Grady Health System
Evaluation of Going Concern
FYE December 31, 2019
HB 321

<u>Accounting Guidance</u>

ASC 205-40-50-5 states:

When evaluating an entity's ability to meet its obligations, management shall consider quantitative and qualitative information about the following conditions and events, among other relevant conditions and events known and reasonably knowable at the date that the financial statements are issued:

a. The entity's current financial condition, including its liquidity sources at the date that the financial statements are issued (for example, available liquid funds and available access to credit)
b. The entity's conditional and unconditional obligations due or anticipated within one year after the date that the financial statements are issued (regardless of whether those obligations are recognized in the entity's financial statements)
c. The funds necessary to maintain the entity's operations considering its current financial condition, obligations, and other expected cash flows within one year after the date that the financial statements are issued.
d. The other conditions and events, when considered in conjunction with (a), (b), and (c) above, which may adversely affect the entity's ability to meet its obligations within one year after the date that the financial statements are issued.

<u>Discussion</u>

a. Grady's Current Financial condition has been favorable for the last five years with results for income from operations of:

- 2015 – $46,385,000
- 2016 –$ 44,321,000
- 2017 – $41,266,000
- 2018 – $29,659,000
- 2019 – $29,776,000

a. Liquidity – Unrestricted Cash was $222M as of 12/31/19 compared to $181M as of 12/31/18. Days Cash on Hand for the last five years have been:

- 2015 – 59
- 2016 – 76
- 2017 – 80
- 2018 – 56
- 2019 – 64

a. Available access to credit:

- As discussed in the notes to the 2019 Audited Financial Statement, Grady has had an unused line of credit of $30M with a bank for emergencies, and did not draw against it as of 12/31/2019 or for the last 6 years. On April 6, 2020, Grady did borrow $30 million dollars against the line in order to provide additional cash flow to the System due to COVID-19 uncertainties, which are described in item d. below.
- Grady also has approx. $2.9M payable in Capital Equipment Leases as of the end of 2019 and $3.6M as of the end of 2018.
- Lastly, Grady has participated in two New Market Tax Credit Transactions and was able to add debt on its books of approx. $51M from 2015-2017. Grady has plans for another NMTC transaction in the future to support a portion of the Center for Ambulatory Surgical Services (CASS) project, which is expected to be completed in 2022.

b. Conditional and unconditional obligations due within 1-year known and unknown:

- Grady's obligations over the next year are to pay approx. $2.5M to the FDHA annually for the next 29 years related to the FDHA lease and transfer agreement that was put in place 12 years ago.
- There is an obligation of payment on our capital leases of approx. $742K in 2020, and our operating lease contracts equate to payment of approx. $6.1M in 2020.
- One of our largest expenses other than payroll is to the Emory and Morehouse Schools of Medicine for professional fees, which in 2019 equated to approx. $194M.
- When looking at our current ratio it has remained stable at 2.49 in 2019 compared to 2.52 in 2018.

c. Funds necessary to maintain operations in current condition:

- Grady ended the CY 2019 below budget and with a margin of approx. 2.2%. Grady experienced a major flood in December 2019, which is discussed in more detail in item d. below.
- The Cares Act delayed Medicaid Disproportionate Share Hospital (DSH) allotment reductions until December 2020.
- Additionally, Grady is currently pursuing several key initiatives over the next 5 years, such as:
  - Care Logistics to improve patient experience and boost efficiency by lowering length-of-stay;
  - Care Coordination savings and revenue maximization;
  - Quality enhancement and variation reduction;
  - State approved legislation to apply for an 1115 Medicaid Waiver for the uninsured and 1332 Waivers to address the private insurance market.

  The results of these initiatives are expected to assist us in meeting our long-term margin goals.

d. Funds necessary to maintain operations in other conditions and events:

- Flood Event

In December 2019, a twenty-four inch water pipe burst between Grady Memorial Hospital's sixth and seventh floors. The resulting water flow was contained without any harm to patients but not before substantial water and structural damage occurred. This flood event damaged six nursing units on three floors and affected many other floors below as well. Consequently, the Hospital lost the use of 220 patient beds and had to move patients to other facilities for their care. Since December 2019, many service area volumes at the Hospital are still reduced and are expected to return in late 2020 when the damaged areas have been repaired and renovated.

As of December 31, 2019, the System has recorded incurred losses of $3.2 million and a loss on impaired assets of $9.3 million related to the flood event. Both losses are included in the consolidated statement of operations. The System has concluded that insurance recoveries for the full amount of incurred losses and loss on impaired assets are probable and reasonably estimated. The System received $2.5 million in proceeds from insurance recoveries in December 2019 and recorded a receivable of $10 million as of December 31, 2019. Of the amounts received and receivable, $3.2 million is presented as an offset to 2019 operating expenses and $9.3 million is presented as an offset to the impaired assets in other non-operating revenue gains (losses).

In addition to actual losses incurred, the amount of business interruption loss incurred for the year ended December 31, 2019 is estimated to be approximately $17.5 million. Insurance recoveries related to business interruption loss will be recognized when all the contingencies related to this event have been resolved. If Grady had been able to record the estimated recoveries in 2019, the margin for 2019 would have been approx. 3.4% and would have been more in line with original expectations.

In summary, the total expected net income loss from the flood event in CY 2020 is expected to be approx. $89M and the overall cost to replace Capital is expected to be approx. $90-100M. Insurance recoveries in 2020 for business interruption (lost revenues, additional expenses and future losses from gov't reimbursement) are expected to be approx. $166M and reimbursement for Capital is expected to be close to what is requested.

- Corona Virus (COVID-19) Pandemic

During the fourth quarter of 2019, a novel strain of coronavirus (COVID-19) surfaced. The spread of COVID-19 around the world and in the U.S. during the first quarter of 2020 has caused significant volatility in the global financial markets, including those in the U.S. There is continued uncertainty as to the breadth and duration of this pandemic and the resultant market disruption to the extent that Grady is currently unable to determine the total impact on its operations and financial condition of potential adverse effects specific to Grady, including reduced normal patient volumes, capacity constraint and resource inefficiencies due to potential surge of COVID-19 patients, unfavorable payor reimbursement patterns and payor mix, and market-driven downward valuation of equity securities, among others.

On March 27, 2020, the President of the United States signed the Coronavirus Aid, Relief, and Economic Security (CARES) Act that provides $100 billion in relief funds to hospitals and other healthcare providers on the front lines of the coronavirus response. This funding is to support healthcare-related expenses or lost revenue attributable to COVID-19 and to ensure uninsured Americans can get testing and treatment for COVID-19.

Recognizing the importance of delivering funds quickly, $30 billion of this amount was distributed via direct deposit to eligible providers throughout the American healthcare system. These are considered to be payments and not loans to healthcare providers, and will not need to be repaid.

Grady was eligible to receive this first round of money as we are a Facility/Provider that received Medicare fee-for-service (FFS) reimbursements in 2019. All relief payments were made to the billing organization of Grady according to our Taxpayer Identification Number (TIN) and as a condition to receiving these funds, providers must sign an attestation confirming receipt of the funds and agree to the CARES's Acts Provider Relief Fund "Terms and Conditions" within 30 days of payment.

The initial payment to Providers has been distributed based on the share of total Medicare FFS reimbursements in 2019. Grady received $11.4M on 4/10/20 for the Hospital and $590K on 4/10/2020 for Grady EMS. In addition to this, we expect to receive additional funds for other areas that have been identified in the Act. Also, a few other areas in the CARES Act that can assist with cash flow temporarily are related to Payroll Tax Deferment and Advance Medicare Payment options. Grady has not determined at this time whether we will take advantage of these options.

The Govt. Administration is working rapidly on targeted distributions for the remaining $70 billion that will focus on providers in areas particularly impacted by the COVID-19 outbreak, rural providers, providers of services with lower shares of Medicare reimbursement or who predominantly serve the Medicaid population, and providers requesting reimbursement for the treatment of uninsured Americans.

In summary, Grady's analysis related to COVID-19 is currently ongoing but projections show that Grady's expected net income loss from this will be around $88M. Known payments are expected to cover approx. $30M, and there will be additional funds from the $70 billion and for Grants (telemedicine, Ryan White Part D, and Poison Control), Behavioral Health, and Infection Control for Crestview, Lab excess costs, and other items that are in the process of being determined.

Overall Conclusion

Based upon our consideration of the qualitative and quantitative information including, but not limited to factors described in ASC 205-40-50 and ASC 205-40-55, we believe that Grady has the ability to meet its obligations for the next year and will continue as a going concern at least for that time period.