

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE

***CONSOLIDATED FINANCIAL STATEMENTS
WITH SUPPLEMENTAL SCHEDULES
AND OTHER REPORTS***

YEARS ENDED JUNE 30, 2019 AND 2018

AND

INDEPENDENT AUDITOR'S REPORT

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
CONSOLIDATED FINANCIAL STATEMENTS
WITH SUPPLEMENTAL SCHEDULES AND OTHER REPORTS
YEARS ENDED JUNE 30, 2019 AND 2018

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Spectrum Health Systems, Inc. and Affiliate

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Spectrum Health Systems, Inc. and Affiliate (the "Organization"), which comprise the consolidated statements of financial position as of June 30, 2019 and 2018, and the related consolidated statements of activities, functional expenses and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Spectrum Health Systems, Inc. and Affiliate, as of June 30, 2019 and 2018, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT

(Continued)

Emphasis of a Matter

As disclosed in Note 2 to the financial statements, the Organization adopted the provisions of ASU 2016-14 - Presentation of Financial Statements of Not-for-Profit Entities. Our opinion is not modified with respect to this matter.

Other Matter

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying Schedule of Expenditures of Federal Awards, as required by Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated January 16, 2020, on our consideration of the Organization'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 Organization's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Governmental Auditing Standards* in considering the Organization's internal control over financial reporting and compliance.

Ballus Lynch, LLP

Worcester, Massachusetts
January 16, 2020

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
JUNE 30, 2019 AND 2018

	2019	2018
Assets		
Current assets		
Cash and cash equivalents	\$ 16,157,884	\$ 8,551,197
Accounts receivable, net of allowance of \$4,939,473 and \$3,740,535 as of June 30, 2019 and 2018, respectively	8,302,081	8,433,761
Prepaid expenses and other current assets	389,172	630,909
Total current assets	24,849,137	17,615,867
Property and equipment, net	22,596,361	23,925,106
Restricted cash	490,866	723,044
Investments	43,383	315,163
Investment in affiliate	383,321	355,296
Other assets	2,250	2,375
Total assets	\$ 48,365,318	\$ 42,936,851
Liabilities and Net Assets		
Current liabilities		
Accounts payable	\$ 1,459,956	\$ 1,258,909
Accrued expenses and other current liabilities	3,966,393	3,484,995
Current portion of long-term debt	-	19,042
Current portion of bonds payable	353,767	341,488
Total current liabilities	5,780,116	5,104,434
Long-term liabilities		
Long-term debt, net of debt issuance costs and current portion	-	288,959
Long-term bonds payable, net of debt issuance costs and current portion	6,392,766	6,737,369
Other liabilities	43,383	315,163
Total liabilities	12,216,265	12,445,925
Net assets		
Without donor restrictions	35,656,685	29,956,702
With donor restrictions	492,368	534,224
Total net assets	36,149,053	30,490,926
Total liabilities and net assets	\$ 48,365,318	\$ 42,936,851

See accompanying independent auditor's report and notes to consolidated financial statements.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE

CONSOLIDATED STATEMENTS OF ACTIVITIES

YEARS ENDED JUNE 30, 2019 AND 2018

	2019			2018		
	Without Donor Restrictions	With Donor Restrictions	Total	Without Donor Restrictions	With Donor Restrictions	Total
Public support and revenues						
Contract revenue	\$ 81,068,852	\$ -	\$ 81,068,852	\$ 74,875,395	\$ -	\$ 74,875,395
Gifts and contributions	36,337	14,821	51,158	7,120	31,462	38,582
Interest income	85,684	-	85,684	31,079	-	31,079
Unrealized gain on investments	1,424	-	1,424	25,233	-	25,233
Other revenue	222,439	-	222,439	315,615	5,000	320,615
Releases from restriction	56,677	(56,677)	-	7,740	(7,740)	-
Total public support and revenue	<u>81,471,413</u>	<u>(41,856)</u>	<u>81,429,557</u>	<u>75,262,182</u>	<u>28,722</u>	<u>75,290,904</u>
Expenses						
Program services	67,926,109	-	67,926,109	64,955,867	-	64,955,867
Management and general	7,686,216	-	7,686,216	7,761,980	-	7,761,980
Fundraising	159,105	-	159,105	150,041	-	150,041
Total expenses	<u>75,771,430</u>	<u>-</u>	<u>75,771,430</u>	<u>72,867,888</u>	<u>-</u>	<u>72,867,888</u>
Change in net assets	5,699,983	(41,856)	5,658,127	2,394,294	28,722	2,423,016
Net assets, beginning of year	<u>29,956,702</u>	<u>534,224</u>	<u>30,490,926</u>	<u>27,562,408</u>	<u>505,502</u>	<u>28,067,910</u>
Net assets, end of year	<u>\$ 35,656,685</u>	<u>\$ 492,368</u>	<u>\$ 36,149,053</u>	<u>\$ 29,956,702</u>	<u>\$ 534,224</u>	<u>\$ 30,490,926</u>

See accompanying independent auditor's report and notes to consolidated financial statements.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES
YEAR ENDED JUNE 30, 2019

	Substance Abuse Services Inpatient	Substance Abuse Services Outpatient	Corrections Services	Adolescent Services	Other Services	Total Program Services	Management and General	Fundraising	Total
Salaries	\$ 10,434,404	\$ 10,871,096	\$ 15,288,664	\$ 3,912,636	\$ 920,967	\$ 41,427,767	\$ 4,554,827	\$ 81,958	\$ 46,064,552
Employee benefits	894,066	1,115,601	1,767,545	377,639	98,201	4,253,052	573,691	(1,538)	4,825,205
Payroll taxes	1,033,740	1,009,046	1,289,397	365,540	92,602	3,790,325	360,600	6,898	4,157,823
	<u>12,362,210</u>	<u>12,995,743</u>	<u>18,345,606</u>	<u>4,655,815</u>	<u>1,111,770</u>	<u>49,471,144</u>	<u>5,489,118</u>	<u>87,318</u>	<u>55,047,580</u>
Occupancy	1,662,876	3,550,108	119,612	175,560	46,785	5,554,941	161,556	-	5,716,497
Professional fees	231,683	962,730	322,472	55,617	53,966	1,626,468	743,111	-	2,369,579
Administrative expense	885,119	1,228,868	338,101	34,878	89,371	2,576,337	144,861	54,855	2,776,053
Food and donations	2,112,135	11,005	599	126,069	-	2,249,808	1,913	14,650	2,266,371
Depreciation and amortization	1,345,285	767,870	32,349	61,583	2,979	2,210,066	221,139	-	2,431,205
Transportation	130,690	142,905	612,429	35,082	81,264	1,002,370	142,816	470	1,145,656
Medical service and supply	205,109	1,582,921	5,629	829	-	1,794,488	-	-	1,794,488
Insurance	203,493	145,466	169,356	58,572	9,075	585,962	(59,240)	316	527,038
Education and training	8,302	38,760	113,671	1,026	7,560	169,319	141,671	1,496	312,486
Bad debt expense	-	-	-	-	-	-	697,417	-	697,417
Program supplies	294,645	60,004	7,253	34,456	853	397,211	1,854	-	399,065
Interest	270,594	17,276	125	-	-	287,995	-	-	287,995
Total expenses	<u>\$ 19,712,141</u>	<u>\$ 21,503,656</u>	<u>\$ 20,067,202</u>	<u>\$ 5,239,487</u>	<u>\$ 1,403,623</u>	<u>\$ 67,926,109</u>	<u>\$ 7,686,216</u>	<u>\$ 159,105</u>	<u>\$ 75,771,430</u>

See accompanying independent auditor's report and notes to consolidated financial statements.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES
YEAR ENDED JUNE 30, 2018

	Substance Abuse Services Inpatient	Substance Abuse Services Outpatient	Corrections Services	Adolescent Services	Other Services	Total Program Services	Management and General	Fundraising	Total
Salaries	\$ 9,936,602	\$ 10,727,799	\$ 13,932,765	\$ 3,834,956	\$ 293,894	\$ 38,726,016	\$ 4,797,162	\$ 61,243	\$ 43,584,421
Employee benefits	1,081,274	1,066,179	1,719,571	484,190	22,051	4,373,265	517,096	536	4,890,897
Payroll taxes	959,480	980,755	1,166,668	358,827	21,933	3,487,663	386,094	5,298	3,879,055
	<u>11,977,356</u>	<u>12,774,733</u>	<u>16,819,004</u>	<u>4,677,973</u>	<u>337,878</u>	<u>46,586,944</u>	<u>5,700,352</u>	<u>67,077</u>	<u>52,354,373</u>
Occupancy	1,790,903	3,593,201	65,654	120,556	1,999	5,572,313	83,913	-	5,656,226
Professional fees	216,621	1,069,023	183,504	15,857	47,579	1,532,584	1,057,455	2,604	2,592,643
Administrative expense	1,156,498	1,483,171	227,191	28,871	28,609	2,924,340	(291,162)	70,470	2,703,648
Food and donations	2,124,785	11,907	2,968	119,453	-	2,259,113	500	9,287	2,268,900
Depreciation and amortization	1,325,700	796,012	15,720	59,512	560	2,197,504	220,419	107	2,418,030
Transportation	155,961	136,307	453,507	35,868	27,340	808,983	143,115	-	952,098
Medical service and supply	204,390	1,502,717	22	497	-	1,707,626	-	-	1,707,626
Insurance	208,345	145,165	148,821	59,621	133	562,085	9,360	276	571,721
Education and training	22,844	49,401	77,982	2,243	1,080	153,550	117,837	220	271,607
Bad debt expense	-	-	-	-	-	-	719,183	-	719,183
Program supplies	266,003	35,238	3,274	34,427	11,560	350,502	1,008	-	351,510
Interest	282,964	12,545	125	-	-	295,634	-	-	295,634
Grant expense	-	-	2,045	2,644	-	4,689	-	-	4,689
Total expenses	<u>\$ 19,732,370</u>	<u>\$ 21,609,420</u>	<u>\$ 17,999,817</u>	<u>\$ 5,157,522</u>	<u>\$ 456,738</u>	<u>\$ 64,955,867</u>	<u>\$ 7,761,980</u>	<u>\$ 150,041</u>	<u>\$ 72,867,888</u>

See accompanying independent auditor's report and notes to consolidated financial statements.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2019 AND 2018

	<u>2019</u>	<u>2018</u>
Cash flows from operating activities:		
Change in net assets	\$ 5,658,127	\$ 2,423,016
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	2,431,205	2,418,030
Amortization of debt issuance costs	15,121	10,382
Uncollectible accounts expense	697,417	719,183
Unrealized gain on investments	(1,424)	(23,369)
Loss on sale of property and equipment	6,811	-
Increase (decrease) in operating assets:		
Accounts receivable, net	(565,737)	(909,652)
Prepaid expenses and other assets	241,862	142,794
Increase (decrease) in operating liabilities:		
Accounts payable	168,082	(139,656)
Accrued expenses and other liabilities	209,618	(266,020)
Total adjustments	<u>3,202,955</u>	<u>1,951,692</u>
Net cash provided by operating activities	<u>8,861,082</u>	<u>4,374,708</u>
Cash flows from investing activities:		
Investment in affiliate	(28,025)	12,948
Purchases of property and equipment	(1,076,306)	(857,921)
Proceeds from sales of investments	288,204	-
Purchase of investments	(15,000)	(15,000)
Net cash used in investing activities	<u>(831,127)</u>	<u>(859,973)</u>
Cash flows from financing activities:		
Change in restricted cash	232,178	(9,652)
Payments of long-term debt	(313,958)	(134,404)
Payments of bond payable	(341,488)	(328,999)
Net cash used in financing activities	<u>(423,268)</u>	<u>(473,055)</u>
Net increase in cash	7,606,687	3,041,680
Cash and cash equivalents, beginning of year	<u>8,551,197</u>	<u>5,509,517</u>
Cash and cash equivalents, end of year	<u>\$ 16,157,884</u>	<u>\$ 8,551,197</u>
Supplemental disclosure of cash flow information is as follows:		
Cash paid during the year for:		
Interest	<u>\$ 390,368</u>	<u>\$ 413,514</u>
Supplemental disclosure of cash flow information is as follows:		
Purchases of property and equipment	\$ 1,109,271	\$ 700,258
Add: Accrued capital improvements, beginning of year	35,527	193,190
Less: Accrued capital improvements, end of year	<u>(68,492)</u>	<u>(35,527)</u>
Cash paid during the year for purchases of property and equipment	<u>\$ 1,076,306</u>	<u>\$ 857,921</u>

See accompanying independent auditor's report and notes to consolidated financial statements.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1 - DESCRIPTION OF ORGANIZATION

Spectrum Health Systems, Inc. and Affiliate (the “Organization”) includes Spectrum Health Systems, Inc. (“Spectrum”) and NE Behavioral Health, Inc. (“NEBH”). Spectrum is a not-for-profit organization that provides residential and outpatient substance abuse treatment and rehabilitation and provides mental health counseling, education and treatment.

NEBH was incorporated on February 11, 2015 and commenced operations in June 2015. NEBH is a not-for-profit organization that shares the same mission as Spectrum and provides residential substance abuse treatment and rehabilitation and provides mental health counseling, education and treatment. Spectrum is the sole member of NEBH.

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Organization prepares its financial statements in accordance with generally accepted accounting principles promulgated in the United States of America (U.S. GAAP) for not-for-profit entities. The significant accounting and reporting policies used by the Organization are described subsequently to enhance the usefulness and understandability of the financial statements.

Basis of accounting

The financial statements of the Organization have been prepared on the accrual basis of accounting. Accordingly, assets are recorded when the Organization obtains the rights of ownership or is entitled to claims for receipt and liabilities are recorded when the obligation is incurred.

Principles of consolidation

The consolidated financial statements of the Organization include the accounts of Spectrum and NEBH. All significant intercompany accounts and transactions have been eliminated in consolidation.

Accounting estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the reporting period and the reported amounts of assets and liabilities at the date of the financial statements. On an ongoing basis, the Organization’s management evaluates the estimates and assumptions based upon historical experience and various other factors and circumstances. The Organization’s management believes that the estimates and assumptions are reasonable in the circumstances; however, the actual results could differ from those estimates.

Net assets

The financial statements report net assets and changes in net assets in two classes that are based upon the existence or absence of restrictions on use that are placed by its donors, as follows:

Net assets without donor restrictions - Net assets without donor restrictions are resources available to support operations. The only limits on the use of these net assets are the broad limits resulting from the nature of the Organization, the environment in which it operates, the purposes specified in its corporate documents and its application for tax-exempt status, and any limits resulting from contractual agreements with creditors and others that are entered into in the course of its operations. In addition, the governing board of the Organization may elect to designate such resources for specific purposes. This designation may be removed at the board’s discretion.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Net assets (continued)

Net assets with donor restrictions - Net assets with donor restrictions are resources that are restricted by a donor for use for a particular purpose or in a particular future period. Some donor-imposed restrictions are temporary in nature, and the restriction will expire when the resources are used in accordance with the donor's instructions or when the stipulated time has passed. Other donor-imposed restrictions are perpetual in nature; the Organization must continue to use the resources in accordance with the donor's instructions.

The Organization's unspent contributions are included in this class if the donor limited their use.

When a donor's restriction is satisfied, either by using the resources in the manner specified by the donor or by the passage of time, the expiration of the restriction is reported in the financial statements by reclassifying the net assets from net assets with donor restrictions to net assets without donor restrictions. Net assets restricted for acquisition of buildings or equipment (or less commonly, the contribution of those assets directly) are reported as net assets with donor restrictions until the specified asset is placed in service by the Organization, unless the donor provides more specific directions about the period of its use.

Classification of transactions

All revenues and net gains are reported as increases in net assets without donor restrictions in the statement of activities unless the donor specified the use of the related resources for a particular purpose or in a future period. All expenses and net losses are reported as decreases in net assets without donor restrictions.

Cash and cash equivalents

For purposes of the statement of cash flows, the Organization defines cash and cash equivalents as short-term, highly liquid investments with original maturities of three months or less. The Organization maintains accounts at various financial institutions which, at times, may exceed federally insured limits. The Organization has not experienced any losses in such accounts. The Organization believes it is not exposed to any significant credit risk on cash and cash equivalents.

Accounts receivable

Accounts receivable are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a provision for bad debt expense and an adjustment to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. Recoveries of accounts receivable previously written off are recorded when received.

Investments

Investments represent portfolio shares in registered investment companies and are carried at fair value. By Board of Trustees' resolution, these investments were earmarked to fund deferred compensation liabilities. Investment income and realized and unrealized gains or losses are recorded as increases or decreases in net assets without donor restrictions.

Investment in affiliate

Investment in affiliate represents the Organization's portion of its investment in a captive insurance company and is accounted for under the equity method.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property and equipment

Property and equipment are reported in the statement of financial position at cost, if purchased, and at fair value at the date of donation, if donated. All land and buildings are capitalized. Equipment is capitalized if it has a cost of \$1,000 or more and a useful life when acquired of more than one year. Repairs and maintenance that do not significantly increase the useful life of the asset are expensed as incurred. Depreciation and amortization is computed using the straight-line method over the estimated useful lives of the assets.

Costs associated with on-going projects are accumulated until completion. The completed asset is then depreciated over its estimated useful life once placed in service.

Impairment of long-lived assets and long-lived assets to be disposed of

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Debt issuance costs

Debt issuance costs consisting of deferred financing costs related to the bonds payable are being amortized over the life of the debt agreement. Debt issuance costs are classified as a reduction of debt on the accompanying consolidated statements of financial position.

Contributions, gifts, grants

Contributions, including unconditional promises to give, are recognized when received. All contributions are reported as increases in net assets without donor restrictions unless use of the contributed assets is specifically restricted by the donor. Amounts received that are restricted by the donor to use in future periods or for specific purposes are reported as increases in net assets with donor restrictions. Unconditional promises with payments due in future years have an implied restriction to be used in the year the payment is due, and therefore are reported as restricted until the payment is due, unless the contribution is clearly intended to support activities of the current fiscal year. Conditional promises, such as matching grants, are not recognized until they become unconditional, that is, until all conditions on which they depend are substantially met.

Gifts-in-kind contributions

The Organization receives contributions in a form other than cash or investments. If material, donated supplies and other items are recorded as contributions at the date of gift and as expenses when the donated items are placed into service or distributed. If the Organization receives a contribution of land, buildings, or equipment, the contributed asset is recognized as an asset at its estimated fair value at the date of gift, provided that the value of the asset and its estimated useful life meets the Organization's capitalization policy. Donated use of facilities is reported as contributions and as expenses at the estimated fair value of similar space for rent under similar conditions. If the use of the space is promised unconditionally for a period greater than one year, the contribution is reported as a contribution and an unconditional promise to give at the date of gift, and the expense is reported over the term of use.

The Organization benefits from personal services provided by volunteers. Those volunteers have donated time and services in the Organization's fund-raising activities. However, the majority of the contributed services do not meet the criteria for recognition in financial statements. GAAP allows recognition of contributed services only if (a) the services create or enhance nonfinancial assets or (b) the services would have been purchased if not provided by contribution, require specialized skills, and are provided by individuals possessing those skills. There were no services that met those criteria in 2019 or 2018.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue recognition

The Organization recognizes revenue when there is persuasive evidence of an arrangement, services have been rendered, the fee is fixed or determinable, and collectability is reasonably assured. Amounts billed or collected prior to satisfying the Organization's revenue recognition policy are reflected as deferred revenue.

The programs of the Organization are principally supported by the Massachusetts Department of Public Health, the Massachusetts Department of Youth Services, and the Massachusetts Department of Corrections. The Organization also contracts with non-Massachusetts agencies in the states of Georgia, Tennessee, Rhode Island, and Virginia. Revenue is recorded as services are provided in individual programs at the rates approved by the Massachusetts Operational Services Division for Massachusetts programs, and as negotiated for out-of-state contracts. Additionally, the Organization derives service revenue and client service fees through third party billing and Medicaid.

Certain third-party payors reimburse the Organization based on a unit rate reimbursement formula. The Organization estimates and excludes from revenue the difference, if any, between full charge and third party defined costs in the period services are rendered. Differences, if any, between the Organization's estimate of the contractual allowance and the final settlement by the third-party payor are recognized as an adjustment to revenue in the period of final settlement.

The Organization is also subject to the regulations of the Massachusetts Executive Office for Administration and Finance Operational Services Division ("OSD"). Excess of revenue over expenses from the Commonwealth of Massachusetts supported programs, up to certain defined limits, can be utilized by the Organization for expenditures in accordance with its exempt purposes provided such expenditures are reimbursable under OSD regulations.

Expense recognition and allocation

The cost of providing the Organization's programs and other activities is summarized on a functional basis in the statement of activities and statement of functional expenses. Expenses that can be identified with a specific program or support service are charged directly to that program or support service. Costs common to multiple functions have been allocated among the various functions benefited using a reasonable allocation method that is consistently applied, as follows:

- Salaries and wages, benefits, and payroll taxes are directly allocated to the specific program or support service personnel are assigned. Certain administrative salaries and wages, benefits, and payroll taxes are allocated based on an estimate of time spent on the program or support service.
- Occupancy, depreciation, and amortization, and interest are separately tracked for each location and directly allocated to the program or support service to which they relate.
- Telephone and internet services, insurance, and supplies and miscellaneous expenses that cannot be directly identified are allocated among the various functions benefited using a reasonable allocation method that is consistently applied.

Management periodically evaluates the basis on which costs are allocated.

General and administrative expenses include those costs that are not directly identifiable with any specific program, but which provide for the overall support and direction of the Organization.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Expense recognition and allocation (continued)

Fundraising costs are expensed as incurred, even though they may result in contributions received in future years. The Organization generally does not conduct its fundraising activities in conjunction with its other activities. In the few cases in which it does, joint costs have been allocated between fundraising and general and administrative expenses in accordance with standards for accounting for costs of activities that include fundraising. Additionally, advertising costs are expensed as incurred. Advertising expense was approximately \$350,755 and \$344,216 in 2019 and 2018, respectively.

Tax-exempt status

The Organization is exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code (IRC), though it would be subject to tax on income unrelated to its exempt purposes (unless that income is otherwise excluded by the IRC). Contributions to the Organization are tax deductible to donors under Section 170 of the IRC. The Organization is not classified as a private foundation.

Management annually reviews for uncertain tax positions and believes that the Organization has no uncertain tax positions that would have a material adverse effect, individually or in the aggregate, upon the Organization's statement of financial position, or the related statements of activities, functional expenses, or cash flows.

The Organization is no longer subject to U.S. federal income tax examinations by tax authorities for years before 2016.

Change in accounting principles

The Organization implemented FASB ASU No. 2016-14 in the current year, applying the changes retrospectively. The new standards change the following aspects of the financial statements:

- The temporarily restricted and permanently restricted net asset classes have been combined into a single net asset class called "net assets with donor restrictions".
- The unrestricted net asset class has been renamed "net assets without donor restrictions".
- The financial statements include a disclosure about liquidity and availability of resources (note 3).
- Investment fees are recorded as a component of investment return.

The changes have the following effect on net assets at June 30, 2017:

	<u>As Originally Presented</u>	<u>After Adoption of ASU 2016-14</u>
Net asset class		
Unrestricted net assets	\$ 27,562,408	\$ -
Temporarily restricted net assets	505,502	-
Permanently restricted net assets	-	-
Net assets without donor restrictions	-	27,562,408
Net assets with donor restrictions	-	505,202
	<u> </u>	<u> </u>
Total net assets	<u>\$ 28,067,910</u>	<u>\$ 28,067,610</u>

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

3 - LIQUIDITY AND AVAILABILITY

Financial assets available for general expenditure, that is, without donor or other restrictions limiting their use, within one year of June 30, 2019 are:

	2019
Financial assets:	
Cash and cash equivalents	\$ 16,157,884
Accounts receivable, net	8,302,081
Restricted cash	490,866
Investments	43,383
Total financial assets	24,994,214
Less: Financial assets held to meet donor-imposed restrictions:	
Purpose-restricted net assets	492,368
Less: Investments designated for deferred compensation plan	43,383
Less: Cash restricted for bond collateral	490,866
Amount available for general expenditures within one year	\$ 23,967,597

The Organization regularly monitors liquidity required to meet its operating needs and other contractual commitments, while also striving to maximize the investment of its available funds. In addition to financial assets available to meet general expenditures over the next 12 months, the Company operates with a balanced budget and anticipates collecting sufficient revenue to cover general expenditures. Refer to the statement of cash flows which identifies the sources and uses of the Organization's cash and shows positive cash generated by operations for fiscal years 2019 and 2018. As discussed in Note 1, the Company receives contract revenues from various state agencies which is expected to meet annual cash needs for general expenditures. The Organization also has a line of credit available to meet its liquidity needs. See note 6 for information about the Organization's line of credit.

4 - RESTRICTED CASH

Restricted cash totaling \$490,866 and \$723,044 as of June 30, 2019 and 2018, respectively, consists of a collateral deposit plus interest for the Organization's bonds payable (see Note 7).

5 - PROPERTY AND EQUIPMENT

Property and equipment, together with estimated useful lives, consists of the following:

	Estimated Useful Lives	2019	2018
Land		\$ 1,664,403	\$ 1,664,403
Buildings and building improvements	28 - 40 years	22,614,149	21,954,776
Leasehold improvements	2 - 30 years	6,455,773	6,418,912
Furniture and equipment	3 - 10 years	12,570,525	12,069,823
Motor vehicles	5 - 7 years	490,938	346,287
Construction in progress		159,034	431,671
		43,954,822	42,885,872
Less: Accumulated depreciation and amortization		21,358,461	18,960,766
		\$ 22,596,361	\$ 23,925,106

Depreciation and amortization expense was \$2,431,205 and \$2,418,030 in 2019 and 2018, respectively.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

6 - LINE OF CREDIT

The Organization has a \$1,000,000 demand line of credit agreement with TD Bank. Under the agreement, the creditor provides for borrowings at the Wall Street Journal Prime variable rate (5.50% and 5.00% as of June 30, 2019 and 2018, respectively). Borrowings are secured by accounts receivable. The line is also subject to the financial and non-financial covenants imposed on long-term debt with the same lender (see Note 7). The line remains in effect as long as the Organization has other obligations outstanding with TD Bank (including the long-term debt described in Note 7). There was no amount outstanding on the line of credit as of June 30, 2019 and 2018.

7 - BOND PAYABLE

On December 18, 2013, the Organization entered into a tax exempt bond agreement funded by the Massachusetts Development Finance Agency ("MDFA"). The Series 2013 revenue bonds, financed through TD Bank, the bond owner, aggregates \$8,500,000 and has a fixed interest rate of 3.68%. The bonds were issued on a draw-down basis through June 18, 2015 with monthly payments of principal and interest beginning at that time, with a maturity date of June 18, 2030. The outstanding balance on the bonds payable as of June 30, 2019 and 2018 was \$6,847,052 and \$7,188,540, respectively.

Maturities of the bonds payable are as follows for the years ended June 30:

2020	\$ 353,767
2021	367,877
2022	381,840
2023	396,333
2024	410,852
Thereafter	<u>4,936,383</u>
	6,847,052
Less: Unamortized bond issuance costs	<u>(100,519)</u>
	<u>\$ 6,746,533</u>

The Organization's performance on repaying the bonds' principal and interest is secured by an initial cash deposit to TD Bank of \$428,000. The initial deposit plus interest is recorded as restricted cash on the consolidated statements of financial position. The bonds are secured by a mortgage on the property. The bonds are also subject to certain financial covenants, including a minimum debt service coverage ratio, a minimum fixed charge coverage ratio and a leverage ratio.

The Organization incurred fees and related costs in connection with the bond agreement, which are being amortized over the term of the bond and included in bonds payable on the consolidated statements of financial position. Included in debt issuance costs as of June 30, 2019 and 2018 are \$137,463 of debt issuance costs, net of accumulated amortization of \$36,944 and \$27,780 as of June 30, 2019 and 2018, respectively.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

8 - LONG-TERM DEBT

Long-term debt consists of the following:

	2019	2018
Term note payable to TD Bank with a fixed interest rate of 3.80% for the first five years (through April 2019), then the TD Bank internal cost of funds rate plus 175 basis points for the remainder of the note. The note is payable in monthly installments of \$2,178 through April 2024 with a balloon payment in full at that time. The note is secured by the Sanford, Maine real estate. This note was paid in full during 2019.	\$ -	\$ 309,389
Note payable, bank, secured by vehicle, due in monthly installments of \$928 including interest at 6.16%, through January, 2019.	-	4,570
	-	313,959
Less: Current maturities of long-term debt	-	19,042
	\$ -	\$ 294,917

9 - OPERATING LEASES

The Organization rents program locations, vehicles and office equipment under cancelable and noncancelable operating leases through November 2023, the expenses for which were \$1,540,786 and \$1,474,906 for the years ended June 30, 2019 and 2018, respectively.

Future minimum lease payments on noncancelable operating leases as of June 30, 2019 are as follows for the years ending June 30:

2020	\$ 1,493,489
2021	1,195,345
2022	862,779
2023	503,188
2024	297,146
	\$ 4,351,947

10 - NET ASSETS WITH DONOR RESTRICTIONS

As of June 30, 2019 and 2018, net assets with donor restrictions totaling \$492,368 and \$533,924 were available for use in several of the Organization's programs.

The Organization met the restrictions set forth by various donors by spending the funds on the various programs operated by the Organization during the years ended June 30, 2019 and 2018 and released a total of \$56,677 and \$7,740 during those years, respectively.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

11 - BENEFIT PLANS

The Organization has a 403(b) plan for highly compensated individuals to which no employer contributions are made. The Organization also has a qualified contributory 401 (k) profit sharing plan. This plan covers substantially all eligible employees meeting certain age and service requirements. Employee contributions are voluntary and are based on specific percentages of compensation. The plan also provides for contributions by the Organization in such amounts as the Board of Trustees may determine annually. Employee and employer contributions may not exceed maximum amounts established by the Internal Revenue Code. The Organization made contributions of \$191,943 and \$176,317 to the 401 (k) profit sharing plan for the years ended June 30, 2019 and 2018, respectively.

In addition, the Organization has a 457(b) deferred compensation plan for key individuals, which was established during the year ended June 30, 2007. Benefits are accrued by the Organization annually up to a maximum contribution of \$15,000 for the years ended June 30, 2019 and 2018. The Organization made a payment of \$288,204 to a former key employee during 2019 in accordance with the deferred compensation agreement. The Organization's related liability of \$43,383 and \$315,163 as of June 30, 2019 and 2018, respectively, is included in other liabilities. The Organization had contributed a total of \$40,000 and \$190,000 as of June 30, 2019 and 2018, respectively, which is included in investments on the consolidated statements of financial position, plus cumulative unrealized gains of \$3,383 and \$125,163 as of June 30, 2019 and 2018, respectively.

12 - FAIR VALUE MEASUREMENTS

The Organization reports fair value measures of its assets and liabilities using a three-level hierarchy that prioritizes the inputs used to measure fair value. This hierarchy, established by GAAP, requires that entities maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The asset or liability's measurement within the fair value hierarchy is based on the lowest level of input that is significant to the measurement. The three levels of inputs used to measure fair value are as follows:

Level 1: Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2: Valuation is based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

When available, the Organization measures fair value using level 1 inputs because they generally provide the most reliable evidence of fair value. However, level 1 inputs are not available for many of the assets and liabilities that the Organization is required to measure at fair value (for example, unconditional promises to give and in-kind contributions).

The primary uses of fair value measures in the Organization's financial statements are:

- initial measurement of noncash gifts, including gifts of investment assets and unconditional promises to give.
- recurring measurement of investments.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (Continued)

12 - FAIR VALUE MEASUREMENTS (Continued)

Determination of fair value

Following is a description of the valuation methodologies used for items measured at fair value. There have been no changes in the methodologies used during the year ended June 30, 2019.

Pooled separate investment accounts: The pooled separate investment accounts invest mainly in mutual funds. The account's value is principally derived from the market value of the underlying mutual funds, generally priced using values obtained from independent pricing sources. Unit values are calculated daily based on the closing price reported in the active market in which the underlying securities are traded.

The preceding method described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Organization believes its valuation method is appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The Organization's financial assets that are measured at fair value on a recurring basis were recorded using the fair value hierarchy at June 30, 2019 as follows:

Description	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Pooled separate investment accounts	\$ -	\$ 43,383	\$ -	\$ 43,383

The Organization's financial assets that are measured at fair value on a recurring basis were recorded using the fair value hierarchy at June 30, 2018 as follows:

Description	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Pooled separate investment accounts	\$ -	\$ 315,163	\$ -	\$ 315,163

There were no significant transfers between the levels during the year. The Organization's policy is to recognize transfers in and out of the levels at the end of the fiscal year; interim changes in the availability of fair value inputs are not recognized.

13 - INVESTMENT IN AFFILIATE

The Organization's investment in affiliate represents a one-twelfth membership interest in The Captive Advantage, LLC, a Delaware Limited Liability Company (the "LLC"). The LLC was founded for the principal purpose of participating in a segregated account captive insurance company in an attempt to provide human service provider organizations with significantly lower insurance costs. The LLC insures claims relating to professional liability, general liability and auto liability. The Organization deposited \$308,672 and \$300,582 with the LLC during the years ended June 30, 2019 and 2018, respectively. The Organization has a stop loss policy, which limits their maximum loss in the investment for any single claim to \$250,000. The deposits are reduced by any claims and expenses incurred to date.

The Organization has accounted for its investment under the equity method of accounting. The carrying value of the investment is recorded based on the Organization's initial investment and then adjusted for the Organization's pro-rated share of the LLC's net earnings. The carrying value of the investment totaled \$383,321 and \$355,296 as of June 30, 2019 and 2018, respectively. The carrying value is the net of the cumulative deposits made and the Organization's share of cumulative expenses incurred of \$829,325 and \$704,529 as of June 30, 2019 and 2018, respectively.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

14 - RELATED-PARTY TRANSACTIONS

A board member of the Organization is a partner in a law firm, which provides legal services to the Organization. During the years ended June 30, 2019 and 2018, legal fees paid to this law firm totaled \$201,891 and \$125,808, respectively. As of June 30, 2019 and 2018, \$312 and \$29,806, respectively, was owed to the law firm and included in accounts payable for the Organization.

The Organization is affiliated with 585 Lincoln Street Condominium Trust (the "Trust") by virtue of one of the Organization's board members being the sole trustee of the Trust. Some of the Organization's programs are the sole tenant of the Trust's property and pay all of the costs incurred in occupying that property. During the years ended June 30, 2019 and 2018, no amounts were paid or owed to the Trust.

During the years ended June 30, 2019 and 2018, reimbursable expenses paid to board members totaled \$6,510 and \$0, respectively. No amounts were owed to board members as of June 30, 2019 and 2018.

15 - SUBSEQUENT EVENTS

Subsequent events have been evaluated through January 16, 2020, which is the date the consolidated financial statements were available to be issued. Events occurring after that date have not been evaluated to determine whether a change in the consolidated financial statements would be required.

16 - RECLASSIFICATIONS

Certain reclassifications have been made to the 2018 consolidated financial statements to conform to the 2019 presentation, with no effect on the change in net assets as previously reported.

SUPPLEMENTAL SCHEDULE PURSUANT
TO UNIFORM GUIDANCE

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE

CONSOLIDATED SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2019

Federal Grantor/Pass-Through Grantor/ Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Passed Through to Subrecipients	Total Federal Expenditures
U.S. Department of Health and Human Services:				
Passed through the Massachusetts Department of Public Health				
Block Grants for Prevention and Treatment of Substance Abuse	93.959	INTF2301MM3160524176	N/A	\$ 2,256
		INTF2303MM3182026080	N/A	74,530
		INTF2304M03171125291	N/A	23,747
		INTF2318MM3160424036	N/A	203,552
		INTF2320MM3400421022	N/A	7,867
		INTF2324MM3200420003	N/A	3,184
		INTF2350M03184319050	N/A	<u>1</u>
				<u>315,137</u>
Passed through the Massachusetts Department of Public Health				
State Targeted Response to the Opioid Crisis Grant	93.788	INTF2330MM3W17040120	N/A	475,009
	93.788	INTF2330MM3W19015139	N/A	165,842
	93.788	INTF2330MM3W19030134	N/A	<u>410,829</u>
				<u>1,051,680</u>
<i>Total Department of Health and Human Services</i>				
				<u>1,366,817</u>
U.S. Department of Justice:				
Passed through Massachusetts Department of Corrections				
Residential Substance Abuse Treatment for State Prisoners	16.593	1000M03SPECTRUMHYSYST	N/A	<u>20,164</u>
U.S. Department of Homeland Security:				
Passed through Massachusetts Department of Corrections				
Financial Assistance for Countering Violent Extremism	97.132	1000M03SPECTRUMHYSYST	N/A	<u>242,429</u>
U.S. Department of Agriculture:				
Passed through the Massachusetts Department of Education				
National School Lunch Program	10.555	SCDOE19758C70532112A	N/A	<u>3,010</u>
<i>Total Expenditures of Federal Awards</i>				
				<u>\$ 1,632,420</u>

See accompanying independent auditor's report and notes to consolidated schedule.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE

NOTES TO CONSOLIDATED SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

1 - BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards (the "Schedule") includes the federal award activity of Spectrum Health Systems, Inc. and Affiliate under programs of the federal government for the year ended June 30, 2019. 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). Because the Schedule presents only a selected portion of the operations of Spectrum Health Systems, Inc. and Affiliate, it is not intended to and does not present the consolidated financial position, changes in net assets, or cash flows of Spectrum Health Systems, Inc and Affiliate.

For the purposes of the Schedule, federal awards include all federal financial assistance received directly or received indirectly through contracts executed with the Commonwealth of Massachusetts.

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting

Expenditures reported on the 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. Negative amounts shown on the Schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years.

Indirect cost rate

Spectrum Health Systems, Inc. and Affiliate have elected not to use the 10-percent de minimis indirect cost rate as allowed under the Uniform Guidance.

Major program determination

The Organization considers programs with expenditures that exceed \$750,000 to be Type A programs. Type A programs with expenditures that, in the aggregate, encompass at least twenty percent of total federal awards are designated as major programs. Smaller programs are designated as Type B programs. Type A programs assessed as "low risk" that have been audited as a major program within the last two years with no audit findings are not designated as major programs, provided the Organization has Type B programs that have federal expenditures exceeding twenty percent of total expenditures. Accordingly, certain Type B programs may be identified as major programs.

OTHER REPORTS PURSUANT
TO UNIFORM GUIDANCE

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

To the Board of Directors
Spectrum Health Systems, Inc. and Affiliate

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Spectrum Health Systems, Inc. and Affiliate (the "Organization") which comprise the consolidated statements of financial position as of June 30, 2019, and the related consolidated statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the consolidated financial statements (collectively, the financial statements), and have issued our report thereon dated January 16, 2020.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

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
(Continued)

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

Ballus Lynch, LLP

Worcester, Massachusetts
January 16, 2020

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

To the Board of Directors
Spectrum Health Systems, Inc. and Affiliate

Report on Compliance for Each Major Federal Program

We have audited Spectrum Health Systems, Inc. and Affiliate (the "Organization") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on the Organization's major federal program for the year ended June 30, 2019. The Organization's major federal program is identified in the summary of auditor's 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.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for the Organization's major federal program 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 the Organization's 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 the major federal program. However, our audit does not provide a legal determination of the Organization's compliance.

Opinion on Each Major Federal Program

In our opinion, the Organization complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2019.

Report on Internal Control Over Compliance

Management of the Organization 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 the Organization's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the 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 the Organization's internal control over compliance.

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

(Continued)

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 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, material weaknesses may exist that have not been identified.

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.

Ballus Lynch, LLP

Worcester, Massachusetts
January 16, 2020

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
CONSOLIDATED SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2019

I. SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of report the auditor issued on whether the consolidated financial statements audited were prepared in accordance with GAAP:

Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? ___ Yes X No
- Significant deficiency(ies) identified? ___ Yes X None Reported

Noncompliance material to consolidated financial statements noted?

___ Yes X No

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? ___ Yes X No
- Significant deficiency(ies) identified? ___ Yes X None Reported

Type of auditor's report issued on compliance for major federal programs:

Unmodified

Any audit findings disclosed that are required to be reported in accordance with section 2 CFR 200.516(a)?

___ Yes X No

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
93.959	Block Grants for Prevention and Treatment of Substance Abuse
97.132	Financial Assistance for Countering Violent Extremism

Dollar threshold used to distinguish between type A and type B programs

\$750,000

Auditee qualified as low-risk auditee?

X Yes ___ No

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
CONSOLIDATED SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2019
(Continued)

II. FINANCIAL STATEMENT FINDINGS

Reportable Conditions in Internal Control

As disclosed in Section I, the audit of the consolidated financial statements of Spectrum Health Systems, Inc. and Affiliate as of and for the year ended June 30, 2019, disclosed no matters involving the internal control over financial reporting and its operation that are considered to be material weaknesses.

Compliance Findings

As disclosed in Section I, the audit disclosed no instances of noncompliance which are material to the consolidated financial statements of Spectrum Health Systems, Inc. and Affiliate as of and for the year ended June 30, 2019.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARDS

Internal Control Over Compliance

No findings noted as of and for the year ended June 30, 2019.

Compliance Findings

No findings noted as of and for the year ended June 30, 2019.

SPECTRUM HEALTH SYSTEMS, INC. AND AFFILIATE
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
YEAR ENDED JUNE 30, 2019

The prior year single audit disclosed no findings in the Schedule of Findings and Questioned Costs, and no uncorrected or unresolved findings exist from the prior audit's Summary Schedule of Prior Audit Findings.