

Carilion Clinic and Subsidiaries

Consolidated Financial Statements as of and for the
Years Ended September 30, 2019 and 2018 and
Independent Auditors' Report

CARILION CLINIC AND SUBSIDIARIES

Roanoke, Virginia
A Nonstock, Nonprofit Corporation
Chartered by the Commonwealth of Virginia

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CARILION CLINIC AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Carilion Clinic and Subsidiaries
Roanoke, Virginia

We have audited the accompanying consolidated financial statements of Carilion Clinic and subsidiaries ("Carilion"), which comprise the consolidated balance sheets as of September 30, 2019 and 2018, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to Carilion'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 Carilion'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 Carilion as of September 30, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Notes 1 and 11 to the consolidated financial statements, the consolidated financial statements include alternative investments valued at \$872,162,000 (35% of total assets) and \$785,323,000 (33% of total assets) as of September 30, 2019 and 2018, respectively, whose fair values have been estimated by management in the absence of readily determinable fair values. In addition, the defined benefit postretirement plan assets discussed in Notes 7 and 11 to the consolidated financial statements include alternative investments of \$813,045,000 and \$727,811,000 as of September 30, 2019 and 2018, respectively, whose fair values have been estimated by management in the absence of readily determinable fair values. Our opinion is not modified with respect to these matters.

Deloitte + Touche LLP

January 27, 2020

CARILION CLINIC AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF SEPTEMBER 30, 2019 AND 2018 (In thousands)

	2019	2018
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 18,031	\$ 10,048
Patient accounts receivable—net of allowance for doubtful accounts of \$167,327 in 2018	326,095	268,034
Inventories	22,420	20,350
Prepaid expenses and other current assets	<u>41,203</u>	<u>22,700</u>
Total current assets	407,749	321,132
INVESTMENTS	196,866	159,740
ASSETS WHOSE USE IS LIMITED	1,217,598	1,186,297
INTEREST RATE SWAPS	9,722	9,745
PROPERTY AND EQUIPMENT—Net	661,549	661,153
OTHER ASSETS	<u>16,608</u>	<u>21,979</u>
TOTAL	<u>\$2,510,092</u>	<u>\$2,360,046</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Current portion of long-term debt	\$ 16,002	\$ 15,017
Accounts payable	81,293	65,805
Accrued salaries and wages	96,210	80,624
Accrued vacation	46,469	45,519
Due to third-party payors	29,484	26,926
Other current liabilities	<u>59,855</u>	<u>68,892</u>
Total current liabilities	329,313	302,783
LONG-TERM DEBT—Net of current portion	529,193	544,437
INTEREST RATE SWAPS	90,082	43,899
PENSION AND OTHER LIABILITIES	<u>787,726</u>	<u>477,069</u>
Total liabilities	<u>1,736,314</u>	<u>1,368,188</u>
COMMITMENTS AND CONTINGENCIES (Notes 3, 5, 6, 9, and 10)		
NET ASSETS:		
Carilion Clinic and subsidiaries	730,217	957,472
Noncontrolling interest	<u>7,166</u>	<u>6,420</u>
Net assets without donor restrictions	737,383	963,892
Net assets with donor restrictions	<u>36,395</u>	<u>27,966</u>
Total net assets	<u>773,778</u>	<u>991,858</u>
TOTAL	<u>\$2,510,092</u>	<u>\$2,360,046</u>

See notes to consolidated financial statements.

CARILION CLINIC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED SEPTEMBER 30, 2019 AND 2018 (In thousands)

	2019	2018
UNRESTRICTED OPERATING REVENUES AND GAINS:		
Patient service revenue—net of contractual allowances and discounts	\$ -	\$ 1,825,321
Provision for bad debts		<u>(130,995)</u>
Net patient service revenue	1,836,224	1,694,326
Other operating revenue	104,997	109,480
Net assets released from restrictions	<u>2,602</u>	<u>2,700</u>
Total unrestricted operating revenues and gains	<u>1,943,823</u>	<u>1,806,506</u>
OPERATING EXPENSES:		
Salaries and outside labor	938,946	901,892
Benefits	194,588	200,137
Supplies and other expenses	598,834	519,194
Depreciation	92,273	90,205
Interest expense	<u>22,675</u>	<u>22,677</u>
Total operating expenses	<u>1,847,316</u>	<u>1,734,105</u>
OPERATING INCOME	<u>96,507</u>	<u>72,401</u>
NONOPERATING GAINS (LOSSES):		
Investment income	198	103,478
Other nonoperating losses	(2,841)	(10,321)
Other components of net periodic pension cost	<u>(7,654)</u>	<u>(20,338)</u>
Total nonoperating (losses) gains	<u>(10,297)</u>	<u>72,819</u>
EXCESS OF UNRESTRICTED REVENUES AND GAINS OVER EXPENSES FROM CONSOLIDATED OPERATIONS	86,210	145,220
PENSION-RELATED CHANGES OTHER THAN NET PERIODIC PENSION COST	(312,759)	129,065
NET ASSETS RELEASED FROM RESTRICTIONS FOR PURCHASES OF PROPERTY AND EQUIPMENT	<u>40</u>	<u>210</u>
(DECREASE) INCREASE IN NET ASSETS WITHOUT DONOR RESTRICTIONS FROM CONSOLIDATED OPERATIONS	(226,509)	274,495
CHANGE IN NET ASSETS WITHOUT DONOR RESTRICTIONS ATTRIBUTABLE TO NONCONTROLLING INTEREST	<u>746</u>	<u>761</u>
CHANGE IN NET ASSETS WITHOUT DONOR RESTRICTIONS ATTRIBUTABLE TO CARILION CLINIC AND SUBSIDIARIES	<u>\$ (227,255)</u>	<u>\$ 273,734</u>

See notes to consolidated financial statements.

CARILION CLINIC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS FOR THE YEARS ENDED SEPTEMBER 30, 2019 AND 2018 (In thousands)

	2019	2018
NET ASSETS WITHOUT DONOR RESTRICTIONS:		
Excess of unrestricted revenues and gains over expenses from consolidated operations	\$ 86,210	\$145,220
Pension-related changes other than net periodic pension cost	(312,759)	129,065
Net assets released from restrictions for purchases of property and equipment	<u>40</u>	<u>210</u>
(Decrease) increase in net assets without donor restrictions	<u>(226,509)</u>	<u>274,495</u>
NET ASSETS WITH DONOR RESTRICTIONS:		
Contributions	10,071	2,297
Investment income	1,000	1,588
Net assets released from restrictions for purchase of property and equipment	(40)	(210)
Net assets released from restrictions for operations	<u>(2,602)</u>	<u>(2,700)</u>
Increase in net assets with donor restrictions	<u>8,429</u>	<u>975</u>
(DECREASE) INCREASE IN NET ASSETS	(218,080)	275,470
NET ASSETS—Beginning of year	<u>991,858</u>	<u>716,388</u>
NET ASSETS—End of year	<u>\$ 773,778</u>	<u>\$991,858</u>

See notes to consolidated financial statements.

CARILION CLINIC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2019 AND 2018 (In thousands)

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
(Decrease) increase in net assets	\$(218,080)	\$ 275,470
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities:		
Depreciation	92,273	90,205
Deferred compensation	1,466	5,984
Provision for bad debts		130,995
Net realized and unrealized losses (gains) on investments and interest rate swaps	14,924	(93,038)
Losses (gains) on sale of property and equipment	752	(23)
Donor restricted contributions and restricted investment income	(11,071)	(3,885)
Pension-related changes other than net periodic pension cost	312,759	(129,065)
Funding in excess of net periodic pension cost	(7,960)	(6,184)
Changes in:		
Patient accounts receivable	(58,061)	(169,708)
Inventories, prepaid expenses, and other current assets	(20,573)	2,889
Other assets	5,371	(730)
Accounts payable and accrued expenses	31,130	31,722
Due to third-party payors	2,558	4,152
Other current liabilities	(9,028)	11,770
Other liabilities	<u>3,751</u>	<u>(4,502)</u>
Net cash provided by operating activities	<u>140,211</u>	<u>146,052</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(93,270)	(100,469)
Proceeds from sale of property and equipment	734	273
Purchases of investments and assets whose use is limited	(278,066)	(312,951)
Proceeds from sale of investments and assets whose use is limited	<u>240,921</u>	<u>280,795</u>
Net cash used in investing activities	<u>(129,681)</u>	<u>(132,352)</u>

(Continued)

CARILION CLINIC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2019 AND 2018 (In thousands)

	2019	2018
CASH FLOWS FROM FINANCING ACTIVITIES:		
Donor restricted contributions and restricted investment income	\$ 11,071	\$ 3,885
Change in annuity obligation	45	51
Principal payments and retirements of long-term debt	(301,168)	(15,651)
Debt refinancing costs	(1,160)	
Proceeds from issuance of long-term debt	<u>288,665</u>	<u>6,734</u>
Net cash used in financing activities	<u>(2,547)</u>	<u>(4,981)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	7,983	8,719
CASH AND CASH EQUIVALENTS—Beginning of year	<u>10,048</u>	<u>1,329</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 18,031</u>	<u>\$ 10,048</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for interest (net of amount capitalized)	<u>\$ 23,458</u>	<u>\$ 23,913</u>
Purchases of property and equipment in accounts payable and other liabilities	<u>\$ 1,610</u>	<u>\$ 725</u>
See notes to consolidated financial statements.		(Concluded)

CARILION CLINIC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2019 AND 2018 (In thousands)

1. CORPORATE ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization—Carilion Clinic and subsidiaries (Carilion) is an integrated, not-for-profit health care organization based in Roanoke, Virginia with a commitment to improve the health of the communities it serves. Carilion consists of seven owned and operated hospitals, more than 225 practice sites, pharmacies, health and wellness facilities, and other complementary services. Carilion provides primary and preventative care services, and more than 75 specialty services including oncology, cardiology, cardiothoracic surgery and vascular care, radiology, gastroenterology, neurology, neurosurgery, orthopedic, infectious disease, obstetrics and gynecology, urology, pediatric and women’s health. Carilion is home to the region’s only Level 1 Trauma Center.

Principles of Consolidation—The consolidated financial statements of Carilion have been prepared under the accrual basis in accordance with accounting principles generally accepted in the United States of America (US GAAP) as set forth in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) and include all subsidiaries for which Carilion has a controlling financial interest. All intercompany accounts and transactions have been eliminated in consolidation.

Entities in which Carilion has a controlling financial interest include Carilion Medical Center (CMC) (t/a Carilion Roanoke Memorial Hospital and Carilion Roanoke Community Hospital); Carilion New River Valley Medical Center (CNRV); Carilion Franklin Memorial Hospital (CFMH); Carilion Giles Community Hospital (CGCH); Carilion Tazewell Community Hospital (CTCH); Carilion Clinic Properties, LLC (CCP); Carilion Clinic Foundation (CF); Carilion Services, Inc. (CSI), and Carilion Stonewall Jackson Hospital (CSJH), a majority owned (80%) subsidiary of Carilion Clinic. Carilion Clinic serves as sole member for each entity, aside from CSJH in which the noncontrolling interest remains with the Stonewall Jackson Hospital Community Health Foundation.

CSI is the sole stockholder of Blue Ridge Indemnity Company, LLC (BRIC), Carilion Clinic Patient Transportation, LLC (CCPT), Carilion Professional Services, LLC (CPS), CHS, Inc. (CHSI), and Carilion Clinic Medicare Resources, LLC (CCMR).

CHSI is a holding company for certain taxable subsidiaries. In 2017, Carilion Clinic Medicare Shared Savings Company, LLC d/b/a Doctors Connected (Doctors Connected) was created as a joint venture between CMC and CHSI. Doctors Connected is a Centers for Medicare and Medicaid Services (CMS) Next Generation Accountable Care Organization (ACO).

The accounts of CMC, CNRV, CFMH, CGCH, CSJH, and CCP are collectively referred to as the Obligated Group as defined by the Master Trust Indenture executed by, and among the members of, the Obligated Group in connection with the issuance of certain long-term debt obligations.

Use of Estimates—The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the 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. Significant estimates and assumptions are used for, but not limited to, recognition of net patient service revenue; valuation of patient accounts receivable; liabilities for losses and expenses related to employee health insurance and professional and general liability risks; valuation of pension plan liabilities; valuation of investments and interest rate swap instruments; depreciation of property and equipment; and estimated third-party settlements. Future events and their effects cannot be predicted with certainty; accordingly, management’s accounting estimates require the use of judgment. The accounting estimates used in the preparation of the accompanying consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained, and as the operating environment changes. Management regularly evaluates the accounting policies and estimates it uses. In general, management relies on historical experience and on other assumptions believed to be reasonable under the circumstances and may employ outside experts to assist in the evaluation, as considered necessary. Although management believes all adjustments considered necessary for fair presentation have been included, actual results may vary from those estimates.

Cash and Cash Equivalents—Cash and cash equivalents consist primarily of demand deposits, temporary investments in bank repurchase agreements, certificates of deposit, and overnight master notes with banks. Carilion considers all highly liquid investments with an original maturity of three months or less at the date of purchase to be cash equivalents. At various times throughout the year, Carilion maintains deposits at financial institutions in excess of amounts covered by Federal Deposit Insurance Corporation limits.

Patient Accounts Receivable—Patient accounts receivable are stated at net realizable amounts due from patients, third-party payors, and other insurers for which Carilion expects to be entitled in exchange for providing patient care. For patient accounts receivable resulting from revenue recognized prior to October 1, 2018, an allowance for doubtful accounts was established to reduce the carrying value of such receivables to net realizable value. Subsequent to the adoption of Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* (ASU 2014-09), the estimated uncollectible amounts are generally considered implicit price concessions that are a direct reduction to patient accounts receivable rather than an allowance for doubtful accounts.

Inventories—Inventories are stated at the lower of cost (first-in, first-out) or market.

Investments and Assets whose Use is Limited—Carilion combines its investments and certain assets whose use is limited in a system-wide investment pool. Assets whose use is limited primarily include assets designated by the Board of Directors (the “Board”) for future capital improvements, over which the Board retains control and may, at its discretion, subsequently use for other purposes.

Carilion’s investments and assets whose use is limited are measured at fair value in the consolidated balance sheets. Investment income, including interest and dividends and realized and unrealized gains and losses, is included in investment income in the consolidated statements of operations, unless restricted by explicit donor stipulations or by law.

Carilion's investments include debt and equity securities with readily determinable fair values, commingled funds, and other investments, including hedge funds, limited partnerships, limited liability corporations, and offshore investment funds (collectively, alternative investments). Commingled funds and alternative investments are measured at fair value using the net asset value (NAV) per share reported by the respective fund managers or the general partners as a practical expedient.

Alternative investments are less liquid compared to Carilion's other investments and may contain elements of both credit and market risk. Such risks could include, but are not limited to, limited liquidity, absence of oversight, dependence upon key individuals, emphasis on speculative investments (both interest rate swaps and nonmarketable investments), and nondisclosure of portfolio composition. Underlying holdings of alternative investments include certain types of financial instruments, including, among others, futures and forward contracts, options, and securities sold not yet purchased, intended to hedge against changes in the market value of investments. These financial instruments, which involve varying degrees of off-balance-sheet risk for the limited partnerships, limited liability corporations, and offshore investment funds, may result in a loss due to changes in the market.

Management, with the assistance of a third-party investment consultant, where appropriate, evaluates the valuations provided by external fund managers or general partners for appropriateness through review of the most recently available annual audited financial statements and unaudited interim reporting for the fund, review of the methodologies used to determine fair value, and comparisons of fund performance to market benchmarks.

The estimated fair value of certain alternative investments, such as private equity interests, is based on valuations performed prior to the consolidated balance sheet's date by the external investment managers and adjusted for cash receipts, cash disbursements, and securities distributions through September 30. Because alternative investments are not readily marketable, their estimated fair value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investments existed. Such differences could be material.

Derivative Instruments—Carilion uses interest rate swap instruments to manage its exposure to movements in interest rates. Interest rate swaps are contractual agreements between two parties for the exchange of interest payments on a notional principal amount at agreed-upon fixed or floating rates for defined periods. Interest rate swaps are measured at fair value in the accompanying consolidated balance sheets, with the change in fair value included in investment income in the accompanying consolidated statements of operations.

Property and Equipment—Property and equipment are stated at cost, less accumulated depreciation. Donated property and equipment are recorded at fair value at the date of donation. Depreciation is computed on the straight-line method over the estimated useful lives of the depreciable assets, except for leasehold improvements, which are amortized over the shorter of the expected useful life of the improvement or the term of the related lease. The estimated useful life of buildings is 25–40 years. The estimated useful life of fixed equipment is 10–20 years. The estimated useful life of movable equipment is 3–15 years.

Long-lived assets are reviewed for impairment whenever events or circumstances indicate that their carrying amount may not be recoverable. The recoverability of long-lived assets is evaluated by comparing the carrying amount to the estimated undiscounted cash flows. If the carrying amount exceeds the estimated undiscounted cash flows, an impairment charge would be recognized for the amount by which the carrying amount exceeds the fair value of the long-lived asset. Management determined there was no impairment of long-lived assets as of or during the years ended September 30, 2019 and 2018.

Interest Costs—Interest costs incurred on borrowed funds, net of interest income earned on the unexpended bond proceeds during the period of construction of capital assets, are capitalized as a component of the costs of acquiring those assets. Such amounts were not material to the consolidated financial statements as of and for the years ended September 30, 2019 and 2018.

Bond Issue Costs and Original Issue Bond Premiums—Unamortized bond issue costs and original issue premiums are netted against long-term indebtedness in the accompanying consolidated balance sheets. Bond issue costs and original issue premiums are amortized over the period the obligation is outstanding using the effective interest method.

Pension Obligation—Pension obligation represents the value of the projected benefit obligation of Carilion's pension plans over the fair value of the plans' assets. The projected benefit obligation is measured by a third-party actuary. The pension plan's obligations and plan assets are measured as of September 30.

Carilion reports the service cost component of net periodic pension costs in benefits in the consolidated statement of operations. The remainder of net periodic pension costs are recorded in other components of net periodic pension costs in the consolidated statement of operations.

Net Assets and Contributions—Net assets are classified into two categories: without donor restrictions and with donor restrictions. Contributions received without specific restrictions from donors and funds that arise from Carilion's operations are classified as net assets without donor restrictions. Contributions are reported as net assets with donor restrictions if they are received with donor stipulations that limit the use of the assets to a particular time or purpose. 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 as net assets released from restrictions in the consolidated statements of operations. Net assets subject to donor restrictions requiring assets to be held in perpetuity are classified as net assets with donor restrictions.

Net Patient Service Revenue—Patient service revenue is reported at the amount that reflects the consideration to which Carilion expects to be entitled in exchange for providing patient care. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided. Revenue for services satisfied over time is recognized based on services incurred in relation to expected charges. Carilion 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 inpatient acute care services. Revenue for performance obligations satisfied at a point in time is recognized when goods or services are provided by Carilion.

The unsatisfied or partially satisfied performance obligations referred to previously are primarily related to inpatient 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. In general, patients and third-parties are billed several days after the services are performed or the patient is discharged.

Carilion has agreements with third-party payors that provide for payments to Carilion at amounts different from its established rates. Carilion determines the transaction price based on standard charges for goods and services provided, reduced by explicit price concessions for contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with Carilion's policy, and/or implicit price concessions provided to uninsured patients. Consistent with Carilion's mission, care is provided to patients regardless of their ability to pay. The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts Carilion expects to collect based on its collection history with those patients.

Carilion determines its estimates of explicit and implicit price concessions using a portfolio approach as a practical expedient in accordance with ASU 2014-09. Subsequent changes in the transaction price that are determined to be the result of an adverse change in the patient's ability to pay are recorded as operating expenses in the consolidated statements of operations. The provision for bad debts for the year ended September 30, 2019 was not material to the consolidated financial statements.

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

Charity Care—Carilion is committed to providing quality health care to all, regardless of ability to pay. Under Carilion's financial assistance policy, patients meeting certain criteria receive care without charge or at amounts less than established rates. Carilion does not pursue collection of amounts determined to qualify as financial assistance, amounts are not included within net revenue, nor included in patient accounts receivable. Carilion estimates the direct and indirect costs to provide financial assistance using a calculated ratio of cost-to-gross charges. The estimated cost of providing financial assistance to patients was \$44,952 and \$69,200 for fiscal years ended September 30, 2019, and 2018, respectively.

Also, management believes that a portion of the implicit price concessions relating to patient service revenue represents amounts from patients who would otherwise qualify for financial assistance, but do not respond to attempts to obtain the necessary financial information. The cost of providing these services is not included in the amounts disclosed above.

Consolidated Statements of Operations—The consolidated statements of operations include excess of unrestricted revenues and gains over expenses. Changes in net assets without donor restrictions that are excluded from excess of unrestricted revenues and gains over expenses include pension-related changes other than net periodic pension cost and net assets released from restrictions for purchases of property and equipment.

Income Taxes—CCMR and CHSI and its subsidiaries are taxable corporations. Due to the losses incurred by Carilion's taxable subsidiaries, there was no income tax expense or benefit for the years ended September 30, 2019 and 2018. The primary differences between the expected income tax benefit at the statutory federal rate with the reported income tax benefit for the years ended September 30, 2019 and 2018 were due to the effect of state income taxes and the changes in the balance of the valuation allowance for deferred tax assets. Deferred income taxes at September 30, 2019 and 2018 relate to temporary differences in the asset and liability basis for financial and income tax reporting purposes and were calculated at income tax rates currently in effect. Temporary differences have primarily resulted from differences in the accounting for allowances for patient accounts receivable, accrued expenses, depreciation, and net operating losses.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax-planning strategies in making this assessment. Based upon the level of historical taxable losses and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that Carilion will not realize the benefits of these deductible differences and loss carryforwards in excess of the amount that can be offset by the reversal of future taxable items.

The remaining Carilion entities as disclosed in Note 1, including the members of the Obligated Group, are exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC) as determined by the Internal Revenue Service.

Recently Issued Accounting Guidance—In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* (ASU 2016-01). ASU 2016-01 requires all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). The update also requires an entity to separately present the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. Carilion has elected to early adopt the amendments allowing the removal of disclosures relating to the fair value of financial instruments measured at amortized cost in the consolidated balance sheets. The remainder of ASU 2016-01 is effective for fiscal years beginning after December 15, 2018. Carilion is currently evaluating the remaining impact of ASU 2016-01.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* (ASU 2016-02). ASU 2016-02 requires that lessees recognize all leases on the balance sheet, except for short-term leases, defined as less than twelve months in term. A lease liability will be recorded for the obligation of a lessee to make lease payments arising from a lease. A

right-of-use asset will be recorded which represents the lessee's right to use, or to control the use of, a specified asset for a lease term. The guidance provided in ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 and requires the modified retrospective approach for transition. The ASU provides certain practical expedients including (i) not being required to reassess whether any expired or existing contracts are or contain leases; (ii) not being required to reassess the lease classification for any expired or existing leases (that is, all existing leases that were classified as operating leases in accordance with Topic 840 will be classified as operating leases, and all existing leases that were classified as capital leases in accordance with Topic 840 will be classified as finance leases); and (iii) not being required to reassess initial direct costs for any existing leases. Carilion expects to recognize material right-of-use-lease assets and lease liabilities upon adoption of the ASU, but does not expect a material impact on the consolidated statements of operations, changes in net assets, or cash flows.

In March 2017, the FASB issued ASU No. 2017-08, *Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities* (ASU 2017-08), which shortens the amortization period for certain callable debt securities held at a premium to be amortized to the earliest call date. The guidance provided in ASU 2017-08 is effective for fiscal years beginning after December 15, 2018. Carilion is currently evaluating the impact on the consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement* (ASU 2018-13), which modifies the disclosure requirements on fair value measurements to improve the effectiveness of fair value measurement disclosures. The guidance in ASU 2018-03 is effective for fiscal years beginning after December 15, 2019. Carilion is currently evaluating the impact on the disclosures to the consolidated financial statements.

Also in August 2018, the FASB issued ASU No. 2018-14, *Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans* (ASU 2018-14), which updates disclosure requirements for employers that sponsor a defined benefit pension or other postretirement plans. The guidance provided in ASU 2018-14 is effective for fiscal years beginning after December 15, 2020. Carilion is currently evaluating the impact on the disclosures to the consolidated financial statements.

Further, in August 2018, the FASB issued ASU No. 2018-15, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract* (ASU 2018-15), which aligned the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. ASU 2018-15 is effective for fiscal years beginning after December 15, 2019. Carilion is currently evaluating the impact on the consolidated financial statements.

Newly Adopted Accounting Pronouncements—On October 1, 2018, Carilion adopted ASU 2014-09 using the modified retrospective method of application for all contracts with customers that existed as of the date of adoption. The core principle of the guidance in ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for providing those goods and services. The adoption of ASU 2014-09 resulted in changes to Carilion's presentation and disclosure for net patient service revenue. Under ASU 2014-09, the estimated amounts uncollectable due

from patients are generally considered implicit price concessions that are a direct reduction to net patient service revenue. For the year ended September 30, 2019, Carilion recorded approximately \$119,737 and \$152,207 of implicit price concessions as a direct reduction to net patient service revenue and patient accounts receivable that would have been recorded as a provision for bad debts and an allowance for doubtful accounts, respectively, prior to the adoption of ASU 2014-19. The adoption of ASU 2014-09 did not have a significant impact on Carilion's revenue recognition for contracts with customers included in other operating revenues in the accompanying consolidated statements of operations.

As part of the adoption of ASC 2014-09, Carilion elected two of the available practical expedients provided for in the standard. First, Carilion does not adjust the transaction price for any financing components as those were deemed to be insignificant. Secondly, Carilion expenses all incremental customer contract acquisition costs as incurred because such costs are not material and would be amortized over a period less than one year.

In August 2016, the FASB issued ASU No. 2016-14, *Not-For-Profit Entities-Presentation of Financial Statement of Not-for-Profit Entities (Topic 958)* (ASU 2016-14). ASU 2016-14 addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment return. The guidance was effective for Carilion for the year ended September 30, 2019. Carilion has adopted this guidance and has adjusted the presentation in these financial statements accordingly. ASU 2016-14 has been applied retrospectively to all periods presented. Carilion elected to apply the practical expedient and to not disclose prior-year liquidity and availability of resources.

2. REVENUES

Carilion has agreements with third-party payors that provide for payments to Carilion at amounts different from its established rates. A summary of the payment arrangements with major third-party payors is as follows:

Medicare—The payment rates under the Medicare program for hospital inpatient acute care services and rehabilitation are based on prospectively determined rates, depending upon the patient's clinical, diagnostic, and other factors, except for CGCH and CSJH, which are reimbursed based on allowable cost. When the estimated cost of treatment for certain patients is higher than the average, Carilion receives additional "outlier" payments. Inpatient nonacute services and defined medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. Certain outpatient service costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology, subject to certain limitations. Pursuant to federal legislation, the Medicare program makes payments for outpatient services on a prospective basis for certain hospitals of Carilion. This payment system classifies outpatient procedures into predetermined groups, Ambulatory Payment Classifications (APCs), with each APC having a predetermined payment amount. Capital costs are paid on a prospective basis based on a predetermined rate per discharge. Carilion is paid for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The Medicare fiscal intermediary has audited and final settled the Medicare cost reports for CMC through September 30, 2004 and for the years ended September 30, 2006, 2007, and 2008; for CNRV, CFMH, and CTCH through September 30, 2015; and for CGCH and CSJH through September 30, 2016. However, cost reports are subject to reopening for three years from the date of final settlement.

Effective January 1, 2017, Carilion began participating in the CMS Center for Medicare and Medicaid Innovation's (Innovation Center) Next Generation ACO Model through its subsidiary Doctors Connected. The Next Generation ACO Model is an Advanced Alternative Payment Model (APM) under the Quality Payment Program established under the Medicare Access and CHIP Reauthorization Act of 2015. Payments received for services to Medicare beneficiaries included in the Next Generation ACO Model are subject to retrospective adjustment based on performance against certain defined benchmarks.

Medicaid—Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient costs are reimbursed on a blended rate of outpatient costs and Enhanced Ambulatory Patient Groups (EAPGs). EAPGs are an outpatient visit classification system, which places patients and services into clinically coherent groups. Carilion is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by Medicaid. Medicaid cost reports for CMC, CNRV, CGCH, CFMH, CSJH, and CTCH have been final settled through September 30, 2018.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term. Adjustments to previous period program reimbursement estimates are reported in the period that such adjustments become known. Adjustments for prior-year cost reports and related allowances, principally related to Medicare and Medicaid, were not material to the consolidated statements of operations for the years ended September 30, 2019 and 2018.

In October 2018, CMS approved the Virginia legislature's plan for Medicaid expansion under the Patient Protection and Affordable Care Act and rate adequacy through increases in upper payment limits. The expansion will allow adults age 19–64 who are not eligible for Medicare and meet certain income requirements to access Medicaid services. The Federal Government will cover 90% of Medicaid expansion costs and 50% of the increase in upper payment limits. The non-federal share of related costs are covered through assessments imposed on private acute care hospitals. Eligible adults began enrolling in the program on November 1, 2018 with coverage beginning January 1, 2019.

Upper payment limit increases were effective for Medicaid payments received beginning October 1, 2018. Settlements are made on a quarterly basis and are recorded in net patient service revenues in the consolidated statements of operations. Carilion recognized \$66,672 and \$7,935 of net patient service revenues for the years ended September 30, 2019 and 2018, respectively, for upper payment limit settlements. At September 30, 2019, Carilion estimated receipts for the enhanced payments of \$33,925 and reserves of \$18,369 related to potential future settlements in patient accounts receivable. Reserves are estimated based on settlement and estimated settlement amounts to account for risks associated with administration of the program at the state and federal level. Carilion recognized \$37,655 and \$3,135 in corresponding provider assessment expenses for upper payment limit increases and coverage expansion for the years ended September 30, 2019 and 2018, respectively.

Anthem—Services rendered to Anthem subscribers are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors.

In addition, in the normal course of business, insurance companies and employers actively negotiate the amounts paid for hospital and physician services at amounts different from its established rates.

Carilion's net patient service revenue for the years ended September 30, 2019 and 2018 is summarized as follows:

	<u>2019</u>		<u>2018</u>	
Medicare	\$ 650,878	35.5 %	\$ 603,795	35.6 %
Medicaid	253,269	13.8	176,034	10.4
Commercial	902,538	49.1	879,178	51.9
Self-Pay	8,008	0.4	7,581	0.5
Other	<u>21,531</u>	<u>1.2</u>	<u>27,738</u>	<u>1.6</u>
Total	<u>\$1,836,224</u>	<u>100.0 %</u>	<u>\$1,694,326</u>	<u>100.0 %</u>

Anthem accounted for 31.9% and 32.9% of total net patient service revenue for the years ended September 30, 2019 and 2018, and is included in the Commercial payor portfolio above.

Carilion provides health care services through its inpatient and outpatient care facilities located primarily in southwest Virginia. The facilities grant credit to patients, substantially all of whom are local residents. The facilities generally do not receive collateral or other security in extending credit to patients; however, they routinely obtain assignment of patients' benefits payable under their health insurance programs, plans, or policies. The mix of receivables from patients and third-party payors at September 30, 2019 and 2018 is as follows:

	<u>2019</u>	<u>2018</u>
Medicare	25 %	28 %
Medicaid	16	17
Commercial	47	42
Self-Pay	3	3
Other	<u>9</u>	<u>10</u>
	<u>100 %</u>	<u>100 %</u>

Anthem accounted for 29% and 24% of total patient accounts receivable for the years ended September 30, 2019 and 2018, and is included in the Commercial payor portfolio above.

Other Operating Revenue—The composition of other operating revenue for the years ended September 30, 2019 and 2018, is as follows:

	2019	2018
Performance obligations recognized at a point in time:		
Retail pharmacy	\$ 35,470	\$ 33,742
Other	25,335	27,803
Performance obligations recognized over time:		
College tuition revenue	20,751	26,940
Athletic club revenue	6,057	6,133
Other:		
Grants	7,999	6,342
Rentals	5,239	4,422
Collection services	<u>4,146</u>	<u>4,098</u>
Total	<u>\$104,997</u>	<u>\$109,480</u>

Significant sources of other operating revenues for which performance obligations are satisfied at a point in time include retail pharmacies, cafeterias, gift shop, linen services, and student health services. College tuition revenue and athletic club revenue are generally recognized over time as services are provided or over the applicable membership period. Revenues from grants and rentals are not within the scope of ASU 2014-09. Grant revenues are generally considered conditional promises to give under and are recognized as conditions on which they depend are substantially met. Rental revenues, representing Carilion’s lease of properties to third-parties, are recognized over the lease term.

Substantially all college tuition revenue relates to the Jefferson College of Health Sciences (“Jefferson College”), a department of CMC. In July 2019, Carilion entered into an Integration and Affiliation Agreement which transferred the operations of Jefferson College to Radford University.

3. INVESTMENTS AND ASSETS WHOSE USE IS LIMITED

Carilion combines its investments and assets whose use is limited in a system-wide investment pool. Investments and assets whose use is limited at September 30, 2019 and 2018, are summarized as follows:

	2019	2018
Investments	\$ 196,866	\$ 159,740
Assets whose use is limited	<u>1,217,598</u>	<u>1,186,297</u>
	<u>\$1,414,464</u>	<u>\$1,346,037</u>

At September 30, 2019, Carilion was committed to invest an additional \$167,590, primarily in private equity limited partnerships, at unspecified future dates. There were no other unfunded investment commitments at September 30, 2019.

The fair values of Carilion's assets whose use is limited at September 30, 2019 and 2018, are summarized as follows:

	2019	2018
Assets whose use is limited under board designations	\$1,088,379	\$1,068,574
Assets whose use is limited for BRIC	54,749	44,725
Assets whose use is limited under deferred compensation arrangements	72,464	70,998
CCMR assets on deposit with regulatory authorities	<u>2,006</u>	<u>2,000</u>
Assets whose use is limited	<u>\$1,217,598</u>	<u>\$1,186,297</u>

Investment income for the years ended September 30, 2019 and 2018, is summarized as follows:

	2019	2018
Dividends and interest	\$ 15,122	\$ 10,440
Net realized gains on investments	30,969	19,968
Net change in unrealized gains in investments	313	49,024
Net realized and unrealized (losses) gains in interest rate swaps	<u>(46,206)</u>	<u>24,046</u>
Investment income	<u>\$ 198</u>	<u>\$103,478</u>

4. LIQUIDITY AND AVAILABILITY

The table below represents financial assets available for general expenditures within one year of September 30, 2019:

Financial assets:	
Cash and cash equivalents	\$ 18,031
Patient accounts receivable—net	326,095
Investments	196,866
Assets whose use is limited:	
Board-designated	1,088,379
BRIC	54,749
Deferred compensation arrangements	72,464
Deposited with regulatory authorities	<u>2,006</u>
Total financial assets	<u>1,758,590</u>
Less amounts not available to be used within one year:	
Investments and board-designated assets whose use is limited with liquidity horizons greater than one year	289,373
BRIC with liquidity horizons greater than one year	54,749
Deferred compensation arrangements with liquidity horizons greater than one year	<u>72,464</u>
Financial assets not available to be used within one year	<u>416,586</u>
Financial assets available to meet general expenditures within one year	<u>\$1,342,004</u>

Carilion has board-designated and donor-restricted assets limited to use that are available for normal expenditure within one year for operations. These assets have been appropriately included in the qualitative information above for financial assets to meet general expenditures within one year. Carilion has other assets limited to use for donor-restricted purposes and board-designated assets that are designated for future capital expenditures and operations. These assets limited to use, are not available for general expenditure within the next year. However, if necessary, board-designated amounts could be made available.

As part of Carilion's liquidity management plan to support capital needs, cash in excess of daily requirements is invested in short-term investments and money market funds. Carilion's investment policy requires that the minimum balance in these investments has a target of \$30 million.

5. PROPERTY AND EQUIPMENT—NET

Property and equipment—net at September 30, 2019 and 2018, consists of the following:

	2019	2018
Land and improvements	\$ 49,962	\$ 50,967
Buildings and fixed equipment	1,093,724	1,058,123
Movable equipment	<u>913,637</u>	<u>869,588</u>
Total depreciable assets	2,057,323	1,978,678
Less accumulated depreciation and amortization	<u>(1,423,149)</u>	<u>(1,343,559)</u>
	634,174	635,119
Construction in progress	<u>27,375</u>	<u>26,034</u>
Property and equipment—net	<u>\$ 661,549</u>	<u>\$ 661,153</u>

Unexpended contractual commitments for projects under construction at September 30, 2019, were approximately \$2,419.

6. LONG-TERM DEBT

Long-term debt at September 30, 2019 and 2018, consists of the following:

	2019	2018
Hospital Revenue Bonds—Series 2012—Serial Bonds, 3.0% to 5.0% fixed-rate interest, maturing from 2020 to 2030	\$ 42,755	\$ 49,770
Hospital Revenue Bonds—Series 2010—Term Bonds, 5.0% fixed-rate interest, maturing from 2021 to 2033	95,740	95,740
Hospital Revenue Bonds—Series 2008A—Variable Rate Bonds, variable-rate interest (1.56% at September 30, 2019), maturing from 2027 to 2042	50,000	50,000
Hospital Revenue Bonds—Series 2008B—Variable Rate Bonds, variable-rate interest (1.58% at September 30, 2019), maturing from 2027 to 2042	110,000	110,000
Hospital Revenue Bonds—Series 2005A—Variable Rate Bonds, variable-rate interest (1.61% at September 30, 2019), maturing from 2028 to 2036	123,110	123,110
Hospital Revenue Bonds—Series 2005B—Serial Bonds, 5.0% fixed-rate interest, maturing in 2020	4,725	8,635
Hospital Revenue Bonds—Series 2005B—Term Bonds, 4.375% to 5.0% fixed-rate interest, maturing from 2026 to 2038	65,310	65,310
Hospital Revenue Bonds—Series 2005C—Serial Bonds, 5.0% fixed-rate interest, maturing in 2020	2,450	5,010
Hospital Revenue Bonds—Series 2005C—Term Bonds, 4.0% to 5.0% fixed-rate interest, maturing from 2024 to 2027	28,240	28,240
Other long-term debt	<u>20,543</u>	<u>19,515</u>
	542,873	555,330
Unamortized bond premiums	7,984	9,332
Unamortized bond issue costs	(5,662)	(5,208)
Scheduled payments due within one year	<u>(16,002)</u>	<u>(15,017)</u>
Long-term debt—net of current portion	<u>\$ 529,193</u>	<u>\$ 544,437</u>

Each member of the Obligated Group is jointly and severally liable for the repayment of the principal and interest as they become due on the Hospital Revenue Bonds (Bonds). The Bonds are governed by a Master Trust Indenture (Indenture), as amended and restated by and among the members of the Obligated Group and U.S. Bank (the "Master Trustee"). The repayment of principal and interest on the Series 2005B and 2005C Bonds is guaranteed by a municipal bond insurance policy.

The Bonds are collateralized by a pledge of revenues of the Obligated Group, and the Master Trustee holds a security interest in the gross receipts of the Obligated Group. During 2010, a deed of trust was established for the benefit of the Master Trustee to secure all current and future obligations issued under the Indenture with substantially all land, buildings, and fixtures of CMC. The deed of trust is supported by \$45,000 of title insurance acquired by CMC. In addition, CNRV has pledged that it will not create, or permit to exist, a lien against its land, buildings, and fixtures.

In February 2019, the Obligated Group tendered the Series 2008A and 2008B Bonds, terminated the related direct purchase agreements, and entered into irrevocable direct-pay letters of credit with two financial institutions for those bonds in the aggregate principal amounts of \$50,000 and \$110,000, respectively. The letters of credit expire in February 2022.

In February 2019, the Obligated Group tendered the Series 2005A Bonds, terminated the related direct purchase agreement, and entered into a standby bond purchase agreement with a financial institution for those bonds in the aggregate principal amount of \$123,110. The standby bond purchase agreement expires in February 2022.

The Obligated Group intends to renew or replace the letters of credit and standby bond purchase agreement for the Series 2008A and 2008B, and 2005A bonds, respectively, on or before their expiration. In the event the agreements are not renewed or replaced, the debt will become due upon expiration.

The aggregate principal maturities of long-term debt, including amounts due upon expiration of the letters of credit and standby bond purchase agreement in fiscal year 2022, are as follows:

**Years Ending
September 30**

2020	\$ 16,002
2021	16,170
2022	300,095
2023	17,859
2024	18,830
Thereafter	<u>173,917</u>
	<u>\$542,873</u>

Sinking Fund Requirements—The Series 2012 Bonds are subject to mandatory annual sinking fund requirements through 2030 in varying amounts ranging from \$1,325 to \$8,705. The Series 2010 Bonds are subject to mandatory annual sinking fund requirements beginning in 2021 through 2033 in varying amounts ranging from \$5,025 to \$13,435. The Series 2008A and 2008B Bonds are subject to mandatory annual sinking fund requirements beginning in 2027 through 2042 in varying amounts ranging from \$425 to \$32,870. The Series 2005A, B, and C Bonds are subject to mandatory annual sinking fund requirements through 2038 in varying amounts ranging from \$2,570 to \$22,355.

Debt Service Reserve Fund—The Obligated Group is required to maintain with the Master Trustee a debt service reserve fund to secure all obligations under the Indenture in the event that (a) the Obligated Group’s days’ cash on hand falls below 120 days at any semiannual test date or (b) the Obligated Group’s long-term debt service coverage ratio is below 1.4. The debt service reserve fund amount, if required, would be equal to the maximum annual debt service for the obligations then outstanding under the Indenture and must be deposited within 90 days of the applicable test date or constitute an event of default under the Indenture, unless such requirement is waived by the bond insurers.

Debt Covenants—The Obligated Group is subject to certain covenants under the Indenture, the municipal bond insurance policies, and the direct purchase agreements that,

among other covenants, place restrictions on the members of the Obligated Group relative to operating ratios, the incurrence of additional indebtedness, and limitations on transfers of cash and investments from the Obligated Group. The Indenture requires that the Obligated Group, among other covenants, maintain a debt-to-capitalization ratio of not more than 65%. The Obligated Group has maintained compliance with these covenants as of and during the years ended September 30, 2019 and 2018.

Interest Rate Swap Agreements—At September 30, 2019 and 2018, the Obligated Group had interest rate swap agreements with financial institutions to hedge a portion of interest rate risk. Under the terms of the interest rate swap agreements in place at September 30, 2019, the Obligated Group receives and pays interest based on the following:

Current Notional Amount (In thousands)	Hedged Bonds	Year of Maturity	Type of Derivative	Pay Rate	Receive Rate
\$62,500	2005A	2036	Fixed payor	3.43%	67% 1m LIBOR ⁽¹⁾
62,500	2005A	2036	Fixed payor	3.43%	67% 1m LIBOR ⁽¹⁾
62,500	2008A/B	2042	Fixed payor	3.29%	67% 1m LIBOR ⁽¹⁾
62,500	2008A/B	2042	Fixed payor	3.29%	67% 1m LIBOR ⁽¹⁾
58,786	2005B-C, 2010	2038	Basis swap	SIFMA Municipal Swap Index ⁽³⁾	67% 3m LIBOR + 0.57% ⁽²⁾
79,998	2005B-C, 2010	2038	Basis swap	SIFMA Municipal Swap Index ⁽³⁾	67% 3m LIBOR + 0.62% ⁽²⁾
60,000	Unassigned	2034	Basis swap	SIFMA Municipal Swap Index ⁽³⁾	67% 3m LIBOR + 0.65% ⁽²⁾
65,970	Unassigned	2038	Fixed payor	1.68%	67% 1m LIBOR ⁽¹⁾
75,000	Unassigned	2039	Constant maturity	67% 1m LIBOR ⁽¹⁾	67% 10yr ISDA - 0.42% ⁽⁴⁾
50,000	Unassigned	2034	Constant maturity	1m LIBOR ⁽¹⁾	82.37% 10yr ISDA ⁽⁴⁾

⁽¹⁾ The 1m LIBOR was 2.03% and 2.26% at September 30, 2019 and 2018, respectively.

⁽²⁾ The 3m LIBOR was 2.10% and 2.40% at September 30, 2019 and 2018, respectively.

⁽³⁾ The SIFMA Municipal Swap Index was 1.58% and 1.56% at September 30, 2019 and 2018, respectively.

⁽⁴⁾ The 10yr ISDA was 1.58% at September 30, 2019.

There were no collateral posting requirements as of and during the years ended September 30, 2019 and 2018 under applicable interest rate swap agreements.

The estimated fair values of the interest rate swap agreements at September 30, 2019 and 2018, are as follows:

Type of Derivative	Fair Value of Asset Derivatives		Fair Value of Liability Derivatives		Amount of Gain (Loss) Recognized	
	2019	2018	2019	2018	2019	2018
Fixed payor	\$ -	\$2,804	\$88,312	\$43,899	\$(47,217)	\$23,993
Basis swap	9,352	6,941			2,411	53
Constant maturity	<u>370</u>	<u> </u>	<u>1,770</u>	<u> </u>	<u>(1,400)</u>	<u> </u>
	<u>\$9,722</u>	<u>\$9,745</u>	<u>\$90,082</u>	<u>\$43,899</u>	<u>\$(46,206)</u>	<u>\$24,046</u>

7. EMPLOYEE BENEFIT PLANS

Carilion maintains a funded defined benefit pension plan (the "Plan"), which covers substantially all employees of Carilion. The benefits are based on years of service and the employee's highest average of total earnings for five consecutive Plan years or the employee's compensation during five of the last ten years of employment. Carilion

contributes to the Plan annually based on actuarially determined funding guidelines. Contributions are intended to provide not only for benefits attributed to service to date, but also for those expected to be earned in the future.

Carilion maintains a nonqualified supplemental pension plan for certain retired employees of CMC. The total net periodic pension cost for the nonqualified plan was \$7 and \$4 for the years ended September 30, 2019 and 2018, respectively. The net pension liability for the plans was \$110 and \$115 as of September 30, 2019 and 2018, respectively, and is included in pension and other liabilities in the accompanying consolidated balance sheets.

The Plan's change in benefit obligation, change in plan assets, current funded status, components of net periodic benefit cost, and pension-related changes other than net periodic pension cost as of and for the years ended September 30, 2019 and 2018, are as follows:

	2019	2018
Change in benefit obligation:		
Benefit obligation—beginning	\$1,396,636	\$1,451,360
Service cost	51,393	56,421
Interest cost	61,763	57,408
Actuarial loss (gain)	285,009	(104,511)
Benefit payments	<u>(41,727)</u>	<u>(64,042)</u>
Benefit obligation—ending	<u>1,753,074</u>	<u>1,396,636</u>
Change in plan assets:		
Fair value of plan assets—beginning	1,023,904	943,393
Actual return on plan assets	26,383	61,553
Employer contributions	67,000	83,000
Benefit payments	<u>(41,727)</u>	<u>(64,042)</u>
Fair value of plan assets—ending	<u>1,075,560</u>	<u>1,023,904</u>
Funded status	<u>\$ (677,514)</u>	<u>\$ (372,732)</u>

	2019	2018
Components of net periodic pension cost:		
Service cost	\$ 51,393	\$ 56,421
Interest cost	61,763	57,408
Expected return on plan assets	(79,367)	(74,100)
Prior service benefit recognized	109	173
Amortization of actuarial losses	<u>25,142</u>	<u>36,944</u>
Net periodic pension cost	<u>59,040</u>	<u>76,846</u>
Other changes in plan assets and benefit obligations not yet recognized in net periodic pension cost:		
Net loss (gain) arising during the period	337,991	(91,963)
Amortization of loss	(25,142)	(36,944)
Amortization of prior service credit	<u>(109)</u>	<u>(173)</u>
Pension-related changes other than net periodic pension cost	<u>312,740</u>	<u>(129,080)</u>
Total recognized in net periodic pension cost and other pension-related changes	<u>\$371,780</u>	<u>\$ (52,234)</u>
Amounts recognized in unrestricted net assets:		
Net loss	\$719,272	\$ 406,423
Prior service cost	<u>167</u>	<u>277</u>
	<u>\$719,439</u>	<u>\$ 406,700</u>

The accumulated benefit obligation was \$1,591,272 and \$1,267,829 as of September 30, 2019 and 2018, respectively.

During 2019 and 2018, Carilion contributed \$67,000 and \$83,000, respectively, to the Plan. Carilion expects to contribute approximately \$92,000 to the Plan in fiscal year 2020.

The estimated net loss and prior service cost recognized as changes in net assets without donor restrictions that will be amortized to net periodic pension cost over the next fiscal year is \$50,203 and \$109, respectively.

Significant assumptions used in determining the actuarial present value of the projected benefit obligation of the Plan as of September 30, 2019 and 2018, are as follows:

	2019	2018
Weighted-average discount rate	3.37 %	4.50 %
Expected long-term rate of return on assets	7.50	7.50
Rate of compensation increase	3.00	3.00

The weighted-average discount rates used to determine net periodic pension cost for the years ended September 30, 2019 and 2018, were 4.50% and 4.02%, respectively. The expected long-term rate of return on assets was 7.50% for the years ended September 30, 2019 and 2018. The rate of compensation increase was the same as those used in determining the actuarial present value of the projected benefit obligation.

The investment policy for the Plan is structured to maintain a diversified portfolio of equity securities, debt securities, cash equivalents, and alternative investment strategies, including real estate, private equity, fund-of-fund hedge funds, and global trading. The structure is designed to reduce risk and generate absolute returns in various market conditions. The portfolio is rebalanced periodically throughout the year.

The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The expected long-term rate of return reflects management's estimate of future returns for the target asset allocation and is based primarily on historical returns. The Plan's target allocation for 2019 and plan asset allocation at September 30, 2019 and 2018, is as follows:

Asset Category	Target Allocation 2019	Percentage of Plan Assets at September 30, 2019	Percentage of Plan Assets at September 30, 2018
Equity securities and funds	30 %	17 %	18 %
Hedge funds	20	34	32
Fixed-income securities and funds	20	6	11
Inflation sensitive	15	13	15
Other investments	<u>15</u>	<u>30</u>	<u>24</u>
	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

Carilion utilizes alternative investment vehicles to satisfy its target allocations, however due to the nature and liquidity of these investments they are reflected in other investments in the table above.

The Plan benefits expected to be paid in future years are summarized as follows:

Years Ending September 30	
2020	\$ 49,375
2021	54,085
2022	59,190
2023	63,903
2024	68,360
2025-2029	<u>405,612</u>
	<u>\$700,525</u>

The expected benefits are based on the same assumptions used to measure Carilion's benefit obligation at September 30 and include estimated future employee service.

Carilion also maintains three defined contribution retirement plans, which cover substantially all Carilion employees. The plans qualify under Section 403(b) or Section 401(k) of the IRC. Carilion does not make contributions on its employees' behalf when they elect to participate in these plans.

Carilion has several nonqualified deferred compensation plans for certain members of management and physicians to defer a portion of their compensation until retirement. The deferred amounts are invested in accordance with the participant's designation. The deferred compensation liability of \$72,464 and \$70,998 as of September 30, 2019 and 2018, respectively, is included in pension and other liabilities in the accompanying consolidated balance sheets. Carilion has placed certain assets in a rabbi trust to be used to pay benefits to certain deferred compensation plan participants. The carrying amount of the trustee assets was \$72,464 and \$70,998 as of September 30, 2019 and 2018, respectively, and is included in assets whose use is limited in the accompanying consolidated balance sheets. Plan assets consist of investments in fixed-income mutual funds, domestic equity mutual funds, and international equity mutual funds (see Note 3 and Note 11).

8. FUNCTIONAL EXPENSES

Carilion provides various health care services to patients within its geographic location. Expenses related to providing these services for the years ended September 30, 2019 and 2018, are as follows:

	2019				
	Clinical Acute Services	Provider Services	Other Healthcare	Non-Clinical General and Administrative	Total
Salaries and outside labor	\$ 399,447	\$390,818	\$21,066	\$127,615	\$ 938,946
Benefits	89,440	69,110	5,639	30,399	194,588
Supplies and other expenses	459,210	53,958	31,390	54,276	598,834
Depreciation	59,907	6,808	1,369	24,189	92,273
Interest expense	<u>18,607</u>	<u>297</u>	<u> </u>	<u>3,771</u>	<u>22,675</u>
Total operating expenses	<u>\$1,026,611</u>	<u>\$520,991</u>	<u>\$59,464</u>	<u>\$240,250</u>	<u>\$1,847,316</u>
	2018				
	Clinical Acute Services	Provider Services	Other Healthcare	Non-Clinical General and Administrative	Total
Salaries and outside labor	\$386,801	\$372,635	\$23,648	\$118,808	\$ 901,892
Benefits	92,593	70,102	6,149	31,293	200,137
Supplies and other expenses	391,511	54,575	31,298	41,810	519,194
Depreciation	57,650	6,585	1,518	24,452	90,205
Interest expense	<u>18,680</u>	<u>233</u>	<u> </u>	<u>3,764</u>	<u>22,677</u>
Total operating expenses	<u>\$947,235</u>	<u>\$504,130</u>	<u>\$62,613</u>	<u>\$220,127</u>	<u>\$1,734,105</u>

9. COMMITMENTS AND CONTINGENCIES

Litigation—Carilion is involved in litigation arising in the ordinary course of business. It is the opinion of management and Carilion’s legal counsel that these cases will be resolved without material effect on Carilion’s consolidated financial position, results of operations, or cash flows.

Other Industry Risks—The health care industry is 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, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for amounts previously received for patient services. Carilion believes it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that would have a material impact on its consolidated financial position or results of operations. Compliance with these and other laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

Management continues to evaluate the impact of health care reform legislation, regulation, and industry trends and their impact on Carilion’s consolidated financial position, results of operations, and cash flows.

Lease Commitments—Certain Carilion entities are parties to operating leases for various property and medical and other equipment. Lease expense was approximately \$7,712 and \$7,783 for the years ended September 30, 2019 and 2018, respectively, and is included in supplies and other expenses in the accompanying consolidated statements of operations.

A schedule of future minimum lease payments under operating leases at September 30, 2019, is summarized as follows:

Years Ending September 30	Amount
2020	\$ 4,505
2021	3,342
2022	3,518
2023	3,419
2024	3,031
Thereafter	<u>26,029</u>
Total	<u>\$43,844</u>

Virginia Tech Carilion School of Medicine and Research Institute—In 2008, Carilion and Virginia Polytechnic Institute and State University (Virginia Tech) entered into a memorandum of understanding (MOU) agreement to establish and fund a portion of the costs related to the Virginia Tech Carilion School of Medicine (the “Medical School”) and the Virginia Tech Carilion Research Institute (VTCRI) in order to address long-term regional health care needs and advance medical research in southwest Virginia. As of July 1, 2018 the Medical School fully integrated into a college of Virginia Tech. Upon integration, Carilion

and Virginia Tech entered into an Affiliation Agreement for a term of two years with subsequent automatic renewals in which Carilion agreed to provide up to \$3,950 annually or 50% of the excess funding required to support the Medical School's operations, net of other sources of funding or revenue for the Medical School.

In December 2017, Carilion and Virginia Tech executed a Comprehensive Agreement (the "Agreement") for the development of an addition to the Fralin Biomedical Research Institute (the "Project"), formerly known as VTCRI, owned by Virginia Tech. As part of the agreement, Carilion agreed to contribute \$12,900 of cash and land to the Project with the remainder of the funding coming from Virginia Tech and the Commonwealth of Virginia. As a result, Carilion has \$12,900 in current liabilities related to these obligations in the accompanying consolidated balance sheet as of September 30, 2019.

10. SELF-INSURANCE LIABILITIES

Employee Health—Carilion offers subsidized health and dental insurance to its employees through a self-insured plan. The related liabilities of \$9,800 and \$11,000 are included in other current liabilities in the accompanying consolidated balance sheets for the years ended September 30, 2019 and September 30, 2018.

Workers' Compensation—Carilion is self-insured for workers' compensation liability up to the first \$500 per accident and has excess coverage up to applicable statutory limits on a claims-made basis. The related liabilities are not material to Carilion's consolidated financial statements.

Medical Malpractice—Carilion is self-insured for medical malpractice losses through its wholly owned subsidiary BRIC. BRIC is licensed as a captive insurance company by the Vermont Commissioner of Banking, Insurance, Securities, and Health Care Administration, pursuant to the provisions of the Vermont Statutes Annotated. Through various independent carriers, BRIC carries reinsurance coverage of up to \$50,000 per each loss or medical incident and in the annual aggregate, excess of a limit up to \$2,400 per loss or medical incident and \$21,000 in the annual aggregate.

Carilion has employed independent actuaries to estimate the ultimate costs of the settlement of claims made and claims incurred but not reported. The liability for medical malpractice losses, discounted at 4%, was \$47,560 at September 30, 2019, of which \$12,226 is included in other current liabilities and \$35,334 is included in pension and other liabilities in the accompanying consolidated balance sheets. The liability for medical malpractice losses, discounted at 4%, was \$43,904 at September 30, 2018, of which \$13,125 is included in other current liabilities and \$30,779 is included in pension and other liabilities in the accompanying consolidated balance sheets. In the opinion of management, adequate liabilities for medical malpractice claims have been established. The consolidated statements of operations reflect a change in estimate in the accrued cost to settle malpractice claims of approximately \$6,462 and \$5,541 for the years ended September 30, 2019 and 2018, respectively, primarily due to settlement of historical outstanding claims. Such change is included in supplies and other expenses.

11. FAIR VALUE OF FINANCIAL INSTRUMENTS

In accordance with US GAAP, certain assets and liabilities are required to be measured at fair value on a recurring basis. For Carilion, the assets and liabilities that are adjusted at fair value on a recurring basis are investments, assets whose use is limited, and interest rate swap agreements.

US GAAP defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. Additionally, the inputs used to measure fair value are prioritized based on a three-level hierarchy. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1—Valuations based on unadjusted quoted prices for identical instruments in active markets that are available as of the measurement date.

Level 2—Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3—Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Transfers between Levels—The availability of market observable data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or valuation methodologies may require the transfer of financial instruments from one fair value hierarchy level to another. In such instances, the transfer would be reported at the beginning of the reporting period. Carilion evaluates the significance of transfers based on the nature of the financial instrument and the size of the transfer. There were no transfers of investments between levels for the years ended September 30, 2019 and 2018.

Investments and Assets Whose Use is Limited—Valuations classified as Level 1 include short-term money market investments and publicly traded mutual funds for which unadjusted quoted market prices for identical securities are available as of the measurement date. Valuations classified as Level 2 include investments in fixed income securities, primarily corporate bonds, for which fair values are determined based on observable inputs.

Interest Rate Swap Agreements—The fair values of Carilion's interest rate swap agreements are determined using a standard valuation model based on observable inputs, including interest rate indices, and unobservable inputs, including extrapolations of observable inputs over the unobservable portion of the duration of the instrument. Interest rate swap agreements are classified as Level 3 fair value measurements because the unobservable inputs are significant to the overall fair value measurement. The fair value of Carilion's swaps are reflected in Note 6.

Nonrecurring Fair Value Measurements—In addition to assets and liabilities that are recorded at fair value on a recurring basis, Carilion records assets and liabilities at fair value on a nonrecurring basis as required by US GAAP. Generally, assets are recorded at fair value on a nonrecurring basis as a result of impairment charges. There were no material nonrecurring fair value measurements as of or during the years ended September 30, 2019 and 2018.

The fair value hierarchy classification of investments in the system-wide investment pool and assets whose use is limited at September 30, 2019, is summarized in the table below:

Fair Value Measurement at September 30, 2019				
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Short-term money market investments	\$ 30,031	\$ 30,031	\$ -	\$ -
Fixed income	1,178		1,178	
Equity securities	74,580	74,580		
Mutual funds:				
Fixed income	47,867	47,867		
Global equity	86,281	86,281		
Assets whose use is limited:				
Short-term money market investments	7,334	7,334		
Debt and equity mutual funds	119,879	119,879		
Assets on deposit with regulatory authorities	<u>2,006</u>	<u>2,006</u>	<u> </u>	<u> </u>
Subtotal	369,156	<u>\$ 367,978</u>	<u>\$ 1,178</u>	<u>\$ -</u>
Investments measured at NAV:				
Commingled funds	173,146			
Alternative investments (Note 1)	<u>872,162</u>			
Total	<u>\$ 1,414,464</u>			

The fair value hierarchy classification of investments in the system-wide investment pool and assets whose use is limited at September 30, 2018, is summarized in the table below:

Fair Value Measurement at September 30, 2018				
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Short-term money market investments	\$ 27,217	\$ 27,217	\$ -	\$ -
Equity securities	80,644	80,644		
Mutual funds:				
Fixed income	90,647	90,647		
Global equity	36,693	36,693		
Assets whose use is limited:				
Short-term money market investments	15,784	15,784		
Debt and equity mutual funds	109,387	109,387		
Assets on deposit with regulatory authorities	<u>2,000</u>	<u>2,000</u>	<u> </u>	<u> </u>
Subtotal	362,372	<u>\$ 362,372</u>	<u>\$ -</u>	<u>\$ -</u>
Investments measured at NAV:				
Commingled funds	198,342			
Alternative investments (Note 1)	<u>785,323</u>			
Total	<u>\$ 1,346,037</u>			

The table below discloses the redemption frequency and redemption notice period for each applicable investment class as of September 30, 2019 and 2018, for which fair value is measured using the reported NAV per share of the investment:

		2019	2018	Redemption Frequency	Redemption Notice Period
Commingled funds:					
Fixed income	(a)	\$ 16,520	\$ 29,181	Daily	N/A
Global equity	(b)	82,492	88,625	Daily	N/A
Inflation sensitive	(c)	<u>74,134</u>	<u>80,536</u>	Daily	N/A
Total		<u>\$ 173,146</u>	<u>\$ 198,342</u>		
Alternative investments:					
Core hedge funds	(d)	\$ 250,001	\$ 119,633	Monthly/quarterly	45-65 days
Core hedge funds	(d)	198,052	310,557	Quarterly/annually	95-105 days
Low-volatility hedge funds	(e)	42	1,461	Scheduled liquidation	N/A
Private equity funds	(f)	289,331	197,786	N/A	N/A
Real estate funds	(g)	90,766	85,764	Quarterly	45-60 days
Fixed income funds	(h)	18,804	18,804	Daily	10 days
Fixed income funds	(i)	<u>43,970</u>	<u>51,318</u>	Quarterly	60 days
Total		<u>\$ 872,162</u>	<u>\$ 785,323</u>		

- (a) Commingled funds designed to provide exposure to a diversified portfolio of fixed income securities.
- (b) Commingled funds designed to invest in both domestic and non-US equity through direct investments in separate accounts and pooled investments.
- (c) Commingled funds designed to invest primarily in liquid asset categories that offer negative correlation in a rising-inflation environment.
- (d) Core hedge funds include investments in fund-of-fund hedge funds that invest both long and short primarily in domestic common stocks. The funds' strategy is to maintain a low correlation to the market and low volatility.
- (e) Low-volatility hedge funds include investments in fund-of-fund hedge funds that seek to achieve long-term, nonmarket directional returns with low relative volatility by utilizing a variety of defensive hedge fund strategies.
- (f) Private equity funds cannot be directly redeemed. Instead, the nature of the investments in this category class is that distributions are received through the liquidation of the underlying assets of the fund. If these investments were held, it is estimated that the underlying assets of the fund would be liquidated over five to eight years.
- (g) Real estate funds include a real estate investment trust and a fund made up of participating mortgages.
- (h) Fixed income funds invested globally in long/short credit, rates and currency macro, relative value trading, capital structure arbitrage, and structured credit.
- (i) Fixed income funds invested in performing structured, corporate, and emerging market debt.

Pension Plan Assets—The fair value hierarchy classification of the Plan assets at September 30, 2019 and 2018, is summarized in the tables below:

		Fair Value Measurement at September 30, 2019		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Total				
Short-term money market investments	\$ 15,282	\$ 15,282	\$ -	\$ -
Fixed income	281		281	
Equity securities	65,186	65,186		
Mutual funds:				
Global equity	<u>42,521</u>	<u>42,521</u>		
Subtotal	123,270	<u>\$ 122,989</u>	<u>\$ 281</u>	<u>\$ -</u>
Investments measured at NAV:				
Commingled funds:				
Fixed income	(a) \$ 16,067			
Global equity	(b) 70,013			
Inflation sensitive	(c) 53,165			
Alternative investments (Note 1):				
Private equity funds	(d) 321,397			
Core hedge funds	(e) 360,441			
Low-volatility hedge funds	(f) 24			
Real estate funds	(g) 86,669			
Fixed income funds	(h) <u>44,514</u>			
Total	<u>\$ 1,075,560</u>			

**Fair Value Measurement at
September 30, 2018**

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Short-term money market investments	\$ 11,720	\$ 11,720	\$ -	\$ -
Equity securities	73,972	73,972		
Mutual funds:				
Fixed income	9,754	9,754		
Global equity	<u>33,264</u>	<u>33,264</u>		
Subtotal	128,710	<u>\$ 128,710</u>	<u>\$ -</u>	<u>\$ -</u>
Investments measured at NAV:				
Commingled funds:				
Fixed income (a)	20,728			
Global equity (b)	78,047			
Inflation sensitive (c)	68,608			
Alternative investments (Note 1):				
Private equity funds (d)	248,926			
Core hedge funds (e)	326,554			
Low-volatility hedge funds (f)	837			
Real estate funds (g)	81,903			
Fixed income funds (h)	<u>69,591</u>			
Total	<u>\$ 1,023,904</u>			

- (a) Commingled funds designed to provide exposure to a diversified portfolio of fixed income securities. These funds can generally be redeemed daily.
- (b) Commingled funds designed to invest in both domestic and non-US equity through direct investments in separate accounts and pooled investments. These funds can generally be redeemed daily.
- (c) Commingled funds designed to invest primarily in liquid asset categories that offer negative correlation in a rising-inflation environment. These funds can generally be redeemed daily.
- (d) Private equity funds cannot be directly redeemed. Instead, the nature of the investments in this category class is that distributions are received through the liquidation of the underlying assets of the fund. If these investments were held, it is estimated that the underlying assets of the fund would be liquidated over five to eight years.
- (e) Core hedge funds include investments in fund-of-fund hedge funds that invest both long and short primarily in domestic common stocks. The funds' strategy is to maintain a low correlation to the market and low volatility. These funds are generally redeemable either monthly, quarterly, or annually.
- (f) Low-volatility hedge funds include investments in fund-of-fund hedge funds that seek to achieve long-term, nonmarket directional returns with low relative volatility by utilizing a variety of defensive hedge fund strategies. These funds are in scheduled liquidation.
- (g) Real estate funds include a real estate investment trust and a fund made up of participating mortgages. These funds can generally be redeemed quarterly.

^(h) Fixed income funds invest globally in long/short credit, rates and currency macro, relative value trading, capital structure arbitrage, and structured credit, as well as, in performing structured, corporate, and emerging market debt. These funds can generally be redeemed quarterly.

12. NET ASSETS

A summary of changes in consolidated net assets without donor restrictions attributable to Carilion and to noncontrolling interest for the year ended September 30, 2019, is as follows:

	Total	Carilion	Noncontrolling Interest
Balance—beginning of year	<u>\$ 963,892</u>	<u>\$ 957,472</u>	<u>\$6,420</u>
Excess of unrestricted revenues and gains over expenses	86,210	85,464	746
Pension-related changes other than net periodic pension cost	(312,759)	(312,759)	-
Net assets released from restrictions for purchases of property and equipment	<u>40</u>	<u>40</u>	<u>-</u>
Change in net assets without donor restrictions	<u>(226,509)</u>	<u>(227,255)</u>	<u>746</u>
Balance—end of year	<u><u>\$ 737,383</u></u>	<u><u>\$ 730,217</u></u>	<u><u>\$7,166</u></u>

A summary of changes in consolidated net assets without donor restrictions attributable to Carilion and to noncontrolling interest for the year ended September 30, 2018, is as follows:

	Total	Carilion	Noncontrolling Interest
Balance—beginning of year	<u>\$689,397</u>	<u>\$683,738</u>	<u>\$5,659</u>
Excess of unrestricted revenues and gains over expenses	145,220	144,469	751
Pension-related changes other than net periodic pension cost	129,065	129,055	10
Net assets released from restrictions for purchases of property and equipment	<u>210</u>	<u>210</u>	<u>-</u>
Change in net assets without donor restrictions	<u>274,495</u>	<u>273,734</u>	<u>761</u>
Balance—end of year	<u><u>\$963,892</u></u>	<u><u>\$957,472</u></u>	<u><u>\$6,420</u></u>

Net assets with donor restrictions at September 30, 2019 and 2018, are as follows:

	2019	2018
Subject to expenditure for specific purpose:		
Neonatal and pediatric care	\$ 6,081	\$ 6,033
Clinical research and education	10,660	2,373
Indigent care	1,150	1,096
Scholarships	713	695
Other	<u>5,915</u>	<u>5,893</u>
	24,519	16,090
Perpetual endowments—neonatal and pediatric care	<u>11,876</u>	<u>11,876</u>
Total net assets with donor restrictions	<u>\$36,395</u>	<u>\$27,966</u>

13. ENDOWMENT FUNDS

Carilion’s endowment consists of net assets with donor restrictions and is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). The income derived from the endowment fund is required by donor stipulations to be used for neonatal and pediatric care.

Management has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. As a result, Carilion classifies assets limited to intent either legally or by donor discretion as net assets with donor restrictions the original value of gifts donated to the permanent endowment and accumulations to the permanent endowment required by the donor gift instrument, if applicable. The remaining portion of the donor restricted endowment fund that is not classified as a fund restricted in perpetuity is classified as net assets with donor restrictions until those amounts are appropriated for expenditure.

In accordance with SPMIFA, the organization considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: the duration and preservation of the fund, the purposes of the donor-restricted endowment fund, general economic conditions, the possible effect of inflation and deflation, the expected total return from income, and the appreciation of investments and other resources of Carilion.

Endowment net assets are held in the system-wide investment pool (see Note 3) and are subject to Carilion’s investment policies. From time to time, the fair value of assets associated with the endowment funds may fall below the level that the donor required the Carilion to retain as a fund of perpetual duration (underwater endowments). Management has interpreted applicable law to permit spending from underwater funds in accordance with the prudent measures required under the law. Management’s policy allows spending from underwater endowment funds, unless otherwise precluded by donor intent or relevant laws and regulations. At September 30, 2019 and 2018 there were no significant deficiencies of this nature that are reported in net assets without restrictions.

The endowment net asset composition at September 30, 2019 and 2018, totaled \$15,151 and \$15,382, respectively.

Changes in endowment assets for the year ended September 30, 2019 consists of the following:

	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets—beginning of year	\$ -	\$15,382	\$15,382
Investment gain		513	513
Appropriations of endowment assets for expenditure	<u> </u>	<u>(744)</u>	<u>(744)</u>
Endowment net assets—end of year	<u>\$ -</u>	<u>\$15,151</u>	<u>\$15,151</u>

Changes in endowment assets for the year ended September 30, 2018 consists of the following:

	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets—beginning of year	\$ -	\$15,126	\$15,126
Investment gain		972	972
Appropriations of endowment assets for expenditure	<u> </u>	<u>(716)</u>	<u>(716)</u>
Endowment net assets—end of year	<u>\$ -</u>	<u>\$15,382</u>	<u>\$15,382</u>

14. SUBSEQUENT EVENTS

Carilion has evaluated transactions and events for potential recognition or disclosure through January 27, 2020, the date of issuance of the consolidated financial statements. Management has determined there are no transactions or events requiring recognition or disclosure in the accompanying consolidated financial statements.

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Carilion Clinic and Subsidiaries

Consolidated Schedule of Expenditures of Federal Awards

Year Ended September 30, 2019

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Independent Auditors' Report

Board of Directors
Carilion Clinic and Subsidiaries
Roanoke, Virginia

Report on the Consolidated Schedule of Expenditures of Federal Awards

We have audited the accompanying consolidated schedule of expenditures of federal awards of Carilion Clinic and Subsidiaries for the year ended September 30, 2019, and the related notes (the Consolidated Schedule).

Management's Responsibility

Management is responsible for the preparation and fair presentation of this Consolidated Schedule 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 a consolidated schedule that is free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the Consolidated Schedule based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether the Consolidated Schedule is free from material misstatement.

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

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 Schedule referred to above presents fairly, in all material respects, the expenditures of federal awards of Carilion Clinic and Subsidiaries for the year ended September 30, 2019, in accordance with accounting principles generally accepted in the United States of America.



Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 8, 2020 on our consideration of Carilion Clinic and Subsidiaries' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters related to the Consolidated Schedule. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance related to the Consolidated Schedule and the results of that testing, and not to provide an opinion on the effectiveness of Carilion Clinic and Subsidiaries' internal control over financial reporting or on compliance. That report is an integral part of an audit of the Consolidated Schedule performed in accordance with *Government Auditing Standards* in considering Carilion Clinic and Subsidiaries' internal control over financial reporting and compliance related to the Consolidated Schedule.

Dixon Hughes Goodman LLP

**Charleston, West Virginia
September 8, 2020**

Carilion Clinic and Subsidiaries
Consolidated Schedule of Expenditures of Federal Awards
Year Ended September 30, 2019

Federal Grantor	Grant Name	Catalog of Federal Domestic Assistance Number	Pass-Through Entity Identifying Number	Passed Through to Subrecipients	Federal Expenditures
Research and Development Cluster:					
Department of Health and Human Services					
	Pass Through Children's Oncology Group - The Research Institute at Nationwide Children's Hospital Cancer Treatment Research	93.395	18583, 19568	\$ -	\$ 23,570
	Pass Through National Institute of Health, Virginia Tech The Reach and Effectiveness of Technology - Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847	431585-19858	-	3,152
	Pass Through National Institute of Health, Virginia Tech Alcohol Research Programs	93.273	Various	-	74,211
	Pass Through NSF, University of Virginia Aging Research	93.866	Various	19,614	202,449
	Pass Through University of Connecticut Health Center Mental Health Research Grants	93.242	UCHC7-86720047	-	6,701
	Pass Through Virginia Tech Carilion Research Institute Family Smoking Prevention and Tobacco Control Act Regulatory Research	93.077	431958-19858	-	8,681
	Pass Through American Society of Nephrology, Virginia Tech The Reach and Effectiveness of Technology - Diabetes, Digestive, and Kidney Diseases Extramural Research	93.000	418589-19858	-	87,558
	Pass Through National Institute of Health, Virginia Tech The Reach and Effectiveness of Technology - Trans-NIH Research Support	93.310	418491-19858	-	25,642
	Pass Through National Institute of Health, University of Virginia National Center for Advancing Translational Sciences (NCATS) - Using Data to Improve Health	93.350	148708-19858	-	175,055
	Pass Through Virginia Tech Carilion Research Institute Nursing Research Initiatives - Outpatient Dialysis	93.361	432084-19858	-	13,195
	Total Research and Development Cluster			\$ 19,614	\$ 620,214
Department of Agriculture					
	Distance Learning and Telemedicine Loans and Grants	10.855	NA	\$ -	\$ 377,801
	Total Department of Agriculture			\$ -	\$ 377,801

See accompanying notes.

Carilion Clinic and Subsidiaries
Consolidated Schedule of Expenditures of Federal Awards
Year Ended September 30, 2019

(Continued)

Federal Grantor	Grant Name	Catalog of Federal Domestic Assistance Number	Pass-Through Entity Identifying Number	Passed Through to Subrecipients	Federal Expenditures
Department of Health and Human Services					
	Pass Through Virginia Department of Health Child Development Clinic Services		706T03070	\$ -	\$ 738,074
	Pass Through Virginia Department of Health Roanoke Care Connection for Children		Various	-	299,916
	Total Maternal and Child Health Services Block Grant to the States	93.994		<u>-</u>	<u>1,037,990</u>
	Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease	93.918	NA	-	151,115
	Nurse Education, Practice Quality and Retention Grants	93.359	NA	-	225,691
	Pass Through Virginia Department of Health, Division of Disease Prevention HIV Care Formula Grants	93.917	Various	-	795,976
	Training in General, Pediatric, and Public Health Dentistry	93.059	NA	-	298,226
	Pass Through Virginia Department of Health Extension for Community Healthcare Outcomes (ECHO - Mental Health Telemedicine)	93.126	709D732691	-	132,099
	Pass Through Commonwealth of Virginia, Virginia Department of Health Health Cancer Prevention and Control Programs for State, Territorial, and Tribal Organizations	93.898	709SA832716	-	122,414
	Pass Through Commonwealth of Virginia, Virginia Department of Health Public Crisis Response	93.354	709BQ932796	3,500	63,559
	Total Department of Health and Human Services			<u>\$ 3,500</u>	<u>\$ 2,827,070</u>
	Total Expenditures of Federal Awards			<u>\$ 23,114</u>	<u>\$ 3,825,085</u>

See accompanying notes.

Carilion Clinic and Subsidiaries
Notes to Consolidated Schedule of Expenditures of Federal Awards

1. Organization and Nature of Activities

Carilion Clinic is the sole member of Carilion Medical Center (CMC) (t/a Carilion Roanoke Memorial Hospital and Carilion Roanoke Community Hospital); Carilion New River Valley Medical Center (CNRV); Carilion Franklin Memorial Hospital (CFMH); Carilion Giles Community Hospital (CGCH); Carilion Tazewell Community Hospital (CTCH); Carilion Clinic Properties, LLC (CCP); Carilion Clinic Foundation (CF); and Carilion Services, Inc. (CSI) (collectively, the "Organization"). The Organization is a not-for-profit organization which specializes in patient-centered care, medical education and clinical research, with a goal of providing the best possible health outcome and healthcare experience for each patient.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated schedule of expenditures of federal awards (the Consolidated Schedule) includes the federal grant expenditures for the Organization. All significant intercompany balances and transactions have been eliminated. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic consolidated financial statements.

Expenditures reported in the Consolidated Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. The Organization has elected not to use the 10 percent de minimis indirect cost rate as allowed under the Uniform Guidance.

Use of Estimates

The preparation of the Consolidated Schedule in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates and assumptions.

3. Grant Contingencies

The federal grant programs are subject to financial and compliance audits by the grantors or their representatives. Such audits could lead to requests for reimbursement to the grantor agencies for expenditures disallowed under terms of the grants. Management believes disallowances, if any, will not be material.

4. Categorization of Expenditures

The categorization of expenditures by program included in the consolidated schedule of expenditures of federal awards is based upon the grant documents. Changes in the categorization of expenditures occur based upon revisions to the Catalog of Federal Domestic Assistance (CFDA), which is issued in June and December of each year. The schedule of expenditures of federal awards for the year ended September 30, 2019 reflects CFDA changes issued through August 2019.

5. Subsequent Events

The Organization evaluated the effect subsequent events would have on the Consolidated Schedule through September 8, 2020, which is the date this schedule was available to be issued.

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Consolidated Schedule of Expenditures of Federal Awards Performed in Accordance with *Government Auditing Standards*

Board of Directors
Carilion Clinic and Subsidiaries
Roanoke, Virginia

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated schedule of expenditures of federal awards of Carilion Clinic and Subsidiaries (the Consolidated Schedule) and the related notes for the year ended September 30, 2019, and have issued our report thereon dated September 8, 2020. We did not audit the consolidated financial statements of Carilion Clinic and Subsidiaries as of and for the year ended September 30, 2019. Those statements were audited by other auditors whose report dated January 27, 2020, expressed an unmodified opinion on those consolidated financial statements. The consolidated financial statements of Carilion Clinic and Subsidiaries were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

Dixon Hughes Goodman LLP

**Charleston, West Virginia
September 8, 2020**

Independent Auditors' Report on Compliance for Each Major Federal Program and on Internal Control Over Compliance Required by the Uniform Guidance

Board of Directors
Carilion Clinic and Subsidiaries
Roanoke, Virginia

Report on Compliance for Each Major Federal Program

We have audited Carilion Clinic and Subsidiaries' compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of Carilion Clinic and Subsidiaries' major federal programs for the year ended September 30, 2019. Carilion Clinic and Subsidiaries' major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations and the terms and conditions of its federal awards applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of Carilion Clinic and Subsidiaries' major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Carilion Clinic and Subsidiaries' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Carilion Clinic and Subsidiaries' compliance.

Opinion on Each Major Federal Program

In our opinion, Carilion Clinic and Subsidiaries' complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2019.

Other Matters

The results of our auditing procedures disclosed an instance of noncompliance which is required to be reported in accordance with the Uniform Guidance and is described in the accompanying schedule of findings and questioned costs as item 2019-001. Our opinion on each major federal program is not modified with respect to these matters.

Carilion Clinic and Subsidiaries' response to the noncompliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. Carilion Clinic and Subsidiaries' response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control over Compliance

Management of Carilion Clinic and Subsidiaries is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Carilion Clinic and Subsidiaries' internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Carilion Clinic and Subsidiaries' internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we did identify a certain deficiency in internal control over compliance, described in the accompanying schedule of findings and questioned costs as item 2019-001, that we consider to be a significant deficiency.

Carilion Clinic and Subsidiaries' response to the internal control over compliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. Carilion Clinic and Subsidiaries' response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Dixon Hughes Goodman LLP

**Charleston, West Virginia
September 8, 2020**

Schedule of Findings and Questioned Costs

Part I. Summary of Auditors' Results

Consolidated Schedule of Expenditures of Federal Awards (Consolidated SEFA)

Type of auditors' report issued on whether the consolidated SEFA was prepared in accordance with GAAP:

	<u>YES</u>	<u>NO</u>
Internal control over financial reporting:		
Material weakness(es) identified?	_____	X
Significant deficiency(ies) identified that are not considered to be material weaknesses?	_____	X
Noncompliance material to consolidated SEFA noted?	_____	X

Federal Awards

Internal control over major programs:

Material weakness(es) identified?	_____	X
Significant deficiency(ies) identified that are not considered to be material weakness(es)?	X	_____

Type of auditors' report issued on compliance for major programs:

	Unmodified	
Any audit findings disclosed that are required to be reported in accordance with the Uniform Guidance?	X	_____

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
93.994	Maternal and Child Health Services Block Grant to the States
10.855	Distance Learning and Telemedicine Loans and Grants

Dollar threshold used to distinguish between type A and type B programs: \$ 750,000

Auditee qualified as low-risk auditee? X Yes No

Part II. Consolidated SEFA Findings

None.

Part III. Federal Award Findings and Questioned Costs

Significant Deficiency

Finding 2019-001- Procurement

Condition: For the year ended September 30, 2019, Carilion Clinic and Subsidiaries did not have a written procurement policy as required by 2 CFR section 200.318 through 200.326 of Title 2 *U.S Code*

Carilion Clinic and Subsidiaries
Schedule of Findings and Questioned Costs
September 30, 2019

of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance).

Criteria: In accordance with 2 CFR section 200.319(c), non-federal entities must have written procedures for procurement transactions. Such policy should incorporate all requirements within 2 CFR section 200.318 through 200.326 of the Uniform Guidance.

Cause: Carilion did not have a written procurement policy for the year ended September 30, 2019.

Effect: Noncompliance with the Uniform Guidance could jeopardize future federal funding.

Questioned Costs: None.

Recommendation: Carilion should prepare and approve a written procurement policy and ensure that the policy includes all requirements of 2 CFR section 200.318 through 200.326.

Part IV. Corrective Action Plan

Contact Person: Ryan Sypniewski

Managements Response: Carilion agrees that a written procurement policy is necessary and will take the appropriate steps to prepare and approve a written procurement policy in accordance with Uniform Guidance.

Proposed Completion Date: September 30, 2020

Part V. Resolution of Prior Year Findings

N/A