# Consolidated Financial Statements
# and Other Information

***Covenant Health***

*Years Ended December 31, 2023 and 2022*

**COVENANT HEALTH**

***Table of Contents***

***Years Ended December 31, 2023 and 2022***


I. INTRODUCTORY SECTION

Board of Directors and Management Officials ..... i

II. FINANCIAL SECTION

Independent Auditor's Report ..... 1
Consolidated Balance Sheets ..... 4
Consolidated Statements of Operations and Changes in Net Assets ..... 6
Consolidated Statements of Cash Flows ..... 7
Notes to Consolidated Financial Statements ..... 9

III. INTERNAL CONTROL AND COMPLIANCE SECTION

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* - Independent Auditor's Report ..... 34
Schedule of Expenditures of Federal Awards ..... 36
Schedule of Expenditures of State Financial Assistance ..... 38
Notes to Schedule of Expenditures of Federal Awards and Schedule of Expenditures of State Financial Assistance ..... 39
Schedule of Findings and Questioned Costs ..... 40
Summary Schedule of Prior Audit Findings ..... 41
Report on Compliance for Each Major Federal Program and Report On Internal Control Over Compliance in Accordance with the Uniform Guidance - Independent Auditor's Report ..... 42

# SECTION I

# INTRODUCTORY SECTION

# BOARD OF DIRECTORS AND MANAGEMENT OFFICIALS

## Board of Directors

| | |
|---|---|
| Willard Campbell, M.D. | William Seale |
| Donald Hickman | James Tramontana, M.D. |
| James Gibson | Gerald Boyd |
| Timothy Matthews | Michael Casey, M.D. |
| Janice McKinley | Mitchell Dickson, M.D. |
| David Miller | Edgar Gray |
| Alvin Nance | Linda Ogle |
| Cosby Stone | William Myers |
| Jim VanderSteeg | King Purnell |
| Jorge Sanabria | Joe Sutter |
| Leslye Hartsell | Stephanie Flood |

## Audit Committee

| | |
|---|---|
| Alvin Nance - Chair | William Seale |
| Edgar Gray - Vice-Chair | Don Hickman |
| Leslye Hartsell | |

## Management Officials

Jim VanderSteeg, President and Chief Executive Officer

Joe Dolan, Executive Vice President and Chief Financial Officer

Mike Belbeck, Executive Vice President of Operations

Jon-David Deeson, Executive Vice President, Physician Enterprise/Ambulatory Services

M. Douglas Campbell, Jr., Executive Vice President and General Counsel

# SECTION II

# FINANCIAL SECTION

PYA, P.C.
One Cherokee Mills
2220 Sutherland Avenue
Knoxville, TN 37919
(865) 673-0844 | pyapc.com

# INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Covenant Health:

***Report on the Audit of the Consolidated Financial Statements***

***Opinion***

We have audited the accompanying consolidated financial statements of Covenant Health (Covenant), which comprise the consolidated balance sheets as of December 31, 2023 and 2022 and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Covenant Health as of December 31, 2023 and 2022 and the results of its operations, changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Basis for Opinion***

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are required to be independent of Covenant, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Responsibilities of Management for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Covenant's ability to continue as a going concern for one year after the date that the consolidated financial statements are issued.

### *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements*

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.

- Obtain an understanding of internal control relevant to the audit 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 Covenant's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Covenant's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

### *Supplementary Information*

Our audits were 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* (Uniform Guidance) and the Schedule of Expenditures of State Financial Assistance are presented for purposes of additional analysis and are not a required part of the consolidated financial statements.

The Schedule of Expenditures of Federal Awards and the Schedule of Expenditures of State Financial Assistance are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such 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 Schedule of Expenditures of Federal Awards and the Schedule of Expenditures of State Financial Assistance are fairly stated in all material respects in relation to the consolidated financial statements as a whole.

***Other Information***

Management is responsible for the other information included in the introductory section. The other information does not include the consolidated financial statements and our auditor's report thereon. Our opinion on the consolidated financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon. In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the combined financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards,* we have also issued our report dated April 18, 2024 on our consideration of Covenant's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Covenant's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Covenant's internal control over financial reporting and compliance.

PYA, P.C.

Knoxville, Tennessee
April 18, 2024, except with respect
to the *Opinion on the Schedule of Expenditures of Federal Awards*,
which is dated June 25, 2024

**COVENANT HEALTH**

***Consolidated Balance Sheets***
***(Dollars in Thousands)***

| | December 31, 2023 | December 31, 2022 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | **$ 125,849** | $ 181,276 |
| Assets limited as to use | **21,955** | 19,411 |
| Patient accounts receivable | **184,079** | 161,719 |
| Other current assets | **82,859** | 59,626 |
| TOTAL CURRENT ASSETS | **414,742** | 422,032 |
| INVESTMENTS | **1,618,122** | 1,498,046 |
| ASSETS LIMITED AS TO USE, less amounts required to meet current obligations | **41,152** | 34,012 |
| PROPERTY, PLANT AND EQUIPMENT, net of accumulated depreciation and amortization | **1,011,006** | 1,022,632 |
| OTHER ASSETS | | |
| Goodwill | **8,553** | 8,553 |
| Intangible assets | **16,955** | 16,955 |
| Right-of-use asset, operating leases | **11,785** | 13,245 |
| Right-of-use asset, finance leases | **3,818** | 5,523 |
| Other assets | **71,826** | 57,167 |
| TOTAL OTHER ASSETS | **112,937** | 101,443 |
| TOTAL ASSETS | **$ 3,197,959** | $ 3,078,165 |

**COVENANT HEALTH**

***Consolidated Balance Sheets - Continued***
***(Dollars in Thousands)***

| | December 31, 2023 | December 31, 2022 |
|---|---|---|
| LIABILITIES AND NET ASSETS | | |
| CURRENT LIABILITIES | | |
| Trade accounts payable, accrued expenses and other liabilities | **$ 153,117** | $ 163,215 |
| Accrued salaries, wages, compensated absences and amounts withheld | **93,089** | 86,600 |
| Estimated third-party payer settlements | **11,754** | 11,350 |
| Current portion of operating lease liability | **4,954** | 5,004 |
| Current portion of finance lease liability | **1,701** | 2,200 |
| Current portion of long-term debt | **37,092** | 33,667 |
| TOTAL CURRENT LIABILITIES | **301,707** | 302,036 |
| OPERATING LEASE LIABILITY, less current portion | **6,831** | 8,241 |
| FINANCE LEASE LIABILITY, less current portion | **2,355** | 3,544 |
| LONG-TERM DEBT, less current portion | **963,006** | 1,001,578 |
| OTHER LONG-TERM LIABILITIES | **83,044** | 72,769 |
| TOTAL LIABILITIES | **1,356,943** | 1,388,168 |
| COMMITMENTS AND CONTINGENCIES - Note J | | |
| NET ASSETS | | |
| Without donor restrictions | **1,831,322** | 1,680,152 |
| With donor restrictions | **9,694** | 9,845 |
| TOTAL NET ASSETS | **1,841,016** | 1,689,997 |
| TOTAL LIABILITIES AND NET ASSETS | **$ 3,197,959** | $ 3,078,165 |

**COVENANT HEALTH**

***Consolidated Statements of Operations and Changes in Net Assets***
***(Dollars in Thousands)***

| | Year Ended December 31, 2023 | 2022 |
|---|---|---|
| Change in net assets without donor restrictions: | | |
| Unrestricted revenue and support: | | |
| Patient service revenue | **$ 1,613,691** | $ 1,485,255 |
| Other operating revenue | **68,973** | 65,679 |
| COVID-19 relief funding - Note O | **-** | 36,996 |
| Net assets released from restrictions used for operations | **1,081** | 1,263 |
| TOTAL REVENUE AND SUPPORT | **1,683,745** | 1,589,193 |
| Expenses: | | |
| Salaries and benefits | **911,384** | 850,782 |
| Supplies and other | **717,229** | 674,056 |
| Provision for depreciation and amortization | **93,839** | 92,563 |
| Interest | **26,099** | 26,168 |
| TOTAL OPERATING EXPENSES | **1,748,551** | 1,643,569 |
| LOSS FROM OPERATIONS | **(64,806)** | (54,376) |
| Non-operating gains (losses): | | |
| Investment income (loss) - Note D | **192,966** | (131,649) |
| Gain on contribution of assets | **11,817** | 5,800 |
| Gain on acquisition and other | **-** | 23,207 |
| TOTAL NON-OPERATING GAINS (LOSSES) | **204,783** | (102,642) |
| EXCESS (DEFICIT) OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES | **139,977** | (157,018) |
| Change in net unrealized gains/losses on investments | **13,651** | (45,737) |
| Contributions of property and other | **(2,970)** | 215 |
| Excess of assets acquired over liabilities assumed | **-** | 1,243 |
| Net assets released from restrictions for capital additions | **512** | 40 |
| INCREASE (DECREASE) IN NET ASSETS WITHOUT DONOR RESTRICTIONS | **151,170** | (201,257) |
| Change in net assets with donor restrictions: | | |
| Restricted gifts and bequests | **1,397** | 2,110 |
| Investment income and realized/unrealized net gains on investments | **45** | 85 |
| Net assets released from restrictions | **(1,593)** | (1,303) |
| INCREASE (DECREASE) IN NET ASSETS WITH DONOR RESTRICTIONS | **(151)** | 892 |
| INCREASE (DECREASE) IN NET ASSETS | **151,019** | (200,365) |
| NET ASSETS, BEGINNING OF YEAR | **1,689,997** | 1,890,362 |
| NET ASSETS, END OF YEAR | **$ 1,841,016** | $ 1,689,997 |

*See notes to consolidated financial statements.*

**COVENANT HEALTH**

***Consolidated Statements of Cash Flows***
***(Dollars in Thousands)***

| | *Year Ended December 31,* 2023 | 2022 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Increase (decrease) in net assets | **$ 151,019** | $ (200,365) |
| Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities | | |
| Provision for depreciation and amortization | **93,839** | 92,563 |
| Net realized and unrealized gains on investments and assets limited as to use | **(165,529)** | 216,004 |
| Interest amortization/accretion on bond discounts, premiums and issue costs | **(1,481)** | (1,455) |
| Gain on contribution of assets | **(11,817)** | (5,800) |
| Gain on acquisition | **-** | (22,914) |
| Contributions of property and other | **2,970** | (215) |
| Excess of assets acquired over liabilities assumed | **-** | (1,570) |
| Restricted contributions | **(1,397)** | (2,110) |
| Equity in (income) loss of unconsolidated affiliate | **1,307** | (3,265) |
| Increase (decrease) in cash due to changes in: | | |
| Patient accounts receivable | **(22,360)** | (12,401) |
| Other current assets | **(23,233)** | 4,350 |
| Other assets | **(3,404)** | 3,655 |
| Trade accounts payable, accrued expenses and other liabilities | **(8,558)** | (17,953) |
| Accrued salaries, wages, compensated absences and amounts withheld | **6,489** | (3,573) |
| Estimated third-party payer settlements | **404** | 8,318 |
| Other long-term liabilities | **10,275** | (4,558) |
| Total adjustments | **(122,495)** | 249,076 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | **28,524** | 48,711 |

**COVENANT HEALTH**

***Consolidated Statements of Cash Flows - Continued***
***(Dollars in Thousands)***

| | Year Ended December 31, 2023 | 2022 |
|---|---|---|
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital expenditures | **(87,385)** | (142,456) |
| Proceeds from sale of property, plant and equipment | **2,995** | 2,847 |
| Purchases of investments | **(163,315)** | (270,098) |
| Proceeds from redemption or maturities of investments | **203,606** | 233,106 |
| Acquisitions, net of cash acquired | **-** | 357 |
| Changes in assets limited as to use | **(4,522)** | 23,989 |
| Investment in unconsolidated affiliates | **(5,916)** | (23,521) |
| Distributions from unconsolidated affiliates | **5,034** | 4,482 |
| NET CASH USED IN INVESTING ACTIVITIES | **(49,503)** | (171,294) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from issuance of long-term debt | **172** | 150,355 |
| Repayment of debt and finance lease obligations | **(36,017)** | (27,269) |
| Payment of acquisition and financing costs | **-** | (413) |
| Restricted contributions | **1,397** | 1,526 |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | **(34,448)** | 124,199 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | **(55,427)** | 1,616 |
| CASH AND CASH EQUIVALENTS, beginning of year | **181,276** | 179,660 |
| CASH AND CASH EQUIVALENTS, end of year | **$ 125,849** | $ 181,276 |
| SUPPLEMENTAL INFORMATION: | | |
| Cash paid for interest | **$ 28,300** | $ 26,438 |
| Cash paid for income taxes | **$ 47** | $ - |
| Capital additions in accounts payable | **$ 702** | $ 2,242 |
| Operating cash flows from finance leases | **$ (173)** | $ (202) |
| Operating cash flows from operating leases | **$ (6,033)** | $ (5,985) |
| Financing cash flows from finance leases | **$ (2,352)** | $ (2,450) |

NOTE A--ORGANIZATION AND OPERATIONS

Covenant Health (Covenant) is a tax-exempt entity as described under Section 501(c)(3) of the Internal Revenue Code. The operations of Covenant and its subsidiaries consist predominantly of the delivery of healthcare and healthcare related services in East Tennessee. Covenant provides management services to, and is the sole member or majority shareholder of numerous controlled or subsidiary entities, the most significant of which are as follows:

> *Fort Sanders Regional Medical Center (Regional)* operates a 468-bed acute care facility located in Knoxville, Tennessee and operates a subsidiary Fort Sanders Perinatal Center, a perinatal physician practice.
>
> *Parkwest Medical Center (Parkwest)* operates 456 acute care beds, consisting of a 337-bed acute care facility located in Knoxville, Tennessee, and a 119-bed inpatient behavioral health facility located in Louisville, Tennessee, and outpatient behavioral medicine facilities in various locations in East Tennessee.
>
> *Methodist Medical Center of Oak Ridge (Methodist)* operates a 283-bed acute care facility located in Oak Ridge, Tennessee, and sponsors *Methodist Medical Center Foundation,* which was formed to raise funds on behalf of Methodist.
>
> *Cumberland Medical Center, Inc. (Cumberland)* operates a 189-bed acute care facility in Crossville, Tennessee.
>
> *Morristown-Hamblen HealthCare System* (*Morristown*) operates a 167-bed acute care hospital located in Morristown, Tennessee. Morristown is the sole member of *Morristown-Hamblen Health Foundation*, whose purpose is to raise funds on behalf of Morristown.
>
> *LeConte Medical Center* (*LeConte)* operates a 79-bed acute care facility located in Sevierville, Tennessee.
>
> *Claiborne Medical Center (Claiborne)* leases and operates an 85-bed acute care facility and a 100-bed nursing home in Tazewell, Tennessee (see Note J).
>
> *Roane Medical Center (Roane)* operates a 54-bed acute care facility located in Harriman, Tennessee.
>
> *Fort Loudoun Medical Center (Loudoun)* operates a 50-bed acute care facility located in Lenoir City, Tennessee (see Note J).
>
> *The Thompson Cancer Survival Center (the Cancer Center) and Subsidiary* operates medical oncology physician practices and provides proton services and other cancer services. *The*

*Thompson Cancer Survival Center Foundation* (TCSCF) was formed to support the Cancer Center's operations.

*Covenant HomeCare (HomeCare)* provides home health and hospice services in East Tennessee.

*Covenant Medical Group (CMG)* is a for-profit entity whose major operations include ownership of physician practices in East Tennessee and the provision of physician management and support services. CMG's subsidiaries include Knoxville Heart Group, and East Tennessee Cardiovascular Surgery Group, Inc. CMG also has an ownership in various surgery center joint ventures. CMG purchased additional ownership in one surgery center for approximately $3,200 during 2023.

*Fortress Corporation (Fortress)* is a for-profit entity located in Knoxville, Tennessee, whose operations include a daycare center, a health and fitness facility and real estate services. Fortress has a noncontrolling ownership in various joint ventures and partnerships and is the sole member of the entities listed below.

*Smith and Hammaker Enterprises, LLC (SHE)* is a for-profit entity located in Knoxville, Tennessee, and operates a data center that offers tailored colocation services that protect mission-critical data from physical dangers such as floods, fires, and weather emergencies. SHE became a department of Fortress during 2022.

*TenHats, LLC (TenHats) (formerly SH Data Centers, LLC)* is a for-profit entity located in Knoxville, Tennessee, whose operations include managed information technology services, custom network design, private and public cloud hosting solutions, and information technology consulting.

*Fort Sanders Foundation (FSF)* is a not-for-profit foundation formed to coordinate the fundraising and development activities of Covenant.

*Dr. Robert F. Thomas Foundation (RFTF)* is a not-for-profit foundation formed to support LeConte. RFTF merged into Covenant during 2022 with no consideration paid.

Covenant, Regional, Parkwest, Methodist, Cumberland, Morristown, LeConte, Roane, Loudoun, the Cancer Center, and HomeCare collectively comprise the Covenant Obligated Group (see Note F).

Covenant (or a subsidiary) is an owner in several partnerships or joint ventures that are accounted for under the equity method of accounting. Covenant's ownership in the equity of these entities, which totaled $57,818 and $46,426 at December 31, 2023 and 2022, respectively, is included as part of other assets, and Covenant's portion of equity in the net income (loss) of these entities totaled ($1,307) and $3,265 for the years ended December 31, 2023 and 2022, respectively, and is included in other operating revenue in the accompanying consolidated financial statements. Certain owners in these joint ventures are physicians that practice at Covenant facilities. Additionally, certain of Covenant's subsidiaries are obligated on all or a portion of the outstanding debt of several of these joint ventures totaling approximately $2,420 and $2,583 at December 31, 2023 and 2022, respectively. Covenant believes it is unlikely it or its subsidiaries will be required to fund any guarantees.

***(Dollars in Thousands)***

The following is combined, condensed, unaudited financial information related to these entities as of and for the years ended December 31:

| | ***2023*** | ***2022*** |
|---|---|---|
| Total assets | $ 209,425 | $ 144,643 |
| Partner's capital/equity | 143,489 | 106,104 |
| Net income (loss) | (2,473) | 20,952 |

During 2020, Covenant entered into a joint venture agreement with an unrelated third party to construct and operate a behavioral health hospital in Knoxville, Tennessee. Covenant has a 30% ownership interest in the joint venture and contributed approximately $500 and $5,000 in capital during 2023 and 2022, respectively. Additionally, during 2022, Covenant contributed the use of its trade name, valued at $5,800, to the joint venture and, as a result, recognized a nonoperating gain of $5,800. Covenant contributed an additional $250 and $7,000 during 2023 and 2022, respectively, to a separate joint venture initially entered into during 2020, where it maintains a 50% ownership interest. Additionally, during 2023, Covenant contributed a certificate of need license, valued at $11,800, to the joint venture and, as a result recognized a nonoperating gain of $11,800.

Covenant invested approximately $2,000 and $9,000 in other joint ventures during 2023 and 2022, respectively. Covenant maintains an ownership interest of 51% in some of these joint ventures, however, they are not considered significant for consolidation as of December 31, 2023.

## NOTE B--SIGNIFICANT ACCOUNTING POLICIES

*Principles of Consolidation:* The accompanying consolidated financial statements include the accounts of Covenant and its subsidiaries after elimination of all significant intercompany accounts and transactions.

*Use of Estimates:* The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires Covenant to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results will differ from these estimates.

*Cash and Cash Equivalents:* Cash and cash equivalents includes cash on-hand and in bank deposit accounts, as well as investments with terms to maturity of less than ninety days when purchased, except amounts designated as assets limited as to use or amounts included in investment portfolios. Covenant has cash deposits significantly in excess of Federal Deposit Insurance Corporation limits at December 31, 2023. Covenant believes that credit risk related to these deposits is minimal.

*Investments and Assets Limited as to Use:* All debt securities and marketable equity securities with readily determinable fair values are recorded at fair value based on quoted market prices of identical or similar securities. Equity investments in commingled trust funds and alternative investments do not have a readily determinable fair value and are recorded at net asset value as determined by the fund manager, or other pricing sources, as a practical expedient to estimate the fair value. Investment portfolios are classified as current or long-term assets dependent upon the objectives of the portfolio relative to current operations.

Assets limited as to use consist of funds held by bond trustees and designated for debt service as required by bond indentures or designated for construction projects, as well as amounts held related to employee benefit plans that have been segregated to pay benefits as they become due but remain general assets of Covenant. Funds designated for construction projects were fully expended as of December 31, 2023. Amounts required to meet current liabilities are shown as current assets.

Investment income, including realized gains or losses, change in unrealized gains or losses on equity securities and any other-than-temporary unrealized losses, is reported as non-operating gains (losses). For any debt securities that are in an unrealized loss position at the consolidated balance sheet date, Covenant assesses whether or not it intends to sell the security, or more likely than not will be required to sell the security, before recovery of its amortized cost basis. If either criteria is met, the security's amortized cost basis is written down to fair value through non-operating gains (losses). If neither criteria is met, Covenant evaluates whether any portion of the decline in fair value is the result of credit deterioration. Such evaluations consider the extent to which the amortized cost of the security exceeds its fair value, changes in credit ratings and any other known adverse conditions related to the specific security. If the evaluation indicates that a credit loss exists, an allowance for credit losses is recorded through provisions for credit losses for the amount by which the amortized cost basis of the security exceeds the present value of cash flows expected to be collected, limited by the amount by which the amortized cost exceeds fair value. Any impairment not recognized in the allowance for credit losses is recorded as a change in net assets. Realized gains and losses are computed using the specific-identification method of cost determination.

*Inventories:* Inventories of medical supplies are stated at the lower of cost (average cost method) or net realizable value and are reported as other current assets.

*Property, Plant and Equipment:* Property, plant and equipment is stated on the basis of cost or, if donated, at fair market value on the date of gift. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The amount capitalized is net of investment earnings on assets limited as to use derived from borrowings designated for capital assets. Costs of maintenance and repairs are expensed as incurred.

Costs incurred for internal use software related to design, installation and testing of the applications are capitalized as incurred. All other costs, including costs related to data conversion and user training, are expensed as incurred.

Depreciation is provided over the estimated useful lives of the related assets using a straight-line method. Covenant reviews property for indicators of potential impairment when changes in circumstances occur. Covenant identified no such impairment for the years ended December 31, 2023 and 2022.

*Goodwill:* Goodwill represents the excess purchase price over the assigned fair value of identifiable tangible assets and separately identified intangible assets acquired in the acquisition of various entities and totals $8,553 at December 31, 2023 and 2022. Covenant annually evaluates goodwill for impairment, initially using a qualitative method, and records any reduction in goodwill in the period such impairment is determined under a quantitative methodology. Covenant identified no such impairment for the years ended December 31, 2023 and 2022.

*Intangible Assets:* Intangible assets consist primarily of trade names, licenses and permits related to the acquisition of healthcare facilities and total $16,955 at December 31, 2023 and 2022. All intangible assets are considered to have an indefinite useful life as there are no legal, regulatory, contractual, competitive, economic, or other factors that limit the useful life. Covenant evaluates the recoverability of intangible assets whenever events or changes in circumstances indicate that an intangible asset's carrying amount may not be recoverable. Covenant believes no such event or circumstances have occurred.

*Leases and Right-of-use Assets:* The present value of lease payments is recorded as a lease liability at the commencement of a contract that has a term in excess of one year. The present value is determined by discounting the required payments using the stated or implicit interest rate in the lease or, if not stated or implied, Covenant's incremental borrowing rate which was 3.0% for 2023 and 2022. Payments include options to extend, or terminate, if Covenant determines that it is reasonably certain that such options will be exercised. A right-of-use asset is also recorded equal to the lease liability plus any initial direct cost, prepayments, or incentives.

*Bond and Note Issuance Costs:* Bond and note issuance costs are amortized over the terms of the related debt issues and are reported as a component of long-term debt. Amortization expense for bond and note issue costs totaled approximately $222 and $215 for each of the years ended December 31, 2023 and 2022, respectively.

*Net Assets with Donor Restrictions:* Net assets with donor restrictions are those whose use has been limited by donors to a specific time period or purpose. The majority of net assets with donor restrictions are restricted to expenditures for programs of specific Covenant entities.

*Patient Service Revenue/Receivables:* Patient service revenue is reported on the accrual basis and reflects the amount which Covenant expects to receive in exchange for services provided during the period, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Revenue is recognized as performance obligations are satisfied. Performance obligations are determined based on the nature of the services provided and may have a term of several days or longer. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected charges.

Covenant determines the transaction price for patient service revenue based on standard charges for goods and services provided, reduced by explicit price concessions for contractual adjustments provided to third-party payers, discounts provided to uninsured patients in accordance with Covenant’s financial assistance policy, and implicit price concessions provided to uninsured patients. Covenant determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies and historical experience. Implicit price concessions are mainly comprised of amounts due directly from patients and represents Covenant’s primary collection risk. Estimated implicit price concessions are recorded for all uninsured accounts, regardless of the age of those accounts. Accounts are written off when all reasonable collection efforts have been made. Covenant determines its estimate of implicit price concessions based on an analysis of historical loss experience and expected net collections, business and economic conditions, trends in federal, state and private employer health care coverage and other collection indicators.

Retroactive adjustments for third-party payers are reported on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined or additional information is obtained.

Patient accounts receivable are reported net of an estimated allowance for contractual adjustments and an allowance for implicit price concessions. Covenant receives payments for services rendered from federal and state agencies, managed care health plans, commercial insurance companies, employers and patients. Covenant recognizes that revenues and receivables from government agencies are significant to operations, but does not believe there are significant credit risks associated with these government agencies. Covenant does not believe there are any other significant concentrations of revenues from any particular payer that would subject Covenant to any significant credit risks in the collection of accounts receivable. Covenant’s policy does not require collateral or other security for patient accounts receivable and Covenant routinely accepts assignment of, or is otherwise entitled to receive, patient benefits payable under health insurance programs, plans or policies.

*Uncompensated Care:* Covenant provides care without charge to patients who meet certain criteria under its charity care policy. Because Covenant does not pursue collection of amounts determined to qualify as charity care, or other standardized discounts, they are not reported as patient service revenue. Charges foregone, based on established rates, totaled approximately $184,100 and $190,800 in 2023 and 2022, respectively, including standardized discounts for certain uninsured patients. The estimated direct and indirect cost of providing these services totaled approximately $48,600 and $49,300 for the years ended December 31, 2023 and 2022, respectively. Such costs are determined using a ratio of cost to charge analysis with indirect cost allocated. In addition, Covenant provides a number of other services to benefit the indigent for which little or no payment is received. Medicare, TennCare and certain other programs do not cover the full cost of providing care to beneficiaries of those programs. Covenant also provides services to the community at large for which it receives little or no payment.

*Estimated Malpractice Costs*: The provision for estimated medical malpractice claims includes estimates of the ultimate costs for reported claims and an estimate for claims incurred but not reported (See Note J).

*Income Taxes:* Covenant and certain of its subsidiaries or controlled entities are exempt from income taxes pursuant to Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes on qualifying activities has been made for these entities in the accompanying consolidated financial statements. However, certain entities and operations are subject to income taxes (see Note H).

*Excess (Deficit) of Revenue, Gains and Support Over Expenses and Losses:* The Consolidated Statements of Operations and Changes in Net Assets include the caption "Excess (Deficit) of Revenue, Gains and Support Over Expenses and Losses." Consistent with industry practice, changes in net assets without donor restrictions which are excluded from this caption include, but are not limited to, changes in unrealized gains and losses on debt securities and other investments (except losses which are determined to be other-than-temporary) and capital contributions.

*Gain on Bargain Purchase:* During 2022, Covenant entered into an asset purchase agreement to acquire substantially all assets of and assume certain liabilities for The Proton Therapy Center, LLC d/b/a Provision CARES Proton Therapy Center, Knoxville (Proton) for a purchase price of $45,250. Operations and activities of Proton are included in the Cancer Center. The fair value of the identifiable assets acquired and liabilities assumed in the purchase of Proton exceeded the purchase price. As a result, the Company reassessed the recognition and measurement of identifiable assets acquired and liabilities assumed and concluded that the valuation procedures and resulting measures were appropriate. Accordingly, the acquisition has been accounted for as a bargain purchase and, as a result, the Company recognized a gain of $22,914 associated with the acquisition.

*Fair Value of Financial Instruments*: The fair value of Covenant's financial instruments (see Note L), other than long-term debt discussed in Note F, approximates their carrying value due to the nature and terms of these assets and liabilities. Patient accounts receivable; certain other assets; accounts payable, accrued expenses, and other liabilities; accrued salaries, wages, compensated absences, and other amounts withheld; and estimated third-party payer settlements have short maturities or will otherwise be settled within a short period of time. The fair value of ownership interests in partnerships and joint ventures (other than commingled trust funds and alternative investments discussed in Note D) reported as other assets is not practical to estimate. The fair value of financial instruments reported as part of other long-term liabilities is not estimable, due to the unpredictable timing of the payments and the nature of the estimates involved (primarily estimated professional and worker's compensation liabilities).

*Reclassifications:* Certain 2022 amounts have been reclassified in the consolidated financial statements to conform to 2023 presentation.

NOTE C--PATIENT SERVICE REVENUE/RECEIVABLES

Covenant has agreements with various third-party payers that provide for payments at amounts different from established rates. A summary of the payment arrangements with significant third-party payers follows:

*Medicare:* The Medicare program pays for inpatient and most outpatient services on a prospective basis based upon the patient's clinical diagnosis and medical procedures utilized. Covenant also receives additional payments from Medicare based on the provision of services to a disproportionate share of TennCare and other low-income patients, as well as other pass-through payments. The Medicare program continues to reimburse certain other services based on a percentage of cost up to predetermined cost limits. Certain other revenue, primarily from physician practices, is reimbursed based upon rate schedules. At December 31, 2023 and 2022, approximately 51% of Covenant's patient accounts receivable were due from the Medicare program.

*TennCare:* The State of Tennessee's Medicaid waiver program (TennCare) provides coverage through managed care organizations (MCOs), and Covenant has contracts with several of these MCOs. TennCare reimbursement for both inpatient and outpatient services is based upon prospectively determined rates and per diem rates. During 2023 and 2022, Covenant received distributions under the TennCare Disproportionate Share program and other programs totaling approximately $37,300 and $19,400, respectively, designed to provide supplemental funding for services provided to TennCare patients. Future distributions under these programs are not guaranteed. Hospital providers in the State of Tennessee are subject to an annual assessment based upon a percentage of net patient revenue. These payments are matched with available federal funds and used to make payments back to providers. At December 31, 2023 and 2022, approximately 10%, of Covenant's patient accounts receivable were due from TennCare MCOs.

*Other:* Covenant has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, preferred provider organizations and employer groups. The basis for payment under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Amounts recorded under certain of these contractual arrangements are subject to review and final determination by various program intermediaries. Settlements with third-party payers for retroactive adjustments due to audits, reviews, or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payer, correspondence from the payer and historical settlement activity, including an assessment to ensure that a significant reversal of revenue recognized will not occur. Estimated settlements are adjusted in future periods as adjustments become known or as years are settled or are no longer subject to such audits, reviews, and investigations. Patient service revenue for the years ended December 31, 2023 and 2022 increased by approximately $3,600 and $2,200, respectively, as a result of changes in or adjustments to prior years' settlement estimates or final settlements of prior periods. Patient service revenue for the year ended December 31, 2023 also included $16,218 as a result of a Supreme Court settlement occurring in 2023 related to underpayment from 2018 to 2022 for the 340B Drug Pricing Program.

Generally, patients who are covered by third-party payers are responsible for related deductibles and coinsurance, which vary in amount. Covenant also provides services to uninsured and underinsured patients that do not qualify for financial assistance. Based on historical experience, a significant portion of uninsured and underinsured patients are unable or unwilling to pay for their responsible amounts for services provided and a significant discount for this implicit price concession is recorded in the period services are provided. Implicit price concessions totaled approximately $81,200 and $83,000 for the years ended December 31, 2023 and 2022, respectively.

Using a portfolio approach, Covenant estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience, current market conditions, and anticipated or known changes in economic conditions or events. In addition, for uninsured patients, Covenant reduces charges from current rates based on average discounts provided to certain third-party payers. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are recorded as adjustments to patient service revenue in the period of the change. Adjustments for such changes in the estimated transaction price were not significant for the years ended December 31, 2023 and

***(Dollars in Thousands)***

2022. Subsequent changes that are determined to be the result of an adverse change in the patient's ability or intention to pay are recorded as bad debt expense or a provision for credit losses. No significant amount of bad debt expense or provision for credit losses was reported for the years ended December 31, 2023 and 2022.

Patient service revenue, net of explicit price concessions, discounts, and implicit price concessions, based on the type of service, is composed of the following for the years ended December 31:

| | ***Inpatient*** | ***Outpatient*** | ***Total*** |
|---|---|---|---|
| ***2023*** | | | |
| Medicare/Medicare Advantage | $ 434,235 | $ 394,246 | $ 828,481 |
| TennCare | 48,777 | 86,160 | 134,937 |
| Managed Care/Commercial | 232,167 | 388,029 | 620,196 |
| Uninsured | 6,996 | 23,081 | 30,077 |
| Total | $ 722,175 | $ 891,516 | $ 1,613,691 |
| ***2022*** | | | |
| Medicare/Medicare Advantage | $ 417,327 | $ 358,694 | $ 776,021 |
| TennCare | 42,914 | 61,361 | 104,275 |
| Managed Care/Commercial | 203,268 | 364,084 | 567,352 |
| Uninsured | 10,932 | 26,675 | 37,607 |
| Total | $ 674,441 | $ 810,814 | $ 1,485,255 |

## NOTE D--INVESTMENTS AND ASSETS LIMITED AS TO USE

Investments and assets limited as to use consist of the following at December 31:

| | ***2023*** | ***2022*** |
|---|---|---|
| Long-Term Investment Portfolio | | |
| Cash and cash equivalents | $ 75,571 | $ 41,941 |
| U.S. Government and Agency securities, including mortgage-backed securities | 74,412 | 71,692 |
| U.S. Government inflation indexed securities | 46,135 | 22,660 |
| Municipal bonds | 29,767 | 34,578 |
| Corporate debt and preferred securities | 274,521 | 361,615 |
| Bond mutual funds | 71,433 | 77,512 |
| Equity mutual funds - domestic | 463,635 | 374,004 |
| Equity mutual funds - international | 196,614 | 168,595 |

***(Dollars in Thousands)***

| | | 2023 | | 2022 |
|---|---|---|---|---|
| Domestic equity securities | | 2,038 | | 1,582 |
| International equity securities | | 53,666 | | 43,840 |
| Commingled trust fund | | 33,091 | | 29,006 |
| Alternative investments | | 297,239 | | 271,021 |
| | | 1,618,122 | | 1,498,046 |
| Assets Limited as to Use | | | | |
| Cash, cash equivalents and commercial paper | | 22,260 | | 19,561 |
| Mutual funds - deferred compensation plans | | 40,847 | | 33,862 |
| | | 63,107 | | 53,423 |
| TOTAL INVESTMENTS AND ASSETS LIMITED AS TO USE | $ | 1,681,229 | $ | 1,551,469 |

The commingled trust fund and the alternative investments include an insignificant ownership percentage in various funds that are structured as limited liability companies, limited partnerships, or offshore limited partnerships. These investments are valued at their estimated fair value based, as a practical expedient, upon Covenant's interest in the net asset value of the respective fund. The funds have a wide range of investment strategies with various levels of risk and restrictions on redemption and certain funds may have restrictions on total liquidity. The estimated valuations of the alternative investments are subject to uncertainty and could differ from the amounts which could be realized in a ready market, and such differences could be material.

Certain investments are managed by a company, an officer of which is a member of Covenant's Board of Directors.

Unrestricted investment income, gains and losses on assets limited as to use, cash equivalents and investments consists of the following for the years ended December 31:

| | | 2023 | | 2022 |
|---|---|---|---|---|
| Investment income: | | | | |
| Interest and dividends | $ | 43,587 | $ | 41,035 |
| Net realized gains | | 8,470 | | 31,476 |
| Less: Investment expenses | | (2,497) | | (2,417) |
| Realized investment income | | 49,560 | | 70,094 |
| Change in net unrealized gains/losses on equity securities | | 143,406 | | (201,743) |
| Investment income (loss) reported as non-operating | $ | 192,966 | $ | (131,649) |

***(Dollars in Thousands)***

| | 2023 | 2022 |
|---|---|---|
| Other changes in net assets without donor restrictions: | | |
| Change in net unrealized gains/losses on investments | | |
| Debt securities | $ 13,653 | $ (45,737) |
| | $ 13,653 | $ (45,737) |

The age of gross unrealized losses on investments and assets limited as to use classified as debt securities that are not considered other-than-temporarily impaired as of December 31, 2023 and 2022 is as follows:

| | Less Than 12 Months | | Greater Than 12 Months | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| ***December 31, 2023*** | | | | | | |
| U.S. Government and Agency securities | $ 40,032 | $ (85) | $ 138,353 | $ (10,890) | $ 178,385 | $ (10,975) |
| Municipal obligations | - | - | 29,767 | (2,777) | 29,767 | (2,777) |
| Corporate debt | - | - | 178,685 | (14,784) | 178,685 | (14,784) |
| | $ 40,032 | $ (85) | $ 346,805 | $ (28,451) | $ 386,837 | $ (28,536) |
| ***December 31, 2022*** | | | | | | |
| U.S. Government and Agency securities | $ 91,402 | $ (3,073) | $ 57,778 | $ (11,643) | $ 149,180 | $ (14,716) |
| Municipal obligations | 14,126 | (573) | 20,451 | (3,698) | 34,577 | (4,271) |
| Corporate debt | 159,145 | (7,991) | 94,773 | (15,210) | 253,918 | (23,201) |
| | $ 264,673 | $ (11,637) | $ 173,002 | $ (30,551) | $ 437,675 | $ (42,188) |

Covenant believes, based on their analysis, that investments listed above with unrealized losses at December 31, 2023 are not other-than-temporarily impaired and that Covenant has the intent and ability to hold these investments to maturity. Such analysis may include industry outlooks, input from investment consultants, current market conditions and other information deemed relevant. Covenant determined that the unrealized losses associated with debt securities at December 31, 2023 are driven by changes in interest rates and are not due to the credit quality of the securities, and accordingly, no allowance for credit losses is considered necessary related to debt securities at December 31, 2023. As such, no provision for credit losses for debt securities was recognized during the year ended December 31, 2023. These securities will continue to be monitored as a part of Covenant's ongoing evaluation of credit quality. Due to uncertainties in the financial market, it is at least reasonably possible that Covenant's estimate may change in 2024. Total net unrealized gains on all investments and assets limited as to use was approximately $285,700 at December 31, 2023.

*(Dollars in Thousands)*

## NOTE E--PROPERTY, PLANT AND EQUIPMENT

Property, plant, and equipment consist of the following at December 31:

| | 2023 | 2022 |
|---|---|---|
| Land and land improvements | $ 105,127 | $ 106,016 |
| Buildings, fixtures and leasehold improvements | 1,330,587 | 1,254,827 |
| Equipment | 1,086,282 | 1,035,925 |
| | 2,521,996 | 2,396,768 |
| Less: Allowances for depreciation | (1,522,761) | (1,437,148) |
| | 999,235 | 959,620 |
| Projects in progress - Note J | 11,771 | 63,012 |
| | $ 1,011,006 | $ 1,022,632 |

Capitalized interest relating to construction in process was approximately $200 in 2022. No interest expense was capitalized in 2023.

## NOTE F--LONG-TERM DEBT

Long-term debt consists of the following at December 31:

| Description | Maturities | Rates | Outstanding Balance 2023 | Outstanding Balance 2022 |
|---|---|---|---|---|
| 2022 Notes* | $138,690 with annual principal payments through 2032 | 2.55%-2.61% | $ 138,690 | $ 150,000 |
| 2019 Bonds | $530,282 with sinking fund redemption through 2051 | 1.59%-2.39% | 530,282 | 531,582 |
| 2019 Notes* | $58,285 with varying payments through 2029 | 2.27%-2.29% | 58,285 | 64,180 |
| 2016 Bonds | $183,012 serially through 2047, net of premium of $16,219 in 2023 and $16,925 in 2022 | 3% to 5% | 199,231 | 200,120 |
| 2012 Bonds | $45,725 serially through 2026, net of premium of $2,342 in 2023 and $3,514 in 2022 | 3% to 5% | 48,067 | 62,549 |
| Note payable | Fixed rate bank loan with quarterly principal and interest payments through 2035 | 2.50% | 21,650 | 23,315 |

***(Dollars in Thousands)***

| | | | Outstanding Balance | |
|---|---|---|---|---|
| ***Description*** | ***Maturities*** | ***Rates*** | ***2023*** | ***2022*** |
| Note payable | Fixed rate bank loan with annual interest payments through 2025 and payment of principal in 2025 | 3.00% | 4,000 | 4,000 |
| Note payable | Life insurance policy loan | 3.90% | 1,343 | 1,171 |
| | | | 1,001,548 | 1,036,917 |
| | Less: Current portion of long-term debt obligations | | (37,092) | (33,667) |
| | Less: Bond issuance costs | | (1,450) | (1,672) |
| | | | $ 963,006 | $ 1,001,578 |

*Taxable debt

During 2022, Covenant issued $150,000 of taxable notes (the 2022 Notes) as direct debt obligations held by lending institutions to fund various joint venture projects and construction projects. The Series 2022A Note of $50,000 bears interest at a fixed rate of 2.61%. The Series 2022B Note of $50,000 bears interest at a fixed rate of 2.61%. The Series 2022C Note of $50,000 bears interest at a fixed rate of 2.55%. The 2022 Notes require semi-annual interest payments and annual principal payments through 2032.

During 2019, Covenant issued $534,172 of tax-exempt bonds through The Health, Educational and Housing Facility Board of the County of Knox, Tennessee to redeem various outstanding bond issues totaling $461,687 and to fund the acquisition, construction and equipping of healthcare facilities. Additionally, Covenant issued $75,000 of taxable notes to fund various joint venture projects.

The Series 2019A Hospital Revenue Bonds totaled $105,140 and are held by a lending institution. The Series 2019A bonds bear interest at a fixed rate of 1.59% through January 1, 2025 at which time the bonds may be converted to other various interest rate options. Upon conversion to another interest rate, the bonds are subject to optional redemption. The Series 2019A bonds require sinking fund redemption payments in various amounts from 2029 to 2043.

The Series 2019B Hospital Revenue Bonds totaled $117,712 and are held by a lending institution. The Series 2019B bonds bear interest at a fixed rate of 1.98% through January 1, 2030 at which time the bonds may be converted to other various interest rate options. Upon conversion to another interest rate, the bonds are subject to optional redemption. The Series 2019B bonds require sinking fund redemption payments in various amounts from 2044 to 2051.

The Series 2019C Note (Taxable) totaled $37,500 and is a direct debt obligation held by a lending institution. The Series 2019C note bears interest at a fixed rate of 2.27% and matures in various amounts from 2021 to 2029.

The Series 2019D Hospital Revenue Bonds totaled $101,920 and are held by a lending institution. The Series 2019D bonds bear interest at a fixed rate of 1.83% through January 1, 2027 at which time the bonds may be converted to other various interest rate options. Upon conversion to another interest rate, the bonds are subject to optional redemption. The Series 2019D bonds require sinking fund redemption payments in various amounts from 2029 to 2041.

The Series 2019E Hospital Revenue Bonds totaled $131,400 and are held by a lending institution. The Series 2019E bonds bear interest at a fixed rate of 2.17% through January 1, 2032 at which time the bonds may be converted to other various interest rate options. Upon conversion to another interest rate, the bonds are subject to optional redemption. The Series 2019E bonds require sinking fund redemption payments in various amounts from 2042 to 2051.

The Series 2019F Note (Taxable) totaled $37,500 and is a direct debt obligation held by a lending institution. The Series 2019F note bears interest at a fixed rate of 2.29% and matures in various amounts from 2021 to 2028.

The Series 2019G Hospital Revenue Bonds totaled $78,000 and are held by a lending institution. The Series 2019G bonds bear interest at a fixed rate of 2.39% and require sinking fund redemption payments in various amounts from 2021 to 2036.

During 2016, Covenant issued $185,515 of Hospital Revenue Bonds, Series 2016A, through The Health, Educational and Housing Facility Board of the County of Knox, Tennessee to redeem a portion of outstanding bonds and to finance construction and renovations for certain facilities. The Series 2016A bonds maturing on or after January 1, 2028 are subject to optional redemption by the issuer on or after January 1, 2027 at 100% of the principal amount. The 2016A bonds maturing in 2042 and 2047 are subject to mandatory sinking fund redemption payments beginning in 2038.

During 2012, Covenant issued $107,555 of Hospital Revenue Refunding Bonds, Series 2012, through The Health, Educational and Housing Facility Board of the County of Knox, Tennessee. The proceeds of the Series 2012 bonds were used to redeem a portion of Covenant's outstanding bonds.

These bonds and notes are secured by an interest in the gross receipts of the Obligated Group. Under the terms of the various bond and note indentures, Covenant is subject to a number of affirmative and negative covenants, including restrictions on the incurrence of additional debt, the maintenance of specific financial ratios, and restrictions on the transfer of assets. In the event such covenants are not met, Covenant may be required to engage a consultant and implement recommended actions or take other actions as required under the Master Trust Indenture. Covenant believes it is in compliance with all such requirements at December 31, 2023 and 2022.

During 2020, SHE entered into a $25,000 bank loan agreement for constructing and equipping a data center. Additionally, SHE established a $5,000 revolving line of credit to meet working capital needs. There were no amounts outstanding on the line of credit at December 31, 2022. This line of credit transferred to Fortress in 2022. The revolving line of credit expired during 2023.

***(Dollars in Thousands)***

RFTF is the beneficiary of a life insurance policy for a Covenant Board member. The cash surrender value of the policy is $6,102 and is included in other assets on the consolidated balance sheets as of December 31, 2023 and 2022. The outstanding policy loan balance includes the loan amount plus loan interest due.

The scheduled maturities and mandatory principal debt service payments on the long-term debt (excluding interest), exclusive of net unamortized original issue discounts and premiums, are as follows:

| *Year Ending December 31,* | | |
|---|---|---|
| 2024 | $ | 37,092 |
| 2025 | | 42,337 |
| 2026 | | 39,607 |
| 2027 | | 40,757 |
| 2028 | | 41,762 |
| Thereafter | | 781,432 |
| | | 982,987 |
| Net premiums | | 18,561 |
| | $ | 1,001,548 |

NOTE G--LEASES

Covenant has entered into various non-cancelable leases with third parties for medical office space and medical equipment. The components of lease expense are as follows:

| | | ***2023*** | | ***2022*** |
|---|---|---|---|---|
| Finance lease costs: | | | | |
| Amortization of right-to-use-asset | $ | 1,985 | $ | 2,337 |
| Interest on lease liability | | 169 | | 206 |
| Operating lease cost | | 6,027 | | 5,979 |
| Short term lease cost | | 2,301 | | 2,933 |
| | $ | 10,482 | $ | 11,455 |
| | | | | |
| Other information: | | | | |
| Right-of-use assets obtained for new finance leases | $ | 491 | $ | 3,011 |
| Right-of-use assets obtained for new operating leases | $ | 4,283 | $ | 9,040 |

***(Dollars in Thousands)***

| | ***2023*** | ***2022*** |
|---|---|---|
| Weighted average remaining lease term - finance leases | 2.9 years | 3.1 years |
| Weighted average remaining lease term - operating leases | 3.3 years | 3.9 years |
| Weighted average discount rate - finance leases | 3.55% | 3.37% |
| Weighted average discount rate - operating leases | 3.00% | 3.00% |

The following is a schedule of future minimum lease payments under operating and finance lease agreements:

| ***Year Ending December 31,*** | ***Finance*** | ***Operating*** |
|---|---|---|
| 2024 | $ 1,817 | $ 5,219 |
| 2025 | 1,416 | 1,822 |
| 2026 | 674 | 1,050 |
| 2027 | 147 | 940 |
| 2028 | 140 | 933 |
| Thereafter | 97 | 2,386 |
| Total lease payments | 4,291 | 12,350 |
| Less: Interest portion | (235) | (565) |
| Present value of lease obligations | 4,056 | 11,785 |
| Less: Current portion | (1,701) | (4,954) |
| Long-term lease obligations | $ 2,355 | $ 6,831 |

In addition, Covenant leases office space to physicians and others under various lease agreements with terms in excess of one year. Rental revenue recognized totaled approximately $13,610 and $13,910 for the years ended December 31, 2023 and 2022, respectively. The following is a schedule of future minimum lease payments to be received:

| ***Year Ending December 31,*** | |
|---|---|
| 2024 | $ 9,324 |
| 2025 | 7,795 |
| 2026 | 6,844 |
| 2027 | 5,704 |
| 2028 | 4,927 |
| Thereafter | 21,065 |
| | $ 55,659 |

NOTE H--INCOME TAXES

Fortress, CMG, and TenHats (the For-Profit Subsidiaries) file a group consolidated federal income tax return and separate company state income tax returns. As of December 31, 2023 and 2022, respectively, the For-Profit Subsidiaries have a net operating loss carryforward for federal income tax purposes of approximately $83,800 and $75,900, and for state purposes, approximately $119,700 and $116,200. These carryforward amounts relate to operating losses generated in prior years which expire through 2038. The remaining net operating loss carryforward may be offset against the future taxable income of each respective group or company.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of combined deferred taxes at December 31, 2023 and 2022 include deferred tax assets of approximately $25,400 and $23,500, respectively, related to net operating loss carryforwards. Other deferred tax assets total approximately $4,800 and $4,200 at December 31, 2023 and 2022, respectively, and relate to other temporary differences; primarily deferred salaries and book/tax differences in income from partnership investments. Deferred tax liabilities of approximately $860 and $240 at December 31, 2023 and 2022, respectively, relate primarily to book/tax differences in depreciation and amortization. Valuation allowances have been established for all net deferred tax assets as of December 31, 2023 and 2022.

Covenant had no unrecognized tax benefits at December 31, 2023 and 2022. As such, no interest or penalties were recognized in the consolidated financial statements related to unrecognized tax benefits. At December 31, 2023, tax returns for 2019 through 2023 are subject to examination by the Internal Revenue Service. Covenant has no uncertain tax positions that would require financial statement recognition or disclosure under GAAP at December 31, 2023 and 2022.

NOTE I--RETIREMENT PLANS

Covenant sponsors defined contribution plans (401(k) and 403(b) plans) for substantially all full-time employees meeting specified age and service requirements. Under these plans, during 2023 and 2022, Covenant made a discretionary matching contribution of up to 6% of participants' eligible wages. Additionally, Covenant sponsors a non-qualified retirement plan for certain members of management to defer a portion of their income. During 2023 and 2022, Covenant made a discretionary contribution of 4.5% of compensation, as defined, to this plan. Expenses related to all retirement plan contributions totaled approximately $20,200 and $18,700 in 2023 and 2022.

NOTE J--COMMITMENTS, CONTINGENCIES AND OTHER

*Professional Liability:* Covenant and subsidiaries maintain insurance policies to protect from catastrophic medical malpractice or general liability exposure. The policies obligate Covenant for the first $1,750 per occurrence for any claim (including claim expenses) made during the period per the policy Self-Insured Retention (SIR) and covers all entities, physicians, and providers. The aggregate SIR obligation is $21,000 annually. Beyond the SIR obligation, Covenant's policy of insurance provides a $50,000 limit of insurance as protection for such insured liabilities. This limit of liability applies "per occurrence" and in the "annual aggregate" for any claims made during the policy period.

An estimated reserve for ultimate losses on claims reported and claims incurred but not reported is established (undiscounted) based upon an actuarial study and is included in accrued expenses or other long-term liabilities based on Covenant's estimate of when such claims will be paid.

Covenant and its subsidiaries are named as defendants in various lawsuits and other actions claiming alleged damages. While the ultimate outcome of these proceedings is not presently determinable, it is the opinion of Covenant that the claims will have no material adverse effect on the financial position or results of operations.

*Employee Benefits*: Covenant is self-insured for worker's compensation claims and records estimated amounts for reported claims, as well as a reserve for claims incurred but not reported, based on an actuarial study. Covenant's estimate of the amount of claims that will be paid in any subsequent year is included in accrued expenses and the remaining liability is reported as other long-term liabilities. Covenant is required by the Tennessee Self-Insured Workers' Compensation Program to maintain an irrevocable Letter of Credit for $13,526 as collateral for workers' compensation claims.

Covenant maintains self-funded healthcare plans to provide reimbursement for covered expenses incurred by eligible employees and covered dependents. Covenant has recorded an estimated reserve for unpaid claims and claims incurred but not yet reported.

*Projects in Progress*: Certain subsidiaries of Covenant were engaged in construction and renovation projects at December 31, 2023. Projects on which commitments or contracts have been signed have an estimated cost to complete of approximately $48,900 at December 31, 2023 and a majority of which relates to facility renovation or expansion projects. Covenant has committed $15,000 towards expansions and improvement projects at Loudoun which began in 2023.

*Physician Agreements*: Covenant (or its subsidiaries) has entered into contractual relationships with physicians. These contracts include management services agreements, employment contracts, clinical scholar agreements and practice assistance agreements. These contracts have terms of varying lengths. Some contracts include certain base annual payments and may include additional incentives based on productivity levels.

*Municipal Leases:* Claiborne leases the real property, buildings, and improvements under an operating lease agreement with Claiborne County, Tennessee. The lease has been prepaid and was amended in 2023 to amend the lease term indefinitely and requiring no less than twenty-four months' written notice to the other party.

*Union Service Agreements:* Methodist participates in two separate union service agreements, the "RN Unit" agreement and the "Service and Technical Unit" agreement. The three-year agreements extend through October 2024 and provide a no strike and no lockout provision to protect both parties to the agreement.

*Healthcare Industry*: 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, Medicare fraud and abuse and under provisions of the Health Insurance Portability and Accountability Act of 1996, patient records privacy, and security. Government activity has increased 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.

NOTE K--FAIR VALUE MEASUREMENT

The framework for measuring fair value provides a fair value hierarchy based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels of the fair value hierarchy are defined as follows:

- *Level 1:* Inputs to the valuation methodology are quoted prices for identical assets or liabilities in active markets.

- *Level 2:* Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.

- *Level 3:* Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The following table presents assets reported at fair value as of December 31, 2023 and 2022 and their respective classification under the valuation hierarchy:

*(Dollars in Thousands)*

| | Carrying Value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| **Assets Measured at Fair Value on a Recurring Basis at December 31, 2023** | | | | |
| Cash and cash equivalents | $ 97,831 | $ 97,831 | $ - | $ - |
| U.S. Government and Agency securities | 74,412 | - | 74,412 | - |
| U.S. Government inflation indexed securities | 46,135 | - | 46,135 | - |
| Municipal bonds | 29,767 | - | 29,767 | - |
| Corporate debt | 274,521 | - | 274,521 | - |
| Mutual funds | 772,529 | 772,529 | - | - |
| Domestic equity securities | 2,038 | 2,038 | - | - |
| International equity securities | 53,666 | 53,666 | - | - |
| | 1,350,899 | $ 926,064 | $ 424,835 | $ - |
| Commingled trust fund at net asset value | 33,091 | | | |
| Alternative investments at net asset value | 297,239 | | | |
| | $ 1,681,229 | | | |
| **Assets Measured at Fair Value on a Recurring Basis at December 31, 2022** | | | | |
| Cash and cash equivalents | $ 61,502 | $ 61,502 | $ - | $ - |
| U.S. Government and Agency securities | 71,692 | - | 71,692 | - |
| U.S. Government inflation indexed securities | 22,660 | - | 22,660 | - |
| Municipal bonds | 34,578 | - | 34,578 | - |
| Corporate debt | 361,615 | - | 361,615 | - |
| Mutual funds | 653,973 | 653,973 | - | - |
| Domestic equity securities | 1,582 | 1,582 | - | - |
| International equity securities | 43,840 | 43,840 | - | - |
| | 1,251,442 | $ 760,897 | $ 490,545 | $ - |
| Commingled trust fund at net asset value | 29,006 | | | |
| Alternative investments at net asset value | 271,021 | | | |
| | $ 1,551,469 | | | |

Covenant's investments in a commingled trust fund and alternative investments are measured at fair value using the net asset value (NAV) per share (or its equivalent.) The commingled trust fund invests primarily in equity securities of international, small capitalization issuers with readily determinable market values. Upon approval by the fund manager, and with a 30-day written notice, Covenant may withdraw its entire interest at the NAV per unit.

The alternative investments include hedge funds with various strategies and restrictions as follows at December 31, 2023:

*(Dollars in Thousands)*

| | | | Redemption Frequency | Notice Period | Withdrawal Limitations |
|---|---|---|---|---|---|
| Long/short corporate credit hedge funds | $ | 76,114 | On-demand; Quarterly; Annually | 0-100 days | 0-25% investor-level gate; 0-15% fund-level gate |
| Long/short equity hedge funds | | 73,024 | On-demand; Quarterly; Annually | 0-60 days | 0-25% investor-level gate; 0-15% fund-level gate |
| Managed futures hedge funds | | 9,912 | Monthly | 14 days | N/A |
| Multi-strategy hedge funds | | 82,711 | On-demand; Quarterly | 0-90 days | 0-25% investor-level gate |
| Event-driven hedge funds | | 42,675 | On-demand; Quarterly | 0-65 days | 0-25% investor-level gate; 0-10% fund-level gate |
| Diversified global strategy hedge funds | | 12,803 | Quarterly | 60 days | N/A |
| | $ | 297,239 | | | |

## NOTE L--FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying value of substantially all financial instruments approximates fair value due to the nature or term of the instruments, except as described below. The following methods and assumptions were used to estimate the fair value of these other financial instruments:

*Long-term Debt:* The fair value of long-term debt is estimated based upon quotes from brokers for certain tax-exempt bonds and discounted future cash flows using current market rates for other debt. For long-term debt with variable interest rates, the carrying value approximates fair value.

*Other Long-term Liabilities*: Other long-term liabilities consist of reserves for professional and workers' compensation liabilities. The fair value of other long-term liabilities is not estimable, due to the uncertainties in determining the future payment date of liability claims.

The estimated fair value of Covenant's significant financial instruments which have carrying values different from fair value is as follows at December 31:

| | 2023 | | 2022 | |
|---|---|---|---|---|
| | ***Carrying Value*** | ***Estimated Fair Value*** | ***Carrying Value*** | ***Estimated Fair Value*** |
| Long-term debt | $ 1,001,548 | $ 973,368 | $ 1,036,917 | $ 985,295 |

## NOTE M--AVAILABILITY AND LIQUIDITY

The following reflects Covenant's financial assets as of December 31, 2023 and 2022 reduced by amounts not available for general use due to contractual or donor-imposed restrictions.

*(Dollars in Thousands)*

| | 2023 | 2022 |
|---|---|---|
| Financial assets | $ 2,048,976 | $ 1,940,890 |
| Less: | | |
| Amounts restricted by donors | 9,694 | 9,845 |
| Amounts restricted under bond agreements or employee benefit plan arrangements | 63,107 | 53,423 |
| Financial assets available to meet cash needs for general expenditures within one year | $ 1,976,175 | $ 1,877,622 |

Covenant receives amounts from donors which are required to be used for specific purposes (primarily operational in nature) or in specific timeframes and, therefore, are not available for general use. Additionally, Covenant has assets limited as to use which are restricted by contractual agreement to be utilized only for debt service or construction projects, as well as amounts which have been designated under various employee benefit plans. The amounts designated under employee benefit plans totaling $40,847 and $33,862 at December 31, 2023 and 2022, respectively, may be re-designated for other purposes upon Board approval. Neither the restricted nor designated assets limited as to use are available for general expenditure within one year from the consolidated balance sheet date. Covenant manages its cash and investments through a formalized investment process, which includes evaluating cash needs for routine and non-routine activities and adjusting the amount of cash held and the maturity of investment portfolios.

NOTE N--EXPENSES BY FUNCTIONAL CLASSIFICATION

Covenant provides healthcare services to residents within its geographic location. Expenses are allocated by function based on estimates of employees' time incurred, usage of resources, and other methods. Expenses based upon the functional classification related to providing these services during the years ended December 31, 2023 and 2022 are as follows:

| | *Healthcare Services* | *Support Services* | *Fundraising* | *Real Estate and Other* | *Total* |
|---|---|---|---|---|---|
| ***2023*** | | | | | |
| Salaries and benefits | $ 751,349 | $ 148,876 | $ 1,223 | $ 9,936 | $ 911,384 |
| Supplies and other | 541,400 | 159,217 | 1,356 | 15,256 | 717,229 |
| Provision for depreciation and amortization | 62,275 | 17,212 | 37 | 14,315 | 93,839 |
| Interest | 25,107 | 85 | 191 | 716 | 26,099 |
| | $ 1,380,131 | $ 325,390 | $ 2,807 | $ 40,223 | $ 1,748,551 |

***(Dollars in Thousands)***

| | *Healthcare Services* | *Support Services* | *Fundraising* | *Real Estate and Other* | *Total* |
|---|---|---|---|---|---|
| ***2022*** | | | | | |
| Salaries and benefits | $ 704,546 | $ 136,659 | $ 1,203 | $ 8,374 | $ 850,782 |
| Supplies and other | 502,423 | 156,611 | 1,389 | 13,633 | 674,056 |
| Provision for depreciation and amortization | 63,182 | 17,632 | 125 | 11,624 | 92,563 |
| Interest | 25,377 | 94 | 184 | 513 | 26,168 |
| | $ 1,295,528 | $ 310,996 | $ 2,901 | $ 34,144 | $ 1,643,569 |

## NOTE O--CORONAVIRUS DISEASE 2019 (COVID-19) IMPACT

In March 2020, the outbreak of COVID-19 was declared a public health emergency (PHE) by the Department of Health and Human Services (HHS) and declared a pandemic by the World Health Organization. Beginning in March 2020, the COVID-19 PHE and pandemic has caused significant volatility in financial markets and the economy. The healthcare industry has faced financial pressure from volatility in patient volumes, cancellations, and delays of elective medical procedures, rising labor costs and shortages, and rising costs associated with obtaining personal protective equipment and other medical supplies, among other factors.

Government support, including the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), provided essential funding to hospitals and other healthcare entities. During the years ended December 31, 2020 and 2021, Covenant received a total of approximately $114,500 of CARES Act Provider Relief funding in both general and targeted distributions and American Rescue Plan Rural payments. Covenant recognized revenues from CARES Act Provider Relief funding of approximately $34,200 during 2022 to offset estimated lost revenue and COVID-19 related expenses incurred based on the reporting guidelines published by HHS. Covenant has reported on expenditures of Provider Relief funding received during prior years in accordance with the reporting deadlines outlined by HHS.

Additionally, Covenant recognized revenues from other grants and supplemental funding from the State of Tennessee and other sources totaling approximately $2,600 during the year ended December 31, 2022. During 2022, Covenant received $16,600 from certain TennCare MCOs, approved by the centers for Medicare and Medicaid Services. The intent of these payments was to provide general financial assistance. Receiving facilities are not required to report COVID-19 costs or lost revenue in order to receive payment. All payments received were recognized as patient service revenue during 2022.

## NOTE P--SUBSEQUENT EVENTS

Subsequent events have been evaluated through the date of the Independent Auditor’s Report, which is the date the consolidated financial statements were available to be issued. Covenant did not note any material recognizable subsequent events that required recognition or disclosure in the December 31, 2023 consolidated financial statements.

# SECTION III

# INTERNAL CONTROL AND COMPLIANCE SECTION

PYA, P.C.
One Cherokee Mills
2220 Sutherland Avenue
Knoxville, TN 37919
(865) 673-0844 | pyapc.com

# 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*

## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Covenant Health:

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 Covenant Health (Covenant) which comprise the consolidated balance sheet as of December 31, 2023, and the related consolidated statements of operations and changes in net assets and cash flows for the year then ended, and the related notes to the consolidated financial statements and have issued our report thereon dated April 18, 2024.

***Report on Internal Control Over Financial Reporting***

In planning and performing our audit of the consolidated financial statements, we considered Covenant's internal control over financial reporting (internal control) as a basis for designing 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 Covenant's internal control. Accordingly, we do not express an opinion on the effectiveness of Covenant'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 Covenant'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 or significant deficiencies may exist that were not identified.

***Report on Compliance and Other Matters***

As part of obtaining reasonable assurance about whether Covenant'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 consolidated financial statements. 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 Covenant's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Covenant's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

PYA, P.C.

Knoxville, Tennessee
April 18, 2024

# COVENANT HEALTH

## *Schedule of Expenditures of Federal Awards*

## *Year Ended December 31, 2023*

| Assistance Listing Number | Award Number (Funding Allocation) | Entity | Program Name (Program Period) | Grantor | Pass-Through Grantor Agency | Expenditures From Direct Awards | Expenditures From Pass-Through Awards | Expenditures Total | Passed Through to Subrecipients |
|---|---|---|---|---|---|---|---|---|---|
| **FEDERAL AWARDS:** | | | | | | | | | |
| 93.498 | None (100% Federal) | Thompson Oncology | COVID-19, Provider Relief Fund and American Rescue Plan (ARP) Rural Distribution (04/10/2020 - 06/30/2023) | U.S. Department of Health & Human Services | None | $ - | | $ 206,443 | $ - |
| 93.788 | 33629 (100% Federal) | Parkwest | State Opioid Response (SOR) II Spoke (9/30/2022 - 9/29/2023) | U.S. Department of Health & Human Services | Tennessee Department of Mental Health & Substance Abuse Services | - | - | 186,085 | - |
| 93.958 | DGA 77421_2023-2025_012 (100% Federal) | Parkwest | Federal Block Grants for Community Mental Health Services (3/1/2023 - 6/30/2025) | U.S. Department of Health & Human Services | Tennessee Department of Mental Health & Substance Abuse Services | - | - | 41,129 | - |
| 93.959 | DGA 78116_2023-2024_010 (100% Federal) | Parkwest | Women's Recovery-Oriented System of Care (7/1/2023 - 6/30/2024) | U.S. Department of Health & Human Services | Tennessee Department of Mental Health & Substance Abuse Services | - | - | 55,594 | - |
| 93.301 | 34352-45723 (100% Federal) | Claiborne | Small Hospital Improvement Grant Program (SHIP) (6/1/2022 - 5/31/2023) | U.S. Department of Health & Human Services | Tennessee Department of Health | - | - | 13,011 | - |
| 93.323 | 34349-04323 (100% Federal) | Regional | COVID 19, LTCF Supply Reimbursement (12/5/2022 - 7/31/2024) | U.S. Department of Health & Human Services | Tennessee Department of Health | - | - | 2,000 | - |
| 93.323 | 34349-04323 (100% Federal) | Claiborne | COVID 19, LTCF Reimbursement of COVID Supplies for SVI counties (12/5/2022 - 7/31/2024) | U.S. Department of Health & Human Services | Tennessee Department of Health | - | - | 4,000 | - |
| 93.323 | 34349-56523 (100% Federal) | Various | COVID 19, TDOH Small and Critical Access Hospital Assistance with National Healthcare Safety Network (NHSN) Antibiotic Use (AU) Option Reporting (10/24/2022 - 12/31/2024) | U.S. Department of Health & Human Services | State of Tennessee | - | - | 17,800 | - |
| | | | | | **Total LTCF Reimbursement** | **-** | **-** | **23,800** | **-** |
| | | | | | **Total U.S. Department of Health & Human Services** | **-** | **-** | **526,062** | **-** |

**COVENANT HEALTH**

***Schedule of Expenditures of Federal Awards - Continued***

***Year Ended December 31, 2023***

| Assistance Listing Number | Award Number (Funding Allocation) | Entity | Program Name (Program Period) | Grantor | Pass-Through Grantor Agency | Expenditures From Direct Awards | From Pass-Through Awards | Total | Passed Through to Subrecipients |
|---|---|---|---|---|---|---|---|---|---|
| 32.006 | None (100% Federal) | Various | Covid-19 Telehealth Program (3/13/2020 - 8/25/2022 | Federal Communications Commission | None | - | | 258,272 | - |
| | | | | | **Total Federal Communications Commission** | **-** | **-** | **258,272** | **-** |
| 84.181A | 33195-00419 (100% Federal) | Methodist | TEIS Vendor Services (7/1/2019-6/30/2024) | U.S. Department of Education | Tennessee Department of Education | - | - | 11,278 | - |
| | | | | | **Total U.S. Department of Education** | **-** | **-** | **11,278** | **-** |
| | | | | | **TOTAL FEDERAL AWARDS** | **$ -** | **$ -** | **$ 795,612** | **$ -** |

# COVENANT HEALTH

## *Schedule of Expenditures of State Financial Assistance*

## *Year Ended December 31, 2023*

| Grant Number (Funding Allocation) | Entity | Program Name (Program Period) | Grantor | Pass-Through Grantor Agency | Receivable (Unexpended) Balance at January 1, 2023 | Receipts | Amounts Earned by Expenditures | Other | Receivable (Unexpended) Balance at December 31, 2023 |
|---|---|---|---|---|---|---|---|---|---|
| GR-20-61131-00 (100% State) | Regional | Service Coordination for TBI Survivors (7/1/2021 - 6/30/2024) | Tennessee Department of Health | N/A | $ - | $ (14,500) | $ 28,435 | $ - | $ 13,935 |
| 34347-53822 (100% State) | Regional | Service Coordination for TBI Survivors (7/1/2022 - 6/30/2023) | Tennessee Department of Health | N/A | 13,938 | (41,640) | 27,702 | - | - |
| DGA_74144_2022-2023_007 (100% State) | Parkwest | Support Behavioral Health Workforce (7/1/2022 - 6/30/2025) | Tennessee Department of Mental Health & Substance Abuse Services | N/A | 24,008 | (254,363) | 248,803 | - | 18,448 |
| DGA 78082_2023-2026_010 (100% State) | Parkwest | Community Targeted Transitional Support (CTTS) (7/1/2023 - 6/30/2026) | Tennessee Department of Mental Health & Substance Abuse Services | N/A | 4,409 | (98,071) | 99,802 | - | 6,140 |
| 74043 (100% State) | Parkwest | Inpatient Uninsured Psychiatric Services (7/1/2022 - 6/30/2027) | Tennessee Department of Mental Health & Substance Abuse Services | N/A | 338,990 | (6,314,929) | 4,922,740 | - | (1,053,199) |
| DGA_74117_2022-2023_009 (100% State) | Parkwest | Behavioral Health Safety Net for Children (7/1/2022 - 6/30/2023) | Tennessee Department of Mental Health & Substance Abuse Services | N/A | 14,943 | (46,056) | 33,970 | - | 2,857 |
| DGA 74143_2022-2025_009 (100% State) | Parkwest | Behavioral Health Safety Net for Adults (7/1/2012 - 6/30/2025) | Tennessee Department of Mental Health & Substance Abuse Services | N/A | 37,667 | (573,316) | 586,013 | - | 50,364 |
| | | | | **TOTAL STATE AWARDS** | **$ 433,955** | **$ (7,342,875)** | **$ 5,947,465** | **$ -** | **$ (961,455)** |

NOTE A--BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards and schedule of expenditures of state financial assistance includes the federal and state award activity of Covenant and subsidiaries and are presented on the accrual basis of accounting. The information in these schedules is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulation (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) and the State of Tennessee Comptroller of the Treasury, respectively. Therefore, some amounts presented in these schedules may differ from amounts presented in, or used in the preparation of, the consolidated financial statements.

NOTE B--SIGNIFICANT ACCOUNTING POLICIES

*De Minimis Indirect Cost Rate:* Covenant has elected not to use the 10 percent de minimis indirect cost rate allowed under the Uniform Guidance.

NOTE C--CONTINGENCIES

Covenant's federal and state programs are subject to financial and compliance audits by grantor agencies which, if instances of material noncompliance are found, may result in disallowed expenditures and affect Covenant's continued participation in specific programs. The amount, if any, of expenditures which may be disallowed by the grantor agencies cannot be determined at this time. Covenant believes such amounts, if any, to be immaterial.

NOTE D--PROVIDER RELIEF FUNDS

As discussed in Note O to the accompanying consolidated financial statements, Covenant received a significant amount of funding from the Coronavirus Aid, Relief, and Economic Security Act Provider Relief Fund (PRF) program. Expenditures under this program are subject to the Uniform Guidance. In accordance with the 2023 Compliance Supplement, PRF amounts received during the period January 1 – June 30, 2022 that were used by June 30, 2023 are included in the accompanying schedule of expenditures of federal awards. Accordingly, amounts received prior to January 1, 2022 have not been included in the accompanying schedule of expenditures of federal awards.

***<u>Section I - Summary of Auditor's Results</u>***

**FINANCIAL STATEMENTS**

The auditor's report expressed an unmodified opinion on the consolidated financial statements of Covenant Health.

| | |
|---|---|
| **Internal control over financial reporting:** | |
| Material weakness(es) identified? | Yes [ ] No [X] |
| Significant deficiency identified? | None Reported |
| Noncompliance material to consolidated financial statements noted? | Yes [ ] No [X] |

**FEDERAL AWARDS**

| | |
|---|---|
| **Internal control over major federal programs:** | |
| Material weakness(es) identified? | Yes [ ] No [X] |
| Significant deficiency identified? | None Reported |
| Type of auditor's report issued on compliance for major federal programs: | Unmodified |
| Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? | Yes [ ] No [X] |

**Identification of Major Programs:**

| *Assisted Listing Number* | *Name of Federal Program or Cluster* |
|---|---|
| 93.498 | COVID-19, Provider Relief Fund and American Rescue Plan (ARP) Distribution - U.S. Department of Health & Human Services |

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

***<u>Section II - Financial Statement Findings</u>***

None.

***<u>Section III - Federal Award Findings and Questioned Costs</u>***

None.

**COVENANT HEALTH**

***Summary Schedule of Prior Audit Findings***

***Year Ended December 31, 2023***

There were no prior audit findings.

PYA, P.C.
One Cherokee Mills
2220 Sutherland Avenue
Knoxville, TN 37919
(865) 673-0844 | pyapc.com

# REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH THE UNIFORM GUIDANCE

## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Covenant Health:

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

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

We have audited Covenant Health's (Covenant) compliance with the types of compliance requirements identified as subject to audit in the U.S. Office of Management and Budget *Compliance Supplement* that could have a direct and material effect on each of Covenant's major federal programs for the year ended December 31, 2023. Covenant's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

In our opinion, Covenant 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 December 31, 2023.

***Basis for Opinion on Each Major Federal Program***

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America (GAAS); the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States (*Government Auditing Standards*); 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). Our responsibilities under those standards and the Uniform Guidance are further described in the Auditor's Responsibilities for the Audit of Compliance section of our report.

We are required to be independent of Covenant and to meet our other ethical responsibilities, in accordance with relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion on compliance for each major federal program. Our audit does not provide a legal determination of Covenant's compliance with the compliance requirements referred to above.

***Responsibilities of Management for Compliance***

Management is responsible for compliance with the requirements referred to above and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules and provisions of contracts or grant agreements applicable to Covenant's federal programs.

***Auditor's Responsibilities for the Audit of Compliance***

Our objectives are to obtain reasonable assurance about whether material noncompliance with the compliance requirements referred to above occurred, whether due to fraud or error, and express an opinion on Covenant's compliance based on our audit. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS, *Government Auditing Standards*, and the Uniform Guidance will always detect material noncompliance when it exists. The risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Noncompliance with the compliance requirements referred to above is considered material, if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about Covenant's compliance with the requirements of each major federal program as a whole.

In performing an audit in accordance with GAAS, *Government Auditing Standards*, and the Uniform Guidance, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material noncompliance, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding Covenant's compliance with the compliance requirements referred to above and performing such other procedures as we considered necessary in the circumstances.

- Obtain an understanding of Covenant's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances 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 Covenant's internal control over compliance. Accordingly, no such opinion is expressed.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that we identified during the audit.

***Report on 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 Auditor's Responsibilities for the Audit of Compliance section above and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance. Given these limitations, during our audit we did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses as defined above. However, material weaknesses or significant deficiencies in internal control over compliance may exist that were not identified.

Our audit was not designed for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, no such opinion is expressed.

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 requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

PYA, P.C.

Knoxville, Tennessee
June 25, 2024