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MCLEAN AFFILIATES, INC.

FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION
SEPTEMBER 30, 2018 AND 2017

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MCLEAN AFFILIATES, INC.

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Independent Auditors' Report

To the Board of Directors
McLean Affiliates, Inc.
Simsbury, Connecticut

We have audited the accompanying financial statements of McLean Affiliates, Inc., which comprise the statements of financial position as of September 30, 2018 and 2017, and the related statements of activities and changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of McLean Affiliates, Inc., as of September 30, 2018 and 2017, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplemental detail of operating expenses is presented for the purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Blum, Shapiro & Company, P.C.

West Hartford, Connecticut
December 11, 2018

MCLEAN AFFILIATES, INC.

STATEMENTS OF FINANCIAL POSITION SEPTEMBER 30, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 6,428,941	\$ 8,889,380
Accounts receivable, net of allowance of \$341,008 in 2018 and \$334,131 in 2017	1,745,906	1,819,494
Due from related party	81,553	-
Notes receivable	189,000	-
Prepaid expenses and other current assets	470,174	322,423
Total current assets	<u>8,915,574</u>	<u>11,031,297</u>
Investments	<u>10,488,692</u>	<u>8,116,040</u>
Assets Whose Use is Limited	<u>287,125</u>	<u>289,873</u>
Charitable Remainder Trust, Net	<u>545,966</u>	<u>524,714</u>
Property and Equipment		
Land	29,950	29,950
Land improvements	3,266,506	2,487,961
Buildings	30,141,974	27,763,298
Fixed equipment	9,591,016	9,319,140
Movable equipment	3,045,174	2,721,877
Construction in progress	426,248	74,121
	<u>46,500,868</u>	<u>42,396,347</u>
Less accumulated depreciation	<u>25,574,827</u>	<u>23,644,766</u>
Property and equipment, net	<u>20,926,041</u>	<u>18,751,581</u>
Other Noncurrent Assets	<u>129,721</u>	<u>147,349</u>
Total Assets	<u>\$ 41,293,119</u>	<u>\$ 38,860,854</u>

The accompanying notes are an integral part of the financial statements

MCLEAN AFFILIATES, INC.

STATEMENTS OF FINANCIAL POSITION (CONTINUED) SEPTEMBER 30, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable	\$ 1,113,991	\$ 1,104,105
Entrance fee refunds payable	3,071	7,405
Accrued salaries, wages, payroll taxes and other	1,129,408	1,084,597
Accrued expenses	364,911	293,939
Deferred revenue	492,364	513,219
Deposits held for residents	1,018,183	430,622
Total current liabilities	<u>4,121,928</u>	<u>3,433,887</u>
Refundable Entrance Fees, Net of Current Portion	5,608,513	6,365,062
Deferred Revenue from Nonrefundable Entrance Fees	3,452,736	3,193,789
Other Liabilities	66,621	84,401
Total liabilities	<u>13,249,798</u>	<u>13,077,139</u>
Net Assets		
Unrestricted	25,816,473	23,681,304
Temporarily restricted	2,226,848	2,102,411
Total net assets	<u>28,043,321</u>	<u>25,783,715</u>
Total Liabilities and Net Assets	<u>\$ 41,293,119</u>	<u>\$ 38,860,854</u>

The accompanying notes are an integral part of the financial statements

MCLEAN AFFILIATES, INC.

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS FOR THE YEARS ENDED SEPTEMBER 30, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
Unrestricted Revenues and Other Support		
Net resident service fee revenue	\$ 27,600,966	\$ 26,485,131
Provision for bad debts	<u>(42,000)</u>	<u>(42,000)</u>
Net patient service revenues	27,558,966	26,443,131
Contributions received from related entities	366,052	322,992
Contributions	191,272	226,779
Other unrestricted revenues	175,662	181,123
Net assets released from restrictions	<u>213,542</u>	<u>138,525</u>
Total unrestricted revenues and other support	<u>28,505,494</u>	<u>27,312,550</u>
Expenses		
Salaries and wages	14,752,973	14,117,570
Employee benefits	3,172,951	2,919,828
Other expenses	6,868,746	6,662,318
Depreciation	<u>1,932,977</u>	<u>1,736,911</u>
Total expenses	<u>26,727,647</u>	<u>25,436,627</u>
Income from Operations	<u>1,777,847</u>	<u>1,875,923</u>
Other Income (Expense)		
Other expense	(15,992)	(1,220)
Interest and dividend income	195,872	154,351
Net other income	<u>179,880</u>	<u>153,131</u>
Excess of Revenues over Expenses	1,957,727	2,029,054
Other Changes in Unrestricted Net Assets		
Change in net unrealized gains on investments	<u>177,442</u>	<u>555,535</u>
Changes in unrestricted net assets	<u>2,135,169</u>	<u>2,584,589</u>
Changes in Temporarily Restricted Net Assets		
Change in value of charitable remainder trust	21,252	45,917
Contributions	316,727	393,449
Net assets released from restrictions	<u>(213,542)</u>	<u>(138,525)</u>
Changes in temporarily restricted net assets	<u>124,437</u>	<u>300,841</u>
Change in Net Assets	2,259,606	2,885,430
Net Assets - Beginning of Year	<u>25,783,715</u>	<u>22,898,285</u>
Net Assets - End of Year	<u>\$ 28,043,321</u>	<u>\$ 25,783,715</u>

The accompanying notes are an integral part of the financial statements

MCLEAN AFFILIATES, INC.

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
Cash Flows from Operating Activities		
Change in net assets	\$ 2,259,606	\$ 2,885,430
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Proceeds from entrance fees	1,687,500	1,313,500
Refunds of entrance fees and entrance fee payable	(424,084)	(339,221)
Amortization of entrance fees	(1,343,202)	(1,000,106)
Depreciation	1,932,977	1,736,911
Provision for bad debts	42,000	42,000
Change in value of charitable remainder trust	(21,252)	(45,917)
Change in net unrealized (gain) on investments	(177,442)	(555,535)
(Increase) decrease in operating assets:		
Accounts receivable	31,588	(46,322)
Due from related party	(81,553)	-
Prepaid expenses and other current assets	(147,751)	2,249
Other noncurrent assets	17,628	17,628
Increase (decrease) in operating liabilities:		
Accounts payable	9,886	158,639
Accrued salaries, wages, payroll taxes and other	44,811	89,649
Accrued expenses	70,972	15,282
Deferred revenue	(20,855)	(55,649)
Deposits held for residents	(23,589)	(303,299)
Other liabilities	(20,696)	-
Net cash provided by operating activities	<u>3,836,544</u>	<u>3,915,239</u>
Cash Flows from Investing Activities		
Purchases of investments, net	(2,192,462)	(1,159,536)
Purchases of property and equipment	(4,104,521)	(1,715,490)
Net cash used in investing activities	<u>(6,296,983)</u>	<u>(2,875,026)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(2,460,439)	1,040,213
Cash and Cash Equivalents - Beginning of Year	<u>8,889,380</u>	<u>7,849,167</u>
Cash and Cash Equivalents - End of Year	<u>\$ 6,428,941</u>	<u>\$ 8,889,380</u>

The accompanying notes are an integral part of the financial statements

MCLEAN AFFILIATES, INC.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION

McLean Affiliates, Inc. (McLean) was incorporated as a nonprofit entity on October 1, 2008, as a subsidiary of the McLean Fund (the Fund), a trust created by the last will of George P. McLean. Prior to this incorporation, McLean operated as a unit of the Fund. The subsidiaries of the Fund include McLean, the McLean Foundation, Inc. (the Foundation) and the McLean Game Refuge (the Refuge). The Foundation and the Refuge are not included in these statements.

McLean operates as a Continuing Care Retirement Community (CCRC) and a long-term care facility located in Simsbury, Connecticut. As of September 30, 2018, McLean has 89 Medicaid and Medicare certified skilled nursing beds, 71 assisted living units, 3 residential care home beds, and 88 independent living apartments and cottages.

McLean provides a full range of services, including physical therapy, occupational therapy and speech therapy. The average occupancy for McLean was 84% and 85% for 2018 and 2017, respectively. In addition, McLean provides home care, hospice, adult day care and Meals on Wheels services to residents of Simsbury and surrounding towns.

Overall occupancy levels at McLean for the years ended September 30, 2018 and 2017, are as follows:

	<u>2018</u>	<u>2017</u>
Independent Living	86%	86%
Assisted Living	79%	82%
Skilled Nursing Care	88%	86%

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

In order to ensure observance of limitations and restrictions placed on the use of the resources available to McLean, the accounts are maintained on the accrual basis of accounting and, accordingly, the accounts of McLean are reported in the following net asset categories.

Unrestricted

Unrestricted net assets represent resources that may be expended at the direction of the Board of Directors. Net assets set aside by the Board of Directors for future capital improvements, over which the Board retains control and may, at its discretion, subsequently use for other purposes, are included in unrestricted net assets.

Temporarily Restricted

These assets represent resources that have donor-imposed restrictions as to purpose or time of expenditure. When the purpose or timing restrictions have been met, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities and changes in net assets as net assets released from restriction. Temporarily restricted net assets as of September 30, 2018 are restricted for time, capital projects and other resident assistance purposes. Details of temporarily restricted net assets are included in Note 7.

MCLEAN AFFILIATES, INC.

NOTES TO FINANCIAL STATEMENTS

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Financial statement areas where management applies the use of estimates consist primarily of the allowance for doubtful accounts, amortization of entrance fees and valuation of the charitable remainder trust. It is management's opinion that the estimates applied in the accompanying financial statements are reasonable. However, actual results could differ from those estimates.

Cash and Cash Equivalents

McLean considers all short-term, highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents. McLean maintains its cash and cash equivalents in bank deposit accounts that, at times, may exceed federally insured limits. McLean believes it is not exposed to any significant credit risk on cash and cash equivalents.

Cash equivalents are comprised of money market funds. Money market funds are not insured by the FDIC and are not a risk-free investment. Money market funds invest in a variety of instruments including mortgage-backed and asset-backed securities. Although a money market fund seeks to preserve its one dollar per share value, it is possible that a money market fund's value can decrease below one dollar per share.

Accounts Receivable

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, McLean analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate an appropriate allowance for doubtful accounts and provision for bad debts based upon management's assessment of historical and expected net collections considering business and economic conditions, trends in health care coverage and other collection indicators. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

Investment Valuation and Income Recognition

Investments are reported at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See Note 3 for a discussion of fair value measurements.

Purchases and sales of securities are recorded on the trade date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

Investments in equity securities with readily determinable fair values and all investments in debt securities are reported at fair value in the accompanying statements of financial position with realized and unrealized gains and losses on these investments included in the accompanying statements of activities and changes in net assets as increases or decreases in unrestricted net assets.

MCLEAN AFFILIATES, INC.

NOTES TO FINANCIAL STATEMENTS

McLean accounts for other-than-temporary impairments in accordance with GAAP and continually reviews its securities for impairment conditions, which could indicate that other-than-temporary declines in market value have occurred. In conducting this review, numerous factors are considered, which include specific information pertaining to an individual company or a particular industry, general market conditions that reflect prospects for the economy as a whole, and the ability and intent to hold securities until recovery. The carrying value of investments is reduced to its estimated realizable value if a decline in fair value is considered to be other-than-temporary. Management does not believe any of these investment declines are other-than-temporary and, therefore, McLean did not record an impairment charge for the years ended September 30, 2018 and 2017.

Assets Whose Use is Limited

Assets whose use is limited include assets restricted under State of Connecticut law governing CCRC entrance fee escrow arrangements and assets set aside for operating CCRC escrow and reserve funds.

Charitable Remainder Trust

Charitable remainder trust consists of assets irrevocably transferred for the benefit of McLean and other beneficiaries. Revocable charitable remainder trust agreements are not recorded as contributions unless enforceable by law. Irrevocable charitable remainder trusts are recorded as contributions at fair value when the assets are received or when McLean is notified of the existence of the agreement. The accounting treatment varies depending upon the type of the agreement created and whether McLean or a third party is the trustee.

McLean is the beneficiary of an irrevocable charitable remainder trust which is managed by a third-party trustee. A charitable remainder trust provides for the payment of distributions to the grantor or other designated beneficiaries over the trust's term (usually the designated beneficiary's lifetime). At the end of the trust's term, the remaining assets are available for McLean's use.

The trusts are carried at the net fair value of the underlying investments less the estimated liability to the designated beneficiary. The portion of the trust attributable to the present value of the future benefits to be received by McLean is recognized in the statement of activities and changes in net assets as a temporarily restricted contribution in the period the trust is established.

Note Receivable

The note receivable includes a promissory note entered into with a CCRC resident in lieu of a portion of their entrance fee. These amounts are to be paid in full upon sale of the resident's real estate or a fixed date, whichever is earlier.

Property and Equipment

Property and equipment are recorded at cost. Routine maintenance, repairs, renewals and replacement costs are charged against income. Expenditures in excess of \$2,000 that materially increase values, change capacities or extend useful lives are capitalized. Upon sale or retirement of property, plant and equipment, the cost and related accumulated depreciation are eliminated from the respective accounts, and the resulting gain or loss is included in other income in the statements of activities and changes in net assets.

MCLEAN AFFILIATES, INC.

NOTES TO FINANCIAL STATEMENTS

Depreciation of property and equipment is provided using the straight-line method over the estimated useful lives of the assets as follows:

Land improvements	5-30 years
Buildings	10-40 years
Fixed equipment	5-25 years
Movable equipment	5-20 years

Depreciation expense totaled \$1,932,977 and \$1,736,911 for the years ended September 30, 2018 and 2017, respectively.

As of September 30, 2018, McLean has spent \$424,348 on capital projects in anticipation of total costs amounting to \$435,451.

Asset Retirement Obligation

McLean accounts for any conditional asset retirement obligations in accordance with the provisions of GAAP. GAAP requires that an entity recognize a liability for the fair value of conditional asset retirement obligations if the fair value of the liability can be reasonably estimated. The fair value of a liability for conditional asset retirement obligations must be recognized when incurred, generally upon acquisition, construction, development or through the normal operation of the asset. McLean conducted a review of its facilities to determine if there are any assets that give rise to the obligation to perform asset retirement activity, which may not be within its control, such as the remediation or removal of asbestos containing materials.

McLean has certain items in its buildings that it believes may result in asset retirement costs. McLean currently has no plans to renovate the areas that contain these items or remove these items from service. However, McLean has determined what it believes to be a reasonable settlement date to retire these items in the event that such retirement is not within their control. The initial estimated current cost associated with the retirement of these items was determined to be \$52,000 and was recorded as an asset retirement obligation in other liabilities on the accompanying statements of financial position. For each of the years ended September 30, 2018 and 2017, the estimated current cost accreted amounted to \$2,919 and has been reflected in the statements of activities and changes in net assets.

Revenue from Residents

Upon occupancy of an independent living unit at McLean, residents pay an entrance fee, a portion of which is refundable and a portion of which is nonrefundable (see Note 6). The nonrefundable portion of the entrance fee is deferred and amortized into income over the estimated remaining lives of the individual residents as determined by McLean use of mortality tables.

Additionally, the residents of the independent living units pay a monthly fee to cover the services they receive. These resident service fees are recorded as revenue when earned.

Health Center Patient Revenues

Patient revenues are recorded when patient services are performed. Amounts received from certain payors are different from the established billing rates of McLean, and these differences are accounted for as contractual allowances. Net patient service revenues are reported at the estimated net realizable amount from patients, third-party payors and others for services rendered.

MCLEAN AFFILIATES, INC.

NOTES TO FINANCIAL STATEMENTS

Contributions

Contributions are defined as voluntary, nonreciprocal transfers. Unrestricted and unconditional contributions are recognized as support when received or pledged, if applicable. Contributions are reported as temporarily restricted support if they are received with donor stipulations that limit the use of such assets. When a restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the accompanying statements of activities and changes in net assets as net assets released from restrictions due to satisfaction of restrictions. Contributions received whose restrictions are met in the same period are presented with unrestricted net assets.

Other Unrestricted Revenues

Other unrestricted revenues consists of charges for additional resident meals, guest meals, cable television, beauty salon services and other miscellaneous charges to residents.

Income Taxes

McLean is a not-for-profit trust described in Section 501(c)(3) of the Internal Revenue Code (the Code) and is exempt from federal income taxes pursuant to Section 501(a) of the Code.

Reclassifications

Certain amounts in the prior year financial statements have been reclassified to conform to the current year's presentation.

Subsequent Events

In preparing these financial statements, management has evaluated subsequent events through December 11, 2018, which represents the date the financial statements were available to be issued.

NOTE 3 - FAIR VALUE OF FINANCIAL INSTRUMENTS

Generally accepted accounting principles establish a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1

Quoted market prices (unadjusted) in active markets for identical assets or liabilities that McLean has the ability to access at the measurement date.

Level 2

Inputs and information other than quoted market indices included in Level 1 that are observable for the asset or liability, either directly or indirectly, and McLean has the ability to redeem the asset or liability in the near term subsequent to the measurement date.

MCLEAN AFFILIATES, INC.

NOTES TO FINANCIAL STATEMENTS

Level 3

Unobservable inputs are used to measure the fair value to the extent that observable inputs are not available, and McLean does not have the ability to redeem the asset or liability in the near term subsequent to the measurement date.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Financial Instruments Measured at Fair Value

The following is a description of the valuation methodologies and investment strategies used for financial instruments measured at fair value:

Fixed Income

Fixed income investments are valued using quoted market prices in an active market in which the securities are traded.

Equity

Equity funds are valued at the quoted net asset value of shares reported in the active market in which the funds are traded.

Charitable Remainder Trust

Fair value inputs used for charitable remainder trusts are based on the estimated present value of the future payment to McLean, which is considered to be the fair value of the assets held in trust less estimated future payments to the designated beneficiaries.

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

There have been no changes in the methodologies used at September 30, 2018 and 2017.

The following is a summary of the source of fair value measurements for assets and liabilities that are measured at fair value as of September 30, 2018 and 2017:

Description	2018			Total
	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	
Assets:				
Investments:				
Fixed income investments	\$ 6,125,843	\$ -	\$ -	\$ 6,125,843
Equity investments	4,362,849	-	-	4,362,849
Total investments	10,488,692	-	-	10,488,692
Charitable remainder trust	-	545,966	-	545,966
Total Assets Measured at Fair Value	\$ 10,488,692	\$ 545,966	\$ -	\$ 11,034,658

MCLEAN AFFILIATES, INC.

NOTES TO FINANCIAL STATEMENTS

Description	2017			Total
	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	
Assets:				
Investments:				
Fixed income investments	\$ 1,504,342	\$ -	\$ -	\$ 1,504,342
Equity investments	6,611,698	-	-	6,611,698
Total investments	8,116,040	-	-	8,116,040
Charitable remainder trust	-	524,714	-	524,714
Total Assets Measured at Fair Value	\$ 8,116,040	\$ 524,714	\$ -	\$ 8,640,754

NOTE 4 - NET PATIENT SERVICE REVENUES

The following table summarizes net patient service revenues for the years ended September 30, 2018 and 2017:

	2018	2017
Gross patient service revenues:		
Long-term care	\$ 10,177,685	\$ 9,665,719
Post-acute care	5,847,943	5,747,059
Home health services	4,852,245	4,947,179
Independent living	5,141,582	4,718,145
Assisted living	5,977,597	6,016,107
Outpatient services	537,520	543,749
	32,534,572	31,637,958
Less contractual allowances	4,933,606	5,152,827
Total Net Patient Service Revenues	\$ 27,600,966	\$ 26,485,131

McLean has agreements with third-party payors that provide for payments to McLean at amounts different from established rates. A summary of the payment arrangements with major third-party payors is as follows:

Medicare

Inpatient long-term care services rendered to Medicare program beneficiaries are paid based upon a per-diem prospective payment rate. Home care services rendered to Medicare program beneficiaries are paid based upon a 60-day episodic prospective payment rate.

Medicaid

Inpatient long-term care services rendered to Medicaid program beneficiaries are paid based upon a per-diem cost-based payment rate, which is subject to State audit adjustments. Home care services rendered to Medicaid program beneficiaries are paid based upon a per visit or per hour payment rate.

MCLEAN AFFILIATES, INC.

NOTES TO FINANCIAL STATEMENTS

Revenue under third-party payor agreements is subject to audit and retroactive adjustments. Provisions for estimated third-party payor settlements and adjustments are estimated in the period in which the related services are rendered and adjusted in future periods as final settlements are determined. Management believes that all applicable government reimbursement principles have been properly applied and that no material adjustments will occur as a result of an audit.

During 2018 and 2017, approximately 29% and 32% of net patient revenue was received under the Medicare program, respectively. During 2018 and 2017, 12% and 14% of net patient service revenue was received under the Medicaid program, respectively. Significant concentrations of net patient receivables are 52% Medicare and 12% Medicaid as of September 30, 2018, and 51% Medicare and 14% Medicaid as of September 30, 2017.

NOTE 5 - ASSETS WHOSE USE IS LIMITED

Under Connecticut state law, McLean is required to maintain certain reserve funds as follows:

Operation and Maintenance Account

McLean is required to maintain one month's budgeted operating expenses in this account as described in Note 2.

Entry Fee Proceeds Account

McLean is required to deposit all entrance fees into the entry fee proceeds account as received. Upon the later of the expiration of the applicable statutory rights of the purchaser to rescind (30 days) or the date of occupancy, the balance in the account is available for operations.

The reserve funds are all included within assets whose use is limited on the statements of financial position.

NOTE 6 - CCRC ENTRY FEES AND OBLIGATIONS TO PROVIDE FUTURE BENEFITS

Certain McLean residents are provided living accommodations and other facilities and services in exchange for payment of entrance fees and monthly service charges. Residents can choose from refundable and nonrefundable agreements.

Under the terms of nonrefundable agreements, entrance fees are not refundable to residents who reside independently at McLean for more than fifty months. A resident who leaves prior to fifty months under this agreement is refunded a portion of their entrance fee, which declines approximately 2% per month for each month the unit was occupied. These entrance fees are recorded as deferred revenue upon receipt and amortized on a straight-line basis into revenue over the remaining estimated life expectancy of the individual resident. Upon termination of the agreement, the amount of any unamortized, nonrefundable entrance fee is recorded as revenue.

Under the terms of refundable agreements, portions of the entrance fees are fully refundable at a designated percentage. The entire amount of this designated refundable percentage is recorded as refundable entry fees on the statements of financial position. The remaining nonrefundable portion of the entrance fees are accounted for and amortized in line with the nonrefundable agreements. Entrance fee refunds due under these agreements but not paid as of year-end are recorded as current liabilities.

MCLEAN AFFILIATES, INC.

NOTES TO FINANCIAL STATEMENTS

Based upon McLean's existing fee structure and management's expectation that future monthly service charges will be reflective of related operating costs, McLean is not required to record a liability for its obligation to provide future services and facilities to current residents. Based upon management's projections, McLean does not believe such a liability on its CCRC contracts exists at this time.

Prior to September 30, 2012, McLean capitalized \$275,000 of costs related to acquiring the initial CCRC contracts. These costs include wages and marketing costs directly related to acquiring these contracts and are being amortized on a straight-line basis over the average remaining residential life expectancies. These amounts are included in other noncurrent assets on the statements of financial position and represent \$129,721 and \$147,349 as of September 30, 2018 and 2017, respectively.

NOTE 7 - TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes as of September 30, 2018 and 2017:

	<u>2018</u>		<u>2017</u>
Capital projects	\$ 545,966	\$	524,714
Sorenson Media Center	895,703		968,321
Healthcare services and other	<u>785,179</u>		<u>609,376</u>
Total	<u>\$ 2,226,848</u>	\$	<u>2,102,411</u>

During the years ended September 30, 2018 and 2017, there were releases of \$89,545 and \$32,609, respectively, for the Sorenson Media Center and \$123,997 and \$105,916, respectively, for healthcare services and other.

NOTE 8 - EMPLOYEE BENEFIT PLAN

McLean sponsors a 401(k) Retirement Savings Plan (the Plan) for its employees. The Plan is a defined contribution plan covering all salaried and hourly employees of McLean who elect to participate and have been scheduled to work 1,000 hours a year and have reached 20 years of age. Participants may contribute up to the Internal Revenue Service salary deferral limits. McLean contributes to the Plan on behalf of its qualified employees based on their wages once the employee has completed one year of service as defined.

McLean contributed \$905,254 and \$839,928 to the Plan for the years ended September 30, 2018 and 2017, respectively.

MCLEAN AFFILIATES, INC.

NOTES TO FINANCIAL STATEMENTS

NOTE 9 - HEALTHCARE INDUSTRY

Regulatory Environment

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare fraud and abuse. 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. Management believes that McLean is in compliance with fraud and abuse regulations as well as other applicable government laws and regulations. While no material regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

NOTE 10 - FUNCTIONAL EXPENSES

McLean's functional expenses are as follows for the years ended September 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Long-term care	\$ 6,021,509	\$ 5,826,188
Home health services	4,535,864	4,229,700
Post-acute care	3,918,773	3,848,946
Independent living	2,507,860	2,526,881
Assisted living	5,083,033	4,566,420
General, administrative and other	4,058,931	3,810,190
Outpatient services	468,376	464,479
Development	133,301	163,823
Total	<u>\$ 26,727,647</u>	<u>\$ 25,436,627</u>

NOTE 11 - RELATED PARTY TRANSACTIONS

The Fund is an entity that holds investment assets used to support the subsidiaries of the Fund. The Fund provided McLean with contributions for programs that McLean provides. These contributions amounted to \$306,052 and \$262,992 for the years ended September 30, 2018 and 2017, respectively. These contributions have been recorded within contributions received from related entities in the statements of activities and changes in net assets. Additionally, McLean paid expenses on behalf of the Fund during the year ended September 30, 2018 totaling \$81,553. Amounts due to McLean from the Fund at September 30, 2018 were \$81,553. No such amounts were paid on behalf of or due from the Fund at September 30, 2017.

MCLEAN AFFILIATES, INC.

NOTES TO FINANCIAL STATEMENTS

The Foundation is a nonprofit corporation whose purpose is to receive, maintain and apply funds to promote and engage in activities in furtherance of the public welfare, principally by supporting and assisting the Fund and its operating entities. McLean received contributions from the Foundation for general use. This support amounted to \$60,000 for both of the years ended September 30, 2018 and 2017, and has been recorded within contributions received from related entities.

McLean has been reimbursed by the Refuge for expenses that have been paid on its behalf. This reimbursement amounted to \$231,383 and \$218,485 for the years ended September 30, 2018 and 2017, respectively, and has been recorded as a reduction to certain operating expenses in the statements of activities and changes in net assets.

NOTE 12 - DEFERRED REVENUE

McLean recognizes deferred revenues in relation to its private payor long-term care and assisted living businesses. In addition, McLean recognizes deferred revenues under its home health Medicare prospective payment system. As of September 30, 2018 and 2017, McLean recorded \$492,364 and \$513,219, respectively, in deferred revenue shown as a current liability.

NOTE 13 - ADDITIONAL CASH FLOW INFORMATION

Noncash Operating Activities

During the year ended September 30, 2018, McLean transferred refundable entrance fees to deposits held for residents totaling \$611,150.

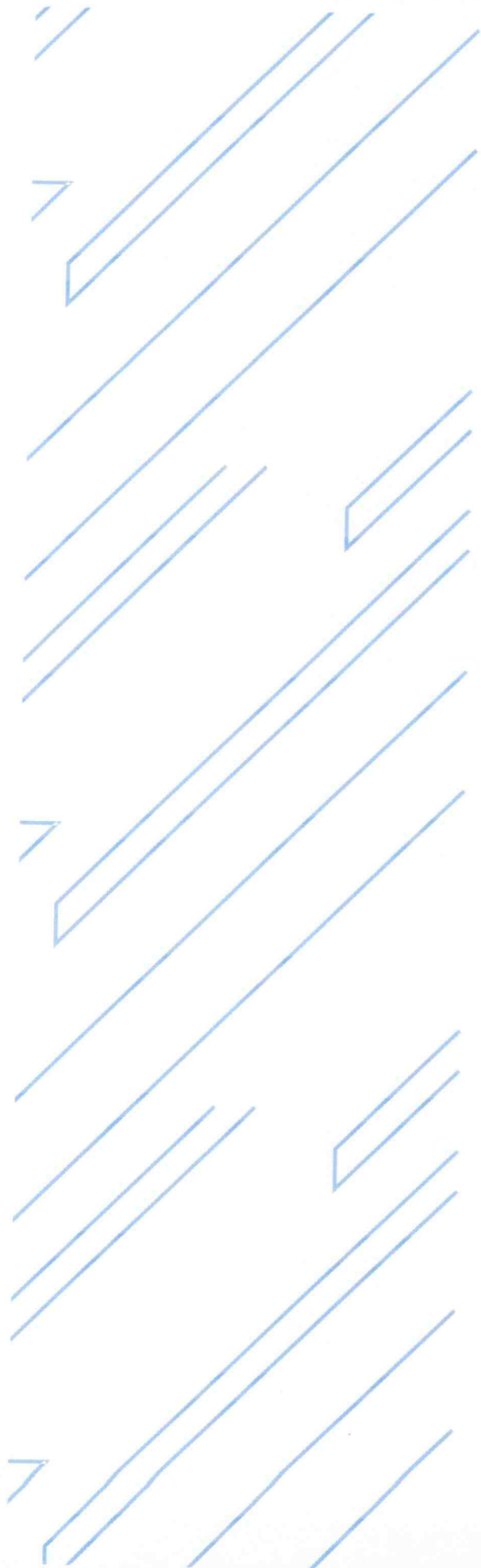
Noncash Financing Activities

During the year ended September 30, 2018, McLean issued a note receivable to a CCRC resident in lieu of cash payment for their entrance fees totaling \$210,000.

NOTE 14 - CONTINGENCIES

The Organization is occasionally party to asserted and unasserted claims arising from the course of operations. Management is of the opinion that the outcome of any such claims will not have a material impact on the Company's financial position or results of operations or cash flows.

Supplementary Information



MCLEAN AFFILIATES, INC.

SCHEDULES OF OPERATING EXPENSES FOR THE YEARS ENDED SEPTEMBER 30, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
Salaries and Wages		
Nursing	\$ 9,144,734	\$ 8,656,936
General and administrative	2,157,258	2,019,618
Auxiliary	1,491,571	1,440,797
Dietary	1,139,948	1,102,534
Housekeeping	380,615	376,788
Plant	352,182	371,729
Development	60,492	125,376
Laundry	26,173	23,792
Total salaries and wages	<u>14,752,973</u>	<u>14,117,570</u>
Employee Benefits		
Payroll taxes	1,072,313	1,017,672
Retirement plan expense	905,254	839,928
Health insurance	816,221	751,883
Workers' compensation	251,041	209,103
Other employee benefits	128,122	101,242
Total employee benefits	<u>3,172,951</u>	<u>2,919,828</u>
Other Expenses		
General and administrative	1,902,110	1,959,167
Dietary	1,378,141	1,341,084
Plant	1,256,905	1,251,996
Nursing	1,319,986	1,164,395
Auxiliary	656,803	624,763
Housekeeping	172,146	171,684
Laundry	109,846	110,683
Development	72,809	38,546
Total other expenses	<u>6,868,746</u>	<u>6,662,318</u>
Depreciation	<u>1,932,977</u>	<u>1,736,911</u>
Total Expenses	<u>\$ 26,727,647</u>	<u>\$ 25,436,627</u>

To the Audit Committee
McLean Affiliates, Inc.
Simsbury, Connecticut

We have audited the financial statements of McLean Affiliates, Inc., for the year ended September 30, 2018 and have issued our report thereon dated December 11, 2018. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you in our communication dated August 13, 2018. Professional standards also require that we communicate to you the following information related to our audit.

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by McLean Affiliates, Inc., are described in Note 2 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by McLean Affiliates, Inc., during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were as follows:

Management's estimate of the allowance for doubtful accounts is based on a review of significant balances and past experiences. We evaluated the key factors and assumptions used to develop the allowance for doubtful accounts in determining that it is reasonable in relation to the financial statements taken as a whole.

Management's estimate of the amortization of entrance fees is based on the nonrefundable portions of the life care entrance fee being amortized into income over the estimated remaining life of the resident. We evaluated the key factors and assumptions used to develop the amortization of entrance fees in determining that it is reasonable in relation to the financial statements taken as a whole.

Management's estimate in determining the present value of the charitable remainder trust is based on actuarial calculations. We evaluated the key factors and assumptions used to develop the value of the charitable remainder trust in determining that it is reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. There were no sensitive disclosures affecting the financial statements.

The disclosures in the financial statements are neutral, consistent and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We did not identify any misstatements in our audit.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated December 11, 2018.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to McLean Affiliates, Inc.'s financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as McLean Affiliates, Inc.'s auditors. However, these discussions occurred in the normal course of our professional relationship, and our responses were not a condition to our retention.

This information is intended solely for the use of the Board of Directors, the Audit Committee and management of McLean Affiliates, Inc., and is not intended to be, and should not be, used by anyone other than these specified parties.

Blum, Shapiro & Company, P.C.

West Hartford, Connecticut
December 11, 2018

To the Audit Committee
McLean Affiliates, Inc.
Simsbury, Connecticut

In planning and performing our audit of the financial statements of McLean Affiliates, Inc. (McLean) as of and for the year ended September 30, 2018, in accordance with auditing standards generally accepted in the United States of America, we considered McLean's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of McLean's internal control. Accordingly, we do not express an opinion on the effectiveness of McLean's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

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

This communication is intended solely for the information and use of management, the Board of Directors, the Audit Committee and others within the organization and is not intended to be, and should not be, used by anyone other than these specified parties.

Blum, Shapiro & Company, P.C.

West Hartford, Connecticut
December 11, 2018