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Board of Directors
Prospect CharterCARE SJHSRI, LLC
3415 South Sepulveda Boulevard, 9th Floor
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August 10, 2020

Please find attached revised consolidated financial statements for Prospect CharterCARE SJHSRI, LLC for the year ended September 30, 2019.

The notes to the consolidated financial statements have been revised solely to clarify statements in Note 7 relating to the sale lease back transaction and loan transaction between Prospect Medical Holdings, Inc. and Medical Properties Trust, Inc. that occurred during the year ended September 30, 2019.

The date of our audit opinion remains the same.

Yours sincerely,

BDO USA, LLP

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CIIH16-006595



Prospect CharterCARE SJHSRI, LLC

Financial Statements

**As of and for the Years Ended
September 30, 2019 and 2018**

The report accompanying these financial statements was issued by
BDO USA, LLP, a Delaware limited liability partnership and the U.S.
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CIIH16-006596

Prospect CharterCARE SJHSRI, LLC

Financial Statements

As of and for the Years Ended September 30, 2019 and 2018

Prospect CharterCARE SJHSRI, LLC

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Independent Auditor's Report

Board of Directors
Prospect CharterCARE SJHSRI, LLC
Los Angeles, California

Report on the Financial Statements

We have audited the accompanying financial statements of Prospect CharterCARE SJHSRI, LLC (the "Company"), which comprise the balance sheets as of September 30, 2019 and 2018, and the related statements of operations, member's equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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Emphasis of Matter

As discussed in Note 1, the Company is financially dependent on its parent companies which have agreed to provide the financial support necessary for the operations of the Company. The accompanying financial statements do not reflect any adjustments or disclosures that would be required should the parent companies discontinue their financial support.

Other Matters

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying Note 9 of the Company's calculation of its Title IV 90/10 revenue test ("Note 9 - Title IV 90/10") and Note 6 on related party transactions are required by the U.S. Department of Education and is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Note 9 - Title IV 90/10 information and Note 6 on related party transactions are fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 6, 2020 on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Company's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting and compliance.

BDO USA, LLP

February 6, 2020

Prospect CharterCARE SJHSRI, LLC

Balance Sheets (in thousands)

<u>September 30,</u>	<u>2019</u>	<u>2018</u>
Assets		
Current assets		
Cash and cash equivalents	\$ -	\$ -
Restricted cash	13	166
Patient accounts receivable, less allowance for doubtful accounts of \$8,458 and \$5,491	20,929	20,224
Other receivables	451	554
Due from government payers	499	894
Inventories	1,996	1,889
Prepaid expenses and other current assets	655	496
Total current assets	24,543	24,223
Property, improvements and equipment, net	23,726	24,064
Intangible assets, net	-	517
Other assets	614	881
Total assets	\$ 48,883	\$ 49,685

See accompanying notes to financial statements.

Prospect CharterCARE SJHSRI, LLC

Balance Sheets (in thousands)

<i>September 30,</i>	2019	2018
Liabilities and Member's Equity		
Current liabilities		
Accrued medical claims and other healthcare costs payable	\$ -	\$ 488
Accounts payable and other accrued liabilities	12,032	11,438
Accrued salaries, wages and benefits	4,642	4,852
Deferred revenue	170	681
Due to government payers	5	424
Due to affiliated companies, net	5,241	5,657
Current portion of capital leases	38	369
Total current liabilities	22,128	23,909
Capital leases, net of current portion	-	38
Deferred revenue, net of current portion	1,327	1,514
Asset retirement obligations	2,290	2,092
Other long-term liabilities	5,001	5,771
Total liabilities	30,746	33,324
Commitments and contingencies		
Member's equity:		
Member's contributions	28,535	28,535
Accumulated deficit	(10,398)	(12,174)
Total member's equity	18,137	16,361
Total liabilities and member's equity	\$ 48,883	\$ 49,685

See accompanying notes to financial statements.

Prospect CharterCARE SJHSRI, LLC

Statements of Operations (in thousands)

<i>For the Years Ended September 30,</i>	2019	2018
Revenues:		
Net patient service revenues	\$ 147,297	\$ 147,129
Provision for bad debts	(6,813)	(6,096)
Net patient service revenues less provision for bad debts	140,484	141,033
Other non-patient Hospital revenues	2,781	3,870
Total net revenues	143,265	144,903
Operating Expenses:		
Salaries, wages and benefits	75,334	81,487
Supplies	19,200	19,662
Taxes and licenses	10,037	9,840
Purchased services	12,015	9,980
Depreciation and amortization	7,188	7,846
Professional fees	6,512	5,124
Other	1,258	5,374
Management fees	2,954	2,994
Utilities	2,125	1,957
Lease and rental	1,544	1,536
Insurance	1,508	1,668
Repairs and maintenance	671	1,261
Registry	293	46
Total operating expenses	140,639	148,775
Operating income from unconsolidated equity method investments	13	-
Operating income (loss)	2,639	(3,872)
Other expense:		
Interest expense	863	876
Total other expense	863	876
Net income (loss)	\$ 1,776	\$ (4,748)

See accompanying notes to financial statements.

Prospect CharterCARE SJHSRI, LLC

Statements of Member's Equity (in thousands)

	Member's Contributions	Accumulated Deficit	Total Member's Equity
Balance at October 1, 2017	\$ 28,535	\$ (7,426)	\$ 21,109
Net loss	-	(4,748)	(4,748)
Balance at September 30, 2018	28,535	(12,174)	16,361
Net income	-	1,776	1,776
Balance at September 30, 2019	\$ 28,535	\$ (10,398)	\$ 18,137

See accompanying notes to financial statements.

Prospect CharterCARE SJHSRI, LLC

Statements of Cash Flows (in thousands)

<i>For the Years Ended September 30,</i>	2019	2018
Operating activities		
Net income (loss)	\$ 1,776	\$ (4,748)
Adjustments to reconcile net income (loss) to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	6,810	7,846
Provision for bad debts	6,813	6,096
Accretion of interest for asset retirement obligations	378	156
Changes in operating assets and liabilities		
Change in restricted cash	153	493
Patient accounts receivable and other receivables	(7,415)	(8,506)
Due to/from government payers, net	(23)	(67)
Inventories	(107)	(138)
Prepaid expenses and other current assets	(159)	426
Other assets	267	(305)
Accrued medical claims and other healthcare costs	(488)	(185)
Accounts payable and other accrued liabilities	(833)	2,772
Deferred revenue	(698)	(477)
Net cash and cash equivalents provided by operating activities	6,474	3,363
Investing activities		
Purchases of property, improvements and equipment	(3,624)	(7,525)
Net cash and cash equivalents used in investing activities	(3,624)	(7,525)
Financing activities		
Change in due to affiliated companies, net	(2,481)	4,913
Repayments of capital leases	(369)	(751)
Net cash and cash equivalents (used in) provided by financing activities	(2,850)	4,162
Change in cash and cash equivalents	-	-
Cash and cash equivalents, beginning of year	-	-
Cash and cash equivalents, end of year	\$ -	\$ -
Supplemental disclosure of cash flow information		
Interest paid	\$ 753	\$ 876
Schedule of non-cash investing activities		
Accrual of property, improvements and equipment	\$ 1,952	\$ 188

See accompanying notes to financial statements.

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

1. Organization

Prospect CharterCARE SJHSRI, LLC (“SJHSRI” or the “Company” dba St. Joseph Health Center and our Lady of Fatima Hospital) is a wholly-owned subsidiary of Prospect CharterCARE, LLC (“PCC”). PCC is owned 85% by Prospect Medical Holdings, Inc. (“Prospect” or “PMH”) and 15% by CharterCARE Community Board. SJHSRI operates a 359-bed acute care general hospital which provides healthcare services in North Providence, Rhode Island and surrounding communities. Additionally, SJHSRI operated the St. Joseph School of Nursing (the “School”) and an integrated network of primary care and specialty clinics serving an economically challenged and ethnically diverse population in Providence, Rhode Island. As of September 30, 2019, the School has been closed.

Admitting physicians are primarily practitioners in the local area. The hospital has payment arrangements with Medicare, Medicaid and other third party payers, including commercial insurance carriers, health maintenance organizations (“HMOs”) and preferred provider organizations (“PPOs”).

The Company is dependent on its parent companies to fund ongoing operations. As of September 30, 2019, the Company had a net liability of \$5,241,000 due to Prospect and to PCC and its subsidiaries, which is payable on demand, does not bear interest, and is included in due to affiliated companies, net in the accompanying balance sheets. Prospect and PCC do not intend to have the Company repay the liability in a manner which would impair the Company’s ability to maintain sufficient liquidity to sustain ongoing operations.

2. Significant Accounting Policies

Basis of Presentation

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”).

Revenues

Net Patient Service Revenues

Operating revenue consists primarily of net patient service revenues. The Company reports net patient service revenues at the estimated net realizable amounts from patients and third-party payers and others in the period in which services are rendered. The Company has agreements with third-party payers, including Medicare, Medicaid, managed care and other insurance programs that are paid at negotiated rates. These payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments, as further described below. Estimates of contractual allowances are based upon the payment terms specified in the related contractual agreements. The Company accrues for amounts that it believes may ultimately be due to or from the third-party payers. Normal estimation differences between final settlements and amounts accrued in previous years are reported as changes in estimates in the current year. Outstanding receivables, net of allowances for contractual discounts and bad debts, are included in patient accounts receivable in the accompanying balance sheets.

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

The following is a summary of sources of net patient service revenues (net of contractual allowances and discounts) before provision for bad debts (in thousands):

<i>For the Years Ended September 30,</i>	2019	2018
Medicare	\$ 59,521	\$ 68,242
Medicaid	42,055	33,216
Managed Care	29,950	31,417
Self-Pay/Other	15,771	14,254
Total	\$ 147,297	\$ 147,129

A summary of the payment arrangements with major third-party payers follows:

Medicare: Medicare is a federal program that provides certain hospital and medical insurance benefits to persons aged 65 and over, some disabled persons with end-stage renal disease and certain other beneficiary categories. Most inpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge, according to a patient classification system based on clinical, diagnostic, and other factors. Outpatient services are generally paid based on prospectively determined rates and cost-reimbursed methodologies. The Company is also reimbursed for various disproportionate share and Medicare bad debt components at tentative rates, with final settlement determined after submission of the annual Medicare cost report and audit thereof by the Medicare fiscal intermediary. The Company also receives Medicare outlier payments on an ongoing basis during the year for cases that are unusually costly, and under certain circumstances these payments may be reconciled to more closely reflect the costs in excess of outlier thresholds after the submission and audit of the annual Medicare cost report. Normal estimation differences between filed settlements and amounts accrued are reflected in net patient service revenue.

Cost report settlement estimates are recorded based upon as-filed cost reports and are adjusted for tentative settlements, if any, and when a final Notice of Program Reimbursement ("NPR") is issued.

Medicaid: Medicaid is a joint federal-state funded healthcare benefit program that is administered by states to provide benefits to qualifying individuals who are unable to afford care. The Company receives reimbursements under the Medicaid program at prospectively determined rates for both inpatient and outpatient services. Similar to Medicare, cost report settlements are recorded based upon as-filed cost reports and adjusted for tentative and final settlements, if any.

SJHSRI is a participant in the State of Rhode Island's Disproportionate Share Hospital ("DSH") program, which assists hospitals that provide a disproportionate amount of uncompensated care. Under the program, Rhode Island hospitals, including SJHSRI, receive federal and state Medicaid funds as additional reimbursement for treating a disproportionate share of low income patients. SJHSRI recognized revenue related to DSH and Upper Payment Limit ("UPL") reimbursement of \$9,868,000 and \$9,856,000 for the years ended September 30, 2019 and 2018, respectively. DSH and UPL payments received were \$9,734,000 and \$9,837,000 for the years ended September 30, 2019 and 2018, respectively. The State of Rhode Island also assesses a license fee to all hospitals in Rhode Island based on each hospital's net patient revenue. SJHSRI recorded license fee

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

expenses of \$8,062,000 and \$7,616,000, respectively, which is included within taxes and licenses expense within the accompanying statements of operations.

Managed Care: The Company has also entered into payment agreements with certain commercial insurance carriers, HMOs, and PPOs. The basis for payment under these agreements is in accordance with negotiated contracted rates or at the Company's standard charges for services provided.

Self-Pay: Self-pay patients represent those patients who do not have health insurance and are not covered by some other form of third party arrangement. Such patients are evaluated, at the time of services or shortly thereafter, for their ability to pay based upon federal and state poverty guidelines, qualifications for Medicaid, as well as the Company's indigent and charity care policy.

Laws and regulations governing the third-party payor arrangements are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Normal estimation differences between subsequent cash collections on patient accounts receivable and net patient accounts receivable estimated in the prior year are reported as adjustments to net patient service revenue in the current period.

The Company is not aware of any material claims, disputes, or unsettled matters with any payers that would affect revenues that have not been adequately provided for and disclosed in the accompanying financial statements.

Charity Care

The Company provides charity care to patients who lack financial resources and are deemed to be medically indigent based on criteria established under the Company's charity care policy. This care is provided without charge or at amounts less than the Company's established rates. Because the Company does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue. The direct and indirect costs related to this care totaled approximately \$280,000 and \$315,000 for the years ended September 30, 2019 and 2018, respectively. Direct and indirect costs for providing charity care are estimated by calculating a ratio of cost to gross charges and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients. In addition, the Company provides services to other medically indigent patients under various state Medicaid programs. Such programs pay amounts that are less than the cost of the services provided to the recipients. The Company has not changed its charity care or uninsured discount policies during the years ended September 30, 2019 or 2018.

Provisions for Contractual Allowances and Doubtful Accounts

Collection of receivables from third-party payers and patients is the Company's primary source of cash and is critical to its operating performance. The Company closely monitors its historical collection rates, as well as changes in applicable laws, rules and regulations and contract terms, to assure that provisions for contractual allowances are made using the most accurate information available. However, due to the complexities involved in these estimations, actual payments from payers may be materially different from the amounts management estimates and records. The Company's primary collection risks relate to uninsured patients and the portion of the bill which is the patient's responsibility, primarily co-payments and deductibles. Payments for services may also

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

be denied due to issues over patient eligibility for medical coverage, the Company's ability to demonstrate medical necessity for services rendered and payer authorization of hospitalization.

Accounts receivable are reduced by an allowance for doubtful accounts. Valuation of the collectability of accounts receivable and provision for bad debts is based on historical collection experience, payer mix and the age of the receivables. Management routinely reviews accounts receivable balances in conjunction with these factors and other economic conditions which might ultimately affect the collectability of the patient accounts, and makes adjustments to the Company's allowances as warranted. For receivables associated with services provided to patients who have third-party coverage, management analyzes contractually due amounts and subsequently calculates an allowance for doubtful accounts and provision for bad debts once the age of the accounts reaches a specific age category based on historical experience. For receivables associated with self-pay patients, management records a significant provision for bad debts beginning in the period services were provided based on past experience that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The allowance for doubtful accounts was 29% and 21% of gross patient accounts receivable as of September 30, 2019 and 2018, respectively. The decrease was due to a self-pay discount which took effect during the year ended September 30, 2019, resulting in a decrease in the bad debt allowance required as of September 30, 2019.

Legislation

All of the Company's hospital facilities are subject to the Emergency Medical Treatment and Active Labor Act ("EMTALA"). This federal law requires any hospital that participates in the Medicare program to conduct an appropriate medical screening examination of every person who presents to the hospital's emergency department for treatment and, if the patient is suffering from an emergency medical condition, to either stabilize that condition or make an appropriate transfer of the patient to a facility that can handle the condition. The obligation to screen and stabilize emergency medical conditions exists regardless of a patient's ability to pay for treatment. There are severe penalties under EMTALA if a hospital fails to screen or appropriately stabilize or transfer a patient or if the hospital delays appropriate treatment in order to first inquire about the patient's ability to pay. Penalties for violations of EMTALA include civil monetary penalties and exclusion from participation in the Medicare program. In addition, an injured patient, the patient's family or a medical facility that suffers a financial loss as a direct result of another hospital's violation of the law can bring a civil suit against that other hospital. The Company believes that it is in compliance with EMTALA and is not aware of any pending or threatened EMTALA investigations involving allegations of potential wrongdoing that would have a material effect on the Company's financial statements.

Other Non-Patient Hospital Revenues

Other non-patient Hospital revenues totaled \$2,781,000 and \$3,870,000 for the years ended September 30, 2019 and 2018, respectively. The principal components of other non-patient Hospital revenues include tuition revenue and rental revenue. Management has evaluated the collectability of other receivables consisting primarily of other non-patient Hospital revenues and determined no allowance is necessary as of September 30, 2019 or 2018.

Property, Improvements and Equipment

Property, improvements and equipment are stated on the basis of cost or, in the case of acquisitions, at their acquisition date fair values. Depreciation is provided using the straight-line method over the estimated useful lives of the assets, and amortization of leasehold improvements is provided

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

using the straight-line basis over the shorter of the remaining lease period or the estimated useful lives of the leasehold improvements. Building improvements are generally depreciated over seven years, buildings are depreciated over 10 years, equipment is depreciated over three to seven years and furniture and fixtures are depreciated over five to seven years. Equipment capitalized under capital lease obligations are amortized over the lesser of the life of the lease or the useful life of the asset.

Long-Lived Assets and Amortizable Intangibles

Intangible assets include trade names. The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. The Company considers assets to be impaired and writes them down to fair value if estimated undiscounted cash flows associated with those assets are less than their carrying amounts. Fair value is based upon the present value of the associated cash flows. Changes in circumstances (for example, changes in laws or regulations, technological advances or changes in strategies) may also reduce the useful lives from initial estimates. Changes in planned use of intangibles may result from changes in customer base, contractual agreements, or regulatory requirements. In such circumstances, management will revise the useful life of the long-lived asset and amortize the remaining net book value over the adjusted remaining useful life. There were no impairments recorded during the years ended September 30, 2019 and 2018.

Insurance Reserves

Medical Malpractice Liability Insurance

The Company carries professional and general liability insurance to cover medical malpractice claims. The General Liability coverage is occurrence coverage and the Professional Liability coverage is claims-made coverage. Under the Professional Liability policy, insurance premiums cover only those claims actually reported during the policy term. Should the Professional Liability claims-made policy not be renewed or replaced with equivalent insurance, claims related to occurrences during the policy term but reported subsequent to the policy's termination may be uninsured.

GAAP requires that a health care organization record and disclose the estimated costs of medical malpractice claims in the period of the incident of malpractice, if it is reasonably possible that liabilities may be incurred and losses can be reasonably estimated. The Company recognizes an estimated liability for incurred but not reported claims and the self-insured risks (including deductibles and potential claims in excess of policy limits) based upon an actuarial valuation of the Company's historical claims experience. The Company's gross claims liability was \$2,895,000 and \$3,470,000 as of September 30, 2019 and 2018, respectively, and insurance receivables were \$565,000 and \$827,000 as of September 30, 2019, and 2018, respectively. The gross claims liability and insurance receivables were estimated using a discount factor of 4% and are included within long-term liabilities and long-term assets, respectively, in the accompanying balance sheets.

Workers' Compensation Insurance

The Company was fully insured for workers' compensation claims with no deductible for the years ended September 30, 2019 and 2018.

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

Reserve Methodology

The claims reserve is based on the best data available to the Company. The estimate, however, is subject to a significant degree of inherent variability. The estimate is continually monitored and reviewed, and as the reserve is adjusted, the difference is reflected in current operations. While the ultimate amount of medical malpractice liability is dependent on future developments, management is of the opinion that the associated liabilities recognized in the accompanying financial statements are adequate to cover such claims. Management is not aware of any potential medical malpractice claims whose settlement, if any, would have a material adverse effect on the Company's financial position, results of operations or cash flows.

Employee Health Plans

The Company maintains self-insured EPO/HMO and PPO plans for all eligible employees. Employee health benefits are administered by a third party claims administrator, based on plan coverage and eligibility guidelines determined by the Company, as well as by collective bargaining agreements. Commercial insurance policies cover per occurrence losses in excess of \$350,000. An actuarially estimated liability of approximately \$0 and \$488,000 for incurred but not reported claims as of September 30, 2019 and 2018, respectively. As of September 30, 2019, Prospect has assumed the liability related to employee health plans.

Asset Retirement Obligations

The Company recognizes the fair value of a liability for legal obligations associated with asset retirements in the period in which it is incurred, if a reasonable estimate of the fair value of the obligation can be made. Over time, the liability is accreted to its present value each period. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the statements of operations. The Company has accrued \$2,290,000 and \$2,092,000 related to asbestos remediation as of September 30, 2019 and 2018, respectively. The Company recorded \$378,000 and \$156,000 of accretion of the asset retirement obligation during the year ended September 30, 2019 and 2018, respectively.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with initial maturities of 90 days or less to be cash equivalents. Cash and cash equivalents are primarily comprised of deposits with banks. The Company maintains its cash at banks with high credit-quality ratings.

Restricted Cash

The Company held restricted cash of \$13,000 and \$166,000 as of September 30, 2019 and 2018, respectively, which is restricted for grants for the Company's School of Nursing.

Inventories

Inventories of supplies are valued at the lower of amounts that approximate the weighted average cost or net realizable value, which approximates market value, and are expensed as incurred. Inventories consist primarily of medical and surgical supplies and pharmaceuticals.

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

Sale-Leaseback Transactions

The Company evaluates sale-leaseback transactions by determining whether the transaction meets the qualifying criteria to be recognized as a sale-leaseback, including the transfer of risk and rewards of ownership as well as the absence of continuing involvement of the Company. When the qualifying criteria for a sale-leaseback transaction are not met, the Company accounts for the transaction as a financing.

Income Taxes

For tax reporting purposes, the Company is treated as a Partnership and is a pass-through entity. Therefore, no provision is made in the accompanying financial statements for liabilities for federal, state or local income taxes since such liabilities are the responsibility of the Company's parent companies. The Company periodically evaluates its tax positions, including its status as a pass-through entity, to evaluate whether it is more likely than not that such positions would be sustained upon examination by a tax authority for all open tax years, as defined by the statute of limitations, based on its technical merits.

As of September 30, 2019 and 2018, the Company has not established a liability for uncertain tax positions. The Company files income tax returns in the U.S. federal jurisdiction and the state of Rhode Island. Generally, the Company is subject to examination by U.S. federal (or state and local) income tax authorities for three to four years from the filing of a tax return.

Concentrations of Credit Risk

Cash and cash equivalents are maintained at financial institutions and, at times, balances may exceed federally insured limits of \$250,000 per depositor of each financial institution. The Company has not experienced any losses to date related to these balances.

Financial instruments that potentially subject the Company to concentrations of credit risk consist of receivables due from Medicare and Medicaid. The Company received revenues from Medicare and Medicaid as follows (in thousands):

	For the Year Ended September 30, 2019	% of Net Patient Services Revenues	For the Year Ended September 30, 2018	% of Net Patient Services Revenues
Medicare	\$ 59,521	40%	\$ 68,242	46 %
Medicaid	42,055	29%	33,216	22 %
Total	\$ 101,576	69%	\$ 101,458	68 %

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities at the dates, and for the periods, that the financial statements are prepared. Actual results could materially differ from those estimates. Principal areas requiring the use of estimates include amounts due from/to government payers, allowances for contractual discounts

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

and doubtful accounts, professional and general liability claims, employee health benefit claims, long-lived assets, intangible assets and asset retirement obligations.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers (Topic 606)” with an effective date deferred by ASU 2015-14. The core principle of ASU 2014-09 is built on the contract between a vendor and a customer for the provision of goods and services, and attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, (v) recognize revenue when (or as) the entity satisfies a performance obligation. Nonpublic entities will apply the new standard for annual periods beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Three basic transition methods are available — full retrospective, retrospective with certain practical expedients, and a cumulative effect approach. Under the third alternative, an entity would apply the new revenue standard only to contracts that are incomplete under legacy U.S. GAAP at the date of initial application and recognize the cumulative effect of the new standard as an adjustment to the opening balance of retained earnings. That is, prior years would not be restated and additional disclosures would be required to enable users of the financial statements to understand the impact of adopting the new standard in the current year compared to prior years that are presented under legacy U.S. GAAP. The Company is currently evaluating the effect of this guidance on its financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)”. The core principle of ASU 2016-02 is that a lessee should recognize the assets and liabilities that arise from leases, including operating leases. Under the new requirements, a lessee will recognize in the statement of financial position a liability to make lease payments (the lease liability) and the right-of-use asset representing the right to the underlying asset for the lease term. For leases with a term of 12 months or less, the lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. The standard was originally scheduled to effective for nonpublic entities for fiscal years beginning after December 15, 2019. In November 2019 the FASB issued ASU 2019-10, “Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842)” which delayed the effective date by one year to December 2020. The Company is currently evaluating the standard and the impact on its financial statements and footnote disclosures.

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230)”. The updated standard addresses eight specific cash flow issues with the objective of reducing diversity in practice. ASU 2016-15 is effective for non-public business entities for annual reporting periods beginning after December 15, 2018, including interim periods within those annual reporting periods. Early adoption is permitted. The Company is assessing the impact of the adoption of ASU 2016-15 on its financial statements.

Reclassifications

Certain reclassifications were made to the prior year financial statements in order to conform to the current year presentation.

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

3. Property, Improvements and Equipment

Property, improvements and equipment, consisted of the following (in thousands):

<i>September 30,</i>	2019	2018
Property, improvements and equipment:		
Land and land improvements	\$ 4,802	\$ 4,802
Buildings and improvements	18,183	18,180
Leasehold improvements	4,048	4,048
Equipment	17,943	16,456
	44,976	43,486
Less: accumulated depreciation	(30,424)	(24,510)
	14,552	18,976
Construction in Progress	9,174	5,088
Property, improvements and equipment, net	\$ 23,726	\$ 24,064

As of September 30, 2019 and 2018, the Company had assets under capitalized leases of \$2,205,000 and \$2,005,000, respectively, and related accumulated depreciation of \$1,154,000 and \$818,000, respectively.

Depreciation expense was \$6,293,000 and \$7,128,000 for the years ended September 30, 2019 and 2018, respectively.

4. Intangible Assets

Identifiable intangible assets are comprised of the following (in thousands):

	Amortization Period	September 30, 2019	September 30, 2018
Trade names	5 years	\$ 3,590	\$ 3,590
Total acquisition cost of intangible assets		3,590	3,590
Less accumulated amortization		(3,590)	(3,073)
Intangible assets, net		\$ -	\$ 517

Amortization is recognized on a straight-line basis (management's best estimate of the period of economic benefit) over the respective useful lives. Amortization expense was \$517,000 and \$718,000 for the years ended September 30, 2019 and 2018, respectively.

There is no future amortization expense as of September 30, 2019.

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

5. Sale-Leaseback Liability and Deferred Revenue

In October 2016, the Company entered into an agreement under which it granted and conveyed an exclusive easement to a water tower utilized for telecommunications purposes for a 99 year term to an unrelated third party. The agreement also assigned certain of the Company's telecommunications leases. The purchase price was approximately \$2,057,000. The income derived from this transaction has been deferred and is being recognized on a straight line basis over the remaining term of the leases, through 2028.

In December 2016, the Company entered into a transaction to sell the former St. Joseph Hospital Campus for \$100,000 to an unrelated third party. The purchaser has agreed to make certain required capital improvements as part of this transaction. In connection with this transaction, the Company also entered into a separate agreement to lease back a portion of the facility for 7 years, with options to renew for three 7 year periods, for an initial base rent of \$80,000 per month. The lease also provides for the payment of a portion of the property taxes for the facility, consisting of \$120,000 per year through 2020 and a pro rata portion of property taxes based on the Company's leased space after 2020. This transaction does not qualify for sale-leaseback accounting because of the Company's deemed continuing involvement with the buyer-lessor, including the guarantee by PCC and because the term of the lease agreement is longer than the economic age of the facility. These are considered a form of contingent collateral and results in the transaction being recorded under the financing method. The sale-leaseback liability, which consists of the purchase consideration and the transfer of the ARO balance, and is presented within other long-term liabilities in the accompanying balance sheets.

Scheduled payments under the Company's sale-leaseback liability as of September 30, 2019 are as follows (in thousands):

<i>Years ending September 30,</i>		
2020	\$	260
2021		367
2022		519
2023		734
2024		226
		2,106
Plus: reduction in liability to be accreted to interest income		1,974
Total sale-leaseback liability		\$ 4,080

The total payments to be paid over the remainder of the lease are \$2,106,000. The interest rate implicit in the calculation is negative 35.1%. The value of the sale-leaseback liability is based on the building that was sold, not just the part of the building that was leased back, because as noted above the transaction did not meet the definition of a minor sale-leaseback under the literature. Accordingly, the liability is greater than the sum of the future payments to be made under the lease and this gives rise to a negative interest rate.

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

6. Related Party Transactions

PCC and its Subsidiaries and Prospect East Hospital Advisory Services, LLC (“PEHAS”), a wholly-owned subsidiary of Prospect, entered into a Management Services Agreement (“MSA”) as of June 20, 2014, under which PEHAS provides certain administrative and management services to PCC and its Subsidiaries. Management fees due to PEHAS under the MSA consist of 2% of net revenues monthly. The Company recognized management fees of \$2,954,000 and \$2,994,000 for the years ended September 30, 2019 and 2018, respectively, which is included within management fee expense in the accompanying statements of operations. As of September 30, 2019 and 2018, \$15,546,000 and \$12,592,000, respectively, due pursuant to the MSA, is included in due to affiliated companies, net, in the accompanying balance sheets.

7. Commitments and Contingencies

Leases

The Company leases various office facilities and equipment from third parties under non-cancelable operating and capital lease arrangements expiring at various dates through 2020. Capital leases bear interest at 4.3% per annum.

The future minimum annual lease payments (net of anticipated sublease income) required under leases in effect at September 30, 2019, are as follows (in thousands):

<i>For the Years ending September 30,</i>	Capital Leases	Operating Leases
2020	\$ 40	\$ 156
2021	-	11
2022	-	-
2023	-	-
2024	-	-
Total minimum lease payments	40	\$ 167
Less: amounts representing interest	(2)	
	38	
Less: current portion	(38)	
	\$ -	

Lease and rental expense was \$1,544,000 and \$1,536,000 for the years ended September 30, 2019 and 2018, respectively.

Contingent Liability for Borrowings by Prospect Under Credit Facilities

The Company is contingently liable as a guarantor, among others, for amounts borrowed by PMH on senior secured notes (through August 23, 2019), and credit facilities at September 30, 2019 and 2018.

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

The obligations and related interest expense related to these credit facilities are not reflected in the Company's financial statements as of and for the years ended September 30, 2019 and 2018, as the borrowings are reflected in the separate consolidated financial statements of PMH.

Total borrowings outstanding as of September 30, 2019, reflected in the consolidated financial statements of PMH, but for which the Company is contingently liable as a guarantor, were (in thousands):

<u>September 30,</u>	<u>2019</u>	<u>2018</u>
Senior secured credit facility (net of discount of \$0 and \$20,085, respectively)	\$ -	\$ 1,094,315
<u>Less: Deferred financing costs, net ("DFC")</u>	<u>-</u>	<u>(16,214)</u>
<u>Total Debt, net of discount, premium and DFC</u>	<u>\$ -</u>	<u>\$ 1,078,101</u>

On June 30, 2016, PMH entered into a six-year \$625,000,000 senior secured term loan B (the "Original Term Loan"). The Original Term Loan was issued with an original discount of 1.50%, or \$9,375,000. Additionally, the Company refinanced the previous revolver with a new \$100,000,000 asset-based revolving credit facility ("Original ABL Facility" and together with the Original Term Loan, the "New Senior Secured Credit Facilities"). Pursuant to various amendments from August 2016 through October 2017, the aggregate commitment amount under the Original ABL facility was increased in stages to \$175,000,000. The original maturity date for the Original ABL Facility was June 30, 2021, and the original maturity date for the Term Loan was June 30, 2022.

On February 22, 2018, PMH refinanced and replaced both the Original Term Loan and the Original ABL Facility, and entered into an Amended and Restated Term Loan Credit Agreement (the "Amended TL Agreement"), by and among PMH (as the borrower), the lenders party thereto and JPMorgan Chase Bank, N.A. ("JPMorgan"), as administrative agent and collateral agent. The Amended TL Agreement replaced the Original Term Loan with a new Term B-1 Loan ("Term B-1 Loan"). The principal amount of the Term B-1 Loan is \$1,120.0 million and such loan incurred interest at LIBOR (subject to a 1.0% floor) plus 5.5%. The Term B-1 Loan was issued with an original discount of 2% and was originally scheduled to mature on February 22, 2024. The Term B-1 Loan was repaid on August 23, 2019 by the proceeds totaling \$1.55 billion from a series of transactions that PMH entered into with affiliates of Medical Properties Trust, Inc. ("MPT"), a publicly traded Real Estate Investment Trust (see further discussion below).

Additionally, on February 22, 2018, PMH entered into an Amended and Restated ABL Credit Agreement (the "Amended ABL Agreement"), by and among PMHs (as the borrower), the lenders party thereto and JPMorgan, as administrative agent and collateral agent. The Amended ABL Agreement replaced the Original ABL Facility. Under the Amended ABL Agreement, the maximum revolving commitment was \$250,000,000 with ability to expand the facility to \$325,000,000, and the new ABL facility (the "New ABL Facility") bears interest at a variable base rate plus an applicable spread that is based on excess availability under the New ABL Facility, as further described in the Amended ABL Agreement, which was 6.0% as of September 30, 2019. From January 2019 through July 2019 PMH entered into various amendments to the Amended ABL Agreement. Such amendments (i) waived certain events of default at September 30, 2018; (ii) increased the maximum revolving commitment from \$250.0 million to \$280.0 million, and further to \$285.0 million, while simultaneously reducing and removing future expansion of the facility; (iii) introduced \$40.0 million

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

of a first in last out (“FILO”) revolving facility, which incurred interest at either 2.5% or 3.5% per annum depending on whether they are Eurodollar loans or ABR loans (which were repaid on August 23, 2019); (iv) provides for a reduction in the maximum revolving commitment by \$20.0 million and \$10.0 million upon the future planned closure or disposition of Nix Health and EOGH, respectively. The New ABL Facility matures on February 22, 2023. As of September 30, 2019, the outstanding balance and the available balance on the New ABL facility was approximately \$70.0 million and \$175.6 million, respectively. On August 23, 2019, PMH closed a series of transactions with affiliates of MPT. Under these transactions, PMH sold to MPT its hospital buildings in California (excluding Foothill Regional Medical Center (“Foothill”), Connecticut and Pennsylvania for an aggregate purchase price of \$1,386,000,000. Concurrent with the sale transactions, PMH entered into two master lease agreements whereby the sold hospital properties and related medical office buildings were leased back for an initial 15 year term, with options to extend twice for an additional 5 years each and for a further 4.75 year extension. Monthly rent is defined as 7.5% of the lease base, subject to annual escalation of consumer price index, limited to a minimum of 2% and a maximum of 4%. For the first master lease, PMH has the option to buy the properties at their fair value at the end of the lease term. For the second master lease, PMH has the option to purchase at a price that is fixed at the time of entering into the lease (the “Option Price”). If PMH chooses not to exercise this option, and the fair value at the end of the lease is below the Option Price, then PMH must pay MPT a sum equal to the difference between the fair value and the Option Price. All of the legal entities that are parties to the master lease agreement (which are the hospital entities themselves) provide cross guarantees on all of the obligations to MPT, which guarantees include both lease payments under the master lease as well as indebtedness due to MPT. The balance under sale-leaseback liabilities was \$1,331,000,000 at September 30, 2019, as reflected in PMH’s consolidated financial statements. Neither the Company, its direct parent, nor any of its subsidiaries (a) are parties to any agreement with MPT, (b) are guarantors of the obligations of PMH, or any of its other subsidiaries, owed to MPT or otherwise under the various agreements with MPT, or (c) have pledged any of their assets as collateral for any obligations owed to MPT or otherwise pursuant to any agreement with MPT.

Further, PMH obtained a mortgage on the Foothill property. This mortgage is secured by the buildings at Foothill. The interest on this mortgage is 7.5% per annum and is subject to annual escalation of consumer price index, limited to a minimum of 2% and a maximum of 4%. The maturity date of this loan is in August 2034. MPT can purchase the property on event of default or at end of term, or if Company does not exercise purchase rights for the aforementioned leased properties. Additionally, if the Foothill property is no longer used as collateral for a promissory note payable to Prospect Medical Group, Inc. (“PMG”), then MPT shall have the right to purchase the Foothill property and lease it back to PMH under the second master lease agreement, for an amount equal to the outstanding principal balance. The referenced promissory note payable to PMG has been included in the calculation of PMG’s Tangible Net Equity in connection with requirements of the California Department of Managed Health Care. The balance under this mortgage loan was \$51,276,000 at September 30, 2019, as reflected in PMH’s consolidated financial statements.

Additionally, PMH entered into a promissory note (the “TRS Note”), under which MPT has advanced to PMH \$112,937,000. The interest on this note is 7.5% per annum and is subject to annual escalation of consumer price index, limited to a minimum of 2% and a maximum of 4%. The maturity date of this note is the earlier of July 2022 or, if it occurs, the sale-leaseback of the properties in Rhode Island. The balance under this promissory note was \$112,937,000 at September 30, 2019, as reflected in PMH’s consolidated financial statements.

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

All of the agreements with MPT are cross-collateralized and cross defaulted among the parties and assets included therein (which do not include SJHSRI, its direct parent, or its subsidiaries). The MPT transaction documents contain certain customary covenants and restrictions and a financial covenant based on EBITDAR performance, and PMH was in compliance with such covenants at September 30, 2019.

Litigation

The Company is subject to a variety of claims and suits that arise from time to time in the ordinary course of its business, acquisitions, or other transactions. While the Company's management currently believes that resolving all of these matters, individually or in the aggregate, will not have a material adverse impact on the Company's financial position or results of operations, the litigation and other claims that the Company faces are subject to inherent uncertainties and management's view of these matters may change in the future. Should an unfavorable final outcome occur, there exists the possibility of a material adverse impact on the Company's financial position, results of operations and cash flows for the period in which the effect becomes probable and reasonably estimable.

Legislation and HIPAA

The healthcare 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 healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

The Company believes that it is in compliance with fraud and abuse regulations as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

The Health Insurance Portability and Accountability Act ("HIPAA") assures health insurance portability, reduces healthcare fraud and abuse, guarantees security and privacy of health information, and enforces standards for health information. The Health Information Technology for Economic and Clinical Health Act ("HITECH Act") expanded upon HIPAA in a number of ways, including establishing notification requirements for certain breaches of protected health information. In addition to these federal rules, states have also developed their own standards for the privacy and security of health information as well as for reporting certain violations and breaches (for example, California's Confidentiality of Medical Information Act and Lanterman-Petris Short Act) which in some cases are more stringent. Other federal privacy laws may also apply to certain services provided by the Company, including 42 C.F.R. Part 2, which addresses the confidentiality of substance use disorder records. The Company may be subject to significant fines and penalties if found not to be compliant with these state or federal provisions.

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

Affordable Care Act

The Patient Protection and Affordable Care Act (“PPACA”) has made significant changes to the United States health care system. The legislation impacted multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid and insurance companies. Under this legislation, 33 states have expanded their Medicaid programs to cover previously uninsured childless adults, and four additional states voted in 2018 to expand Medicaid or to elect a governor that pledged to expand Medicaid. In addition, many uninsured individuals have had the opportunity to purchase health insurance via state-based marketplaces, state-based marketplaces using a federal platform, state-partnership marketplaces or the federally-facilitated marketplace. PPACA also implemented a number of health insurance market reforms, such as allowing children to remain on their parents’ health insurance until age 26 or prohibiting certain plans from denying coverage based on pre-existing conditions. Nationally, these reforms have reduced the number of uninsured individuals.

It is unclear what changes may be made to PPACA with the divided Congress, current presidential administration, and pending litigation over the validity of PPACA. The Administration has promulgated rules to broaden the availability of coverage options that do not comply with the full range of PPACA requirements for individual market coverage, namely Association Health Plans and Short-Term Limited-Duration Insurance. The Administration has also provided additional guidance on state PPACA waivers. These executive actions have been or may be challenged in court. In addition, the Tax Cuts and Jobs Act (“TCJA”), passed in December 2017, eliminates the individual mandate penalty under PPACA, effective January 1, 2019. The individual mandate penalty was included in PPACA to address concerns that other market reforms expanding access to coverage might produce adverse selection and higher premiums. The extent to which the repeal of the individual mandate penalty will impact the uninsured rate and future premiums are unclear at this juncture. On December 14, 2018, the United States District Court for the Northern District of Texas ruled that the individual mandate without the penalty is unconstitutional and that PPACA is therefore invalid in its entirety. Litigation on this issue is ongoing, with a decision pending from a panel of the United States Court of Appeals for the Fifth Circuit following oral arguments in July 2019. This litigation along with any future legislative changes to PPACA or other federal and state legislation could have a material impact on the operations of the Company. The Company is continuing to monitor the legislative environment and developments in pending litigation for risks and uncertainties.

Collective Bargaining Agreements

The Company has 304 employees that are subject to a collective bargaining agreement with United Nurses and Allied Professionals (“UNAP”), which was effective beginning July 15, 2019 and expires July 31, 2019. During April 2015, a hospital unit consisting of approximately 430 service employees of Fatima elected to be represented by UNAP. The parties entered into a new collective bargaining agreement which was effective beginning July 2, 2019 and expires on June 30, 2022. A small number of employees are subject to a collective bargaining agreement with the Federation of Nurses and Health Professionals (“FNHP”), which expires on July 30, 2021.

Provider Contracts

Many of the Company’s payer and provider contracts are complex in nature and may be subject to differing interpretations regarding amounts due for the provision of medical services. Such differing interpretations may not come to light until a substantial period of time has passed following contract

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

implementation. Liabilities for claims disputes are recorded when the loss is probable and can be estimated. Any adjustments to reserves are reflected in current operations.

8. Defined Contribution Plan

Prospect sponsors defined contribution plans (the “Plans”) covering substantially all employees who meet certain eligibility requirements. Under the Plans, employees can contribute up to 100% of their compensation up to the IRS deferred annual maximum. Effective May 1, 2018, the plans covering employees at Prospect’s facilities in Connecticut and Pennsylvania merged into the plans covering employees at CharterCARE, and the two remaining plans were renamed and segregated between union and non-union employees. The Company may make discretionary matching contributions to the Plans. Employer contributions to the Plan were \$1,118,000 and \$1,096,000 for the years ended September 30, 2019 and 2018, respectively.

9. Regulatory

General

The Company participates in Student Financial Aid (“SFA”) under the Federal Title IV programs administered by the Department of Education (“ED”) pursuant to the Higher Education Act of 1965, as amended (“HEA”). The Company must comply with the regulations promulgated under HEA.

Financial Responsibility

All institutions participating in the Title IV Programs must satisfy specific standards of financial responsibility as promulgated by the ED. The ED evaluates institutions for compliance with these standards each year, based on the institution's annual audited financial statements. Compliance with the financial responsibility standards are determined through the calculation of a composite score based upon certain financial ratios as defined in the regulations. Institutions receiving a composite score of 1.5 or greater are considered fully financially responsible. Institutions receiving a composite score between 1.0 and 1.4 are subject to additional monitoring and institutions receiving a composite score below 1.0 are required to submit financial guarantees in order to continue participation in the Title IV programs. As of September 30, 2019, and for the year then ended, the Company’s composite score was 1.5.

Compliance with 90/10 Cash Basis Revenue Regulations

The Company derives a portion of its tuition revenues from SFA received by its students under the Title IV programs administered by the ED pursuant to the HEA. To continue to participate in the SFA programs the Company must comply with the regulations promulgated under HEA. The regulations restrict the proportion of cash receipts for tuition and fees from eligible programs to not more than 90 percent from the Title IV programs. In July 2008, modifications to the regulations were made with respect to amounts to be included in the 90 percent calculations including temporary provisions related to certain Title IV funds received and institutional loans made to students. The modifications also allow for the inclusion of funds received for certain qualifying non-Title IV programs. In addition, the modifications included provisions for institutions that do not comply with the 90 percent rule for a single fiscal year, whereby such institutions would be placed on provisional certification status for a period of two years. Institutions that do not comply with the 90 percent rule for two consecutive fiscal years are subject to the loss of their ability to participate in the SFA programs.

Prospect CharterCARE SJHSRI, LLC

Notes to Financial Statements

In October 2009, HEA amended the regulations with respect to the disclosure requirements to the 90 percent calculations and allowed institutions to implement the new and amended provisions. The amended provisions require an institution to disclose the dollar amount of the numerator and denominator of its 90 percent calculation as well as the individual revenue amounts by fund source received by the institution.

For the years ended September 30, 2019 and 2018, the Company's 90/10 cash basis revenue test percentages were computed as follows:

<i>(in thousands)</i>	2019	2018
Revenue by Source		
Student Title IV cash basis revenue		
Subsidized loan	\$ 113	\$ 344
Unsubsidized loan	216	579
Plus loan	15	55
Federal Pell grant	73	207
	\$ 417	\$ 1,185
Student Non-Title IV revenue		
Funds provided from private loans	\$ 59	\$ 147
State loans	40	148
Scholarships	6	23
Student payments	200	454
	\$ 305	\$ 772
Student Title IV cash basis revenue	\$ 417	\$ 1,185
Student title IV cash basis revenue + Student Non-Title IV cash basis revenue	\$ 722	\$ 1,957
	58%	61%

10. Subsequent Event

The Company has evaluated subsequent events through February 6, 2020, the date the Company's financial statements were available for issuance.

Supplemental Report and Schedule



Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

Board of Directors
Prospect CharterCARE SJHSRI, LLC
Los Angeles, California

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 financial statements of Prospect CharterCARE SJHSRI, LLC (the "Company"), which comprise the balance sheet as of September 30, 2019, and the related statements of operations, member's equity, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated February 6, 2020.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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



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 Company's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BDO USA, LLP

February 6, 2020

Prospect CharterCARE SJHSRI, LLC
Schedule of Findings and Questioned Costs

Section I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued:

Unmodified

Internal control over financial reporting:

Material weaknesses identified?

_____ yes

 X no

Significant deficiencies identified?

_____ yes

 X none
reported

Noncompliance material to financial statements
noted?

_____ yes

 X no

Section II - Financial Statement Findings

There were no findings as of September 30, 2019 and for the year ended.

Prospect CharterCARE SJHSRI, LLC

Summary Schedule of Prior Audit Findings

Status of Prior Audit Findings

2018 Findings Status

Condition

The Company had a material weakness in internal controls over financial reporting. The Company's control environment had not been maintained in a way to appropriately and positively influence the effectiveness of the organization's internal control. Accordingly, this material weakness is a causal factor that allowed for greater opportunity for management to override existing internal controls.

Status

Management believes this finding has been resolved.

Prospect CharterCARE SJHSRI, LLC

Summary Schedule of Prior Audit Findings



Status of Prior Audit Findings

2018 Findings Status

Condition

The Company had a material weakness in internal controls over financial reporting. The Company's control environment had not been maintained in a way to appropriately and positively influence the effectiveness of the organization's internal control. Accordingly, this material weakness is a causal factor that allowed for greater opportunity for management to override existing internal controls.

Status

Management believes this finding has been resolved.

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