# Prospect CharterCARE, LLC

## Consolidated Financial Statements
As of and for the Years Ended
September 30, 2017 and 2016

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## Consolidated Financial Statements

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## Contents

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# Independent Auditor's Report

Board of Directors
Prospect CharterCARE, LLC
Los Angeles, California

We have audited the accompanying consolidated financial statements of Prospect CharterCARE, LLC, which comprise the consolidated balance sheets as of September 30, 2017 and 2016, and the related consolidated statements of operations, members' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

***Management's Responsibility for the 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 financial position of Prospect CharterCARE, LLC and its subsidiaries as of September 30, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Emphasis of Matter***

As discussed in Note 1, the Company is financially dependent on its parent company which has 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 company discontinue its financial support.

BDO USA, LLP

February 28, 2018

# Prospect CharterCARE, LLC

## Consolidated Balance Sheets
## (in thousands)

| *As of September 30,* | **2017** | 2016 |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents | **$ -** | $ 4,091 |
| Restricted cash | **3,028** | 2,198 |
| Patient accounts receivable, less allowance for doubtful accounts of $7,245 and $8,587 | **42,427** | 38,511 |
| Other receivables | **12,295** | 8,883 |
| Due from government payers | **5,143** | 785 |
| Inventories | **5,805** | 6,196 |
| Prepaid expenses and other current assets | **3,286** | 3,372 |
| Current assets held for sale | **-** | 3,887 |
| **Total current assets** | **71,984** | 67,923 |
| Property, improvements and equipment, net | **53,850** | 55,592 |
| Goodwill | **5,822** | 3,774 |
| Intangible assets, net | **2,854** | 4,499 |
| Equity method investments | **4,357** | 4,611 |
| Other assets | **1,473** | 1,205 |
| **Total assets** | **$ 140,340** | $ 137,604 |

*See accompanying notes to consolidated financial statements.*

# Prospect CharterCARE, LLC

## Consolidated Balance Sheets
(in thousands)

| *As of September 30,* | | **2017** | | 2016 |
|---|---|---|---|---|
| **Liabilities and Members' Equity** | | | | |
| **Current liabilities** | | | | |
| Accounts payable and other accrued liabilities | **$** | **26,881** | $ | 26,297 |
| Accrued salaries, wages and benefits | | **16,589** | | 14,849 |
| Deferred revenue | | **170** | | - |
| Due to government payers | | **4,505** | | 125 |
| Due to affiliated companies, net | | **20,056** | | 28,006 |
| Current portion of capital leases | | **1,475** | | 1,439 |
| Current liabilities held for sale | | **-** | | 7,205 |
| **Total current liabilities** | | **69,676** | | 77,921 |
| Capital leases, net of current portion | | **895** | | 2,012 |
| Asset retirement obligations | | **2,438** | | 4,943 |
| Deferred revenue, net of current portion | | **2,891** | | - |
| Other long-term liabilities | | **10,673** | | 5,451 |
| **Total liabilities** | | **86,573** | | 90,327 |
| **Commitments, contingencies, and subsequent events** | | | | |
| **Members' equity:** | | | | |
| Member contributions | | **82,261** | | 71,645 |
| Accumulated deficit | | **(28,494)** | | (24,368) |
| Total members' equity | | **53,767** | | 47,277 |
| **Total liabilities and members' equity** | **$** | **140,340** | $ | 137,604 |

*See accompanying notes to consolidated financial statements.*

# Prospect CharterCARE, LLC

## Consolidated Statements of Operations
## (in thousands)

| *For the Years Ended September 30,* | | **2017** | | 2016 |
|---|---|---|---|---|
| **Revenues:** | | | | |
| Net patient service revenues | $ | **343,050** | $ | 338,440 |
| Provision for bad debts | | **(11,936)** | | (15,264) |
| Net patient service revenues less provision for bad debts | | **331,114** | | 323,176 |
| Other revenues | | **7,678** | | 6,357 |
| Total net revenues | | **338,792** | | 329,533 |
| **Operating Expenses:** | | | | |
| Salaries, wages and benefits | | **186,382** | | 189,529 |
| Supplies | | **60,005** | | 59,152 |
| Taxes and licenses | | **25,581** | | 20,459 |
| Purchased services | | **21,542** | | 19,629 |
| Depreciation and amortization | | **13,843** | | 12,376 |
| Professional fees | | **10,535** | | 11,774 |
| Other | | **7,277** | | 9,750 |
| Insurance | | **5,659** | | 8,141 |
| Management fees | | **7,033** | | 6,888 |
| Utilities | | **3,993** | | 4,506 |
| Lease and rental | | **4,792** | | 3,615 |
| Research grant expense | | **2,231** | | 2,424 |
| Repairs and maintenance | | **2,315** | | 1,624 |
| Registry | | **713** | | 788 |
| Total operating expenses | | **351,901** | | 350,655 |
| Operating income from unconsolidated equity method investments | | **605** | | 512 |
| **Operating loss** | | **(12,504)** | | (20,610) |
| Interest expense | | **1,131** | | 82 |
| Other expense (income), net | | **(98)** | | - |
| **Net loss from continuing operations** | | **(13,537)** | | (20,692) |
| Income (loss) from discontinued operations | | **9,411** | | (2,280) |
| **Net loss** | $ | **(4,126)** | $ | (22,972) |

*See accompanying notes to consolidated financial statements.*

# Prospect CharterCARE, LLC

## Consolidated Statements of Members' Equity
## (in thousands)

| | Member Contributions | Accumulated Deficit | Total Members' Equity |
|---|---|---|---|
| **Balance** at October 1, 2015 | $ 68,856 | $ (1,396) | $ 67,460 |
| Member contributions | 2,789 | - | 2,789 |
| Net loss | - | (22,972) | (22,972) |
| **Balance** at September 30, 2016 | 71,645 | (24,368) | 47,277 |
| Member contributions | 10,616 | - | 10,616 |
| Net loss | - | (4,126) | (4,126) |
| **Balance** at September 30, 2017 | $ 82,261 | $ (28,494) | $ 53,767 |

*See accompanying notes to consolidated financial statements.*

# Prospect CharterCARE, LLC

## Consolidated Statements of Cash Flows
## (in thousands)

| *For the Years Ended September 30,* | | **2017** | | 2016 |
|---|---|---|---|---|
| **Operating activities** | | | | |
| Net loss | $ | **(4,126)** | $ | (22,972) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | | | |
| Depreciation and amortization | | **13,843** | | 12,376 |
| Provision for bad debts | | **11,936** | | 15,264 |
| Accretion of interest for asset retirement obligations | | **158** | | 360 |
| Operating income from equity method investments, net of distributions | | **254** | | (64) |
| Gain on sale of property, improvements and equipment | | **(2,891)** | | - |
| Write-off of asset retirement obligation | | **(272)** | | - |
| Changes in operating assets and liabilities, net of business combinations: | | | | |
| Change in restricted cash | | **(830)** | | (921) |
| Patient accounts receivable and other receivables | | **(15,852)** | | (19,580) |
| Due to/from government payers, net | | **22** | | (136) |
| Inventories | | **765** | | (57) |
| Prepaid expenses and other current assets | | **(3,324)** | | (1,204) |
| Other assets | | **(268)** | | 522 |
| Accounts payable and other accrued liabilities | | **8,401** | | 8,576 |
| Net cash and cash equivalents (used in) provided by operating activities from discontinued operations | | **(10,967)** | | 573 |
| **Net cash used in operating activities** | | **(3,151)** | | (7,263) |
| **Investing activities** | | | | |
| Purchases of property, improvements and equipment | | **(13,507)** | | (10,324) |
| Cash paid for acquisitions | | **(2,268)** | | (374) |
| Proceeds from sale of property, improvements and equipment | | **6,498** | | - |
| Net cash and cash equivalents provided by (used in) investing activities from discontinued operations | | **5,882** | | (146) |
| **Net cash used in investing activities** | | **(3,394)** | | (10,844) |
| **Financing activities** | | | | |
| Member contributions | | **10,616** | | 2,789 |
| (Decrease) increase in due to affiliated companies, net | | **(7,950)** | | 3,892 |
| Repayments of capital leases | | **(2,036)** | | (796) |
| Proceeds from financing hospital facility | | **1,824** | | - |
| Net cash and cash equivalents provided by financing activities from discontinued operations | | **-** | | 3,025 |
| **Net cash provided by financing activities** | | **2,454** | | 8,910 |
| Decrease in cash and cash equivalents | | **(4,091)** | | (9,197) |
| Cash and cash equivalents, beginning of year | | **4,091** | | 13,288 |
| Cash and cash equivalents, end of year | $ | **-** | $ | 4,091 |
| **Supplemental disclosure of cash flow information:** | | | | |
| Interest paid | $ | **975** | $ | 82 |
| **Schedule of non-cash investing and financing activities:** | | | | |
| Equipment acquired under capital lease | $ | **366** | $ | 3,252 |

*See accompanying notes to consolidated financial statements.*

## 1. Organization

Prospect CharterCARE, LLC (“PCC” or the “Company”) was formed on August 21, 2013 and is owned 85% by a wholly-owned subsidiary of Prospect Medical Holdings, Inc. (“Prospect”) and 15% by CharterCARE Community Board.

PCC’s operating subsidiaries include Prospect CharterCARE RWMC, LLC (“RWMC”, dba Roger Williams Medical Center), Prospect CharterCARE SJHSRI, LLC (“SJHSRI”, dba St. Joseph Health Center and Our Lady of Fatima Hospital), Prospect CharterCARE Elmhurst, LLC (“Elmhurst Extended Care”), Prospect CharterCARE Physicians, LLC (“CharterCARE Physicians”), Prospect CharterCARE Ancillary Services, Inc., and New University Medical Group, LLC (“New UMG”), which collectively consist of hospitals, medical centers and a skilled nursing facility located in Rhode Island with 785 licensed beds. The Company provides a comprehensive range of services at Roger Williams Medical Center, St. Joseph’s Health Center, and Our Lady of Fatima Hospital as well as multiple levels of elder care at Elmhurst Extended Care.

Admitting physicians are primarily practitioners in the local area. The hospitals have 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 Prospect to fund ongoing operations. As of September 30, 2017 and 2016, the Company had a liability of $20,056,000 and $28,006,000, respectively, due to Prospect and its subsidiaries, which is payable on demand, does not bear interest, and is included in due to affiliated companies, net in the accompanying consolidated balance sheets. Prospect does 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. Acquisitions

On May 1, 2017, the Company’s wholly-owned subsidiary, Prospect Blackstone Valley Surgicare, LLC (“Prospect Blackstone”), completed an asset acquisition of a freestanding ambulatory surgery center located near the CharterCARE facilities in Rhode Island, in exchange for cash consideration of $1.6 million, of which $100,000 is subject to a one-year indemnification escrow hold-back.

During the year ended September 30, 2017, CharterCARE Physicians entered into asset purchase agreements to acquire two medical practices with primary care physicians. Total cash consideration for the medical practices was $1.1 million.

During the year ended September 30, 2016, CharterCARE Physicians entered into asset purchase agreements to acquire two medical practices with primary care physicians as well as a practice specializing in surgical services. Total cash consideration for the medical practices was $374,000.

The acquisitions of the medical practices were accounted for as business combinations using purchase accounting. Under the purchase accounting method, assets acquired and liabilities assumed are recorded based on their estimated fair values. As asset purchases, goodwill acquired is expected to be deductible for tax purposes.

The following table summarizes the assets acquired and liabilities assumed in connection with the Prospect Blackstone and CharterCARE Physician medical practices acquisitions (in thousands):

| *For the Years Ended September 30,* | | **2017** | | 2016 |
|---|---|---|---|---|
| Inventories | $ | **374** | $ | 11 |
| Improvements and equipment | | **813** | | 21 |
| Goodwill | | **2,048** | | 342 |
| Capital leases | | **(588)** | | - |
| Remaining purchase consideration due to seller | | **(379)** | | - |
| Net cash consideration | $ | **2,268** | $ | 374 |

## 3. Discontinued Operations

During December 2016, the Company sold assets related to Elmhurst Extended Care. The Company's decision to discontinue the operations of each of the entities was based on the Company's management's strategy in their respective markets and financial results. Elmhurst Extended Care's assets and liabilities are classified as held for sale as of September 30, 2016 in the accompanying consolidated balance sheets, and the results of Elmhurst Extended Care's operations are included within loss from discontinued operations in the accompanying consolidated statements of operations.

Summarized financial information for discontinued operations is included below (in thousands):

| *September 30,* | | **2017** | | 2016 |
|---|---|---|---|---|
| Carrying amounts of major classes of assets included as part of discontinued operations | | | | |
| Cash | $ | **-** | $ | (129 ) |
| Restricted cash | | **-** | | 22 |
| Patient accounts receivable, net of allowance for doubtful accounts | | **-** | | 2,555 |
| Other current assets | | **-** | | 301 |
| Total current assets | | **-** | | 2,749 |
| Property, plant and equipment, net | | **-** | | 739 |
| Long-term assets | | **-** | | 399 |
| Total assets of the disposal groups classified as held for sale in the consolidated balance sheets | $ | **-** | $ | 3,887 |
| Carrying amounts of major classes of liabilities included as part of discontinued operations | | | | |
| Accounts payable and other accrued liabilities | $ | **-** | $ | 1,103 |
| Due to affiliated companies, net | | **-** | | 5,315 |
| Long-term liabilities | | **-** | | 787 |
| Total liabilities of the disposal groups classified as held for sale in the consolidated balance sheets | $ | **-** | $ | 7,205 |

| *For the Years Ended September 30,* | | **2017** | | 2016 |
|---|---|---|---|---|
| Major line items constituting pretax loss of discontinued operations | | | | |
| Net revenues | $ | **4,324** | $ | 19,590 |
| Operating expenses | | **5,403** | | 21,870 |
| Loss on discontinued operation | | **(1,079)** | | (2,280) |
| Gain from sale of discontinued operations | | **10,490** | | - |
| Income (loss) on discontinued operations | $ | **9,411** | $ | (2,280) |

## 4. Significant Accounting Policies

***Principles of Consolidation and Basis of Presentation***

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and include the accounts of all wholly-owned subsidiaries, but do not include the accounts of the parent companies, Prospect or CharterCARE Community Board.

Operating results for the Company's subsidiaries are consolidated with the Company's financial statements from their acquisition dates. All significant intercompany balances and transactions have been eliminated in consolidation.

***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 consolidated balance sheets.

The following is a summary of sources of patient service revenues (net of contractual allowances and discounts) before provision for doubtful accounts and exclude revenues for discontinued operations (in thousands):

| *For the Years Ended September 30,* | **2017** | 2016 |
|---|---|---|
| Medicare | **$ 152,240** | $ 151,015 |
| Medicaid | **72,948** | 74,216 |
| Managed Care | **74,920** | 82,109 |
| Self-Pay/Other | **42,942** | 31,100 |
| Total | **$ 343,050** | $ 338,440 |

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 persons with end-stage renal disease and certain other beneficiary categories, including eligible disabled person. Most inpatient hospital services rendered to Medicare program beneficiaries are paid on a fee-for-service basis at prospectively determined rates per discharge, according to a patient classification system based on clinical, diagnostic, and other factors. Most outpatient services also are paid on a fee-for-service basis generally using prospectively determined rates. The Company is also reimbursed, as appropriate, for Medicare disproportionate share hospital and bad debt payments at tentative rates, with final settlement determined after submission of the annual Medicare cost report and audit thereof by the Medicare Administrative Contractor. 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.

The Company is reimbursed by Medicare for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare Administrative Contractor. The estimated amounts due to or from the program are reviewed and adjusted annually based on the status of such audits and any subsequent appeals. Differences between final settlements and amounts accrued in previous years are reported as adjustments to net patient service revenue in the year that examination is substantially completed.

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. The latest updated SSI ratios for 2014, which are used in determining disproportionate share payments, were issued on July 19, 2016. To date, the Company has not received any final NPRs since inception on June 20, 2014.

*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.

RWMC and SJHSRI are participants 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 RWMC and SJHSRI, receive federal and state Medicaid funds as additional reimbursement for treating a disproportionate share of low income patients. RWMC and SJHSRI recognized revenue related to DSH and Upper Payment Limit ("UPL") reimbursement of $24,402,000 and $20,496,000 for the years ended September 30, 2017 and 2016, respectively. DSH and UPL payments received were $20,249,451 and $20,496,000 for the years ended September 30, 2017 and 2016, 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. RWMC and SJHSRI recorded license fee expenses of $20,137,000 and $16,199,000 for the years ended September 30, 2017 and 2016, respectively, which is included within taxes and licenses expense within the accompanying consolidated 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 local hospital'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 consolidated 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 $833,000 and $1,225,000 for the years ended September 30, 2017 and 2016, 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, 2017 or 2016.

*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 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 15% and 18% of gross accounts receivable as of September 30, 2017 and 2016, respectively. The decrease was due to a self-pay discount which took effect during the year ended September 30, 2017, resulting in a decrease in the bad debt allowance required as of September 30, 2017.

***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 consolidated financial statements.

*Other Revenues*

Other revenues totaled $7,678,000 and $6,357,000 for the years ended September 30, 2017 and 2016, respectively. A summary of the principal components of other revenues is as follows:

Tuition Revenue: Tuition revenues include student fees and outside course reimbursement and are recognized ratably during the approximately seven months of instruction provided per year. The Company recorded tuition revenues of $2,002,000 and $1,727,000 for the years ended September 30, 2017 and 2016, respectively.

Grant Revenue: The Company receives grant revenue for direct research from the federal government, other institutions and other sources for a range of research areas including oncology, cardiology, HIV and diabetes. The Company recorded grant revenue of $1,841,000 and $1,479,000 for the years ended September 30, 2017 and 2016, respectively.

Rental Revenue: Rental revenue from operating leases is recorded based on the fixed, minimum required rents (base rents) per the lease agreements. Rental revenue from base rents is recorded on the straight-line method over the terms of the related lease agreements. The Company recorded rental revenues of $704,000 and $670,000 for the years ended September 30, 2017 and 2016, respectively.

***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 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.

***Goodwill***

Goodwill represents the excess of the consideration paid and liabilities assumed over the fair value of the net assets acquired, including identifiable intangible assets.

Goodwill is not amortized; rather it is reviewed annually for impairment for each reporting unit, or more frequently if impairment indicators arise. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. A two-step impairment test is used to identify potential goodwill impairment and to measure the amount of goodwill impairment loss to be recognized, if any. The Company consists of one reporting unit.

The Company tests for goodwill impairment as of September 30 each year, at the reporting unit level, by comparing the reporting unit's carrying amount, including goodwill, to the fair value of the reporting unit. The fair value of the reporting units are estimated. In evaluating whether indicators of impairment exist, the Company considers adverse changes in market value, laws and regulations, profitability, cash flows, ability to maintain enrollment and renew payer contracts at favorable terms, among other factors. The goodwill impairment test is a two-step process. The first step consists of estimating based on a weighted combination of (i) the guideline company method that utilizes revenue or earnings multiples for comparable publicly-traded companies, and (ii) a discounted cash flow model. If the estimated fair value of the reporting unit is less than its carrying value, this indicates that goodwill may be impaired and a second step is performed to measure the amount of the impairment, if any. There were no impairments recorded for the years ended September 30, 2017 or 2016.

***Intangible Assets***

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, 2017 and 2016.

***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 coverage, 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. CharterCARE was included in Prospect's consolidated medical malpractice insurance policy effective June 20, 2014 (inception). Assets and liabilities related to malpractice insurance related to events prior to June 20, 2014 (inception) were not assumed by the Company.

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 of the Company's hospitals. The Company's gross claims liability was $7,591,000 and $5,083,000 as of September 30, 2017 and 2016, respectively, and insurance receivables were $1,316,000 and $806,000 as of September 30, 2017 and 2016, respectively. The gross claims liability and insurance receivables were estimated using a discount factor of 4% and are included within long-term assets and long-term liabilities, respectively, in the accompanying consolidated balance sheets.

*Workers' Compensation Insurance*

The Company was fully insured for workers' compensation claims with no deductible during the years ended September 30, 2017 and 2016. Assets and liabilities related to workers' compensation insurance related to events prior to June 20, 2014 (inception) were not assumed by the Company.

*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 consolidated 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 consolidated financial position, results of operations or cash flows.

*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 $2,438,000 and $4,943,000 related to asbestos remediation as of September 30, 2017 and 2016, respectively. The liability was estimated using a discount factor which ranged from 7% - 9%.

***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 $3,028,000 and $2,198,000 as of September 30, 2017 and 2016, respectively, which was restricted for research at the Company's hospitals as well as for School of Nursing grants.

***Inventories***

Inventories of supplies are valued at the lower of amounts that approximate the weighted average cost or market. Inventories consist primarily of medical and surgical supplies and pharmaceuticals.

***Income Taxes***

For tax reporting purposes, the Company is treated as a Partnership. PCC and its wholly-owned subsidiaries are pass-through entities. Therefore, no provision is made in the accompanying consolidated 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, 2017, 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.

### *Fair Value of Financial Instruments*

Financial instruments consist primarily of cash and cash equivalents, restricted cash, patient and other accounts receivables, accounts payable and accrued expenses, accrued salaries and benefits, amounts due from/to government payers, capital lease obligations, and other liabilities. The carrying amounts of current assets and liabilities approximate their fair value due to the relatively short period of time between the origination of the instruments and their expected realization.

### *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 (excluding revenues for discontinued operations, in thousands):

| | **For the Year Ended September 30, 2017** | **% of Net Patient Service Revenues** | For the Year Ended September 30, 2016 | % of Net Patient Service Revenues |
|---|---|---|---|---|
| Medicare | **$ 152,240** | **44 %** | $ 151,015 | 45 % |
| Medicaid | **72,948** | **21 %** | 74,216 | 22 % |
| Total | **$ 225,188** | **65 %** | $ 225,231 | 67 % |

### *Use of Estimates*

The preparation of consolidated 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 consolidated 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 and doubtful accounts, professional and general liability claims, long-lived assets, intangible assets and asset retirement obligations.

### *Recent Accounting Pronouncements*

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" which defers the effective date of the revenue standard 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, including interim periods therein. 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 (e.g. October 1, 2019) 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 understa8nd the impact of adopting the new standard in the current year compared to prior years that are presented under legacy U.S. GAAP. Early adoption is permitted for fiscal years beginning after December 15, 2016. The Company is currently evaluating the effect of this guidance on its consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, "Presentation of Financial Statements – Going Concern: Disclosures of Uncertainties about an Entity's Ability to Continue as a Going Concern (Subtopic 205-40)" This ASU provides guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Specifically, this ASU provides a definition of the term substantial doubt and requires an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). It also requires certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans and requires an express statement and other disclosures when substantial doubt is not alleviated. The new standard will be effective for reporting periods beginning after December 15, 2016, with early adoption permitted. The Company has early adopted this guidance and such adoption did not have a material impact on its consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, "Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustment". ASU 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. Prior to the issuance of the standard, entities were required to retrospectively apply adjustments made to provisional amounts recognized in a business combination. The standard will be effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. Early adoption is permitted, and the Company adopted this standard in the current fiscal year. The adoption of this guidance did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

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 is effective for nonpublic entities for fiscal years beginning after December 15, 2019. Early application of the amendment is permitted. The Company is currently evaluating the standard and the impact on its consolidated 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 consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business.” These amendments clarify the definition of a business. The amendments affect all companies and other reporting organizations that must determine whether they have acquired or sold a business. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation. The amendments are intended to help companies and other organizations evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted under certain circumstances. The amendments should be applied prospectively as of the beginning of the period of adoption. The Company is evaluating the effect that this update will have on its consolidated financial statements and related disclosures.

In January 2017, the FASB issued ASU 2017-04, “Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment)”. The new guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years, and should be applied on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017, and the Company will adopt this standard effective for the year ending September 30, 2018. The new guidance simplifies the current two-step goodwill impairment test by eliminating Step 2 of the test. The new guidance requires a one-step impairment test in which an entity compares the fair value of a reporting unit with its carrying amount and recognizes an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value, if any. The Company is currently evaluating the impact of this guidance on its consolidated financial statements.

## 5. Property, Improvements and Equipment

Property, improvements and equipment, excluding assets held for sale, consisted of the following (in thousands):

| *September 30,* | | **2017** | | 2016 |
|---|---|---|---|---|
| Property, improvements and equipment: | | | | |
| Land and land improvements | **$** | **7,468** | $ | 7,868 |
| Buildings and improvements | | **35,598** | | 32,313 |
| Leasehold improvements | | **3,394** | | 3,280 |
| Equipment | | **35,541** | | 27,412 |
| | | **82,001** | | 70,837 |
| Less: accumulated depreciation | | **(32,035)** | | (21,865) |
| | | **49,966** | | 48,972 |
| Construction in Progress | | **3,884** | | 6,620 |
| Property, improvements and equipment, net | **$** | **53,850** | $ | 55,592 |

At September 30, 2017 and 2016, the Company had assets under capitalized leases of approximately $4,697,000 and $4,095,000, respectively, and related accumulated depreciation of $1,792,000 and $610,000, respectively.

Depreciation expense, excluding discontinued operations, was $12,200,000 and $10,730,000 for the years ended September 30, 2017 and 2016, respectively.

## 6. Goodwill and Intangible Assets

Goodwill and intangible assets relate to the Prospect CharterCARE and CharterCARE Physicians medical practices acquisitions. The following is a roll-forward of goodwill from October 1, 2015 to September 30, 2017 (in thousands):

| | | Amount |
|---|---|---|
| Balance, October 1, 2015 | $ | 3,432 |
| Acquisitions | | 342 |
| Balance, September 30, 2016 | | 3,774 |
| Acquisitions | | 2,048 |
| Balance, September 30, 2017 | $ | 5,822 |

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

| | Amortization Period | **September 30, 2017** | September 30, 2016 |
|---|---|---|---|
| Trade names | 5 years | **$ 8,130** | $ 8,130 |
| Other | 5 years | **97** | 97 |
| Total acquisition cost of intangible assets | | **8,227** | 8,227 |
| Less accumulated amortization | | **(5,373)** | (3,728) |
| Intangible assets, net | | **$ 2,854** | $ 4,449 |

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 $1,643,000 and $1,646,000 for the years ended September 30, 2017 and 2016, respectively.

Estimated amortization expense for each future fiscal year is as follows (in thousands):

| *Years ended September 30,* | |
|---|---|
| 2018 | $ 1,642 |
| 2019 | 1,192 |
| 2020 | 19 |
| Total | $ 2,854 |

The weighted-average remaining useful life for the intangible assets was approximately 2 years as of September 30, 2017.

## 7. Members' Equity

In accordance with the Amended & Restated Limited Liability Company Agreement of PCC ("LLC Agreement"), the profit or loss of PCC is to be allocated to the members based on their Adjusted Capital Contribution, as defined in the LLC Agreement. As a result of the acquisition of PCC as of June 20, 2014 (inception), the Company recorded a bargain gain of $3,975,000, which was allocated only to Prospect's capital account as the purchaser. The Company's earnings, with the exception of the bargain gain, have been allocated 85% to Prospect and 15% to CharterCARE Community Board, consistent with their ownership percentages.

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Total member contributions were $10,616,000 and $2,789,000 for the years ended September 30, 2017 and 2016, respectively. In accordance with the LLC Agreement, the contributions were accounted for as additional member contributions and allocated 85% to Prospect and 15% to CharterCARE Community Board, consistent with their ownership percentages. The following is a summary of the members' capital accounts (in thousands):

| | Prospect | CharterCARE Community Board | Total |
|---|---|---|---|
| **Balance** at October 1, 2015 | $ 57,341 | $ 10,119 | $ 67,460 |
| Member contributions | 2,370 | 419 | 2,789 |
| Net loss | (19,526) | (3,446) | (22,972) |
| **Balance** at September 30, 2016 | 40,185 | 7,092 | 47,277 |
| Member contributions | 9,024 | 1,592 | 10,616 |
| Net loss | (3,507) | (619) | (4,126) |
| **Balance** at September 30, 2017 | $ 55,494 | $ 9,413 | $ 53,767 |

## 8. Related Party Transactions

The Company 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 $7,033,000 and $6,888,000 for the years ended September 30, 2017 and 2016, respectively, which is included within management fees expense in the accompanying consolidated statements of operations. As of September 30, 2017 and 2016, the Company does not have a liability related to the MSA due PEHAS.

## 9. 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 September 2020. Capital leases bear interest at rates ranging from 3.0% to 8.0% per annum.

The future minimum annual lease payments (net of anticipated sublease income) required under leases in effect at September 30, 2017, are as follows (in thousands):

| For the Years ending September 30, | Capital Leases | Operating Leases |
|---|---|---|
| 2018 | $ 1,561 | $ 760 |
| 2019 | 824 | 419 |
| 2020 | 49 | 415 |
| 2021 | 44 | 359 |
| 2022 | - | 344 |
| Total minimum lease payments | 2,478 | $ 2,297 |
| Less: amounts representing interest | (108) | |
| | 2,370 | |
| Less: current portion | (1,475) | |
| | $ 895 | |

Lease and rental expense was $4,792,000 and $3,615,000 for the years ended September 30, 2017 and 2016, respectively.

***Contingent Liability for Borrowings by Prospect***

PCC and its Subsidiaries are contingently liable as a guarantor among others for amounts borrowed by Prospect on senior secured borrowings and credit facilities as of September 30, 2017 and 2016. The obligations and related interest expense related to these credit facilities are not reflected in the Company's consolidated financial statements as of September 30, 2017 and 2016, as the borrowings are reflected in the separate consolidated financial statements of Prospect.

Total borrowings outstanding as of September 30, 2017 and 2016, reflected in the consolidated financial statements of Prospect, but for which the Company is contingently liable as a guarantor, were (in thousands):

| *September 30,* | **2017** | 2016 |
|---|---|---|
| Senior secured notes (net of discount of $7,374 and $8,984) | **$ 609,813** | $ 614,454 |
| Less: deferred financing costs, net | **(9,906)** | (11,649) |
| | **$ 599,907** | $ 602,805 |

On June 30, 2016, Prospect entered into a six-year $625 million senior secured term loan B (the "Term Loan"), the proceeds of which were used to repay $425 million for Holdings' existing 8.375% senior secured notes due during 2019; to repay $60 million for borrowings under Holdings' existing revolving credit facility (the "Replaced Revolver"); to fund acquisitions; and to finance transaction fees and expenses. The Term Loan bears interest at LIBOR (subject to a 1.0% floor) plus 6.0%, and the effective interest rate was 7.00% as of September 30, 2017. The Term Loan was issued with an original discount of 1.5%, or $9,375,000.

Additionally, Prospect refinanced the Replaced Revolver with a new $100 million asset-based revolving credit facility ("ABL Facility" and together with the Term Loan, the "New Senior Secured Credit Facilities"). The ABL facility was amended in August 2016 to $115 million, August 2017 to $155 million and October 2017 to $175 million. The ABL Facility bears interest at a variable base rate plus an applicable spread, contingent on Prospect's ABL Facility availability, as defined in the ABL Facility credit agreement. The ABL Facility effective interest rate was 3.25% as of September 30, 2017. The ABL Facility balance as of September 30, 2017 was $115,300,000. As of September 30, 2017, Prospect had unused letters of credit of $9,800,000, which offset Prospect's ability to borrow additional funds, and the ABL Facility had unused lender commitments of $29,900,000 as of September 30, 2017. The maturity date for the ABL facility is June 30, 2021, and the maturity date for the Term Loan is June 30, 2022. As of September 30, 2017, Prospect was in compliance with the financial covenants of the New Senior Secured Credit Facilities. Subsequent to year end, Prospect refinanced the Term Loan and amended the ABL Facility, see Note 12.

### *Letter of Credit*

As of September 30, 2017, Prospect secured an irrevocable letter of credit for $584,000 on behalf of SJHSRI for its School of Nursing ("School") as required by the U.S. Department of Education. The purpose of the letter of credit is to (i) pay refunds of charges owed on behalf of current or former students, whether or not the School remains open; (ii) to provide for the "teach-out" of currently enrolled students if the School closes; and (iii) to pay any liabilities owed to the U.S. Department of Education.

### *Other Commitments*

The Company has additional commitments for reagents that are based on tests performed. They are non-cancelable agreements but the future dollar commitments are not quantifiable as they are volume-driven.

### *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 consolidated 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 consolidated 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, California has also developed strict standards for the privacy and security of health information as well as for reporting certain violations and breaches. The Company may be subject to significant fines and penalties if found not to be compliant with these state or federal provisions.

### *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, 32 states have expanded their Medicaid programs to cover previously uninsured childless adults. 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 an their parents’ health insurance until age 26 or prohibiting certain plans from denying coverage based on pre-existing conditions. Nationally, these reforms have reduced number of uninsured.

In light of the transition to a new presidential administration, it is unclear what changes may be made to PPACA. The Tax Cuts and Jobs Act (“TCJA”), passed in December 2017, eliminates the individual mandate under PPACA, effective January 1, 2019. The individual mandate 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 will impact the uninsured rate and 2019 premiums is unclear at this juncture. Future changes to PPACA and in 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 for risks and uncertainties.

### *Collective Bargaining Agreements*

Approximately 422 employees at SJHSRI are subject to a collective bargaining agreement with United Nurses and Allied Professionals (“UNAP”), which will expire July 2019. The parties are currently negotiating a new collective bargaining agreement. During April 2015, a hospital unit consisting of approximately 400 service employees of Fatima elected to be represented by UNAP. The parties entered into a new collective bargaining agreement which expires October 2018. A small number of employees are subject to a collective bargaining agreement with the Federation of Nurses and Health Professionals (“FNHP”), which expires April, 2018.

### *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 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.

## 10. Defined Contribution Plan

The Company sponsors a defined contribution plan (the "Plan") covering substantially all employees who meet certain eligibility requirements. Under the Plan, employees can contribute up to 100% of their compensation up to the IRS deferred annual maximum. The Company may make discretionary matching contributions to the Plan. Employer contributions to the Plan were $839,000 and $2,797,000 for the years ended September 30, 2017 and 2016, respectively.

## 11. Equity Method Investments

Roger Williams Medical Center and an unrelated third party are owners of Roger Williams Radiation Therapy ("RWRT") and Southern New England Regional Cancer Center, LLC ("SNERCC"), which provide radiation therapy services. On January 6, 2015, RWMC sold a 9% interest in RWRT for $1,233,000, reducing its ownership in RWRT from 29% to 20%. Also on January 6, 2015, RWMC increased its investment in SNERCC by $1,600,000 in connection with SNERCC's acquisition of a radiation oncology business. RWMC's interest in SNERCC remained at 20% after the additional investment as RWMC's additional investment was its pro rata portion of the radiation oncology business purchase price. Roger Williams accounts for these investments using the equity method of accounting.

RWMC is not liable for any obligations insured by RWRT or SNERCC nor is it obligated to make any further capital contributions or lend funds to RWRT or SNERCC. As of September 30, 2017 and 2016, the Company's investments in RWRT, SNERCC, and other minor investments under the equity method were approximately $4,358,000 and $4,611,000, respectively, and are included in equity method investments in the accompanying consolidated balance sheets. For the years ended September 30, 2017 and 2016, the Company recognized approximately $605,000 and $512,000, respectively, as its share of the financial results of RWRT, SNERCC, and other minor investments and received $836,000 and $448,000, respectively, in distributions.

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Summarized combined unaudited financial information for RWRT and SNERCC as of and for the years ended September 30, 2017 and 2016 is as follows (in thousands):

| *September 30,* | | **2017** | | 2016 |
|---|---|---|---|---|
| Cash | $ | **1,549** | $ | 2,567 |
| Receivables and other current assets | | **2,121** | | 1,536 |
| Total current assets | | **3,670** | | 4,103 |
| Property, improvements and equipment, net | | **6,104** | | 6,495 |
| Goodwill | | **7,142** | | 7,142 |
| Intangible assets | | **882** | | 912 |
| Other long-term assets | | **1,603** | | 1,641 |
| Total assets | $ | **19,401** | $ | 20,293 |
| Accounts payable and accrued liabilities | $ | **1,201** | $ | 1,251 |
| Other long-term liabilities | | **400** | | 378 |
| Equity | | **17,800** | | 18,664 |
| Total liabilities and partner's capital | $ | **19,401** | $ | 20,293 |

| *For the Years Ended September 30,* | | **2017** | | 2016 |
|---|---|---|---|---|
| Revenues | $ | **16,387** | $ | 15,007 |
| Net income | $ | **2,841** | $ | 1,927 |
| RWMC's income from equity method investments | $ | **507** | $ | 384 |

## 12. Subsequent Events (Unaudited)

The Company has evaluated subsequent events through February 28, 2018, the date the Company's consolidated financial statements were available for issuance.

In December 2017, New University Medical Group LLC ("New UMG") entered into a Second Closing to acquire the remaining assets of University Medical Group ("UMG") that were not acquired in the initial acquisition in December 2014. As consideration for the acquisition, New UMG has assumed certain designated liabilities of the practice. As part of the transaction, New UMG has assigned all assets acquired from UMG to New UMG's parent company, Prospect CharterCARE Physicians, LLC, dba CharterCARE Medical Associates ("CCMA"). CCMA entered into a Post Closing Administrative Services Agreement pursuant to which CCMA and its affiliates provide services to the seller of the practice in connection with its termination of all operations and the wind up its affairs and operations.

On February 22, 2018, Prospect entered into an Amended and Restated Term Loan Credit Agreement. Under this agreement, the Term Loan is replaced by a new Term B-1 Loan and Additional Term B-1 Commitment ("Term B-1 Loans"). The total maximum borrowing under the Term B-1 Loans is $1,120 million and such loans bear interest at LIBOR (subject to a 1.0% floor) plus 5.5%, and were issued with an original discount of 2%, and matures on February 24, 2024. Additionally on February 22, 2018, Prospect entered into an Amended and Restated ABL Guarantee And Security Agreement. Under this agreement, the maximum borrowing is $250 million, and the facility bears interest at a variable base rate plus an applicable spread, contingent on the Prospect's ABL Facility availability, as defined in the agreement. The facility matures on February 22, 2023.

# TAB 28A

# Prospect CharterCARE RWMC, LLC

## Consolidated Financial Statements

## Schedule of Expenditures of Federal Awards and Independent Auditor's Reports as Required by the Uniform Guidance and *Government Auditing Standards*

As of and for the Year Ended
September 30, 2017

(With Independent Auditor's Report Thereon)

# Prospect CharterCARE RWMC, LLC

## Consolidated Financial Statements

**Schedule of Expenditures of Federal Awards and Independent Auditor's Reports as Required by the Uniform Guidance and *Government Auditing Standards***

As of and for the Year Ended September 30, 2017

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# Independent Auditor's Report

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

**Report on the Consolidated Financial Statements**

We have audited the accompanying consolidated financial statements of Prospect CharterCARE RWMC, LLC (the "Company"), which comprise the consolidated balance sheet as of September 30, 2017, and the related consolidated statements of operations, member's equity, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

***Management's Responsibility for the 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 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 consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Prospect CharterCARE RWMC, LLC and its subsidiary as of September 30, 2017, and the results of their operations and their cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

***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 consolidated financial statements do not reflect any adjustments or disclosures that would be required should the parent company discontinue its financial support.

***Other Matters***

*Other 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 (CFR) 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 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 April 9, 2018 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 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 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

April 9, 2018

# Prospect CharterCARE RWMC, LLC

## Consolidated Balance Sheet
## (in thousands)

| *September 30,* | | 2017 |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents | $ | 299 |
| Restricted cash | | 2,369 |
| Patient accounts receivable, less allowance for doubtful accounts of $3,974 | | 21,506 |
| Other receivables | | 9,303 |
| Due from government payers | | 580 |
| Inventories | | 3,750 |
| Prepaid expenses and other current assets | | 1,378 |
| **Total current assets** | | 39,185 |
| Property, improvements and equipment, net | | 30,679 |
| Intangible assets, net | | 1,561 |
| Equity method investments | | 4,052 |
| Insurance receivable and other assets | | 601 |
| **Total assets** | $ | 76,078 |

*See accompanying notes to consolidated financial statements.*

# Prospect CharterCARE RWMC, LLC

## Consolidated Balance Sheet
## (in thousands)

| *September 30,* | | 2017 |
|---|---|---|
| **Liabilities and Member's Equity** | | |
| **Current liabilities** | | |
| Accrued medical claims and other healthcare costs payable | $ | 394 |
| Accounts payable and other accrued liabilities | | 13,946 |
| Accrued salaries, wages and benefits | | 6,540 |
| Due to government payers | | 282 |
| Due to affiliated companies, net | | 18,357 |
| Current portion of capital leases | | 596 |
| Current portion of sale-leaseback liability | | 257 |
| **Total current liabilities** | | 40,372 |
| Capital leases, net of current portion | | 326 |
| Malpractice reserves | | 3,273 |
| Asset retirement obligations | | 750 |
| Sale-leaseback liability, net of current portion | | 3,760 |
| Other long-term liabilities | | 335 |
| **Total liabilities** | | 48,816 |
| **Commitments, contingencies and subsequent events** | | |
| **Member's equity:** | | |
| Member contributions | | 34,241 |
| Accumulated deficit | | (6,979) |
| Total member's equity | | 27,262 |
| **Total liabilities and member's equity** | $ | 76,078 |

*See accompanying notes to consolidated financial statements.*

## Prospect CharterCARE RWMC, LLC

### Consolidated Statement of Operations
### (in thousands)

| *For the year ended September 30,* | | 2017 |
|---|---|---|
| **Revenues:** | | |
| Net patient service revenues | $ | 177,720 |
| Provision for bad debts | | (6,190) |
| Net patient service revenues less provision for bad debts | | 171,530 |
| Other revenues | | 3,001 |
| Total net revenues | | 174,531 |
| **Operating Expenses:** | | |
| Salaries, wages and benefits | | 83,968 |
| Supplies | | 38,638 |
| Purchased services | | 13,629 |
| Taxes and licenses | | 11,347 |
| Depreciation and amortization | | 6,168 |
| Professional fees | | 6,728 |
| Other | | 6,219 |
| Management fees | | 3,665 |
| Utilities | | 1,792 |
| Research grant expense | | 120 |
| Insurance | | 2,799 |
| Lease and rental | | 1,434 |
| Repairs and maintenance | | 978 |
| Registry | | 623 |
| Total operating expenses | | 178,108 |
| Operating income from unconsolidated equity method investments | | 507 |
| **Operating loss** | | (3,070) |
| Other income: | | |
| Interest income, net | | (217) |
| Other income | | (89) |
| Total other income, net | | (306) |
| **Net loss** | $ | (2,764) |

*See accompanying notes to consolidated financial statements.*

# Prospect CharterCARE RWMC, LLC

## Consolidated Statement of Member's Equity
(in thousands)

| | Member Contributions | Retained Earnings (Accumulated Deficit) | Total Member's Equity |
|---|---|---|---|
| **Balance** at October 1, 2016 | $ 34,241 | $ 330 | $ 34,570 |
| Net loss | - | (2,764) | (2,764) |
| Noncash distribution | - | (4,545) | (4,545) |
| **Balance** at September 30, 2017 | $ 34,241 | $ (6,979) | $ 27,262 |

*See accompanying notes to consolidated financial statements.*

# Prospect CharterCARE RWMC, LLC

## Consolidated Statement of Cash Flows
## (in thousands)

| *For the year ended September 30,* | | 2017 |
|---|---|---|
| **Operating activities** | | |
| Net loss | $ | (2,764) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | | 6,168 |
| Provision for bad debts | | 6,190 |
| Undistributed earnings from equity method investments | | (507) |
| Accretion for asset retirement obligations | | (5) |
| Accretion of sale-leaseback liability | | (335) |
| Gain on sale of property, improvements and equipment | | (2,539) |
| Changes in operating assets and liabilities: | | |
| Change in restricted cash | | (633) |
| Patient accounts receivable and other receivables | | (8,527) |
| Due to/from government payers, net | | 17 |
| Inventories | | 467 |
| Prepaid expenses and other current assets | | 18 |
| Insurance receivable and other assets | | (100) |
| Accrued medical claims and other healthcare | | 394 |
| Accounts payable and other accrued liabilities | | (1,448) |
| Malpractice reserve | | 883 |
| **Net cash used in operating activities** | | (182) |
| **Investing activities** | | |
| Purchases of property, improvements and equipment | | (5,077) |
| Cash distributions from equity investments | | 761 |
| **Net cash used in investing activities** | | (4,316) |
| **Financing activities** | | |
| Change in due to affiliated companies | | 5,938 |
| Repayments on financing liability | | (193) |
| Repayments of capital leases | | (947) |
| **Net cash provided by financing activities** | | 4,797 |
| Change in cash and cash equivalents | | 299 |
| Cash and cash equivalents, beginning of year | | - |
| Cash and cash equivalents, end of year | $ | 299 |
| **Supplemental disclosure of cash flow information** | | |
| Interest paid | $ | 1,999 |
| Noncash distribution | $ | 4,545 |
| Sale-leaseback liability | $ | 4,545 |
| Capital lease commitments transferred to affiliate | $ | 1,669 |

*See accompanying notes to consolidated financial statements*

## 1. Organization

Prospect CharterCARE RWMC, LLC ("RWMC") is a wholly-owned subsidiary of Prospect CharterCARE, LLC ("PCC"). PCC is owned 85% by Prospect Medical Holdings, Inc. ("Prospect") and 15% by CharterCARE Community Board. RWMC operates a 220-bed acute care general hospital which provides healthcare services in Providence, Rhode Island and surrounding communities. New University Medical Group, LLC ("New UMG"), a wholly-owned subsidiary of RWMC (together, the "Company"), was formed during the year ended September 30, 2015.

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 Prospect to fund ongoing operations. As of September 30, 2017, the Company had a liability of $24,469,000 to Prospect, which is payable on demand, does not bear interest, and is included in due to affiliated companies, net in the accompanying consolidated balance sheets. Prospect does 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

***Principles of Consolidation and Basis of Presentation***

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and include the accounts of RWMC's wholly-owned subsidiary, New UMG, but do not include the accounts of PCC, Prospect or CharterCARE Community Board. All significant intercompany balances and transactions have been eliminated in consolidation.

***Revenues***

*Net Patient Service Revenues*

Operating revenue consists primarily of net patient service revenue. The Company reports net patient service revenue 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 consolidated balance sheet.

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):

| *For the years ended September 30,* | | 2017 |
|---|---|---|
| Medicare | $ | 82,046 |
| Medicaid | | 34,725 |
| Managed Care/Commercial | | 39,163 |
| Self-Pay/Other | | 21,786 |
| Total | $ | 177,720 |

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. 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 paid based on a blend of 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. 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. The latest updated Supplemental Security Income ("SSI") ratios for 2014, which are used in determining disproportionate share payments, were issued on July 19, 2016. To date, the Company has not received any final NPRs since inception on June 20, 2014.

*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.

RWMC 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 RWMC, receive federal and state Medicaid funds as additional reimbursement for treating a disproportionate share of low income patients. RWMC recognized revenue related to DSH and Upper Payment Limit ("UPL") reimbursement of $9,458,000 for the year ended September 30, 2017. DSH and UPL payments received were $8,446,000 for the year ended September 30, 2017. The State of Rhode Island also assesses a license fee to all hospitals in Rhode Island based on each hospital's net patient revenue. RWMC recorded license fee expenses of $8,667,000, which is included within taxes and licenses expense within the accompanying statement 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.

*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 $547,000 for the year ended September 30, 2017. 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 year ended September 30, 2017.

*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 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 16% of gross accounts receivable as of September 30, 2017.

### *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 consolidated financial statements.

*Other Revenues*

Other revenues totaled $3,001,000 for the year ended September 30, 2017. Management has evaluated the collectability of other receivables consisting primarily of other revenues and grant revenues and determined no allowance is necessary as of September 30, 2017.

A summary of the principal components of other revenues is as follows:

Rental Revenue: Rental revenue from operating leases is recorded based on the fixed, minimum required rents (base rents) per the lease agreements. Rental revenue from base rents is recorded on the straight-line method over the terms of the related lease agreements. The Company recorded rental revenues of $324,000 for the year ended September 30, 2017.

Research Grant Revenues: The Company receives grant revenue for direct research from the federal government, other institutions and other sources for a range of research areas including oncology, cardiology, HIV and diabetes. The Company recorded research grant revenue of $1,439,000 for the year ended September 30, 2017.

### *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 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 year ended September 30, 2017.

***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. The Company was included in Prospect's consolidated medical malpractice insurance policy effective June 20, 2014 (inception). Assets and liabilities related to malpractice insurance related to events prior to June 20, 2014 (inception) were not assumed by the Company.

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 $3,273,000 and as of September 30, 2017, and insurance receivables were $478,000 as of September 30, 2017. 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 consolidated balance sheet.

*Workers' Compensation Insurance*

The Company was fully insured for workers' compensation claims with no deductible for the year ended September 30, 2017. Assets and liabilities related to workers' compensation insurance related to events prior to June 20, 2014 (inception) were not assumed by the Company.

*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 consolidated 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 $367,000 for incurred but not reported claims as of September 30, 2017has been included in accrued medical claims and other healthcare costs payable on the accompanying balance sheet.

### *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 consolidated statement of operations. The Company has accrued $750,000 related to asbestos remediation as of September 30, 2017.

### *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 $2,369,000 as of September 30, 2017, which is restricted for research.

### *Inventories*

Inventories of supplies are valued at the lower of amounts that approximate the weighted average cost or market. Inventories consist primarily of medical and surgical supplies and pharmaceuticals.

### *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, 2017, 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.

### *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, see Note 5.

### *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, 2017 | % of Net Patient Services Revenues |
|---|---|---|
| Medicare | $ 82,046 | 46 % |
| Medicaid | 34,725 | 20 % |
| Total | $ 116,771 | 66 % |

### *Use of Estimates*

The preparation of consolidated 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 consolidated 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 and doubtful accounts, professional and general liability claims, impairment of long-lived assets and intangible assets, and asset retirement obligations.

*New Accounting Pronouncements*

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" which defers the effective date of the revenue standard 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, including interim periods therein. 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 (e.g. October 1, 2019) 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. Early adoption is permitted for fiscal years beginning after December 15, 2016. The Company is currently evaluating the effect of this guidance on its consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, "Presentation of Financial Statements – Going Concern: Disclosures of Uncertainties about an Entity's Ability to Continue as a Going Concern (Subtopic 205-40)" This ASU provides guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Specifically, this ASU provides a definition of the term substantial doubt and requires an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). It also requires certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans and requires an express statement and other disclosures when substantial doubt is not alleviated. The new standard will be effective for reporting periods beginning after December 15, 2016, with early adoption permitted. The Company has early adopted this guidance and such adoption did not have a material impact on its consolidated 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 is effective for nonpublic entities for fiscal years beginning after December 15, 2019. Early application of the amendment is permitted. The Company is currently evaluating the standard and the impact on its consolidated 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 consolidated financial statements.

On November 17, 2016, the FASB issued Accounting Standards Update (ASU) 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, providing specific guidance on the cash flow classification and presentation of changes in restricted cash and restricted cash equivalents. The amendments in ASU 2016-18 require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents (collectively “CASH”). Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the SCF. The amendments in ASU 2016-18 are effective for private business entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company is currently evaluating the impact of this accounting standard on its financial statements.

## 3. Property, Improvements and Equipment

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

| *September 30,* | 2017 |
|---|---|
| Property, improvements and equipment: | |
| Land and land improvements | $ 2,946 |
| Buildings and improvements | 23,266 |
| Leasehold improvements | 6,164 |
| Equipment | 10,362 |
| | 42,738 |
| Less: accumulated depreciation | (14,423) |
| | 28,315 |
| Construction in Progress | 2,364 |
| Property, improvements and equipment, net | $ 30,679 |

At September 30, 2017, the Company had assets under capitalized leases of approximately $1,928,000 and related accumulated depreciation of $885,000.

Depreciation expense was $5,260,000 for the years ended September 30, 2017.

## 4. Intangible Assets

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

| | Amortization Period | September 30, 2017 |
|---|---|---|
| Trade names | 5 years | $ 4,540 |
| Total acquisition cost of intangible assets | | 4,540 |
| Less accumulated amortization | | (2,979) |
| Intangible assets, net | | $ 1,561 |

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 $908,000 for the year ended September 30, 2017.

Estimated amortization expense for each future fiscal year is as follows (in thousands):

| *Years ended September 30,* | |
|---|---|
| 2018 | $ 908 |
| 2019 | 653 |
| Total | $ 1,561 |

The weighted-average remaining useful life for the intangible assets was approximately 2 years as of September 30, 2017.

## 5. Sale of Real Estate and Sale-Leaseback

PCC previously operated Elmhurst Extended Care ("Elmhurst"), a 206 bed skilled nursing facility, and the Company owned the land and building in which Elmhurst's business was carried out. In December 2016, PCC and the Company entered into a transaction to sell the operations of Elmhurst and the land and building in which Elmhurst operated, to an unrelated third party. PCC's decision to discontinue the operations of this entity was based on the Company's strategy in its market and financial results. The transaction price was approximately $15.2 million, of which approximately $8.3 million was allocated to the land and building. After the land and building were sold, the building was then subdivided into two condominiums, one of which was deeded back to the Company. Additionally, the Company entered into a transaction to lease a portion of the other condominium back for a period of 10 years, with monthly rent of approximately $21,000. 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, which is considered a form of contingent collateral and results in the transaction being recorded under the financing method. Further, the building cannot be bifurcated, for accounting purposes, between the portion that was leased and the remainder because the transaction does not meet the definition of a minor sale-leaseback, under applicable accounting literature. PCC received and retained the cash received from the seller, and accordingly the transaction has been accounted for as a noncash distribution to PCC. In accordance with applicable accounting literature, as the Company is a wholly owned subsidiary of PCC, the value of the noncash distribution is based on the carrying value of the assets distributed at the time of sale, which was $4,545,000, and accordingly this is the value that the sale-leaseback liability has been set up at that date.

Scheduled payments under the Company's sale-leaseback liability as of September 30, 2017 are as follows (in thousands):

| *Years ending September 30,* | | |
|---|---|---|
| 2018 | $ | 257 |
| 2019 | | 257 |
| 2020 | | 257 |
| 2021 | | 257 |
| 2022 | | 257 |
| Thereafter | | 1,093 |
| | | 2,380 |
| Plus: reduction in liability to be accreted to interest income | | 1,637 |
| Total sale-leaseback liability | $ | 4,017 |

The total payments to be paid over the remainder of the lease are $2,380,000. The interest rate implicit in the calculation is negative 10.4%. 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.

## 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 $3,665,000 for the year ended September 30, 2017, which is included within management fee expense in the accompanying statement of operations. As of September 30, 2017, $11,758,000, due pursuant to the MSA, is included in due to affiliates, net, in the accompanying consolidated balance sheet.

The Company recognized $319,000 of rental income from Elmhurst Extended Care for the year ended September 30, 2017, respectively, which is included in other revenues in the accompanying consolidated statement of operations.

## 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 June 2022. Capital leases bear interest at rates ranging from 3.0% to 4.0% per annum.

The future minimum annual lease payments required under leases in effect at September 30, 2017, are as follows (in thousands):

| For the Years ending September 30, | Capital Leases | Operating Leases |
|---|---|---|
| 2018 | $ 631 | $ 398 |
| 2019 | 334 | 133 |
| 2020 | - | 129 |
| 2021 | - | 74 |
| 2022 | - | 74 |
| Total minimum lease payments | 965 | $ 808 |
| Less: amounts representing interest | (43) | |
| | 922 | |
| Less: current portion | (596) | |
| | $ 326 | |

Lease and rental expense was $1,626,000 for the year ended September 30, 2017.

***Contingent Liability for Borrowings by Prospect***

The Company is contingently liable as a guarantor among others for amounts borrowed by Prospect on senior secured borrowings and credit facilities at September 30, 2017 and 2016. The obligations and related interest expense related to these credit facilities are not reflected in the Company's financial statements as of September 30, 2017 and 2016, as the borrowings are reflected in the separate consolidated financial statements of Prospect.

Total borrowings outstanding as of September 30, 2017, reflected in the consolidated financial statements of Prospect, but for which the Company is contingently liable as a guarantor, were (in thousands):

| *September 30,* | 2017 |
|---|---|
| Senior secured term loan (net of discount of $7,374) | $ 609,813 |
| Less: original issue discount, net | (9,906) |
| | $ 599,907 |

On June 30, 2016, Prospect entered into a six-year $625 million senior secured term loan B (the "Term Loan"), the proceeds of which were used to repay $425 million for Holdings' existing 8.375% senior secured notes due during 2019; to repay $60 million for borrowings under Holdings' existing revolving credit facility (the "Replaced Revolver"); to fund acquisitions; and to finance transaction fees and expenses. The Term Loan bears interest at LIBOR (subject to a 1.0% floor) plus 6.0%, and the effective interest rate was 7.00% as of September 30, 2017. The Term Loan was issued with an original discount of 1.5%, or $9,375,000.

Additionally, Prospect refinanced the Replaced Revolver with a new $100 million asset-based revolving credit facility ("ABL Facility" and together with the Term Loan, the "New Senior Secured Credit Facilities"). The ABL facility was amended in August 2016 to $115 million, August 2017 to $155 million and October 2017 to $175 million. The ABL Facility bears interest at a variable base rate plus an applicable spread, contingent on Prospect's ABL Facility availability, as defined in the ABL Facility credit agreement. The ABL Facility effective interest rate was 3.25% as of September 30, 2017. The ABL Facility balance as of September 30, 2017 was $115,300,000. As of September 30, 2017, Prospect had unused letters of credit of $9,800,000, which offset Prospect's ability to borrow additional funds, and the ABL Facility had unused lender commitments of $29,900,000 as of September 30, 2017. The maturity date for the ABL facility is June 30, 2021, and the maturity date for the Term Loan is June 30, 2022. As of September 30, 2017, Prospect was in compliance with the financial covenants of the New Senior Secured Credit Facilities. Subsequent to year end, Prospect refinanced the Term Loan and amended the ABL Facility, see Note 10.

### *Other Commitments*

The Company has additional commitments for reagents that are based on tests performed. They are non-cancelable agreements but the future dollar commitments are not quantifiable as they are volume-driven.

### *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. The Company may be subject to significant fines and penalties if found not to be compliant with these federal provisions.

***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, 32 states have expanded their Medicaid programs to cover previously uninsured childless adults. 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 an their parents' health insurance until age 26 or prohibiting certain plans from denying coverage based on pre-existing conditions. Nationally, these reforms have reduced number of uninsured.

In light of the transition to a new presidential administration, it is unclear what changes may be made to PPACA. The Tax Cuts and Jobs Act ("TCJA"), passed in December 2017, eliminates the individual mandate under PPACA, effective January 1, 2019. The individual mandate 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 will impact the uninsured rate and 2019 premiums is unclear at this juncture. Future changes to PPACA and in 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 for risks and uncertainties.

***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 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

PCC sponsors a defined contribution plan (the "Plan") covering substantially all employees of the Company who meet certain eligibility requirements. Under the Plan, employees can contribute up to 100% of their compensation up to the IRS deferred annual maximum. The Company may make discretionary matching contributions to the Plan. The Company did not contributions to the Plan for the year ended September 30, 2017.

## 9. Equity Method Investments

Roger Williams Medical Center and an unrelated third party are owners of Roger Williams Radiation Therapy (“RWRT”) and Southern New England Regional Cancer Center, LLC (“SNERCC”), which provide radiation therapy services. On January 6, 2015, RWMC sold a 9% interest in RWRT for $1,233,000, reducing its ownership in RWRT from 29% to 20%. Also on January 6, 2015, RWMC increased its investment in SNERCC by $1,600,000 in connection with SNERCC’s acquisition of a radiation oncology business. RWMC’s interest in SNERCC remained at 20% after the additional investment as RWMC’s additional investment was its pro rata portion of the radiation oncology business purchase price. Roger Williams accounts for these investments using the equity method of accounting.

RWMC is not liable for any obligations insured by RWRT or SNERCC nor is it obligated to make any further capital contributions or lend funds to RWRT or SNERCC. As of September 30, 2017, the Company’s investments in RWRT, SNERCC, and other minor investments under the equity method were approximately $4,052,000, and are included in equity method investments in the accompanying consolidated balance sheet. For the year ended September 30, 2017, the Company recognized approximately $507,000, as its share of the financial results of RWRT, SNERCC, and other minor investments and received $761,000, in distributions.

Summarized combined unaudited financial information for RWRT and SNERCC as of September 30, 2017 is as follows (in thousands):

| *September 30,* | | 2017 |
|---|---|---|
| Cash | $ | 1,549 |
| Receivables and other current assets | | 2,121 |
| Total current assets | | 3,670 |
| Property, improvements and equipment, net | | 6,104 |
| Goodwill | | 7,142 |
| Intangible assets | | 882 |
| Other long-term assets | | 1,603 |
| Total assets | $ | 19,401 |
| Accounts payable and accrued liabilities | $ | 1,201 |
| Other long-term liabilities | | 400 |
| Equity | | 17,800 |
| Total liabilities and partner’s capital | $ | 19,401 |

| *For the Year Ended September 30,* | | 2017 |
|---|---|---|
| Revenues | $ | 16,387 |
| Net income | $ | 2,841 |
| RWMC’s income from equity method investments | $ | 507 |

## 10. Subsequent Events (Unaudited)

The Company has evaluated subsequent events through April 9, 2018, the date the Company's consolidated financial statements were available for issuance.

In December 2017, New UMG entered into a Second Closing to acquire the remaining assets of University Medical Group ("UMG") that were not acquired in the initial acquisition in December 2014. As consideration for the acquisition, New UMG has assumed certain designated liabilities of the practice. As part of the transaction, New UMG has assigned all assets acquired from UMG to New UMG's parent company, Prospect CharterCARE Physicians, LLC, dba CharterCARE Medical Associates ("CCMA"). CCMA entered into a Post Closing Administrative Services Agreement pursuant to which CCMA and its affiliates provide services to the seller of the practice in connection with its termination of all operations and the wind up its affairs and operations.

On February 22, 2018, Prospect entered into an Amended and Restated Term Loan Credit Agreement. Under this agreement, the Term Loan is replaced by a new Term B-1 Loan and Additional Term B-1 Commitment ("Term B-1 Loans"). The total maximum borrowing under the Term B-1 Loans is $1,120 million and such loans bear interest at LIBOR (subject to a 1.0% floor) plus 5.5%, and were issued with an original discount of 2%, and mature on February 24, 2024. Additionally on February 22, 2018, Prospect entered into an Amended and Restated ABL Guarantee And Security Agreement. Under this agreement, the maximum borrowing is $250 million, and the facility bears interest at a variable base rate plus an applicable spread, contingent on the Prospect's ABL Facility availability, as defined in the agreement. The facility matures on February 22, 2023.

# Schedule of Expenditures of Federal Awards

# Prospect CharterCARE RWMC, LLC

## Schedule of Expenditures of Federal Awards
## For the Year Ended September 30, 2017

| Federal grantor/pass-through grantor | CFDA number | Pass-through number | Expenditures |
|---|---|---|---|
| Department of Health and Human Services: | | | |
| Environmental Public Health and Emergency Response | 93.074 | N/A | 26,472 |
| Cancer Research Manpower | 93.398 | N/A | 106,269 |
| Cardiovascular Diseases Research | 93.837 | N/A | 404,498 |
| Allergy and Infectious Diseases Research – Allergy and Infectious Diseases Allergy and Infectious Diseases | 93.855 | N/A | 47,326 |
| Diabetes, Digestive, and Kidney Diseases Extramural Research | 93.847 | N/A | 229,374 |
| Heart Lung and Blood | 93.837 | N/A | 149,098 |
| Total Department of Health and Human Services | | | 963,037 |
| Total direct programs | | | 963,037 |
| Passed through from other organizations: | | | |
| Research and development program: | | | |
| Department of Defense: Passed through University of Washington | 12.420 | W81XWH-16-1-0152 | 18,714 |
| Department of Defense: Passed through The Research Foundation for State University of New York (SUNY) | 12.420 | W81XWH-17-1-0444 | 1,793 |
| Department of Health and Human Services: | | | |
| Department of Health and Human Services: Passed Through University of Rhode Island | 93.969 | 1UB4HP19208-01-00 | 944 |
| Total passed-through from other organizations | | | 21,451 |
| Total expenditures of federal awards | | | $ 984,488 |

*See accompanying notes to schedule of expenditures of federal awards.*

## 1. Definition of Reporting Entity

The Schedule of Expenditures of Federal Awards presents the activity of all federal awards of Prospect CharterCARE RWMC, LLC (“RWMC”). All federal awards received directly from federal agencies, as well as federal awards passed through other agencies, are included in this schedule.

## 2. Basis of Presentation

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 the Company, it is not intended to and does not present the financial position, changes in net assets or cash flows of the Company.

# Independent Auditor's Reports Required by the Uniform Guidance and *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***

Board of Directors
Prospect CharterCARE RWMC, 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 consolidated financial statements of Prospect CharterCARE RWMC, LLC (the "Company"), which comprise the consolidated balance sheet as of September 30, 2017 the related consolidated statements of operations, member's equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated April 9, 2018.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the consolidated 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 consolidated 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.

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.

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 consolidated financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses (*2017-001*).

*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.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Company'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 consolidated 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*.

**The Company's Response to Findings**

The Company's response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The Company's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on it.

**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

April 9, 2018

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Costa Mesa, CA 92626

## Independent Auditor's Report on Compliance for Each Major Federal Program; Report on Internal Control Over Compliance Required by the Uniform Guidance

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

**Report on Compliance for Each Major Federal Program**

We have audited Prospect CharterCARE RWMC, LLC's (the "Company") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Company's major federal programs for the year ended September 30, 2017. The Company's major federal programs are 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 the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

***Auditor's Responsibility***

Our responsibility is to express an opinion on compliance for each of the Company's major federal programs based on our audits of the types of compliance requirements referred to above. We conducted our audits 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 Company'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 each major federal program. However, our audit does not provide a legal determination of the Company's compliance.

***Opinion on Each Major Federal Program***

In our opinion, the Company complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2017.

**Report on Internal Control Over Compliance**

Management of the Company 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 Company's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 Company's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or 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.

BDO USA, LLP

April 9, 2018

# Schedule of Findings and Questioned Costs

# Prospect CharterCARE RWMC, LLC

## Schedule of Findings and Questioned Costs
## For the Year Ended September 30, 2017

### Section I – Summary of Auditor's Results

***Financial Statements***

| | | | | |
|---|---|---|---|---|
| Type of auditor's report issued: | Unmodified | | | |
| Internal control over financial reporting: | | | | |
| Material weakness(es) identified? | X | yes | | no |
| Significant deficiency(ies) identified | | yes | X | none reported |
| Noncompliance material to financial statements noted? | | yes | X | no |

***Federal Awards Section***

| | | | | |
|---|---|---|---|---|
| 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 programs: | Unmodified | | | |
| Any audit findings disclosed that are required to be reported in accordance with OMB Circular A-133, section .510(a)? | | yes | X | no |

Identification of major programs:

| *CFDA Number/Contract Number* | *Name of Federal Program or Cluster* |
|---|---|
| Various | Research and Development Cluster |

| | | | | |
|---|---|---|---|---|
| Dollar threshold used to distinguish between Type A and Type B programs: | | | $750,000 | |
| Auditee qualified as low-risk auditee? | | yes | X | no |

(Continued)

## Section II - Financial Statement Findings

**Finding 2017-001**

*Condition*

The Company has a material weakness in internal controls over financial reporting. There were certain, material additional post-closing adjustments identified as a result of our audit procedures, which were not identified by the Company's internal control over the financial statement close process.

*Cause*

The internal control over financial reporting were not effective in identifying certain required adjustments to the financial statements.

*Effect*

As a result of this material weakness, the financial reporting process audit adjustments were made to the Company's financial statements in order to be presented in accordance with accounting principles accepted in the United States of America.

*Recommendation*

The Company should review its policies and procedures over the financial close and reporting process as well as the adequacy of its internal resources.

*Views of Responsible Officials*

Management agrees with the findings above and has already taken actions to strengthen the internal controls which include the hiring of a Chief Accounting Officer at PMH who will oversee the Company's financial statement close process.

## Section III - Federal Award Findings and Questioned Costs

There were no findings and questioned costs for federal awards (as defined in 2 CFR 200.516(a)) that were required to be reported.

# TAB 28B

# Prospect CharterCARE SJHSRI, LLC

## Financial Statements
As of and for the Years Ended
September 30, 2017 and 2016

The report accompanying these financial statements was issued by
BDO USA, LLP, a Delaware limited liability partnership and the U.S.
member of BDO International Limited, a UK company limited by guarantee.

# Prospect CharterCARE SJHSRI, LLC

## Financial Statements

As of and for the Years Ended September 30, 2017 and 2016

## Contents

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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, 2017 and 2016, 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, 2017 and 2016, and the results its operations and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

*Emphasis of 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 March 27, 2018 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 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 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

March 27, 2018

# Prospect CharterCARE SJHSRI, LLC

## Balance Sheets
## (in thousands)

| *September 30,* | | **2017** | | 2016 |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current assets** | | | | |
| Cash and cash equivalents | **$** | **-** | $ | - |
| Restricted cash | | **659** | | 462 |
| Patient accounts receivable, less allowance for doubtful accounts of $3,633 and $3,811 | | **17,399** | | 16,321 |
| Other receivables | | **969** | | 821 |
| Due from government payers | | **439** | | 350 |
| Inventories | | **1,751** | | 1,971 |
| Prepaid expenses and other current assets | | **922** | | 1,073 |
| **Total current assets** | | **22,139** | | 20,998 |
| Property, improvements and equipment, net | | **23,152** | | 24,763 |
| Intangible assets, net | | **1,235** | | 1,953 |
| Other assets | | **576** | | 583 |
| **Total assets** | **$** | **47,102** | $ | 48,297 |

*See accompanying notes to financial statements.*

# Prospect CharterCARE SJHSRI, LLC

## Balance Sheets
## (in thousands)

| *September 30,* | | **2017** | | 2016 |
|---|---|---|---|---|
| **Liabilities and Member's Equity** | | | | |
| **Current liabilities** | | | | |
| Accrued medical claims and other healthcare costs payable | **$** | **673** | $ | 653 |
| Accounts payable and other accrued liabilities | | **9,299** | | 8,847 |
| Accrued salaries, wages and benefits | | **4,483** | | 4,276 |
| Deferred revenue | | **971** | | - |
| Due to government payers | | **36** | | 6 |
| Due to affiliated companies, net | | **744** | | 4,484 |
| Current portion of capital leases | | **750** | | 718 |
| **Total current liabilities** | | **16,956** | | 18,984 |
| Capital leases, net of current portion | | **408** | | 969 |
| Deferred revenue, net of current portion | | **1,701** | | - |
| Asset retirement obligations | | **1,945** | | 4,188 |
| Other long-term liabilities | | **4,983** | | 2,115 |
| **Total liabilities** | | **25,993** | | 26,256 |
| **Commitments, contingencies, and subsequent event** | | | | |
| **Member's equity:** | | | | |
| Member's contributions | | **28,535** | | 28,535 |
| Accumulated deficit | | **(7,426)** | | (6,494) |
| Total member's equity | | **21,109** | | 22,041 |
| **Total liabilities and member's equity** | **$** | **47,102** | $ | 48,297 |

*See accompanying notes to financial statements.*

# Prospect CharterCARE SJHSRI, LLC

## Statements of Operations
## (in thousands)

| *For the Years Ended September 30,* | 2017 | 2016 |
|---|---|---|
| **Revenues:** | | |
| Net patient service revenues | $ 144,498 | $ 144,754 |
| Provision for bad debts | (5,819) | (6,913) |
| Net patient service revenues less provision for bad debts | 138,679 | 137,841 |
| Other revenues | 2,159 | 1,679 |
| Tuition revenues | 2,002 | 1,727 |
| Total net revenues | 142,840 | 141,247 |
| **Operating Expenses:** | | |
| Salaries, wages and benefits | 80,979 | 82,417 |
| Supplies | 19,948 | 20,707 |
| Taxes and licenses | 9,355 | 9,544 |
| Purchased services | 7,476 | 7,260 |
| Depreciation and amortization | 7,248 | 6,784 |
| Professional fees | 4,075 | 4,849 |
| Other | 3,957 | 4,369 |
| Management fees | 2,981 | 2,915 |
| Utilities | 1,862 | 2,227 |
| Lease and rental | 1,577 | 1,957 |
| Insurance | 2,142 | 3,287 |
| Repairs and maintenance | 1,247 | 783 |
| Registry | 89 | 222 |
| Total operating expenses | 142,936 | 147,321 |
| Operating income from unconsolidated equity method investments | 61 | 64 |
| **Operating income (loss)** | (35) | (6,010) |
| Other (income) expense: | | |
| Interest expense | 995 | 55 |
| Other (income) expense | (98) | - |
| Total other expense | 897 | 55 |
| **Net loss** | $ (932) | $ (6,065) |

*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, 2015 | $ 28,535 | $ (429) | $ 28,106 |
| Net loss | - | (6,065) | (6,065) |
| **Balance** at September 30, 2016 | 28,535 | (6,494) | 22,041 |
| Net loss | - | (932) | (932) |
| **Balance** at September 30, 2017 | $ 28,535 | $ (7,426) | $ 21,109 |

*See accompanying notes to financial statements.*

# Prospect CharterCARE SJHSRI, LLC

## Statements of Cash Flows
## (in thousands)

| *For the Years Ended September 30,* | | **2017** | | 2016 |
|---|---|---|---|---|
| **Operating activities** | | | | |
| Net loss | $ | **(932)** | $ | (6,065) |
| Adjustments to reconcile net loss to net cash and cash equivalents provided by operating activities: | | | | |
| Depreciation and amortization | | **7,248** | | 6,784 |
| Provision for bad debts | | **5,819** | | 6,913 |
| Accretion of interest for asset retirement obligations | | **149** | | 305 |
| Gain on sale of property, improvements and equipment | | **(167)** | | - |
| Changes in operating assets and liabilities | | | | |
| Change in restricted cash | | **(197)** | | (154) |
| Patient accounts receivable and other receivables | | **(7,045)** | | (6,461) |
| Due to/from government payers, net | | **(58)** | | 55 |
| Inventories | | **220** | | (118) |
| Prepaid expenses and other current assets | | **151** | | (570) |
| Other assets | | **7** | | 62 |
| Accrued medical claims and other healthcare costs | | **20** | | (186) |
| Accounts payable and other accrued liabilities | | **1,159** | | 1,477 |
| Deferred revenue | | **2,672** | | - |
| **Net cash and cash equivalents provided by operating activities** | | **9,046** | | 2,042 |
| **Investing activities** | | | | |
| Purchases of property, improvements and equipment | | **(4,862)** | | (3,148) |
| Proceeds from sale of property, improvements and equipment | | **483** | | - |
| **Net cash and cash equivalents used in investing activities** | | **(4,379)** | | (3,148) |
| **Financing activities** | | | | |
| Change in due to affiliated companies, net | | **(3,740)** | | 1,527 |
| Repayments of capital leases | | **(927)** | | (432) |
| **Net cash and cash equivalents (used in) provided by financing activities** | | **(4,667)** | | 1,095 |
| Change in cash and cash equivalents | | **-** | | (11) |
| Cash and cash equivalents, beginning of year | | **-** | | 11 |
| Cash and cash equivalents, end of year | $ | **-** | $ | - |
| **Supplemental disclosure of cash flow information** | | | | |
| Interest paid | $ | **756** | $ | 55 |
| **Schedule of non-cash investing activities** | | | | |
| Transfer of ARO to long-term liabilities | $ | **2,391** | $ | - |
| Equipment acquired under capital lease | $ | **408** | $ | 1,885 |

*See accompanying 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”) 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 operates the St. Joseph School of Nursing and an integrated network of primary care and specialty clinics serving an economically challenged and ethnically diverse population in Providence, Rhode Island.

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, 2017, the Company had a net liability of $744,000 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.

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):

| *For the Years Ended September 30,* | **2017** | 2016 |
|---|---|---|
| Medicare | **$ 63,629** | $ 61,762 |
| Medicaid | **31,842** | 36,447 |
| Managed Care | **30,132** | 33,124 |
| Self-Pay/Other | **18,895** | 13,421 |
| Total | **$ 144,498** | $ 144,754 |

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. The latest updated Supplemental Security Income ("SSI") ratios for 2014, which are used in determining disproportionate share payments, were issued on July 19, 2016. To date, the Company has not received any final NPRs since inception on June 20, 2014.

*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 $10,819,000 and $9,476,000 for the years ended September 30, 2017 and 2016, respectively. DSH and UPL payments received were $9,935,000 and $9,476,000 for the years ended September 30, 2017 and 2016, 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 expenses of $7,284,000 and $7,527,000, 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 $286,000 and $682,000 for the years ended September 30, 2017 and 2016, 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, 2017 or 2016.

*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 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 17% and 19% of gross accounts receivable as of September 30, 2017 and 2016, respectively. The decrease was due to a self-pay discount which took effect during the year ended September 30, 2017, resulting in a decrease in the bad debt allowance required as of September 30, 2017.

***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 Revenues*

Other revenues totaled $2,159,000 and $1,679,000 for the years ended September 30, 2017 and 2016, respectively. A summary of the primary components of other revenues is as follows:

Rental Revenue: Rental revenue from operating leases is recorded based on the fixed, minimum required rents (base rents) per the lease agreements. Rental revenue from base rent is recorded on the straight-line method over the terms of the related lease agreements. The Company recorded rental revenues of $380,000 and $441,000 for the years ended September 30, 2017 and 2016, respectively.

*Tuition Revenues*

Tuition revenues include student fees and outside course reimbursement and are recognized ratably during the approximately 7 months of instruction provided per year. The Company recorded tuition revenues of $2,002,000 and $1,727,000 for the years ended September 30, 2017 and 2016, respectively. Amounts receivable related to tuition revenues were $268,000 and $462,000 as of September 30, 2017 and 2016, respectively, which is included within other receivables in the accompanying balance sheets. The tuition receivable is net of an allowance for uncollectible tuition of $226,000 and $199,000 as of September 30, 2017 and 2016, respectively. The receivable for tuition is included in other receivables in the accompanying balance sheets.

***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 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, 2017 and 2016.

***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. The Company was included in Prospect's consolidated medical malpractice insurance policy effective June 20, 2014 (inception). Assets and liabilities related to malpractice insurance related to events prior to June 20, 2014 (inception) were not assumed by the Company.

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 $2,535,000 and $2,096,000 as of September 30, 2017 and 2016, respectively, and insurance receivables were $522,000 and $409,000 as of September 30, 2017, and 2016, respectively. The gross claims liability and insurance receivables were estimated using a discount factor of 4% and are included within long-term assets and long-term liabilities, 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, 2017 and 2016. Assets and liabilities related to workers' compensation insurance related to events prior to June 20, 2014 (inception) were not assumed by the Company.

*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 consolidated 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 $673,000 and $653,000 for incurred but not reported claims as of September 30, 2017 and 2016, respectively.

***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 $1,945,000 and $4,188,000 related to asbestos remediation as of September 30, 2017 and 2016, respectively. The Company recorded $149,000 of accretion of the asset retirement obligation during the year ended September 30, 2017. The remainder of the change is a reclassification to other long term liabilities as part of a sale-leaseback transaction (see Note 5).

***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 $659,000 and $462,000 as of September 30, 2017 and 2016, 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 market. Inventories consist primarily of medical and surgical supplies and pharmaceuticals.

***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, 2017, 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, 2017 | % of Net Patient Services Revenues | For the Year Ended September 30, 2016 | % of Net Patient Services Revenues |
|---|---|---|---|---|
| Medicare | $ 63,629 | 44% | $ 61,762 | 43 % |
| Medicaid | 31,842 | 22% | 36,447 | 25 % |
| Total | $ 95,471 | 66% | $ 98,209 | 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 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 ASU 2014-09, “Revenue from Contracts with Customers (Topic 606)” which defers the effective date of the revenue standard 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, including interim periods therein. 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 (e.g. October 1, 2019) 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. Early adoption is permitted for fiscal years beginning after December 15, 2016. The Company is currently evaluating the effect of this guidance on its financial statements.

In August 2014, the FASB issued ASU 2014-15, "Presentation of Financial Statements – Going Concern: Disclosures of Uncertainties about an Entity's Ability to Continue as a Going Concern (Subtopic 205-40)" This ASU provides guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Specifically, this ASU provides a definition of the term substantial doubt and requires an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). It also requires certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans and requires an express statement and other disclosures when substantial doubt is not alleviated. The new standard will be effective for reporting periods beginning after December 15, 2016, with early adoption permitted. The Company has early adopted this guidance and such adoption did not have a material impact 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 is effective for nonpublic entities for fiscal years beginning after December 15, 2019. Early application of the amendment is permitted. 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.

In November 2016, the FASB issued ASU 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash." The updated standard requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. As a result, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted. The amendments should be applied using a retrospective transition method to each period presented. The Company is evaluating the impact of the adoption of ASU 2016-18 on its financial statements.

***Reclassifications***

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

## 3. Property, Improvements and Equipment

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

| September 30, | 2017 | 2016 |
|---|---|---|
| Property, improvements and equipment: | | |
| Land and land improvements | $ 4,692 | $ 4,931 |
| Buildings and improvements | 16,956 | 14,349 |
| Leasehold improvements | 3,292 | 3,280 |
| Equipment | 14,817 | 12,239 |
| | 39,757 | 34,799 |
| Less: accumulated depreciation | (17,709) | (11,665) |
| | 22,048 | 23,134 |
| Construction in Progress | 1,104 | 1,629 |
| Property, improvements and equipment, net | $ 23,152 | $ 24,763 |

As of September 30, 2017 and 2016, the Company had assets under capitalized leases of $2,410,000 and $2,217,000, respectively, and related accumulated depreciation of $884,000 and $359,000, respectively.

Depreciation expense was $6,530,000 and $6,066,000 for the years ended September 30, 2017 and 2016, respectively.

## 4. Intangible Assets

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

| | Amortization Period | September 30, 2017 | September 30, 2016 |
|---|---|---|---|
| Trade names | 5 years | $ 3,590 | $ 3,590 |
| Total acquisition cost of intangible assets | | 3,590 | 3,590 |
| Less accumulated amortization | | (2,355) | (1,637) |
| Intangible assets, net | | $ 1,235 | $ 1,953 |

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 $718,000 and $715,000 for the years ended September 30, 2017 and 2016, respectively.

Estimated amortization expense for each future fiscal year is as follows (in thousands):

| *Years ended September 30,* | | |
|---|---|---|
| 2018 | $ | 718 |
| 2019 | | 517 |
| Total | $ | 1,235 |

The weighted-average remaining useful life for the intangible assets was approximately 2 years as of September 30, 2017.

## 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 was $2,419,000 at September 30, 2017, 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.

## 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 $2,981,000 and $2,915,000 for the years ended September 30, 2017 and 2016, respectively, which is included within management fee expense in the accompanying statements of operations. As of September 30, 2017 and 2016, $9,599,000 and $6,617,000, respectively, due pursuant to the MSA, is included in due to affiliates, 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 2022. Capital leases bear interest at rates ranging from 4% to 8% per annum.

The future minimum annual lease payments (net of anticipated sublease income) required under leases in effect at September 30, 2017, are as follows (in thousands):

| *For the Years ending September 30,* | Capital Leases | Operating Leases |
|---|---|---|
| 2018 | $ 843 | $ 362 |
| 2019 | 384 | 286 |
| 2020 | 38 | 286 |
| 2021 | - | 286 |
| 2022 | - | 271 |
| Total minimum lease payments | 1,265 | $ 1,491 |
| Less: amounts representing interest | (62) | |
| | 1,203 | |
| Less: current portion | (750) | |
| | $ 453 | |

Lease and rental expense was $1,577,000 and $1,957,000 for the years ended September 30, 2017 and 2016, respectively.

***Contingent Liability for Borrowings by Prospect***

The Company is contingently liable as a guarantor among others for amounts borrowed by Prospect on senior secured borrowings and credit facilities at September 30, 2017 and 2016. The obligations and related interest expense related to these credit facilities are not reflected in the Company's financial statements as of September 30, 2017 and 2016, as the borrowings are reflected in the separate consolidated financial statements of Prospect.

Total borrowings outstanding as of September 30, 2017 and 2016, reflected in the consolidated financial statements of Prospect, but for which the Company is contingently liable as a guarantor, were (in thousands):

| *September 30,* | **2017** | 2016 |
|---|---|---|
| Senior secured term loan (net of discount of $7,374 and $8,984) | **$ 609,813** | $ 623,438 |
| Less: original issue discount, net | **(9,906)** | (8,984) |
| | **$ 599,907** | $ 614,454 |

On June 30, 2016, Prospect entered into a six-year $625 million senior secured term loan B (the "Term Loan"), the proceeds of which were used to repay $425 million for Holdings' existing 8.375% senior secured notes due during 2019; to repay $60 million for borrowings under Holdings' existing revolving credit facility (the "Replaced Revolver"); to fund acquisitions; and to finance transaction fees and expenses. The Term Loan bears interest at LIBOR (subject to a 1.0% floor) plus 6.0%, and the effective interest rate was 7.00% as of September 30, 2017. The Term Loan was issued with an original discount of 1.5%, or $9,375,000.

Additionally, Prospect refinanced the Replaced Revolver with a new $100 million asset-based revolving credit facility ("ABL Facility" and together with the Term Loan, the "New Senior Secured Credit Facilities"). The ABL facility was amended in August 2016 to $115 million, August 2017 to $155 million and October 2017 to $175 million. The ABL Facility bears interest at a variable base rate plus an applicable spread, contingent on Prospect's ABL Facility availability, as defined in the ABL Facility credit agreement. The ABL Facility effective interest rate was 3.25% as of September 30, 2017. The ABL Facility balance as of September 30, 2017 was $115,300,000. As of September 30, 2017, Prospect had unused letters of credit of $9,800,000, which offset Prospect's ability to borrow additional funds, and the ABL Facility had unused lender commitments of $29,900,000 as of September 30, 2017. The maturity date for the ABL facility is June 30, 2021, and the maturity date for the Term Loan is June 30, 2022. As of September 30, 2017, Prospect was in compliance with the financial covenants of the New Senior Secured Credit Facilities. Subsequent to year end, Prospect refinanced the Term Loan and amended the ABL Facility, see Note 9.

### *Letter of Credit*

As of September 30, 2017, Prospect secured an irrevocable letter of credit for $584,000 on behalf of the Company for its School of Nursing ("School") as required by the U.S. Department of Education. The purpose of the letter of credit is to (i) pay refunds of charges owed on behalf of current or former students, whether or not the School remains open; (ii) to provide for the "teach-out" of currently enrolled students if the School closes; and (iii) to pay any liabilities owed to the U.S. Department of Education.

### *Other Commitments*

The Company has additional commitments for reagents that are based on tests performed. They are non-cancelable agreements but the future dollar commitments are not quantifiable as they are volume-driven.

### *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 consolidated 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, California has also developed strict standards for the privacy and security of health information as well as for reporting certain violations and breaches. The Company may be subject to significant fines and penalties if found not to be compliant with these state or federal provisions.

*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, 32 states have expanded their Medicaid programs to cover previously uninsured childless adults. 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 an their parents' health insurance until age 26 or prohibiting certain plans from denying coverage based on pre-existing conditions. Nationally, these reforms have reduced number of uninsured.

In light of the transition to a new presidential administration, it is unclear what changes may be made to PPACA. The Tax Cuts and Jobs Act ("TCJA"), passed in December 2017, eliminates the individual mandate under PPACA, effective January 1, 2019. The individual mandate 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 will impact the uninsured rate and 2019 premiums is unclear at this juncture. Future changes to PPACA and in 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 for risks and uncertainties.

### *Collective Bargaining Agreements*

The Company has 422 employees that are subject to a collective bargaining agreement with United Nurses and Allied Professionals ("UNAP"), which was effective beginning September 2016 and expires July 2019. During April 2015, a hospital unit consisting of approximately 400 service employees of Fatima elected to be represented by UNAP. The parties entered into a new collective bargaining agreement which expires October 2018. A small number of employees are subject to a collective bargaining agreement with the Federation of Nurses and Health Professionals ("FNHP"), which expires on April 30, 2018.

### *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 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

PCC sponsors a defined contribution plan (the "Plan") covering substantially all employees of the Company who meet certain eligibility requirements. Under the Plan, employees can contribute up to 100% of their compensation up to the IRS deferred annual maximum. The Company may make discretionary matching contributions to the Plan. The Company's contributions to the Plan were $1,101,000 and $1,894,000 for the years ended September 30, 2017 and 2016, 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, 2017, and for the year then ended, the Company's composite score was 1.6.

***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.

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, 2017 and 2016, the Company's 90/10 cash basis revenue test percentages were computed as follows:

| *(in thousands)* | **2017** | 2016 |
|---|---|---|
| **Revenue by Source** | | |
| Student Title IV cash basis revenue | | |
| Subsidized loan | **$ 474** | $ 340 |
| Unsubsidized loan | **696** | 509 |
| Plus loan | **50** | 34 |
| Federal Pell grant | **245** | 273 |
| | **$ 1,465** | $ 1,156 |
| Student Non-Title IV revenue | | |
| Funds provided from private loans | **$ 182** | $ 91 |
| State loans | **193** | 76 |
| Scholarships | **47** | 27 |
| Student payments | **400** | 422 |
| | **$ 822** | $ 616 |
| Student Title IV cash basis revenue | **$ 1,465** | $ 1,156 |
| Student title IV cash basis revenue + Student Non-Title IV cash basis revenue | **$ 2,287** | $ 1,772 |
| | **64%** | 65% |

***Student Default Rate***

For each fiscal year, the ED calculates a rate of student defaults for each educational institution which is known as a "cohort default rate." An institution may lose its eligibility to participate in some or all Title IV programs if, for each of the three most recent federal fiscal years for which information is available, 30% or more of its students who became subject to a repayment obligation in that federal fiscal year defaulted on such obligation by the end of the following federal fiscal year. In addition, an institution may lose its eligibility to participate in some or all Title IV programs if its cohort default rate exceeds 40% in the most recent federal fiscal year for which default rates have been calculated by the ED. The Company's 3-Year cohort default rate for the 2017 federal fiscal year was 0.0%. Federal fiscal year 2017 is the most recent year for which this information is available.

## 10. Subsequent Event

The Company has evaluated subsequent events through March 27, 2018, the date the Company's financial statements were available for issuance.

On February 22, 2018, Prospect entered into an Amended and Restated Term Loan Credit Agreement. Under this agreement, the Term Loan is replaced by a new Term B-1 Loan and Additional Term B-1 Commitment ("Term B-1 Loans"). The total maximum borrowing under the Term B-1 Loans is $1,120 million and such loans bear interest at LIBOR (subject to a 1.0% floor) plus 5.5%, and were issued with an original discount of 2%, and mature on February 24, 2024. Additionally on February 22, 2018, Prospect entered into an Amended and Restated ABL Guarantee And Security Agreement. Under this agreement, the maximum borrowing is $250 million, and the facility bears interest at a variable base rate plus an applicable spread, contingent on the Prospect's ABL Facility availability, as defined in the agreement. The facility matures on February 22, 2023.

# Supplemental Report and Schedule

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## 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, 2017, 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 March 27, 2018.

### *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. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses (*2017-001*).

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*.

**The Company's Response to Findings**

The Company's response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The Company's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on it.

***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

March 27, 2018

# Prospect CharterCARE SJHSRI, LLC

## Schedule of Findings and Disposition of Prior Year Findings

## Section I – Summary of Auditor's Results

***Financial Statements***

Type of auditor's report issued: Unmodified

Internal control over financial reporting:

| | | | | |
|---|---|---|---|---|
| Material weakness(es) identified? | X | yes | | no |
| Significant deficiency(ies) identified that are not considered to be material weaknesses? | | yes | X | none reported |
| Noncompliance material to financial statements noted? | | yes | X | no |

## Section II - Financial Statement Findings

**Finding 2017-001**

*Condition*

The Company has a material weakness in internal controls over financial reporting. There were certain, material additional post-closing adjustments identified as a result of our audit procedures, which were not identified by the Company's internal control over the financial statement close process.

*Cause*

The internal control over financial reporting were not effective in identifying certain required adjustments to the financial statements.

*Effect*

As a result of this material weakness, the financial reporting process audit adjustments were made to the Company's financial statements in order to be presented in accordance with accounting principles accepted in the United States of America.

*Recommendation*

The Company should review its policies and procedures over the financial close and reporting process as well as the adequacy of its internal resources.

*Views of Responsible Officials*

Management agrees with the findings above and has already taken actions to strengthen the internal controls which include the hiring of a Chief Accounting Officer at PMH who will oversee the Company's financial statement close process.

## Disposition of Prior Year Findings

Not applicable; there were no findings in the prior year related to the financial statements which are required to be reported in accordance with generally accepted government auditing standards (GAGAS).