



**Community Health
Network, Inc.**

**Consolidated Financial Statements
December 31, 2019 and 2018**

Community Health Network, Inc.

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December 31, 2019 and 2018

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Report of Independent Auditors

To the Board of Directors of Community Health Network, Inc.

We have audited the accompanying consolidated financial statements of Community Health Network, Inc. and its affiliates, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of operations and changes in net assets and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Community Health Network, Inc. and its affiliates as of December 31, 2019 and 2018, and the results of their operations, changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

March 26, 2020

Community Health Network, Inc.
Consolidated Balance Sheets (in 000's)
As of December 31, 2019 and 2018

	2019	2018
Assets		
Current assets		
Cash and cash equivalents	\$ 363,353	\$ 377,594
Patient accounts receivable	333,101	298,003
Estimated third-party payor settlements receivable	9,794	73,712
Current portion of assets limited as to use—held by trustee	-	4,117
Inventories	30,915	31,885
Other accounts receivable	22,264	25,852
Other current assets	22,432	19,916
Total current assets	781,859	831,079
Assets limited as to use		
Board-designated funds	1,222,481	963,919
Reinsurance trust assets	19,044	16,209
Property, plant and equipment, net	1,039,730	988,317
Investments in unconsolidated affiliates	52,710	42,611
Capitalized software, net	43,692	47,763
Right of use operating assets	189,275	-
Other assets	33,562	20,748
Total assets	\$ 3,382,353	\$ 2,910,646
Liabilities and net assets		
Current liabilities		
Current portion of long-term debt	\$ 23,013	\$ 23,060
Accounts payable	123,268	115,196
Accrued salaries and wages	99,572	102,804
Estimated third-party payor settlements payable	18,246	15,999
Self-insured liabilities	24,772	25,493
Lease liabilities	32,552	-
Other current liabilities	47,888	71,406
Total current liabilities	369,311	353,958
Long-term debt, net of current portion	902,927	926,681
Lease liabilities, net of current portion	157,601	-
Other liabilities	12,085	13,431
Total liabilities	1,441,924	1,294,070
Net assets		
Net assets without donor restrictions		
Network net assets without donor restrictions	1,879,677	1,575,045
Noncontrolling interest	26,740	22,775
Total net assets without donor restrictions	1,906,417	1,597,820
Net assets with donor restrictions	34,012	18,756
Total net assets	1,940,429	1,616,576
Total liabilities and net assets	\$ 3,382,353	\$ 2,910,646

The accompanying notes are an integral part of these financial statements.

Community Health Network, Inc.
Consolidated Statements of Operations and Changes in Net Assets (in 000's)
Years ended December 31, 2019 and 2018

	2019	2018
Revenues:		
Patient service revenue	\$ 2,536,318	\$ 2,424,956
Service fee revenue	23,043	21,306
Other revenue	40,634	45,289
Earnings from unconsolidated affiliates	43,386	29,783
Total operating revenues	<u>2,643,381</u>	<u>2,521,334</u>
Operating expenses		
Salaries, benefits and pension	1,408,972	1,321,261
Supplies and other expenses	953,788	890,349
Depreciation and amortization	105,469	96,208
Impairment charge	-	8,067
Interest and financing costs	38,591	33,272
Total operating expenses	<u>2,506,820</u>	<u>2,349,157</u>
Income from operations	136,561	172,177
Excess of net assets acquired in Fairbanks acquisition	28,737	-
Investment income (loss) and other, net	178,710	(66,788)
Excess of revenues over expenses before income taxes	<u>344,008</u>	<u>105,389</u>
Provision for income taxes	<u>5,152</u>	<u>4,948</u>
Excess of revenues over expenses	<u>338,856</u>	<u>100,441</u>
Excess of expenses over revenues attributable to noncontrolling interest	<u>(18,563)</u>	<u>(19,910)</u>
Excess of revenues over expenses attributable to the Network	<u>\$ 320,293</u>	<u>\$ 80,531</u>

Continued on next page

The accompanying notes are an integral part of these financial statements.

Community Health Network, Inc.
Consolidated Statements of Operations and Changes in Net Assets (in 000's)
Years ended December 31, 2019 and 2018

	2019	2018
Change in net assets without donor restrictions		
Excess of revenues over expenses attributable to the Network	\$ 320,293	\$ 80,531
Change in noncontrolling interest	3,965	387
Other changes, net	(15,661)	(1,816)
Increase in total net assets without donor restrictions	308,597	79,102
Change in net assets with donor restrictions		
Increase in net assets with donor restrictions	15,256	206
Increase in total net assets	323,853	79,308
Total net assets, beginning of year	1,616,576	1,537,268
Total net assets, end of year	\$ 1,940,429	\$ 1,616,576

The accompanying notes are an integral part of these financial statements.

Community Health Network, Inc.
Consolidated Statements of Cash Flows (in 000's)
Years ended December 31, 2019 and 2018

	2019	2018
Cash flows from operating activities		
Increase in net assets	\$ 323,853	\$ 79,308
Adjustments to reconcile increase in net assets to net cash provided by operating activities		
Depreciation and amortization	105,469	96,208
Impairment charge	-	8,067
Deferred tax benefit provision	183	470
Excess of net assets acquired in Fairbanks acquisition	(28,737)	-
Earnings from unconsolidated affiliates	(43,386)	(29,783)
Unrealized and realized (gains) losses on investments	(153,946)	91,467
Distributions received from unconsolidated affiliates	33,458	22,476
Legal reserves	-	22,500
Other	(1,730)	1,583
Changes in operating assets and liabilities		
Patient accounts receivable	(30,594)	862
Other assets	(201,034)	(3,689)
Accounts payable	(4,947)	(16,982)
Estimated third-party payor settlements	66,306	(47,927)
Other liabilities	160,864	(9,566)
Net cash provided by operating activities	<u>225,759</u>	<u>214,994</u>
Cash flows from investing activities		
Purchases of property, plant and equipment	(124,106)	(135,262)
Proceeds from sale of property, plant and equipment	34	6,791
Purchases of investments	(178,698)	(287,034)
Sales of investments	79,008	105,118
Cash acquired in Fairbanks acquisition	7,735	-
Investments in unconsolidated affiliates	(171)	(2,243)
Net cash used in investing activities	<u>(216,198)</u>	<u>(312,630)</u>
Cash flows from financing activities		
Proceeds from issuance of debt	-	203,863
Repayments of debt, net	(23,802)	(25,387)
Changes in restricted contributions and investment income	-	(302)
Cash flows (used in) provided by financing activities	<u>(23,802)</u>	<u>178,174</u>
Net (decrease) increase in cash and cash equivalents	(14,241)	80,538
Cash and cash equivalents beginning of year	<u>377,594</u>	<u>297,056</u>
Cash and cash equivalents end of year	<u>\$ 363,353</u>	<u>\$ 377,594</u>
Supplemental disclosures of cash flow information		
Cash paid during the year for		
Interest	\$ 40,138	\$ 37,375
Income taxes	5,716	5,175
Non cash disclosures of cash flow information		
Acquisition of property, plant and equipment included in accounts payable at December 31	\$ 11,687	\$ 20,941

The accompanying notes are an integral part of these financial statements.

Community Health Network, Inc.
Notes to Consolidated Financial Statements (in 000's except percentage amounts)
December 31, 2019 and 2018

1. Organization and Summary of Significant Accounting Policies

Organization

Community Health Network, Inc. ("CHNw"), an Indiana non-profit corporation, and its non-profit and for-profit affiliates (collectively the "Network") comprise a full-service integrated health delivery system in central Indiana. The Network consists of acute care and/or specialty hospitals, immediate care centers, primary care and specialty employed physicians, ambulatory care centers, freestanding surgery centers, outpatient imaging centers, endoscopy centers, and cancer centers.

Basis of Presentation and Consolidation

The accompanying consolidated financial statements were prepared in accordance with generally accepted accounting principles in the United States of America ("US GAAP" or "GAAP") and include the assets, liabilities, revenues and expenses of all wholly owned subsidiaries, and when applicable, entities that are not wholly owned for which the Network has a controlling interest.

The consolidated financial statements include the following wholly owned entities:

- Community Hospital South, Inc. ("CHS"), a non-profit corporation which operates an acute care hospital facility on the south side of Indianapolis;
- Community Hospitals of Anderson and Madison County, Inc. ("CHA"), a non-profit corporation which provides acute health care services to residents of Anderson, Indiana and surrounding communities;
- Community Howard Regional Health, Inc., ("Howard") a non-profit corporation which provides acute health care services to residents in Howard County, Indiana and surrounding areas;
- Fairbanks Hospital, Inc. ("Fairbanks") is a not-for-profit chemical dependency treatment center that provides services in central Indiana;
- Community Physicians of Indiana, Inc. ("CPI") d/b/a Community Physicians Network, a non-profit corporation which employs the Network's primary care and specialty physicians;
- Community Health Network Foundation, Inc., ("Foundation") a non-profit corporation established to raise and expend funds for the benefit of CHNw and other affiliated organizations;
- Visionary Enterprises, Inc. ("VEI"), a taxable, for-profit subsidiary corporation which consists primarily of ambulatory surgery center development in Indiana, management services and other consulting services;
- Community Home Health Services, Inc. ("CHHS"), a non-profit corporation whose operations consist primarily of providing home health care, home infusion and hospice services to patients in central Indiana counties. Effective August 2019, the Network contributed its home health business to a joint venture. CHNw maintains a controlling ownership interest in the joint venture. Effective January 2020, the Network contributed its infusion business to a joint venture. The Network maintains a noncontrolling ownership interest in the joint venture;
- Indiana ProHealth Network, LLC ("ProHealth"), a provider association consisting of physicians and hospital members in central Indiana and the primary vehicle by which the Network contracts for risk with payers. ProHealth is a pass-through taxable entity that is consolidated into CHNw;

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- CHN Assurance Company, Ltd. ("Captive") a company incorporated under the law of the Cayman Islands and a wholly owned subsidiary of CHNw. The Captive reinsures policies for the Network including: primary hospital professional liability, doctor's professional liability and general liability. The Captive's professional liability policy is on a claims-made basis and includes prior acts coverage for various entities owned by the Network, while the general liability policy is on an occurrence basis. On an annual basis, the Captive's ceding insurer requires the Captive to maintain an outstanding letter of credit to address any potential exposure between premiums paid and expected losses. Due to favorable claims experience and adequate funding, the fronting company does not require a letter of credit for the policy years beginning March 1, 2019 and 2020;
- North Campus Surgery Center, LLC ("NCSC"), a wholly owned for profit subsidiary of VEI and CHNw on the campus of Community Hospital North. NCSC provides outpatient surgeries; and
- Michigan Surgery Investment, LLC ("MSI"), a wholly owned for profit subsidiary of VEI and CHNw.

The Network also consolidates its interest in the following entities, which are not wholly owned:

- South Campus Surgery Center, LLC ("SCSC")
- East Campus Surgery Center, LLC ("ECSC")
- Hamilton Surgery Center, LLC ("Noblesville")
- Howard Community Surgery Center, LLC ("Howard Surgery")
- Northwest Surgery Center, LLC ("Northwest")
- Howard Regional Specialty Care, LLC ("Howard Rehab")
- Surgery Center Plus Indianapolis, LLC ("SCPI")
- Community Health at Home, LLC ("CHH")

Intercompany accounts and transactions have been eliminated.

Use of Estimates in the Preparation of Financial Statements

The preparation of the consolidated financial statements in conformity with US GAAP 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. Future events and their effects cannot be predicted with certainty; accordingly, the accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of the consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained and as our operating environment changes. The Network evaluates and updates its assumptions and estimates on an ongoing basis and may employ outside experts to assist in its evaluation, as considered necessary. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, amounts due from banks and funds invested temporarily in money market accounts that are purchased with original maturities of generally three months or less.

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Patient Accounts Receivable

Patient accounts receivable at December 31, 2019 and 2018, are reported at the amounts that reflects the consideration which the Network expects to be entitled in exchange for providing patient care, as further described in Note 2.

The collection of outstanding receivables for Medicare, Medicaid, managed care and commercial insurance payers, and patients is the Network's primary source of cash and is critical to the Network's operating performance. The primary collection risks relate to uninsured patient accounts and patient accounts for which the primary insurance carrier has paid the amounts covered by the applicable agreement, but patient responsibility amounts (deductibles and coinsurance) remain outstanding. The Network grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. The concentration of net receivables by payer class for both patients and third-party payers at December 31, 2019 and 2018 is as follows. Net receivable for patients includes uninsured balances which are the responsibility of the patient associated with third-party payers listed below:

	2019	2018
Medicare	21 %	23 %
Medicaid	11 %	11 %
Managed care and commercial insurance	55 %	53 %
Patients	13 %	13 %
	100 %	100 %

Accounts Receivable with Recourse

The Network has an agreement with a bank whereby the Network sells certain patient account receivables to the bank. Under this agreement, the bank can require the Network to repurchase the patient account receivables under certain conditions. Eligible receivables include self-pay patient financial obligations incurred for services provided by the Network, excluding any portion of the obligation to be paid by Medicare, Medicaid, managed care and commercial insurance, or any other third-party payer. The maximum amount the Network can place in the program is \$20,000. Patient accounts receivable purchased by the bank are considered legally extinguished and, therefore, not included on the consolidated balance sheets. A guarantee liability is recorded representing an estimate for amounts which the bank will require the Network to repurchase under the terms of the agreement. As of December 31, 2019 and 2018, a guarantee liability of \$2,120 and \$1,864, respectively, was recorded and included in other current liabilities on the consolidated balance sheets. As of December 31, 2019 and 2018, the maximum exposure to loss under the guarantee liability was \$10,598 and \$9,318, respectively. Total costs associated with the program were not material in 2019 and 2018.

Charity Care

The Network maintains records to identify and monitor the level of charity care it provides. The Network provides 100% charity care to patients whose income level is equal to or below 200% of the Federal Poverty Level. Patients with income levels ranging from 200% - 300% of the current year's Federal Poverty Level will qualify for partial assistance determined by a sliding scale. The Network uses cost as the measurement basis for charity care disclosure purposes with the cost being identified as the direct and indirect costs of providing the charity care.

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Charity care at cost was \$11,870 and \$10,719 for the years ended December 31, 2019 and 2018, respectively. Charity care cost was estimated on the application of the associated cost-to-charge ratios.

Estimated Third-party Payer Settlements Receivable and Payable

The Network's hospitals are required to submit cost reports at least annually to various state and federal agencies administering the respective reimbursement programs. In many instances, interim cash payments to the Network are only an estimate of the amount due for services provided. Any overpayment or underpayment to the Network arising from the completion of a cost report is recorded as a liability or asset, respectively.

As a result of the Network's participation in the Medicare and Medicaid programs, the Network faces and is currently subject to various governmental and internal reviews, audits and investigations to verify the Network's compliance with these programs and applicable laws and regulations. The Network is routinely subject to audits under various government programs, such as the Centers for Medicare and Medicaid Services ("CMS") Recovery Audit Contractor program, in which third-party firms engaged by CMS conduct extensive reviews of claims data and medical and other records to identify potential improper payments to healthcare providers under the Medicare program. In addition, the Network, like other healthcare providers, is subject to ongoing investigations by the U.S. Department of Health and Human Services Office of Inspector General, the Department of Justice and state attorney generals into the billing of services provided to Medicare and Medicaid patients. Private pay sources such as third-party insurance and managed care entities also often reserve the right to conduct audits. The Network's costs to respond to and defend any such reviews, audits and investigations are significant and are likely to increase in the current enforcement environment. These audits and investigations may require the Network to refund or retroactively adjust amounts that have been paid under the relevant government program or by other payers. Further, an adverse review, audit or investigation also could result in other adverse consequences, particularly if the underlying conduct is found to be pervasive or systemic. These consequences include (1) state or federal agencies imposing fines, penalties and other sanctions on the Network; (2) loss of the Network's right to participate in the Medicare or Medicaid programs or one or more third-party payer networks; (3) indemnity claims asserted by customers and others for which the Network provides services; and (4) damage to the Network's reputation, which could adversely affect the Network's ability to attract patients, residents and employees. Any accruals for such matters are recorded to estimated third-party payer settlements payable or as a reduction to estimated third-party payer settlements receivable when a loss is probable and the amount is reasonably determinable.

The State of Indiana's Hospital Assessment Fee ("HAF") and Medicaid Disproportionate Share Hospital ("DSH") payments, further described in Note 2, are estimated and recorded to third-party payer settlements receivable and payable.

Inventories

Inventories consist primarily of medical and surgical supplies and pharmaceuticals. All inventories are valued at the lower-of-cost or market and net realizable value. Cost is determined by the Network using a weighted average cost method, which approximates cost under the first-in, first-out method.

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Assets Limited as to Use

Assets limited as to use consist of short-term investments with original maturities of three months or less, U.S. Government obligations, corporate bonds, mutual funds, marketable equity securities and hedge fund of funds and are stated at fair value and marked to market each month. Debt securities are classified as trading. Reinsurance trust assets are maintained by the Captive.

All realized and unrealized gains or losses are recorded in "Investment income (loss) and other, net". Realized gains and losses on sales of investments are determined using the specific identification cost method and are included in excess of revenues over expenses in the period in which the sale occurs.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost or, if donated, at the fair value at date of donation. The Network uses the straight-line method of computing depreciation over the estimated useful lives of the respective assets.

Costs of maintenance and repairs are charged to expense when incurred; costs of renewals and betterments are capitalized. Upon sale or retirement of property, plant and equipment, the cost and related accumulated depreciation are eliminated from the respective accounts, and the resulting gain or loss is included in the consolidated statements of operations and changes in net assets.

Long-lived assets are evaluated for possible impairment whenever circumstances indicate that the carrying amount of the asset, or related group of assets, may not be recoverable from future estimated cash flows. Fair value estimates are derived from independent appraisals, established market values of comparable assets or internal calculations of future estimated cash flows.

Change in Estimates for Long-lived Assets

The Network periodically performs assessments of the estimated useful lives of its long-lived assets. In evaluating the useful lives, the Network considers how long the long-lived assets will remain functionally efficient and effective, given changes in the physical and economic environments, the levels of technology and competitive factors. If the assessment indicates that the long-lived assets will be used for a period differing from that than previously anticipated, the Network will revise the estimated useful lives resulting in a change in estimate. Changes in estimates are accounted for on a prospective basis by depreciating the assets current carrying values over their revised remaining useful lives.

Investments in Unconsolidated Affiliates

Investments in affiliates not controlled by the Network are reported under the equity method of accounting. Under the equity method, the investments are initially recorded at cost, increased or decreased by the investor's share of the profits or losses of the investee and reduced by cash distributions received. The Network accounts for distributions received from investees using the cumulative earnings approach. The Network compares distributions received to our cumulative equity method earnings since inception. Any distributions received up to the amount of cumulative equity earnings are considered a return on investment and classified in operating activities on the consolidated statement of cash flows. Any excess distributions are considered a return of investment and classified in investing activities.

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Deferred Financing Costs

Costs associated with the issuance of long-term debt are capitalized and presented on the consolidated balance sheets as a direct deduction from the carrying amount of the debt. The debt issuance costs related to line-of-credit arrangements is presented as a component of other noncurrent assets. Deferred financing costs are amortized to interest expense utilizing the effective interest method over the life of the related debt. Amortization of deferred financing costs totaled \$263 and \$238 for the years ended December 31, 2019 and 2018, respectively.

Discounts and premiums associated with long-term debt are reported as a direct deduction from, or addition to, the face amount of the long-term debt. The discounts/premiums are accreted/amortized using the effective interest method over the life of the related debt. The related income or expense is included in interest expense in the consolidated statements of operations and changes in net assets.

Capitalized Software

The costs of obtaining or developing internal-use software, including external direct costs for materials and services and directly related payroll costs are capitalized. Amortization begins when the internal-use software is ready for its intended use. The software costs are amortized over the estimated useful lives of the software. The estimated useful lives range from 5-10 years. Costs incurred during the preliminary project stage and post-implementation stage as well as maintenance and training costs are expensed as incurred. Amortization expense related to capitalized software was \$10,458 and \$12,384 for the years ended December 31, 2019 and 2018, respectively.

	Estimated Useful Lives	2019	2018
Software	5-10 years	\$ 102,216	\$ 95,865
Less: Accumulated amortization		<u>58,524</u>	<u>48,102</u>
		<u>\$ 43,692</u>	<u>\$ 47,763</u>

Self-Insured Risk

A substantial portion of the Network's professional and general liability risks are insured through a self-insured retention program written by the Network's consolidated wholly owned offshore captive insurance subsidiary, the Captive, as previously described.

Reserves for professional and general liability risks, including self-insured liabilities, were \$15,576 and \$14,701 at December 31, 2019 and 2018, respectively. These amounts are recorded and included in the self-insured liabilities on the consolidated balance sheets.

Provisions for the self-insured risks are based upon actuarially-determined estimates. Loss and loss expense reserves represent the estimated ultimate net cost of all reported and unreported losses incurred through the respective consolidated balance sheets dates. The reserves for unpaid losses and loss expenses are estimated using individual case-basis valuations and actuarial analyses. Those estimates are subject to the effects of trends in loss severity and frequency.

The estimates are continually reviewed and adjustments are recorded as experience develops or new information becomes known. The changes to the estimated reserve amounts are included in current operating results for the years ended December 31, 2019 and 2018.

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The Network is self-insured for employee medical benefit risks through ProHealth. Reserves for medical claims liabilities and estimated self-insured claims were \$427 and \$2,902 net of claims liabilities payable to the Network providers, at December 31, 2019 and 2018, respectively. These amounts are recorded and included in self-insured liabilities on the consolidated balance sheets. Self-insured claims reserves are determined using individual case-basis data and are continually reviewed and adjusted as new experienced information becomes known. The changes in estimated reserve amounts are included in current operating results.

Although considerable variability is inherent in reserve estimates, management believes the reserves for losses and loss expenses are adequate; however, there can be no assurance that the ultimate liability will not exceed management's estimates.

Net Assets with Donor Restriction

Donor restricted net assets are those assets whose use has been limited by donors to a specific time period or purpose or maintained by the Network in perpetuity. These net assets are generally restricted for medical education, medical supplies and equipment, and patient care services.

Contributions

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as net assets with donor restrictions 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, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the consolidated statements of operations and changes in net assets without donor restrictions as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as net assets without donor restrictions in the accompanying consolidated financial statements.

Pledge receivables as of December 31, 2019 and 2018 are not material.

Taxes and Tax Status

CHNw, CHS, CHA, CHHS, CPI, Howard, Fairbanks and the Foundation are exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code ("IRC"). ProHealth, NCSC, SCSC, ECSC, Noblesville, Howard Surgery, Northwest, SPCI, CHH and MSI, are generally not subject to federal or state income taxes as income earned flows through to its members. The Network and its tax exempt affiliates are, however, subject to federal and state income taxes on unrelated business income under the provisions of IRC section 511.

VEI is a for-profit taxable entity and is subject to federal and state income taxes. Income tax expense and income tax related assets and liabilities of the Network are not material to the consolidated financial statements. Deferred tax liabilities and assets are classified as noncurrent in the Network's consolidated balance sheets at December 31, 2019 and 2018.

Fair Value of Financial Instruments/Measurements

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable, and other current liabilities approximate fair value because of the relatively short maturities of these financial instruments.

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The Network measures fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Network also uses a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The Network uses a fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1- Observable inputs such as quoted prices in active markets;
- Level 2- Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3- Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Additionally, as a practical expedient, the Network is permitted under US GAAP to estimate the fair value of investments in investment companies that have a calculated value of their capital account or net asset value ("NAV") at the measurement date using the reported NAV without further adjustment unless the entity expects to sell the investment at a value other than NAV or if the NAV is not calculated in accordance with US GAAP.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques. The three valuation techniques are as follows:

- Market approach- Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities;
- Cost approach- Amount that would be required to replace the service capacity of an asset (i.e. replacement cost); and
- Income approach- Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing models and lattice models).

Reclassifications

Certain immaterial reclassifications have been made to the 2018 financial statements to conform to the 2019 presentation.

Subsequent Events

The Network evaluated subsequent events through March 26, 2020, the date these consolidated financial statements were issued.

Recently Adopted Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2016-02 ("ASC 842"), which amended the accounting for leases, requiring lessees to recognize most leases on their balance sheets with a right-of-use asset and a corresponding lease liability. Leases are classified as either finance or operating leases, which impacts the manner and timing of expense recognition of such leases over the lease term. The ASU also modified the lease classification criteria for lessors and eliminated some of the real estate leasing guidance previously applied for certain leasing transactions. The Network adopted this ASU on January 1, 2019. In July 2018, the FASB issued ASU 2018-11, which provided entities relief from

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the transition requirements in ASU 2016-02 by allowing them to elect not to recast prior comparative periods. The Network elected this method of transition upon adoption of this ASU. Because of the number of leases the Network utilizes to support its operations, the adoption of this ASU had a significant impact on the Network's consolidated financial position, but did not have a significant impact on the Network's results of operations or cash flows. Upon adoption, the Network recognized total right-of-use assets and lease liabilities of approximately \$180,000 on the consolidated balance sheets. The adoption of this ASU did not have an impact on the Network's compliance with financial debt covenants. See Note 8 for more information.

In June 2018, the FASB issued ASU 2018-08, Not-for-Profit Entities – Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made (Topic 958). This ASU provided a more robust framework to determine when a transaction should be accounted for as a contribution or as an exchange transaction and provided additional guidance about how to determine whether a contribution is conditional. The ASU was effective for the Network beginning January 1, 2019 and did not have a material impact on the Network's consolidated financial position, results of operations, or cash flows.

In January 2016, the FASB issued ASU 2016-01, which required all equity investments, other than those accounted for under the equity method or those that result in the consolidation of the investee, to be measured at fair value with changes in the fair value recognized through "Investment income (loss) and other, net." The new guidance also eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for non-public business entities. The Network adopted this ASU on January 1, 2019. Under the Network's accounting policies under previous guidance, equity securities, all of which had readily-determinable fair values, were classified as trading securities and marked to market each month. Accordingly, the adoption of the guidance did not have a material impact on the consolidated financial position, results of operations, or cash flows. Disclosures have been updated in accordance with the new guidance.

Recently Issued Accounting Pronouncements

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The new guidance introduces a new model for recognizing credit losses on financial instruments based on an estimate of current expected credit losses (CECL). The guidance is effective for the Network January 1, 2023. The new CECL model generally calls for the immediate recognition of all expected credit losses and applies to a wide variety of financial assets, including loans, accounts and trade receivables as well as other financial assets measured at amortized cost. The Network is evaluating the impact of this new guidance on its results of operations, financial position and cash flows.

2. Patient Service Revenue

The Network's revenues generally relate to contracts with patients in which the Network's performance obligations are to provide health care services to the patients. Patient service revenue is reported at the amount that reflects the consideration to which the Network expects to be entitled in exchange for providing patient care. These amounts are due from patients and third-party payers (including government programs and managed care and commercial insurance companies), and include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, the Network bills the patients and third-party payers several days after the services are performed or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied. The Network determines the transaction price based on standard charges, reduced by contractual adjustments provided to

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third-party payers, discounts provided to uninsured patients in accordance with the Network's policy, and implicit price concessions.

Performance obligations are determined based on the nature of the services provided by the Network. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected or actual charges. The Network believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in our hospitals receiving inpatient acute care services. The Network measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time, which includes outpatient services, is generally recognized when services are provided to our patients and the Network does not believe it is required to provide additional services to the patient.

Because all of its performance obligations relate to contracts with a duration of less than one year, the Network has elected to apply the optional exemption provided in FASB ASC 606-10-50-14a and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to previously are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

The Network determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience. Management continually reviews the contractual estimation process to consider and incorporate updates to laws and regulations and the frequent changes in managed care contractual terms resulting from contract renegotiations and renewals. Estimates of contractual adjustments under managed care and commercial insurance plans are based upon the payment terms specified in the related contractual agreements. The payment arrangements with third-party payers provide for payments to the Network at amounts different from its established rates.

Generally, patients who are covered by third-party payers are responsible for related deductibles and coinsurance, which vary in amount. The Network also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. The Network estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. For the years ended December 31, 2019 and 2018, estimated implicit price concessions of \$564,440 and \$583,943, respectively, were recorded to adjust revenues to the estimated amounts collectible.

Estimated implicit price concessions are recorded for all uninsured accounts, which includes uninsured patients and uninsured coinsurance and deductible amounts for patients who have health care coverage, regardless of the aging of those accounts. The estimates for implicit price concessions are based upon management's assessment of historical write-offs and expected net collections, business and economic conditions, trends in federal, state and private employer health care coverage and other collection indicators. Management relies on the results of detailed reviews of historical write-offs and collections as a primary source of information in estimating the collectability of our accounts receivable. The Network performs a hindsight analysis quarterly, utilizing historical accounts receivable collection and write-off data. The Network believes its

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quarterly updates to the estimated implicit price concession amounts at each of its hospital facilities provide reasonable valuation estimates of the Network's revenues and accounts receivable.

Payment arrangements with major third-party payers include the following for 2019 and 2018:

- Medicare—Inpatient acute care services, outpatient services and home health services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. The Network is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Network and audits thereof by the Medicare fiscal intermediary. The Network's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Network. The Network's Medicare cost reports have been audited by the Medicare fiscal intermediary through December 31, 2015 with the exception of two, which are audited through December 31, 2016. Laws and regulations governing the Medicare program are complex and subject to interpretation. As a result, there is at least a possibility that recorded estimates could change by a material amount in the near term. Adjustments to revenue related to prior period cost reports decreased patient service revenue by \$6,870 and \$271 for the years ended December 31, 2019 and 2018, respectively.
- Medicaid—Inpatient services rendered to Medicaid program beneficiaries are reimbursed based on prospectively determined rates per discharge and outpatient services are reimbursed based on a fee for service basis, based on predetermined fee schedules.
- The Network has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Network under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined per diem rates.

The Network's patient service revenues by payer for the years ended December 31, 2019 and 2018 are as follows:

	2019	2018
Medicare	\$ 715,923	\$ 666,783
Medicaid	399,461	389,052
Managed care and commercial insurance	1,386,745	1,342,660
Patients	34,189	26,461
	<u>\$ 2,536,318</u>	<u>\$ 2,424,956</u>

The Network's practice is to assign a patient to the primary payer and not reflect other uninsured balances as patient revenues. Therefore, the third-party payers listed above contain patient responsibility components, such as coinsurance and deductibles.

The Network has qualified as a Medicaid DSH provider under Indiana Law (IC 12-15-16(1-3)) and, as such, is eligible to receive DSH payments for the most recently determined state fiscal year. The amount of these additional DSH funds is dependent on regulatory approval by agencies of the federal and state governments, and is determined by the level, extent and cost of uncompensated

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care as well as other factors. For the years ended December 31, 2019 and 2018, DSH payments have been made by the State of Indiana and amounts received were recorded as revenue based on data acceptable to the State of Indiana less any amounts management believes may be subject to adjustment. DSH payments are recorded by the Network after eligibility is determined by the State of Indiana. DSH amounts of \$17,932 and \$53,335 were recorded as revenue for the years ended December 31, 2019 and 2018, respectively. DSH amounts recorded as revenue in 2018 include a change in estimate of \$38,300 related to State fiscal year 2016 and 2017. Final settlement for State fiscal year 2017 was received in December 2019.

Beginning June 2012, the State of Indiana offered voluntary participation in the State of Indiana's HAF program. The State of Indiana implemented this program to utilize supplemental reimbursement programs for the purpose of providing reimbursement to providers to offset a portion of the cost of providing care to Medicaid and indigent patients. This program is designed with input from CMS and is funded with a combination of state and federal resources, including fees or taxes levied on the providers.

Reimbursement under the program is reflected within patient service revenue and the fees paid for participation in the HAF program are recorded in supplies and other expenses within the consolidated statements of operations and changes in net assets. The fees and reimbursements are settled monthly. Revenue recognized related to the HAF program was \$198,105 and \$135,510 for the years ended December 31, 2019 and 2018, respectively. Expense for fees related to the HAF program was \$83,600 and \$66,236 for the years ended December 31, 2019 and 2018, respectively.

The HAF program runs on an annual cycle from July 1 to June 30 and is effective until June 30, 2021. The consolidated balance sheets at December 31, 2019 and 2018 includes less than one month of HAF activity, or \$939 and \$1,880, respectively, in estimated third-party payer settlements payable related to the HAF program.

As discussed in Note 1, under the Network's participation in the Medicare and Medicaid programs, the Network is subject to various reviews, audits and investigations. In 2015, the Network entered into a five year corporate integrity agreement (the "CIA") with the Office of Inspector General of the United States Department of Health and Human Services to promote compliance with the statutes, regulations and written directives of Medicare, Medicaid and all other Federal health care programs. Key requirements under the CIA include maintaining the existing compliance program with required attestations provisions, minimum hours of training and education and external review of claims submitted by two of the Network's provider based locations, among others.

3. Assets Limited as to Use

The fair values of the assets limited as to use are provided by the Network's investment manager and are determined as follows:

- a) The investments designated as Level 1 inputs represent primarily cash and cash equivalents, commercial paper, equity securities and investable mutual fund shares that are traded on major stock exchanges. Thus, the fair value is determined based on quoted prices in an active market.

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- b) The investments designated as Level 2 inputs represent fixed income securities, including corporate bonds generally determined on the basis of valuations provided by a pricing service which will typically utilize industry accepted valuation models and observable market inputs to determine valuation; some valuations or model inputs provided/used by the pricing service are based upon broker quotes.
- c) The Network's investments in hedge fund of funds and private equity funds are fair valued based on the most current NAV.

Liquidity and Availability

The Network has a working capital surplus of \$412,548 and \$477,121 as of December 31, 2019 and 2018, respectively.

Financial assets available for general expenditure within one year as of December 31, 2019 and 2018 consist of the following:

	2019	2018
Cash and cash equivalents	\$ 363,353	\$ 377,594
Accounts receivable, net	333,101	298,003
Estimated third-party payor settlements receivable	9,794	73,712
Assets limited to use:		
Board-designated	1,188,005	937,293
Other accounts receivable	22,264	25,852
	<u>\$ 1,916,517</u>	<u>\$ 1,712,454</u>

The Network has certain donor-restricted assets limited to use which are available for general expenditure within one year in the normal course of operations. Accordingly, these assets have been included in the quantitative information above. Private equity securities included in board-designated funds and assets limited to use for the professional and general liability captive insurance program, which are more fully described below (Reinsurance Trust Assets), are not available for general expenditure within the next year and are not reflected in the amounts above.

As part of the Network liquidity management plan, cash in excess of daily requirements are invested in short-term investments and money market funds.

Additionally, the Network maintains a \$100,000 line of credit, as discussed in more detail in Note 6. As of December 31, 2019, the Network was in compliance with its financial debt covenants.

Funds Held by Trustee

The Hospital Revenue Bond Agreements (Note 6) require that the initial bond proceeds be held by a bank trustee until such funds are expended for eligible assets. Certain other funds are also held by the bank trustee as additional security for the bondholders and the periodic deposits of principal and interest requirements. These amounts, including interest earned from temporary investments, are segregated in accounts maintained by a bank trustee. Use of the funds is restricted to debt service requirements.

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Board-Designated Funds

The following is a summary of assets limited as to use, which are board-designated funds, at December 31, 2019 and 2018:

2019 Description	Fair Value Measurement at Reporting Date				
	Total	Level 1	Level 2	Level 3	NAV
Short-term investments	\$ 48,680	\$ 48,680	\$ -	\$ -	\$ -
Equity securities	214,605	214,605	-	-	-
Mutual funds	677,981	677,981	-	-	-
Private Equity	34,476	-	-	-	34,476
Hedge fund of funds/REITS/Other	246,739	-	-	-	246,739
Total	<u>\$ 1,222,481</u>	<u>\$ 941,266</u>	<u>\$ -</u>	<u>-</u>	<u>\$ 281,215</u>

2018 Description	Fair Value Measurement at Reporting Date				
	Total	Level 1	Level 2	Level 3	NAV
Short-term investments	\$ 16,465	\$ 16,465	\$ -	\$ -	\$ -
Equity securities	8,094	8,094	-	-	-
Mutual funds	722,390	722,390	-	-	-
Private Equity	13,042	-	-	-	13,042
Hedge fund of funds/REITS/Other	203,928	-	-	-	203,928
Total	<u>\$ 963,919</u>	<u>\$ 746,949</u>	<u>-</u>	<u>-</u>	<u>\$ 216,970</u>

The following table presents liquidity information for hedge fund of funds at December 31, 2019 and 2018:

Investment Type	Redemption Frequency	Notice Period
Hedge fund of funds	Quarterly	45 days

Reinsurance Trust Assets

The assets in the trust are maintained in a domestic trust account. These assets are restricted and may not be withdrawn or used without the consent of the trust administrator.

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The following is a summary of the assets limited as to use, which are reinsurance trust assets, at December 31, 2019 and 2018:

2019 Description	Fair Value Measurement at Reporting Date				
	Level 1	Level 2	Level 3	NAV	
Short-term investments held in trust	\$ 1,616	\$ 1,616	\$ -	\$ -	\$ -
Corporate bonds	16,559	-	16,559	-	-
Equities	869	869	-	-	-
Total	<u>\$ 19,044</u>	<u>\$ 2,485</u>	<u>\$ 16,559</u>	<u>\$ -</u>	<u>\$ -</u>

2018 Description	Fair Value Measurement at Reporting Date				
	Level 1	Level 2	Level 3	NAV	
Short-term investments held in trust	\$ 6,254	\$ 6,254	\$ -	\$ -	\$ -
Corporate bonds	9,778	-	9,778	-	-
Equities	177	177	-	-	-
Total	<u>\$ 16,209</u>	<u>\$ 6,431</u>	<u>\$ 9,778</u>	<u>\$ -</u>	<u>\$ -</u>

4. Property, Plant and Equipment

Property, plant and equipment and accumulated depreciation consist of the following at December 31, 2019 and 2018:

	Estimated Useful Lives	2019	2018
Land and land improvements	0–40 years	\$ 41,864	\$ 39,782
Buildings and improvements	2–90 years	1,324,284	1,121,741
Equipment and other	3–40 years	840,989	778,360
Construction in progress		34,278	165,676
		<u>2,241,415</u>	<u>2,105,559</u>
Less: Accumulated depreciation		<u>1,201,685</u>	<u>1,117,242</u>
		<u>\$ 1,039,730</u>	<u>\$ 988,317</u>

Depreciation expense was \$94,048 and \$83,125 for the years ended 2019 and 2018, respectively.

Property, plant and equipment includes \$845 and \$4,388 of capitalized interest at December 31, 2019 and 2018, respectively.

The Network recognized an impairment charge of \$8,067 for the year ended December 31, 2018 on goodwill associated with CHHS. In connection with a 2018 resolution by the Board of Directors to enter into the joint venture transaction described in Note 1, the Network determined the goodwill associated with a previous CHHS acquisition was impaired.

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5. Investments in Unconsolidated Affiliates

The Network has equity investments in various surgery centers, Mid America Clinical Laboratory ("MACL") and other entities. The following is a summary of the Network's investments in unconsolidated affiliates for the years ended December 31, 2019 and 2018:

	Surgery Centers	MACL	Other	Total
Balance, December 31, 2017	\$ 10,562	\$ 8,607	\$ 13,892	33,061
Capital contributions	-	-	2,243	2,243
Distributions	(11,968)	(3,352)	(7,156)	(22,476)
Equity in net income	11,735	2,958	15,090	29,783
Balance, December 31, 2018	10,329	8,213	24,069	42,611
Capital contributions	-	-	171	171
Distributions	(11,894)	(3,115)	(18,449)	(33,458)
Equity in net income	11,760	3,190	28,436	43,386
Balance, December 31, 2019	\$ 10,195	\$ 8,288	\$ 34,227	\$ 52,710

Summarized and aggregated financial statement information for the surgery centers, MACL and the other unconsolidated affiliates as of and for the year ended December 31, 2019, is as follows:

	Surgery Centers	MACL	Other	Total
Total assets	\$ 34,048	\$ 47,992	\$ 82,109	\$ 164,149
Total liabilities	14,306	10,308	19,823	44,437
Net assets	19,742	37,684	62,286	119,712
Revenues	68,796	134,333	167,448	370,577
Operating income	28,878	14,502	64,971	108,351
Net income	28,878	14,499	63,402	106,779
Network's equity in net income of unconsolidated affiliates	\$ 11,760	\$ 3,190	\$ 28,436	\$ 43,386

6. Debt

Short-term Borrowings

Short-term borrowings represent outstanding borrowings under bank lines of credit. At December 31, 2019 and 2018 there were no amounts outstanding. The maximum borrowings are \$100,000. The bank lines of credit are due on demand. The Network's short-term debt is collateralized under the same terms as the Master Indentures described below. Interest is at a floating rate.

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Long-term Debt

Long-term debt at December 31, 2019 and 2018 as obligated by CHNw, is summarized as follows:

	2019	2018
Indiana Finance Authority, Fixed Rate		
Hospital Revenue Bonds, Taxable Series 2018A		
4.79% Due May 1, 2053	\$ 102,000	\$ 102,000
4.94% Due May 1, 2058	100,000	100,000
Unamortized Discount	(798)	(821)
	<u>201,202</u>	<u>201,179</u>
Indiana Finance Authority, Variable Rate		
Hospital Revenue Bonds, Series 2016A		
Due May 1, 2017 to 2045	<u>80,080</u>	<u>82,335</u>
	80,080	82,335
Indiana Finance Authority, Variable Rate		
Hospital Revenue Bonds, Series 2016B		
Due May 1, 2017 to 2028	<u>16,100</u>	<u>19,500</u>
	16,100	19,500
Indiana Finance Authority, Fixed Rate		
Hospital Revenue Bonds, Taxable Series 2015A		
4.24% Due May 1, 2025	100,000	100,000
5.43% Due May 1, 2045	101,728	101,728
Unamortized Discount	(651)	(713)
	<u>201,077</u>	<u>201,015</u>
Indiana Finance Authority, Fixed Rate		
Hospital Revenue Bonds, Series 2012A		
Due May 1, 2013 to May 1, 2028	75,404	80,944
4.00% term bonds due May 1, 2025	88,930	88,930
5.00% term bonds due May 1, 2042	174,455	174,455
Unamortized premium	21,505	22,443
	<u>360,294</u>	<u>366,772</u>
Indiana Finance Authority, Variable Rate		
Hospital Revenue Bonds Series 2012B,		
Due November 27, 2012 to November 27, 2039	<u>61,530</u>	<u>63,605</u>
	61,530	63,605
PNC Bank; Term Loan interest payable monthly		
Due January 1, 2022	2,571	3,714
BMO Harris Bank; Term Loan;		
Due November 18, 2020	7,217	14,847
Other long-term debt	<u>1,039</u>	<u>2,207</u>
	931,110	955,174
Less: Current portion of long-term debt	23,013	23,060
Deferred financing costs, net	<u>5,170</u>	<u>5,433</u>
	278,927	278,127
Long-term debt, net of current portion and deferred financing costs	<u>\$ 902,927</u>	<u>\$ 926,681</u>

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Series 2018A

On February 21, 2018, CHNw issued Taxable Bonds, Series 2018A in the aggregate amount of \$202,000. The proceeds are available to finance, refinance or reimburse the costs of constructing, acquiring, renovating or equipping certain health facility property used by CHNw. At any time on or after May 1, 2028, the Series 2018A bonds are subject to redemption prior to their maturity at the option of CHNw, in whole or in part, in any order of maturity designated by CHNw, at a redemption price of 100% of the principal amount of each Series 2018A Bond to be redeemed, plus accrued and unpaid interest to the date fixed for redemption. Interest rates are fixed for the Series 2018A bonds, with stated rates of 4.79% and 4.94%.

Series 2016A and 2016B

On September 22, 2016, the Indiana Finance Authority ("IFA") issued Hospital Revenue Bonds, Series 2016A and Series 2016B, in the aggregate amount of \$112,600 for the purpose of making a loan to CHNw. The proceeds of this loan from IFA are available to finance, refinance or reimburse the costs of constructing, acquiring, renovating or equipping certain health facility property used by CHNw. The Series 2016A and Series 2016B bonds are subject to redemption prior to their stated maturity at the option of CHNw on a 30-day notice in whole or in part, at a redemption price equal to 100% of the principal amount plus interest at the date of redemption. Interest rates are variable for the Series 2016A and 2016B bonds, with stated rates of 1.83% and 2.05%, respectively, as of December 31, 2019.

Series 2015A

On June 1, 2015, CHNw issued Taxable Bonds, Series 2015A in the aggregate amount of \$201,728. The proceeds are available to pre-fund the termination of the Network's defined benefit retirement plan, finance, refinance or reimburse the costs of constructing, acquiring, renovating or equipping certain health facility property used by CHNw. The Series 2015A bonds are subject to redemption prior to their stated maturity at the option of CHNw on a 25-day notice in whole or in part, at a redemption price equal to the Make-Whole redemption price. The "Make-Whole Redemption Price" is the greater of (i) 100% of the principal amount of the Series 2015A Bonds to be redeemed and (ii) the sum of the present value of the remaining scheduled payments of principal and interest to the maturity date of the Series 2015A Bonds to be redeemed, not including any portion of those payments of interest accrued and unpaid as of the date on which the Series 2015A Bonds are to be redeemed, discounted to the date on which the Series 2015A Bonds are to be redeemed on a semiannual basis assuming a 360-day year consisting of twelve 30-day months at the Treasury Rate plus 35 basis points; plus, in each case, accrued and unpaid interest on the Series 2015A Bonds to be redeemed on the redemption date of the principal amount plus interest at the date of redemption. Interest rates are fixed for the Series 2015A bonds, with stated rates of 4.24% and 5.43%.

Series 2012A and 2012B

On November 27, 2012, IFA issued Hospital Revenue Bonds, Series 2012A and Adjustable Rate Hospital Revenue Bonds, Series 2012B, in the aggregate amount of \$450,445 for the purpose of making a loan to CHNw. The proceeds of this loan from IFA are available to finance, refinance or reimburse the costs of constructing, acquiring, renovating or equipping certain health facility property used by CHNw. The Series 2012A and Series 2012B bonds are subject to redemption prior to their stated maturity at the option of CHNw on a 30-day notice in whole or in part, at a redemption price equal to 100% of the principal amount plus interest at the date of redemption. Interest rates are fixed for the Series 2012A bonds, with stated rates of 4% and 5%. The Series 2012B bond has a variable rate set at 70% of the 30-day LIBOR, subject to change daily and payable monthly with stated rate of 2.11% as of December 31, 2019.

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Term Loan – CHNw – PNC Bank

On December 22, 2014, CHNw entered into a Master Note Obligation, Series 2014-TL to evidence and secure payments between CHNw and PNC Bank. The loan was made to refinance Howard's promissory notes. Principal is due quarterly and interest payments are due monthly. The loan matures January 1, 2022. The loan bears interest at rates determined monthly and payable on the first business day of each calendar month. Interest is computed based on LIBOR plus 85 basis points and was 2.5% as of December 31, 2019. Principal payments are due quarterly.

Term Loan – CHNw – BMO Harris Bank

On November 18, 2013, CHNw entered into a Master Note Obligation, Series 2013-TL to evidence and secure payments between CHNw and BMO Harris Bank. The loan was made to secure costs associated with the Network's electronic medical record information system. Principal and interest payments are due monthly. The loan matures November 18, 2020. The interest is fixed at 1.33%, with principal and interest payments due monthly.

In general, the various Network debt agreements restrict the amount of indebtedness that the Network may incur, the sale, lease or other disposition of operating assets, and the acceptable investments of the trust funds. These agreements require a debt service ratio at the end of any fiscal year of at least 1.10 to 1. The Network was in compliance with its financial debt covenant at December 31, 2019 and 2018.

Scheduled principal repayments on long-term debt are as follows:

2020	\$ 23,013
2021	15,510
2022	15,218
2023	14,830
2024	15,425
Thereafter	<u>827,058</u>
	911,054
Plus: Unamortized premium, net	<u>20,056</u>
	<u>\$ 931,110</u>

For 2019 and 2018, interest cost incurred and capitalized in connection with the construction of capital assets aggregated to \$845 and \$4,388, respectively.

7. Retirement Plans

Defined Contributions Plans

The Network sponsors various defined contribution benefit plans covering eligible employees, including a 401(k) plan and 403(b) plan. Effective December 16, 2019, the CHA 403(b) plan was merged into the Network's 403(b) plan. These plans participants may contribute up to 100% of compensation, as defined, and include employer matching contributions based on the amount of the participant's contributions to the plans. The CHA 403(b) plan also provides a 3% annual employer contribution, and the Network may elect to provide an annual discretionary employer contribution to 401(k) plan participants. During 2019 and 2018, the Network made zero discretionary contributions to 401(k) plan participants. The expense associated with the defined contribution plans was \$43,224 and \$36,376 for 2019 and 2018, respectively.

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Defined Benefit Plans

The Network has a defined benefit replacement plan. The defined benefit provisions of the replacement plan apply to all employees of the Network hired prior to January 1, 1984. The replacement plan was originally established on that date to provide such employees those benefits otherwise available under the Federal Insurance Contributions Act during the period January 1, 1981 to December 31, 1983 when the Network withdrew coverage of its employees under the Act. Pursuant to the Social Security Amendment Act of 1983, the Network reentered the Social Security system on January 1, 1984. As a result, funding of the plan was terminated during 1985. If authorized by the Network's Board of Directors, each replacement plan participant may elect to contribute to the plan an amount each pay period, subject to the maximum established by the Board of Directors. Such authorization was not granted during 2019 and 2018. During 2019 and 2018, CHNw made \$0 contributions to the replacement plan. Net pension expense (income) for 2019 and 2018 was \$537 and \$(260), respectively. Net accrued pension expense at December 31, 2019 and 2018 was \$1,123 and \$2,316, respectively.

8. Leases

Beginning in 2019, the Network determines if a contract contains a lease by evaluating the nature and substance of the contract. The Network records a right of use asset and lease liability for substantially all leases for which it is a lessee. The Network leases property and equipment under operating and finance leases. Right of use assets and lease liability associated with finance leases are not material. The Network has no significant lease agreements in place for which the Network is a lessor.

Right of use assets and lease liabilities are recognized based on the net present value of the future minimum lease payments over the lease term at commencement date. The Network uses a risk free rate in measuring the lease liabilities. Lease payments are recognized on a straight-line basis over the lease term. When portions of the lease payments are not fixed or depend on an index or rate we consider those payments to be variable in nature. Variable lease payments are not material.

Most leases include options to renew, with renewal terms that can extend the lease term. The exercise of the lease renewal options is at the sole discretion of the Network. When determining the lease term, we included options to extend or terminate the lease when it is reasonably certain that we will exercise that option. The Network lease agreements do not contain any material residual value guarantees or material restrictive covenants.

Upon adoption of ASC 842, the Network utilized the following elections of practical expedients:

- The Network elected to not separate lease component from the non-lease component and account for as a single lease for property and equipment.
- If a lease had a term of less than 12 months, then the Network elected to not apply ASC 842 recognition requirements.
- The Network elected to not reassess arrangements entered into prior to January 1, 2019 in terms of whether an arrangement contained a lease.
- The Network elected to not use hindsight in determining the lease term for lease contracts that have historically been renewed or amended.

Operating lease expenses, excluding short-term lease expenses, were \$42,167 at December 31, 2019 and are included within operating expenses in the consolidated statement of operations. Short-term lease costs were not material.

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The weighted average remaining lease term is 8.17 years with a weighted average discount rate of 4.0% at December 31, 2019.

Scheduled minimum lease payments required under non-cancellable operating leases for the next five years and thereafter as of December 31, 2019 were as follows:

	<u>Operating</u>
2020	\$ 40,178
2021	35,021
2022	28,409
2023	21,728
2024	19,441
Thereafter	<u>82,876</u>
Total future minimum lease payments	227,653
Less: Imputed interest	<u>37,500</u>
Net present value of minimum lease payments	<u>\$ 190,153</u>

Cash for amounts included in the measurement of lease liabilities for operating leases was \$41,228 for the year ended December 31, 2019. Noncash lease liabilities arising from obtaining right of use assets was \$45,531 for the year ended December 31, 2019.

For the year ended 2018, under prior lease disclosure requirements

The Network leases certain of its facilities and equipment under noncancelable operating lease agreements. The leases contain various renewal options and clauses for escalation based on increases in interest costs, as defined. Rental expense for these leased facilities and equipment aggregated \$43,924.

Future minimum rental payments for each of the next five years at December 31, 2018 are as follows:

2019	\$ 39,716
2020	35,011
2021	30,486
2022	24,061
2023	17,757
Thereafter	<u>68,868</u>
	<u>\$ 215,899</u>

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9. Functional Expenses

The Network provides health care services to residents within its community and surrounding areas. The Network's consolidated financial statements report certain categories of expenses that are attributable to more than one supporting function. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. Salaries, benefits and pension expenses are allocated on a per full-time equivalent basis. Depreciation, amortization, interest and financing costs are allocated based on square footage. Expenses by both their nature and function for 2019 and 2018 are as follows:

	2019	2018
Healthcare services		
Salaries, benefits and pension	\$ 1,066,855	\$ 994,366
Supplies and other expenses	748,582	693,696
Depreciation and amortization	60,315	51,970
Interest and financing costs	24,004	19,993
	<u>1,899,756</u>	<u>1,760,025</u>
Administrative and general		
Salaries, benefits and pension	342,117	326,898
Supplies and other expenses	205,205	204,718
Depreciation and amortization	45,155	44,237
Interest and financing costs	14,587	13,279
	<u>607,064</u>	<u>589,132</u>
	<u>\$ 2,506,820</u>	<u>\$ 2,349,157</u>

10. Net Assets with Donor Restrictions

Net assets with donor restrictions are funds limited by donors to a specific time period or purpose or maintained by the Network in perpetuity. Net assets with donor restrictions as of December 31, 2019 and 2018 are as follows:

	2019	2018
Medical education	\$ 4,627	\$ 4,516
Clinical/patient support	26,352	11,721
Capital improvements	3,033	2,519
	<u>\$ 34,012</u>	<u>\$ 18,756</u>

The Network is an income beneficiary of certain irrevocable trusts. The aggregated income from these trusts was \$2,935 and \$954 for the years ended December 31, 2019 and 2018, respectively.

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11. Commitments and Contingencies

Pending Litigation

Claims for employment matters, and breach of contract have been asserted against the Network by various claimants, and provision for such claims is made in the financial statements when management considers the likelihood of loss from the contingency to be probable and reasonably estimable. The claims are in various stages of processing and some will ultimately be brought to trial. There are known incidents occurring through December 31, 2019 that may result in the assertion of additional claims, and other claims may be asserted arising from services provided to patients in the past. The Network does not believe that claims and lawsuits individually or in aggregate will have a material adverse effect on the Network's future consolidated financial position, results from operations, or cash flows.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Management believes that the Network is in compliance with applicable government laws and regulations. Regulatory inquiries are made in the normal course of business and compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time. Violations of these regulations could result in the imposition of significant fines and penalties, as well as having a significant effect on reported income from operations or cash flows.

In November 2014, the Network and CPI received a subpoena duces tecum from the Office of Inspector General within the U.S. Department of Health and Human Services requesting information regarding certain financial relationships with physicians and physician groups as well as an arrangement with one hospital system (the "CPN Subpoena"). In connection with the CPN Subpoena, the Network collected and produced responsive documents and otherwise responded to the numerous government requests and follow-up inquiries. Additionally, the Network, through legal counsel, participated in several in-person meetings with representatives from the Department of Justice, the U.S. Attorney's Office for the Southern District of Indiana, and other government representatives. The Network believes it is in compliance with applicable laws and regulations, but in order to avoid future costs and risks associated with potential litigation, the Network engaged in settlement negotiations in mid-2018, which included several settlement offers, with the Network's most recent offer being \$22,500. As of December 31, 2019 and 2018, this offer is accrued in "Other current liabilities" on the consolidated balance sheet. Settlement negotiations were ultimately unsuccessful and, in January 2020, the whistleblower's complaint was unsealed. On January 6, 2020, the Department of Justice filed a complaint against CHNw in the Southern District of Indiana alleging that CHNw violated the Federal False Claims Act based upon a theory that CHNw violated the Stark Law. Although the government declined to intervene in connection with all of the whistleblower's allegations, the whistleblower is nevertheless attempting to convince the court that it should be permitted to continue to pursue these additional claims. The Network believes the allegations presented by the government and the whistleblower are without merit and as such will defend itself vigorously. The ultimate potential exposure in this matter is not determinable but could have a material adverse effect on the Network's results of operations, financial position, and cash flows.

The Network is in compliance with the Indiana Medical Malpractice Act which limits the amount of recovery to \$1,800 for individual malpractice claims, \$500 of which would be paid by the Network and the balance being paid by the State of Indiana Patient Compensation Fund. Management believes the ultimate disposition of existing medical malpractice and other claims will not have a material effect on the consolidated financial position or results of operations of the Network.

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Purchase Commitments

As of December 31, 2019, the Network had purchase commitments for various equipment and services of \$51,929.

12. Acquisitions

On November 8, 2019, the Network entered into an integration agreement with Fairbanks. No consideration was exchanged related to the integration. The integration of Fairbanks into the Network closed on November 30, 2019. The integration was accounted for as an acquisition and thus the purchase accounting rules were applied in accordance with ASC 958-805, Not for Profit Entities: Business Combinations. The Network recorded the fair value of Fairbank's assets and liabilities in its consolidated financial statements using various fair value techniques including independent appraisals for property, plant and equipment. The excess of the fair value of the assets received over the liabilities assumed represent an inherent contribution received and is recognized as excess of net assets acquired in the accompanying consolidated financial statements. Fairbank's 2019 results of operations since the date of acquisition are reflected in the Network's accompanying consolidated statement of operations.

The fair value of the assets and liabilities acquired as of November 30, 2019 is as follows:

Cash and cash equivalents	\$ 7,735
Patient accounts receivable, net	4,503
Estimated third-party payor settlements receivable	215
Other accounts receivable	632
Other assets	473
Board-designated funds	807
Property, plant and equipment	17,053
Right of use operating assets	<u>187</u>
Total assets	31,605
Accounts payable	1,332
Accrued salaries and wages	1,275
Estimated third-party payor settlements payable	74
Lease liabilities	<u>187</u>
Total liabilities	<u>2,868</u>
Excess in fair value of net assets acquired	<u><u>\$ 28,737</u></u>