improvements, limits on all-payor per capita hospital growth, and limits on annual Medicare per capita hospital cost growth to a rate lower than the national annual per capita growth rate.

Beginning in fiscal year 2014, the System entered into an agreement with HSCRC to participate in the Global Budgeted Revenue (GBR) program. GBR methodology encourages hospitals to focus on population health strategies by establishing a fixed annual revenue cap for each GBR hospital. The agreement is evergreen in nature and covers both regulated inpatient and outpatient revenues.

Under GBR, hospital revenue is known at the beginning of each fiscal year. Annual revenue is calculated from a base year and is adjusted annually for inflation, infrastructure requirements, population changes, performance in quality-based programs, and changes in levels of uncompensated care. Revenue may also be adjusted annually for market levels and shifts of services to unregulated services.

The Commission's rate-setting methodology for hospital service centers consists of establishing an acceptable unit rate for defined inpatient and outpatient service centers within the System. The actual average unit charge for each service center is compared to the approved rate monthly and annually.

Overcharges and undercharges due to either patient volume or price variances, adjusted for penalties where applicable, are applied to decrease (in the case of overcharges) or increase (in the case of undercharges) future approved rates on an annual basis. The System exceeded the allowable target by $1,616 and $293 for the years ended June 30, 2018 and 2017, respectively, which are both within the allowable variance threshold of 0.5%, and no immediate corrective action is required for either year.

17. Regulatory Environment (continued)

The timing of HSCRC's rate adjustments for the System could result in an increase or reduction in rates due to the variances and penalties described above in a year subsequent to the year in which such items occur, and there is at least a possibility that the amounts may be material. The System's policy is to record revenue based on actual charges for services to patients in the year in which the services are performed. The System recognizes unbilled revenue for in-house patients.

Starting in January 2019, Maryland's hospitals will operate under a new 10-year contract with the federal government entitled Maryland Total Cost of Care Model (TCOC). TCOC is designed to test whether the improvements hospitals have made under the previous modernized waiver can be expanded to all health care providers. The GBR methodology will remain in place for hospital rate setting under the TCOC model. In addition, programs aimed to measure and reduce total health care spending for attributed Medicare patients, including pre- and post-acute care by all providers, are being introduced and will be further defined in the next fiscal year.

HSCRC established an uncompensated care fund whereby certain hospitals are required to contribute to the fund to help cover the costs associated with uncompensated care for all Maryland hospitals equitably. The System's contribution to the fund was $490 and $2,682 for the years ended June 30, 2018 and 2017, respectively.

18. Subsequent Events

The System has evaluated subsequent events through October 10, 2018, the date of issuance of these consolidated financial statements.

The System is unaware of any significant subsequent events that would require recognition or disclosure at this time.

Supplementary Information

Frederick Regional Health System, Inc. and Subsidiaries

Supplementary Consolidating Balance Sheet

(Dollars in Thousands)

June 30, 2018

	Frederick Regional Health System, Inc.	Frederick Memorial Hospital, Inc. Consolidated	Monocacy Insurance, Ltd.	Monocacy Health Partners, LLC	Frederick Health Services Corporation	Frederick Integrated Healthcare Network, LLC	Elimination	Frederick Regional Health System, Inc. Consolidated
Assets								
Current assets:								
Cash and cash equivalents	$ 29	$ 30,568	$ 67	$ 1,029	$ 1,023	$ 56	$ –	$ 32,772
Patient receivables, net	–	43,552	–	4,985	674	–	–	49,211
Other receivables	–	1,992	–	25	–	–	–	2,017
Inventory	–	4,946	–	833	–	–	–	5,779
Prepaid expenses	–	2,392	6	–	194	–	–	2,592
Assets limited as to use	–	3,173	94	–	–	–	–	3,267
Promises to give, net	–	981	–	–	–	–	–	981
Total current assets	29	87,604	167	6,872	1,891	56	–	96,619
Net property and equipment	–	229,294	–	3,058	4,845	–	–	237,197
Other assets:								
Assets limited as to use	–	1,294	–	–	–	–	–	1,294
Investments – donor restricted	–	2,729	–	–	–	–	–	2,729
Promises to give, net	–	4,559	–	–	–	–	–	4,559
Long-term investments	–	150,170	11,084	–	–	–	–	161,254
Other investments	255,909	23,863	–	–	4,991	–	(272,197)	12,566
Other assets	–	11,770	6,393	–	411	–	(11,487)	7,087
Intercompany receivables	–	66,012	–	–	1,461	–	(67,473)	–
Total other assets	255,909	260,397	17,477	–	6,863	–	(351,157)	189,489
Total assets	$ 255,938	$ 577,295	$ 17,644	$ 9,930	$ 13,599	$ 56	$ (351,157)	$ 523,305

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Frederick Regional Health System, Inc. and Subsidiaries

Supplementary Consolidating Balance Sheet (continued)

(Dollars in Thousands)

June 30, 2018

	Frederick Regional Health System, Inc.	Frederick Memorial Hospital, Inc. Consolidated	Monocacy Insurance, Ltd.	Monocacy Health Partners, LLC	Frederick Health Services Corporation	Frederick Integrated Healthcare Network, LLC	Elimination	Frederick Regional Health System, Inc. Consolidated
Liabilities and net assets								
Current liabilities:								
Current maturities of long-term debt, line of credit, and capital lease obligations	$ –	$ 5,013	$ –	$ –	$ –	$ –	$ –	$ 5,013
Accounts payable	–	25,795	–	64	608	103	–	26,570
Accrued expenses	–	20,147	92	3,198	890	–	–	24,327
Advances from third-party payors	–	8,027	–	–	–	–	–	8,027
Loans payable, affiliates	–	–	–	–	4,505	–	(4,505)	–
Other current liabilities	–	2,064	5,550	845	–	–	(5,550)	2,909
Total current liabilities	–	61,046	5,642	4,107	6,003	103	(10,055)	66,846
Long-term liabilities, net of current portion:								
Long-term debt and capital lease obligations	–	174,573	–	–	–	–	–	174,573
Interest rate swap contract	–	6,706	–	–	–	–	–	6,706
Accrued pension expense	–	14,475	–	–	–	–	–	14,475
Other long-term liabilities	–	9,286	11,882	333	1,431	–	(1,432)	21,500
Intercompany liabilities	403	1,461	–	63,310	–	2,299	(67,473)	–
Total long-term liabilities, net of current portion	403	206,501	11,882	63,643	1,431	2,299	(68,905)	217,254
Total liabilities	403	267,547	17,524	67,750	7,434	2,402	(78,960)	284,100
Net assets:								
Unrestricted	255,535	301,481	120	(57,820)	6,165	(2,346)	(272,197)	230,938
Temporarily restricted	–	7,291	–	–	–	–	–	7,291
Permanently restricted	–	976	–	–	–	–	–	976
Total net assets	255,535	309,748	120	(57,820)	6,165	(2,346)	(272,197)	239,205
Total liabilities and net assets	$ 255,938	$ 577,295	$ 17,644	$ 9,930	$ 13,599	$ 56	$ (351,157)	$ 523,305

Frederick Regional Health System, Inc. and Subsidiaries

Supplementary Consolidating Statement of Operations

(Dollars in Thousands)

Year Ended June 30, 2018

	Frederick Regional Health System, Inc.	Frederick Memorial Hospital, Inc.	Monocacy Insurance, Ltd.	Monocacy Health Partners, LLC	Frederick Health Services Corporation	Frederick Integrated Healthcare Network, LLC	Elimination	Frederick Regional Health System, Inc. Consolidated
Net patient service revenue	$ –	$ 368,496	$ –	$ 43,736	$ 5,829	$ –	$ (206)	$ 417,855
Provision for bad debts	–	(11,241)	–	(632)	–	–	–	(11,873)
Net patient service revenue less provision for bad debts	–	357,255	–	43,104	5,829	–	(206)	405,982
Other operating revenue	–	6,016	2,495	2,942	2,586	997	(5,455)	9,581
Gifts, bequests, and contributions	–	3,234	–	89	–	–	–	3,323
Net assets released from restrictions	–	208	–	–	–	–	–	208
Total unrestricted revenue and other support	–	366,713	2,495	46,135	8,415	997	(5,661)	419,094
Operating expenses:								
Salaries and contract labor	–	124,657	–	28,775	4,523	840	(3)	158,792
Employee benefits	–	27,329	–	5,195	1,062	154	(79)	33,661
Professional fees	–	16,062	171	215	90	355	(749)	16,144
Cost of goods sold	–	42,198	–	18,458	885	–	–	61,541
Supplies	–	10,786	–	432	–	10	(7)	11,221
Contract services	–	72,876	–	3,442	445	106	(1,325)	75,544
Other	–	9,846	86	3,288	1,044	8	(1,003)	13,269
Utilities	–	4,214	–	233	76	2	–	4,525
Insurance	–	2,643	2,303	902	83	–	(2,495)	3,436
Depreciation and amortization	–	24,201	–	635	292	–	–	25,128
Interest	–	5,224	–	–	204	–	(204)	5,224
Total operating expenses	–	340,036	2,560	61,575	8,704	1,475	(5,865)	408,485
Operating income (loss)	–	26,677	(65)	(15,440)	(289)	(478)	204	10,609

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Frederick Regional Health System, Inc. and Subsidiaries

Supplementary Consolidating Statement of Operations (continued)

(Dollars in Thousands)

Year Ended June 30, 2018

	Frederick Regional Health System, Inc.	Frederick Memorial Hospital, Inc.	Monocacy Insurance, Ltd.	Monocacy Health Partners, LLC	Frederick Health Services Corporation	Frederick Integrated Healthcare Network, LLC	Elimination	Frederick Regional Health System, Inc. Consolidated
Other income (loss):								
Gain on sale of assets	$ –	$ 13	$ –	$ –	$ –	$ –	$ –	$ 13
Loss on extinguishment of debt	–	–	–	–	–	–	–	–
Investment income (loss)	–	8,018	223	2	(265)	–	(204)	7,774
Change in unrealized losses on trading securities, net	–	(1,114)	(158)	–	–	–	–	(1,272)
Realized and unrealized gains (losses) on interest rate swap contract, net	–	1,271	–	–	–	–	–	1,271
Periodic pension expense	–	(1,793)	–	(245)	–	–	–	(2,038)
Pension settlement expense	–	(3,544)	–	–	–	–	–	(3,544)
Other nonoperating income (loss)	–	54	–	–	(259)	–	–	(205)
Total other income (loss)	–	2,905	65	(243)	(524)	–	(204)	1,999
Excess of unrestricted revenue and other support over expenses	–	29,582	–	(15,683)	(813)	(478)	–	12,608
Other changes in unrestricted net assets:								
Pension adjustment	–	10,633	–	–	–	–	–	10,633
Released from restriction used to purchase capital	–	2,295	–	–	–	–	–	2,295
Total other changes in unrestricted net assets	–	12,928	–	–	–	–	–	12,928
Increase (decrease) in unrestricted net assets	$ –	$ 42,510	$ –	$ (15,683)	$ (813)	$ (478)	$ –	$ 25,536

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