

FRONTIER HEALTH
CONSOLIDATED FINANCIAL REPORT
June 30, 2017

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Frontier Health
Gray, Tennessee

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Frontier Health (a nonprofit organization) and affiliate (collectively, the "Organization"), which comprise the consolidated statement of financial position as of June 30, 2017, and the related consolidated statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Frontier Health and affiliate as of June 30, 2017, and the changes in their net assets and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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 and state financial assistance, 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* and the Comptroller of the Treasury, State of Tennessee, is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. The other statements listed as other supplementary information in the table of contents are presented for purposes of additional analysis as required by local funding agencies and are also not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 18, 2017, on our consideration of the Organization's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is 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 Organization's internal control over financial reporting and compliance.

Brown, Edwards & Company, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

Kingsport, Tennessee
October 18, 2017

FRONTIER HEALTH
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
June 30, 2017

ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	\$ 2,777,451
Net patient accounts receivable, less allowance for uncollectible accounts of \$406,079 and contractual allowance of \$1,895,614	4,927,317
Grants receivable	1,972,787
Other receivables, less allowance for uncollectible accounts of \$453,813	1,057,297
Inventories	128,925
Prepaid expenses	618,801
Total current assets	<u>11,482,578</u>
ASSETS LIMITED AS TO USE	<u>4,607,325</u>
PROPERTY AND EQUIPMENT, net	<u>13,018,357</u>
INVESTMENTS	<u>21,015,998</u>
Total assets	<u><u>\$ 50,124,258</u></u>
LIABILITIES AND NET ASSETS	
CURRENT LIABILITIES	
Accounts payable and accrued expenses	\$ 1,013,473
Current maturities of long-term debt	19,426
Accrued salaries and related expenses	4,922,018
Unearned revenue	506,922
Total current liabilities	<u>6,461,839</u>
LONG-TERM DEBT, less current maturities	<u>73,256</u>
Total liabilities	6,535,095
UNRESTRICTED NET ASSETS	<u>43,589,163</u>
Total liabilities and net assets	<u><u>\$ 50,124,258</u></u>

FRONTIER HEALTH
CONSOLIDATED STATEMENT OF ACTIVITIES
Year Ended June 30, 2017

REVENUES, GAINS, AND OTHER SUPPORT

Net patient service revenue	\$ 26,584,002
Net premium revenue	1,693,533
State of Tennessee grants	14,851,474
State of Virginia grants	4,144,200
Fees – contracted services	3,627,882
Local support	1,144,126
Contributions	529,655
Other	373,962
Investment return	1,161,053
	<hr/>
Total revenues, gains, and other support	54,109,887

EXPENSES

Tennessee services:	
Mental health outpatient	17,121,951
Substance abuse outpatient	3,850,198
Intellectual disabilities	1,485,801
Drop-in centers	541,297
Residential	10,926,056
Rehabilitation	560,261
Other	1,183,293
Virginia services:	
Mental health services	6,572,525
Substance abuse services	1,589,830
Mental intellectual disabilities	4,330,586
Administrative and general	5,404,145
	<hr/>
Total expenses	53,565,943
	<hr/>
Change in unrestricted net assets	543,944

NET ASSETS, UNRESTRICTED

Beginning	43,045,219
	<hr/>
Ending	\$ 43,589,163
	<hr/>

FRONTIER HEALTH

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES Year Ended June 30, 2017

	Tennessee Mental Health Outpatient	Tennessee Substance Abuse Outpatient	Tennessee Intellectual Disabilities	Tennessee Drop-In Centers	Tennessee Residential	Tennessee Rehabilitation
EXPENSES						
Personnel:						
Salaries and wages	\$ 10,849,981	\$ 2,474,379	\$ 856,368	\$ 269,113	\$ 6,703,702	\$ 353,957
Employee benefits and payroll taxes	2,808,574	653,968	206,350	65,211	1,652,795	87,134
Total personnel expenses	13,658,555	3,128,347	1,062,718	334,324	8,356,497	441,091
Other:						
Professional fees	961,244	39,513	22,616	3,187	329,008	11,219
Supplies	271,447	93,899	46,755	37,398	1,128,356	15,143
Telephone	259,655	62,068	40,460	23,977	138,825	9,674
Postage and shipping	20,019	4,160	945	614	5,537	218
Occupancy	551,031	96,347	122,916	36,955	410,273	22,115
Equipment rental and maintenance	44,944	8,319	10,022	1,440	37,453	3,112
Printing and publications	104,639	25,556	3,567	5,510	25,716	3,459
Travel	338,562	94,976	61,544	36,043	116,393	15,136
Conferences and meetings	49,269	18,733	1,809	6,565	8,209	5,351
Interest	-	-	-	-	8,383	-
Insurance	157,271	20,892	6,680	2,931	38,153	1,772
Specific assistance to individuals	142,195	185,074	-	-	13,761	487
Depreciation	361,101	69,617	105,499	52,240	280,959	28,843
Dues	12,665	806	270	113	4,403	508
Bad debts	189,354	1,891	-	-	24,130	2,133
Total nonpersonnel expenses	3,463,396	721,851	423,083	206,973	2,569,559	119,170
TOTAL DIRECT PROGRAM EXPENSE	17,121,951	3,850,198	1,485,801	541,297	10,926,056	560,261
Administrative expenses	1,942,733	468,476	158,417	64,959	1,184,348	65,679
TOTAL DIRECT AND ADMINISTRATIVE EXPENSES	<u>\$ 19,064,684</u>	<u>\$ 4,318,674</u>	<u>\$ 1,644,218</u>	<u>\$ 606,256</u>	<u>\$ 12,110,404</u>	<u>\$ 625,940</u>

The Notes to Consolidated Financial Statements are an integral part of this statement.

Tennessee Other	Virginia Mental Health Services	Virginia Substance Abuse Services	Virginia Mental Intellectual Disabilities	Administrative and General	Total
\$ 389,092	\$ 3,774,469	\$ 753,331	\$ 2,377,553	\$ 2,423,541	\$ 31,225,486
100,469	983,387	200,994	598,984	642,930	8,000,796
489,561	4,757,856	954,325	2,976,537	3,066,471	39,226,282
197,098	561,651	226,270	107,784	871,777	3,331,367
309,165	191,023	166,020	232,016	178,991	2,670,213
9,691	126,252	29,070	60,752	87,813	848,237
3,166	5,292	1,340	2,479	29,560	73,330
122,197	304,914	62,585	136,169	191,084	2,056,586
6,363	24,327	5,699	9,718	2,759	154,156
2,594	25,775	7,445	11,853	44,832	260,946
10,395	83,872	32,783	113,381	56,306	959,391
16,498	38,391	27,901	13,796	29,425	215,947
-	-	-	-	-	8,383
484	42,279	9,660	18,983	436,958	736,063
-	154,466	6,428	528,370	-	1,030,781
14,643	205,158	51,351	102,666	339,589	1,611,666
1,434	2,535	372	1,082	68,580	92,768
4	48,734	8,581	15,000	-	289,827
693,732	1,814,669	635,505	1,354,049	2,337,674	14,339,661
1,183,293	6,572,525	1,589,830	4,330,586	5,404,145	53,565,943
58,761	762,825	180,712	517,235	(5,404,145)	-
\$ 1,242,054	\$ 7,335,350	\$ 1,770,542	\$ 4,847,821	\$ -	\$ 53,565,943

FRONTIER HEALTH
CONSOLIDATED STATEMENT OF CASH FLOWS
Year Ended June 30, 2017

CASH FLOWS FROM OPERATING ACTIVITIES

Change in net assets	\$ 543,944
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation and amortization	1,611,666
Loss on disposal of property and equipment	13,083
Net realized loss on sale of investments	26,463
Net unrealized gain on investments	(530,096)
Changes in operating assets and liabilities:	
Patient accounts receivable	(617,841)
Grants receivable	(266,326)
Other receivables	(128,094)
Inventories	(132)
Prepaid expenses	18,620
Deposits	2,129
Assets limited as to use	12,638
Accounts payable and accrued expenses	187,830
Accrued salaries and related expenses	(793,458)
Unearned revenue	161,197
	<hr/>
Net cash provided by operating activities	241,623 <hr/>

CASH FLOWS FROM INVESTING ACTIVITIES

Purchases of property and equipment	(969,787)
Proceeds from maturities, calls, and sales of investments	6,118,627
Purchases of investments	(6,326,111)
	<hr/>
Net cash used in investing activities	(1,177,271) <hr/>

CASH FLOWS FROM FINANCING ACTIVITIES

Principal payments on long-term debt	(17,884)
	<hr/>
Net decrease in cash and cash equivalents	(953,532)

CASH AND CASH EQUIVALENTS

Beginning	3,730,983
	<hr/>
Ending	\$ 2,777,451 <hr/>

**SUPPLEMENTAL DISCLOSURES OF
CASH FLOW INFORMATION**

Cash payments for interest	\$ 8,507
	<hr/>
In-kind facility rental donations	\$ 82,600 <hr/>

FRONTIER HEALTH
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017

Note 1. Nature of Activities and Summary of Significant Accounting Policies

Nature of activities:

Frontier Health (“Frontier”) is a private not-for-profit organization with over 60 facilities across its region. Headquartered in Washington County, Tennessee, Frontier offers an array of services in the areas of mental health, family violence, mental retardation, vocational rehabilitation, developmental disabilities, and substance abuse. Frontier’s primary service area includes eight counties in Northeast Tennessee – Hancock, Hawkins, Greene, Washington, Unicoi, Carter, Johnson and Sullivan counties and four counties in Southwest Virginia – Lee, Wise, Scott, and Washington counties and the City of Norton, Virginia. Frontier employs more than a thousand individuals from these service areas to provide the wide array of services offered.

Frontier Health Foundation solicits, receives, holds, administers, invests, and disburses funds to be used for and on behalf of Frontier’s programs.

Principles of consolidation:

The consolidated financial statements include the accounts of Frontier Health and the Frontier Health Foundation (collectively, the “Organization”). All significant inter-entity transactions and balances have been eliminated in the consolidation.

Basis of accounting and financial reporting:

The consolidated financial statements of the Organization have been prepared in accordance with the accounting principles generally accepted in the United States of America. The consolidated financial statements present information regarding the Organization’s financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted. The three classes are differentiated by donor restrictions.

Unrestricted net assets – net assets not subject to donor-imposed stipulations.

Temporarily restricted net assets – net assets subject to donor-imposed stipulations that may be met by actions of the Organization or the passage of time.

Permanently restricted net assets – net assets subject to donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by the actions of the Organization.

The Organization currently has no temporarily or permanently restricted net assets.

Cash and cash equivalents:

The Organization considers highly liquid investments with a maturity of three months or less to be cash equivalents. Accounts in financial institutions are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. At times, cash balances may exceed these limits; however, the Organization does not believe it is subject to any significant credit risk as a result of these deposits.

FRONTIER HEALTH
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017

Note 1. Nature of Activities and Summary of Significant Accounting Policies (Continued)

Net patient service revenue and accounts receivable:

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payers, and others for services rendered and includes estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known.

Accounts receivable are recorded at the net expected reimbursement or are otherwise reduced to a net expected reimbursement through the allowances for contractual adjustments and uncollectible accounts. The estimated allowances are comprised of amounts management normally considers uncollectible based upon historical trends and an analysis of the likelihood of collectability of individual accounts.

Inventories:

Inventories consist primarily of psychiatric testing supplies, marketing merchandise, raw materials for the vocational rehabilitation training program, and donated household items for resale at the thrift store. Inventories are stated at the lower of cost or market determined by the first-in, first-out method. Household items donated to the organization's thrift store are recorded at their estimated fair value.

Assets limited as to use:

Assets limited as to use include funds set aside by the Board of Directors for specific purposes, over which the Board retains control and may at its discretion subsequently use for other purposes. Other assets limited as to use include certain restricted deposit accounts, which are required by a regulatory agreement with VHDA to be held in a separate bank account.

Property and equipment:

Property and equipment are carried at cost if purchased or at fair market value if donated. Expenditures for improvements and betterments which substantially increase the useful lives of existing property and equipment are capitalized; maintenance, repairs, and minor renewals are expensed. Land, buildings, improvements, construction, and equipment that have a useful life of two years or more are capitalized, including those acquired through capital leases. Furniture and equipment with a unit cost of \$1,000 or more are capitalized. Leasehold improvements (including painting) with a cost exceeding \$2,500 are capitalized. The Organization provides for depreciation using the straight-line method over the estimated useful lives of the related assets. Interest expense incurred on debt related to capital improvements is capitalized as part of the actual construction costs.

FRONTIER HEALTH
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017

Note 1. Nature of Activities and Summary of Significant Accounting Policies (Continued)

Donated property and equipment:

Donations of property and equipment are recorded as contributions at their estimated fair value at the date of donation. Such donations are reported as increases in unrestricted net assets unless the donor has restricted the donated asset to a specific purpose. Assets donated with explicit restrictions regarding their use and contributions of cash that must be used to acquire property and equipment are reported as restricted contributions. Absent donor stipulations regarding how long those donated assets must be maintained, the Organization reports expirations of donor restrictions when the donated or acquired assets are placed in service. The Organization reclassifies temporarily restricted net assets to unrestricted net assets at that time.

Investments:

Investments in marketable securities with readily determinable fair values and all investments in debt securities are carried at their fair values. Investments in fixed annuities are carried at initial cost of the investment plus accumulated earnings, as reported by the issuer of the contract. Other investments without readily determinable fair values are included at cost in the statement of financial position.

Paid time off:

Employees of the Organization are entitled to paid time off, a program of integrating paid vacation, holidays, and sick leave, depending on length of service. The estimated amount of compensation for future absences has been recorded as a liability in the accompanying consolidated financial statements.

Grants:

For grant awards that are on a cost reimbursement basis, revenue is recognized to the extent cost has been incurred. Any excess of expenditures over revenues is reflected as grant funds receivable to the maximum reimbursable amount allowed and any excess of revenues over expenditures is reflected as unearned revenue.

In-kind support:

The Organization records various types of in-kind support including contributed facilities, equipment, and food. Contributed professional services are recognized if the services received either create or enhance property and equipment assets or are services provided by individuals possessing specialized skills that would need to be purchased if not provided by donation. Contributions of tangible assets are recognized at fair market value when received.

Additionally, a large number of people have contributed significant amounts of time to the activities of the Organization. The financial statements do not reflect the value of these contributed services because they do not meet the two recognition criteria described above.

FRONTIER HEALTH
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017

Note 1. Nature of Activities and Summary of Significant Accounting Policies (Continued)

Premium revenue:

The Organization has agreements with various companies as well as behavioral health organizations to provide mental health services to subscribing participants. Under these arrangements, the Organization receives monthly capitation payments based on the number of plan participants, regardless of services performed. Premium revenue is recognized in the month that coverage for services is provided.

Charity care:

The Organization accepts all patients regardless of their ability to pay. The Organization's established policies define charity services as those services provided to patients who are unable to pay and for which no payment is expected. In assessing a patient's inability to pay, the Organization utilizes generally recognized poverty income levels. Charges at established rates related to charity are not included in net patient service revenue.

Expense allocation:

The costs of providing various programs and activities have been summarized on a functional basis in the statement of activities and in the statement of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Income taxes:

Both Frontier and the Foundation are exempt from income tax under Internal Revenue Code Section 501(c)(3) and, accordingly, no provision for income taxes has been included in the accompanying financial statements.

Estimates:

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from those estimates.

Subsequent events:

The Organization has evaluated subsequent events through October 18, 2017, the date which the financial statements were available to be issued.

FRONTIER HEALTH

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

Note 2. Net Patient Accounts Receivable

Net patient accounts receivable is reported at the estimated net realizable amount from patients, third-party payers, and others for services rendered. A summary of the accounts receivable is as follows:

TennCare	\$ 2,739,735
Medicaid	1,040,715
Medicare	451,996
Private pay, commercial insurance and other	2,996,564
Allowance for uncollectible accounts	(406,079)
Contractual allowance	(1,895,614)
	<u>\$ 4,927,317</u>

Note 3. Investments

Investments consist of the following:

Investments carried at fair value	
Municipal bonds	\$ 154,935
Fixed annuity contracts	7,091,574
Mutual funds	5,551,072
Exchange traded funds	4,162,058
U.S. Government securities	2,104,534
Certificates of deposit	6,416,261
	<u>25,480,434</u>
Other investments carried at cost	
PHP of the Tri-Cities, LLC	2,000
Highlands Physicians	3,500
	<u>5,500</u>
Total investments	<u>\$ 25,485,934</u>

Investments are reported on the statement of financial position as follows:

Assets limited as to use – capital improvements	\$ 4,469,936
Investments	<u>21,015,998</u>
Total investments	<u>\$ 25,485,934</u>

Investment return is summarized as:

Interest and dividend income	\$ 657,420
Net realized losses on sale of securities	(26,463)
Net unrealized gains	530,096
Total investment return	<u>\$ 1,161,053</u>

(Continued)

FRONTIER HEALTH

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

Note 3. Investments (Continued)

The Organization has internally designated \$4,469,936 of the total investments for capital improvements and \$21,015,998 as long-term investments based on the Organization's investment plan, reinvestment intention and intended use of the funds. The Organization does not anticipate using the internally designated long-term investments to meet operating expenses, capital expenditures or any other obligations due in the next year.

Fixed annuity contracts:

At June 30, 2017, investments in fixed annuities consisted of an initial cost of \$6,275,510. The annuities provide for fixed rates of return, but such guarantees are dependent upon the solvency of the issuer. If the contracts are not held to maturity various charges may apply, therefore the carrying value may vary from the surrender value. The accumulated investment value and cash surrender value at June 30, 2017 was \$7,091,574 and \$6,750,974, respectively.

Note 4. Assets Limited as to Use

Assets limited as to use consist of the following:

Sunhouse M/R VHDA deposits	\$ 48,335
Self-insurance deposits	79,247
Investments designated for capital improvements	4,469,936
Other deposits	9,807
	<hr/>
	\$ 4,607,325

Note 5. Property and Equipment

Property and equipment consist of the following:

Land and improvements	\$ 3,020,381
Buildings and improvements	24,251,593
Equipment and vehicles	10,335,693
Construction in progress	245,860
	<hr/>
	37,853,527
Less accumulated depreciation	(24,835,170)
	<hr/>
	\$ 13,018,357

Note 6. Line of Credit

The Organization has a \$5,000,000 bank line of credit which matures December 31, 2017. Amounts borrowed under this agreement bear interest at the greater of one month LIBOR plus 2.50% subject to a minimum floor of 3% (3.72% at June 30, 2017). At June 30, 2017, there was no outstanding balance on this line of credit. The line is secured by certain real and personal property and the Organization's accounts receivable.

(Continued)

FRONTIER HEALTH
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017

Note 7. Long-Term Debt

Long-term debt consists of the following:

Virginia Housing Development Authority (VHDA) due in monthly installments of \$2,199 including interest at 8.3% to August 1, 2021, collateralized by land and building. Amortization payments are collected by VHDA through offsets against subsidy payments.	\$ 92,682
Less current maturities	<u>(19,426)</u>
Long-term portion	<u><u>\$ 73,256</u></u>

Future aggregate maturities required on long-term debt are as follows:

2018	\$ 19,426
2019	21,101
2020	22,921
2021	24,897
2022	<u>4,337</u>
	<u><u>\$ 92,682</u></u>

Note 8. Net Patient Service and Premium Revenues

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the statement of activities is as follows:

Outpatient service charges	\$ 53,153,434
Less:	
Third-party contractual adjustments, charity care, and other discounts	<u>(26,569,432)</u>
Net patient service revenue	<u><u>\$ 26,584,002</u></u>

The Organization renders services to patients under contractual arrangements with the Medicare, TennCare, and Medicaid programs. The Medicare program pays for costs of outpatient services according to prospectively determined rates, fee schedules and on the basis of reasonable costs, subject to certain limitations. The TennCare and Medicaid programs reimburse the Organization on the basis of prospectively determined rates and per diem amounts. Amounts earned under these contractual arrangements are subject to review and final determination by fiscal intermediaries and other appropriate governmental authorities or their agents. In the opinion of management, adequate provision has been made in the consolidated financial statements for any adjustments which may result from such reviews.

(Continued)

FRONTIER HEALTH

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

Note 8. Net Patient Service and Premium Revenues (Continued)

The Organization has also entered into agreements with certain commercial insurance companies and other organizations which provide reimbursement for services in the form of prospectively determined rates, per diems, and discounts from established charges. In addition to grant funding for specific services, the Organization participates in fee-for-service contract arrangements with the State of Tennessee for specific other services. In recent years, the State has changed the funding method for various services from grants to fee-for-service contracts administered by behavioral health organizations.

The approximate percentages of gross patient service charges in 2017 derived from arrangements with Medicare, Medicaid, and TennCare are 4%, 20%, and 36%, respectively.

The approximate percentages of net patient accounts receivable from TennCare and the State of Tennessee (all arrangements except TennCare), are 43% and 10%, respectively, at June 30, 2017.

Note 9. Employee Benefit Plans

Retirement plans:

The Organization offers both an employee-funded 403(b) plan and an employer-funded, 401(a) qualified retirement plan. Employees are eligible to make discretionary contributions to the 403(b) plan upon employment. After two years of service (1,000 hours per year) the Organization makes a discretionary contribution to the defined contribution plan based on the participant's compensation. The Organization elected to contribute four percent (4%) for the fiscal year ended June 30, 2017. In addition, the Organization contributes \$0.50 for every \$1.00 an employee contributes to the plan up to a total match of three percent (3%) of the employee's compensation.

The Organization also offers a section 457(b) plan, which is designed to benefit a select group of management and other highly compensated employees as selected by the employer. The plan permits the eligible employee to defer a portion of future compensation up to the maximum allowable by law. The Board of Directors determines the amount of the contribution on an annual basis. The Organization elected not to contribute any amount for the plan year ended December 31, 2017.

The total retirement expense for the fiscal year ended June 30, 2017 was \$1,226,616.

State unemployment insurance:

The Organization has elected to be a reimbursing employer to the Tennessee Department of Employment Security for all disbursements made on valid claims for unemployment insurance. For the fiscal year ended June 30, 2017, claims incurred were \$19,303.

FRONTIER HEALTH
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017

Note 9. Employee Benefit Plans (Continued)

Self-insured group health coverage:

The Organization is self-insured for a portion of group health coverage it provides to its employees. An employee who retires and meets certain age and consecutive years of service requirements is eligible to retain group health coverage at the same contribution level as a full-time active employee of the employer until the age of 65 or until the employee is eligible for a Medicare program or other federally funded program, whichever occurs first. The maximum exposure to the Organization under the plan is approximately \$110,000 per insured person annually. For the fiscal year ended June 30, 2017, total claims paid totaled \$3,963,484.

Although the outcome of claims against the Organization cannot be predicted with certainty, management believes that there are no existing claims that are likely to have a material adverse effect on the Organization's financial position or results of operations for which it has not already provided. Claims incurred but not reported at June 30, 2017 were estimated to be \$795,225.

Note 10. Operating Leases

The Organization leases certain buildings under noncancellable operating leases with terms of one year or more. Future minimum lease payments under these lease arrangements are as follows:

<u>Year Ending June 30, 2017</u>	
2018	\$ 68,400
2019	24,000
2020	24,000
2021	24,000
2022	8,000
	<u>\$ 148,400</u>

Rent expense under terms of the operating leases for buildings was \$245,052 for the year ended June 30, 2017.

Note 11. Contingencies

The Organization may be involved in potential lawsuits arising in the normal course of business. It is management's belief that any liability resulting from such lawsuits would not be material in relation to the Organization's financial position.

FRONTIER HEALTH

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

Note 11. Contingencies (Continued)

Grants

Under the terms of certain grant programs, periodic audits may be made, and certain costs may be questioned as not being appropriate expenses. Laws and regulations governing the grant programs and allowability of program costs are complex and subject to interpretation. Accordingly, such audits could lead to disallowances requiring reimbursements to the grantor agencies, which could be material to the Organization's financial statements. Management of the Organization believes that the Organization is in compliance with applicable laws and regulations in all material respects.

State restricted buildings:

The Organization owns three outpatient treatment centers located on Waverly Road in Kingsport, Tennessee, Charlotte Taylor Center in Elizabethton, Tennessee and Holston Drive in Greeneville, Tennessee whereby the ownership is subject to a condition imposed by the State of Tennessee (the State). The condition maintains that each location be used solely as a mental health facility. In the event of failure to do so, the real estate shall revert to the State, at the State's option. At June 30, 2017, the net carrying value of these properties was \$851,328.

The Organization owns a non-hospital facility, offering twenty-four hour intensive, short-term stabilization for medically stable Tennessee adults eighteen years of age and over whereby the ownership is subject to a condition imposed by the State of Tennessee. The condition maintains that the facility will be used solely for this purpose and for an affordability period of fifteen years from the date funds were disbursed to the grant recipient. In the event of default, the State of Tennessee can demand repayment of the grant which is \$433,302. At June 30, 2017, the net carrying value of this property was \$533,283.

The Organization owns a non-hospital facility, offering twenty-four hour intensive, long-term support services for Tennessee adults eighteen years of age who meet certain eligibility requirements and whereby the ownership is subject to a condition imposed by the State of Tennessee. The condition maintains that the facility will be used solely for the purpose and for an affordability period of fifteen years from the date funds were disbursed to the grant recipient. In the event of default, the State of Tennessee can demand repayment of the grant which is \$300,000. At June 30, 2017, the net carrying value of this property was \$525,714.

Note 12. Related Parties

The Organization serves as the management agent for seventeen HUD facilities, one of which is owned by Frontier Health, and the results of which operations are included in these consolidated financial statements. The other sixteen HUD facilities are owned by separate non-profit corporations and the results of their operations are reported separately by those corporations. Members of Frontier Health's senior management serve as board of directors on thirteen of these sixteen HUD facilities. These HUD facilities have agreed to reimburse Frontier Health for any administrative and other operational costs incurred, which have been paid on behalf of these HUD facilities by Frontier Health. As of June 30, 2017, a receivable of \$654,859 (net of an allowance for uncollectible accounts of \$453,813) is due from the sixteen separately owned HUD facilities. The allowance is based on management's judgment about the ability of these entities to pay.

(Continued)

FRONTIER HEALTH

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

Note 13. Fair Value Measurements

Authoritative guidance establishes a three-level fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. There have been no changes in the techniques and inputs used since the prior year. The three levels are described as follows:

Level 1 – quoted prices in active markets for identical securities.

Level 2 – other significant observable inputs (including quoted prices for similar securities, interest rates, credit risk, etc.). Municipal bonds and certificates of deposit are usually valued using references to similar instruments, adjusting for differences in interest rates or credit risk as appropriate.

Level 3 – significant unobservable inputs that are not corroborated by observable market data. Annuities are valued using accumulated investment values provided by the issuers; such accumulated values are generally based upon the returns of other underlying investments or indexes, and may include a guaranteed return component. The accumulated value is considered to be approximately equivalent to fair value.

The summary of inputs used to value the Organization's investments as of June 30 is as follows:

	Fair Value Measurements			
	Fair Value	(Level 1)	(Level 2)	(Level 3)
Municipal bonds	\$ 154,935	\$ -	\$ 154,935	\$ -
Fixed annuity contracts	7,091,574	-	-	7,091,574
Mutual funds	5,551,072	5,551,072	-	-
Exchange traded funds	4,162,058	4,162,058	-	-
U.S. Government securities	2,104,534	2,104,534	-	-
Certificates of deposit	6,416,261	-	6,416,261	-
	<u>\$ 25,480,434</u>	<u>\$ 11,817,664</u>	<u>\$ 6,571,196</u>	<u>\$ 7,091,574</u>

The change in value of Level 3 investments is as follows:

	Fixed Annuity Contracts
July 1, 2016	\$ 6,465,470
Purchases	400,000
Accumulated earnings on contracts	<u>226,104</u>
June 30, 2017	<u>\$ 7,091,574</u>

FRONTIER HEALTH

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS AND STATE FINANCIAL ASSISTANCE Year Ended June 30, 2017

Federal Grantor/Pass-through Grantor/ Program or Cluster Title	Federal CFDA Number	Pass Through Grantor's Number	Federal Expenditures
<u>Federal Awards</u>			
<u>U.S. Department of Agriculture</u>			
Pass-through programs from:			
Tennessee Department of Education:			
Child Nutrition Cluster			
National School Lunch Program	10.555	R300	\$ 23,195
School Breakfast Program	10.553	R300	19,449
			<hr/>
Total U.S. Department of Agriculture			42,644
			<hr/>
<u>U.S. Department of Health and Human Services</u>			
Direct programs:			
Basic Center Grant			
Runaway and Homeless Youth Program (10/01/15 to 09/29/16)	93.623	90-CY673702	50,000
Runaway and Homeless Youth Program (09/30/16 to 09/29/17)	93.623	90-CY673702	150,000
			<hr/>
			200,000
Pass-through programs from:			
East TN Human Resource Agency			
HIV Prevention Activities Health Department Based			
HIV/AIDS Prevention	93.940	N/A	30,845
HIV Care Formula Grants			
Ryan White	93.917	N/A	91,389
United Way of Metropolitan Nashville			
HIV Prevention Activities Health Department Based			
HIV/AIDS Prevention	93.940	N/A	24,282
HIV Care Formula Grants			
Ryan White	93.917	N/A	26,290
Tennessee Department of Children's Services			
Community Based Child Abuse Prevention Grants			
Child Abuse Prevention Services	93.590	44879	14,705
			<hr/>
			187,511
Block Grants for Prevention and Treatment of			
Substance Abuse			
Planning District One Behavioral Health Services			
SA FBG Alcohol/Drug Treatment	93.959	N/A	447,451
SA FBG SARPOS	93.959	N/A	31,963
SA FBG Women	93.959	N/A	24,070
SA FBG Prevention	93.959	N/A	118,208
			<hr/>
			621,692

(Continued)

FRONTIER HEALTH

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS AND STATE FINANCIAL ASSISTANCE Year Ended June 30, 2017

Federal Grantor/Pass-through Grantor/ Program or Cluster Title	Federal CFDA Number	Pass Through Grantor's Number	Federal Expenditures
<u>Federal Awards</u>			
<u>U.S. Department of Health and Human Services (Continued)</u>			
Pass-through programs from: (Continued)			
Block Grants for Prevention and Treatment of Substance Abuse (Continued)			
Tennessee Department of Mental Health & Substance Abuse			
Adolescent Substance Use Disorders Svc Program	93.959	49740	\$ 329,543
Adult Continuum of Care	93.959	DGA 48972_2016-2017_009	1,260,118
HIV/AIDS Early Intervention Services Program	93.959	49703	141,235
Medication Assisted Treatment	93.959	50781	36,415
Tennessee Prevention Network	93.959	DGA 49113_2016-2017_008	159,990
Women's Services	93.959	DGA 48975_2016-2017_005	392,815
			<hr/> 2,320,116
			2,941,808
Tennessee Department of Mental Health & Substance Abuse Projects of Regional and National Significance			
Cooperative Agreement to Benefit Homeless Ind Enh (09/30/15 to 09/29/16)	93.243	48201	73,942
Cooperative Agreement to Benefit Homeless Ind Enh (09/30/16 to 09/29/17)	93.243	52231	226,390
System of Care – Expansion Initiative (10/01/15 to 09/30/16)	93.243	47925	50,817
			<hr/> 351,149
Block Grants for Community Mental Health Services Planning District One Behavioral Health Services			
MH FBG SED C&A	93.958	N/A	44,996
MH FBG SMI (Restricted Funds)	93.958	N/A	63,268
			<hr/> 108,264
Tennessee Department of Mental Health & Substance Abuse			
Community Supportive Housing	93.958	49820	317,185
Better Attitudes and Skills in Children (B.A.S.I.C.) & TA	93.958	50071	296,557
Community Targeted Transitional Support	93.958	49896	55,500
Older Adult Program	93.958	49641	70,000
Planned Respite Services	93.958	50067	79,940
Regional Intervention Program	93.958	50042	143,164
			<hr/> 962,346
			<hr/> 1,070,610
Total U.S. Department of Health and Human Services			<hr/> 4,751,078

FRONTIER HEALTH

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS AND STATE FINANCIAL ASSISTANCE Year Ended June 30, 2017

Federal Grantor/Pass-through Grantor/ Program or Cluster Title	Federal CFDA Number	Pass Through Grantor's Number	Federal Expenditures
<u>Federal Awards</u>			
(Continued)			
<u>U.S. Department of Education</u>			
Pass-through programs from:			
Planning District One Behavioral Health Services			
Special Education – Grants for Infants and Families			
Early Intervention Part C – FY2017	84.181	N/A	\$ 48,307
Tennessee Department of Mental Health & Substance Abuse			
Special Communication Cluster (IDEA)			
Special Education – Grants to States (IDEA, Part B)			
School-Based Mental Health Liaison (SBMHL)			
Expanded	84.027	50062	<u>129,428</u>
Total U.S. Department of Education			<u>177,735</u>
<u>U.S. Department of Housing and Urban Development</u>			
Pass-through programs from:			
Virginia Housing Development Authority			
Supportive Housing for the Elderly (Section 202)	14.157	N/A	92,682
Section 8 Project – Based Cluster			
Lower Income Housing Assistance Program			
Section 8 Moderate Rehabilitation	14.856	N/A	<u>37,496</u>
			130,178
Tennessee Department of Health			
Provision of Housing Opportunities for Persons			
with AIDS (HOPWA)	14.241	GR-12-35774-06	<u>100,000</u>
Total U.S. Department of Housing and Urban Development			<u>230,178</u>
Total Federal Awards			<u><u>\$ 5,201,635</u></u>

FRONTIER HEALTH

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
AND STATE FINANCIAL ASSISTANCE**

Year Ended June 30, 2017

Granting Agency/Pass-through Agency Grant Program	Contract/Grant Number	Expenditures
<u>State Financial Assistance</u>		
TN DEPT OF MHSAS		
Grantor: TN Department of Mental		
Health & Substance Abuse Services		
07/01/16 - 06/30/17 Forensics Service-FY2017	DGA -49040-03	\$ 116,100
07/01/16 - 06/30/17 Forensics Service-FY2017	DGA -49040-03	8,650
07/01/16 - 06/30/17 Inpatient Targeted Transitional Support	49873	108,160
07/01/16 - 06/30/17 Peer Support Centers	49935	451,551
07/01/16 - 06/30/17 Homeless	49652	44,006
07/01/16 - 06/30/17 School Based Behavioral Health Liaisons	50062	200,000
07/01/16 - 06/30/17 Mobile Crisis	51490	422,100
07/01/16 - 06/30/17 Crisis Walk In	51490	32,450
07/01/16 - 06/30/17 Crisis Stabilization Unit	51490	1,497,812
07/01/16 - 06/30/17 Crisis Diversionary	51490	136,513
07/01/16 - 06/30/17 Mobile Crisis C&Y	51490	72,957
07/01/16 - 06/30/17 Crisis Respite	51490	35,186
07/01/16 - 06/30/17 Regional Housing	49889	89,249
07/01/16 - 06/30/17 Intensive Long-term Support Services	49888	846,709
07/01/16 - 06/30/17 Peer Wellness Coaches	50193	123,486
07/01/16 - 06/30/17 Supportive Employment	49670	108,232
07/01/16 - 06/30/17 Recovery Drug Court Washington County	49844	69,381
07/01/16 - 06/30/17 Recovery Drug Court Sullivan County	49844	69,217
07/01/16 - 06/30/17 Community Supportive Housing	49820	141,832
07/01/16 - 06/30/17 Community Targeted Transitional Support	49896	9,427
05/01/17 - 06/30/17 Creating Affordable Housing	54525	115,743
07/01/16 - 06/30/17 Alcohol and Drug Addiction Treatment - I/P	48976	21,392
07/01/16 - 06/30/17 BOPP Community Treatment Collaborative	48973	79,952
07/01/16 - 06/30/17 Supervised Probation Offender Treatment	49039	5,070
07/01/16 - 06/30/17 Medically Monitored Crisis Withdrawal Management Services	49718	499,980
07/01/16 - 06/30/17 Criminal Justice BH ST	49726	99,308
07/01/16 - 06/30/17 Criminal Justice BH LS	49726	466,436
07/01/16 - 06/30/17 Medication Assisted Treatment (VIVITROL)	45421	610
07/01/16 - 06/30/17 Safety Net	DGA-48977-006	2,189,955
		<u>8,061,464</u>
GRANTOR: TN Department of Corrections		
JC Crime Reduction Project		
07/01/16 - 06/30/17 JC Crime Reduction	51222	50,371
		<u>8,111,835</u>
HEARING IMPAIRED		
GRANTOR: TN DEPARTMENT OF HUMAN		
SERVICES		
07/01/16 - 06/30/17 CCDHH - Deaf Services and Advocacy Services	49500	148,207

FRONTIER HEALTH

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
AND STATE FINANCIAL ASSISTANCE**

Year Ended June 30, 2017

Granting Agency/Pass-through Agency Grant Program	Contract/Grant Number	Expenditures
<u>State Financial Assistance</u>		
CHILDREN'S SERVICES		
GRANTOR: TN Department of Childrens Services		
07/01/16 - 06/30/17 Traces - Level 2	PBC-00409	286,441
07/01/16 - 06/30/17 Child Abuse Prevention	44879	31,301
10/17/16 - 06/30/17 Adverse Childhood Exp.	51738	45,081
07/01/16 - 06/30/17 Traces - Level 3	PBC-00409	837,025
Performance Based Incentive	N/A	35,970
07/01/16 - 06/30/17 Traces - Level 2	PBC-00409	1,272,720
07/01/16 - 06/30/17 Traces - Level 1	PBC-00409	22,597
		2,531,135
GRANTOR: TN ASSOC. FOR CHILD CARE		
07/01/16 - 06/30/17 TACC	N/A	63,980
		63,980
		2,595,115
JUVENILE JUSTICE GROUP HOME		
GRANTOR: TN DEPARTMENT OF FINANCE AND ADMINISTRATION		
07/01/16 - 06/30/17 - Family Violence	26808	115,809
		115,809
TENN CARE		
GRANTOR: ADVOCARE		
07/01/16 - 06/30/17	N/A	1,691,160
		1,691,160
VIRGINIA MENTAL HEALTH, SUBSTANCE ABUSE & MENTAL RETARDATION SERVICES		
GRANTOR: PD1 Behavioral Health Services		
07/01/16 - 06/30/17	N/A	12,505,755
		12,505,755
GRANTOR: HIGHLANDS COMMUNITY SERVICES BOARD - COMMONWEALTH OF VA		
07/01/16 - 06/30/17 - Mental Retardation	N/A	782
		782
		12,506,537
Total State Awards		\$ 25,168,663
Total Federal and State Awards		\$ 30,370,298

FRONTIER HEALTH
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS AND
STATE FINANCIAL ASSISTANCE
June 30, 2017

Note 1. Basis of Presentation

The accompanying schedule of expenditures of federal awards and state financial assistance (the schedule) includes the federal and state grant activity of Frontier Health under programs of the federal and state governments for the year ended June 30, 2017 on the accrual basis. The Organization has not elected to use the 10 percent *de minimis* indirect cost rate as allowed under the Uniform Guidance.

Note 2. Virginia Housing Development Authority (VHDA)

Section 202 Mortgage Assistance is the balance of the note payable to VHDA at June 30, 2017. Amortization payments are collected by VHDA through offsets against subsidy payments.

FRONTIER HEALTH

STATEMENT OF RECEIPTS AND DISBURSEMENTS

VIRGINIA MENTAL HEALTH, RETARDATION AND SUBSTANCE ABUSE

OPERATIONS LEE, SCOTT, AND WISE COUNTIES AND THE CITY OF NORTON

Year Ended June 30, 2017

RECEIPTS

Grants:

Mental Health Services	\$ 2,295,161	
Mental Retardation Services	42,108	
Substance Abuse Services	<u>1,797,800</u>	
		\$ 4,135,069

Patient Services:

Medicaid SPO	4,498,381	
Medicaid Clinic	39,046	
Medicaid Waiver	2,976,958	
Self-pay and private insurance	1,556,462	
Other fees	<u>894,273</u>	
		9,965,120

Local Agencies and Other Programs:

Virginia local funds	356,350	
Other programs	<u>562,293</u>	
		<u>918,643</u>

Total receipts		<u>15,018,832</u>
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DISBURSEMENTS

Total staff salaries and fringe benefits	8,990,812
Dues/memberships	23,466
Workshops	23,367
In-service	17,025
Subscriptions	2,350
Rent	88,935
Utilities	127,994
Telephone	253,524
Maintenance services	12,351
Other facility expenses	42,656
Maintenance/service contracts	360,305
Office/facility supplies	320,143
Educational/rec. supplies	29,030
Food	93,851
Drugs/medical	111,426
Other supplies	482,599
Private mileage	134,356
Vehicle operations	90,446
Food/lodging	45,886
Professional fees	1,487,508
Insurance	104,991
Postage	17,020
Printing/duplicating	67,081
Miscellaneous	76,224
Equipment	<u>280,672</u>

Total disbursements		<u>13,284,018</u>
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EXCESS OF RECEIPTS OVER DISBURSEMENTS		<u><u>\$ 1,734,814</u></u>
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FRONTIER HEALTH

STATEMENT OF RECEIPTS AND DISBURSEMENTS – SULLIVAN HOUSE Year Ended June 30, 2017

RECEIPTS

Sullivan County	\$ 292,552
Program fees and grants	<u>145,046</u>
Total receipts	437,598

DISBURSEMENTS

Personnel costs:	
Salaries and wages	195,126
Fringe benefits	<u>49,736</u>
Total personnel costs	<u>244,862</u>

Other:

Travel	1,432
Staff development	75
Motor vehicle operations	3,233
Dues and memberships	427
Professional services	2,340
Printing	939
Utilities	19,793
Communications	6,040
Supplies	22,704
Food	50,830
Maintenance and repairs	11,203
Depreciation	4,809
Miscellaneous	<u>216</u>

Total other	<u>124,041</u>
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Administration and general allocation	<u>47,677</u>
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Total disbursements	<u>416,580</u>
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EXCESS OF RECEIPTS OVER DISBURSEMENTS	<u><u>\$ 21,018</u></u>
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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**

To the Board of Directors of
Frontier Health
Gray, Tennessee

We have audited, 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, the consolidated financial statements of Frontier Health (a nonprofit organization) and affiliate (collectively, the "Organization"), which comprise the consolidated statement of financial position as of June 30, 2017, and the related consolidated statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the consolidated financial statements which collectively comprise the Organization's consolidated financial statements and have issued our report thereon dated October 18, 2017.

Internal Control over Financial Reporting

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

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

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

Compliance and Other Matters

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

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 Organization'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 Organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Brown, Edwards & Company, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

Kingsport, Tennessee
October 18, 2017

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

To the Board of Directors of
Frontier Health
Gray, Tennessee

Report on Compliance for the Major Federal Program

We have audited Frontier Health's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on Frontier Health's major federal program for the year ended June 30, 2017. Frontier Health's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

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

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for Frontier Health's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; 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 Frontier Health's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of Frontier Health's compliance.

Report on Compliance for the Major Federal Program (Continued)

Opinion on Each Major Federal Program

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

Other Matters

The results of our auditing procedures disclosed an instance of noncompliance, which is required to be reported in accordance with the Uniform Guidance and which is described in the accompanying schedule of findings and questioned costs as item 2017-001. Our opinion on the major federal program is not modified with respect to these matters.

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

Report on Internal Control over Compliance

Management of Frontier Health 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 Frontier Health'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 the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Frontier Health'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.

Brown, Edwards & Company, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

Kingsport, Tennessee
October 18, 2017

FRONTIER HEALTH
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended June 30, 2017

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an **unmodified opinion** on the consolidated financial statements.
2. **No significant deficiencies** relating to the audit of the financial statements were reported in the 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 Accounting Standards*.
3. **No instances of noncompliance** material to the financial statements were disclosed during the audit.
4. **No significant deficiencies** relating to the audit of the major federal award program was reported in the Independent Auditor's Report on Compliance for Each Major Program and on Internal Control over Compliance Required by Uniform Guidance.
5. The auditor's report on compliance for the major federal award program expresses an **unmodified opinion**.
6. The audit disclosed **one audit finding relating to the major program**.
7. The program tested as a major program was:

Block Grants for Prevention and Treatment of Substance Abuse	CFDA # 93.959
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8. The threshold used for distinguishing Type A programs was **\$750,000**.
9. Frontier Health was determined to be a **low-risk auditee**.

B. FINDINGS – FINANCIAL STATEMENTS AUDIT

None.

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C. FINDINGS AND QUESTIONED COSTS – MAJOR FEDERAL AWARD PROGRAM AUDIT

2017-001: Block Grants for Prevention and Treatment of Substance Abuse – CFDA 93.959

Condition: We noted that on one individual the wrong service code was entered when billing the grant, resulting in a \$400 overpayment by the State of Tennessee to the Organization. The overbilling was discovered by management upon review of the monthly billing records, and reimbursement was submitted to the state.

Criteria: The Organization is required to follow the Rate Sheet include in the grant contract.

Cause: The Organization failed to properly enter the correct billing code for the service provided.

Effect: The Organization is not in compliance with the service fee rates established by the grantor.

Context: Of the 25 transactions examined, we found one instance of noncompliance.

Recommendation: Service codes should be reviewed carefully before billing.

Views of Responsible Officials and Planned Corrective Action: We contacted the State of Tennessee and returned the amount that was over charged.