



January 25, 2021

The Board of Directors
St. Francis Health Services of Morris, Inc. and Subsidiaries
Morris, Minnesota

We have audited the consolidated financial statements of St. Francis Health Services of Morris, Inc. and Subsidiaries (St. Francis) as of and for the year ended September 30, 2020, and have issued our report thereon dated January 25, 2021. Professional standards require that we advise you of the following matters relating to our audit.

Our Responsibility in Relation to the Consolidated Financial Statement Audit

As communicated in our engagement letter dated October 6, 2020, our responsibility, as described by professional standards, is to form and express an opinion about whether the consolidated financial statements that have been prepared by management with your oversight are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America. Our audit of the consolidated financial statements does not relieve you or management of its respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the consolidated financial statements are free of material misstatement. An audit of consolidated financial statements includes consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, as part of our audit, we considered the internal control of St. Francis solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

Planned Scope and Timing of the Audit

We conducted our audit consistent with the planned scope and timing we previously communicated to you.

Compliance with All Ethics Requirements Regarding Independence

The engagement team, others in our firm, as appropriate, and our firm have complied with all relevant ethical requirements regarding independence.

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Qualitative Aspects of the Entity's Significant Accounting Practices

Significant Accounting Policies

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by St. Francis is included in Note 1 to the consolidated financial statements. As discussed in Note 1 to the consolidated financial statements, during 2020, St. Francis adopted Accounting Standards Update (ASU) 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. The accounting changes have been retroactively applied to the consolidated financial statements presented. No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

Significant Accounting Estimates

Accounting estimates are an integral part of the consolidated financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on 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 consolidated financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments.

The most sensitive accounting estimates affecting the consolidated financial statements are:

Collectability of Resident Receivables – Management's estimate of the collectability of resident receivables is based on historical loss levels and an analysis of the collectability of individual accounts.

Self-Funded Health Insurance Liability – Management's estimate of the self-funded health insurance liability is based on historical trends, utilization history and other relevant factors.

Provider Relief Funds – Amounts received from the CARES Act Provider Relief Fund are subject to terms and conditions imposed by the Department of Health and Human Services (HHS), which state payments will only be used to prevent, prepare for, and respond to coronavirus and shall reimburse the recipient only for healthcare-related expenses or lost revenues that are attributable to the coronavirus. Recipients may not use the payments to reimburse expenses, or losses that have been reimbursed from other sources or that other sources are obligated to reimburse. Management's estimate of the funds recognized as operating revenue is based on estimates associated with such terms and conditions and the terms and conditions are subject to interpretation and potential future guidance. Management utilized estimates in calculating lost revenue, as defined currently by HHS, attributable to coronavirus.

We evaluated the key factors and assumptions used to develop these estimates and determined that they are reasonable in relation to the basic consolidated financial statements taken as a whole.

Significant Difficulties Encountered During the Audit

We encountered no significant difficulties in dealing with management relating to the performance of the audit.

Uncorrected and Corrected Misstatements

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. Further, professional standards require us to also communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the consolidated financial statements as a whole.

The following misstatements that we identified as a result of our audit procedures were brought to the attention of, and corrected by, management:

- \$1,241,000 understatement of receivable and payable for estimated workers compensation claims.
- \$546,000 understatement of allowance for doubtful accounts and bad debt expense.

The following summarizes an uncorrected financial statement misstatement whose effect in the current period, as determined by management, is immaterial, both individually and in the aggregate, to the consolidated financial statements taken as a whole:

- \$372,000 understatement of receivable and payable for credit balances.

The effect of this uncorrected misstatement had no impact to net assets.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to St. Francis' consolidated financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Representations Requested from Management

We have requested certain written representations from management, which are included in the management representation letter dated January 25, 2021.

Management's Consultations with Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Other Significant Matters, Findings, or Issues

In the normal course of our professional association with St. Francis, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, business conditions affecting the entity, and business plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as St. Francis' auditors.

Modification of the Auditor's Report

We have made the following modification to our auditor's report.

We have included an emphasis of matter paragraph regarding the adoption of Financial Accounting Standards Board Accounting Standards Update No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*.

New or Emerging Accounting Matters

Accounting Standards Update 2016-02, Leases

On February 25, 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-02, *Leases*. As expected, a lessee will recognize, for leases with terms greater than one year, an asset representing its right to use the leased asset for the expected lease term (the 'right-of-use' asset) and a corresponding lease liability. The lease liability will be measured at the present value of future lease payments, utilizing St. Francis' incremental borrowing rate. Nonpublic organizations will have an election to utilize a term-appropriate risk-free rate. Substantially, all leases classified as operating leases under the current standard will be recorded on the consolidated balance sheet upon implementation of this standard.

Assets and liabilities recognized by lessees will be measured on a basis that:

- Assumes the longest possible lease term, taking into account the effect of any options to extend or terminate the lease that are "reasonably certain" to occur.
- Is updated when changes in facts or circumstances indicate that there would be a significant change in those assets or liabilities since the previous reporting period.

The proposed changes will result in two lease types: financing and operating. The classification of lease types will be based on five criteria. The criteria established to be considered a financing lease involve more judgement than under current guidance.

Financing leases (comparable to capital leases under current guidance) will incur amortization (depreciation) of the right-of-use asset on the straight-line method and interest expense on the lease liability, in a similar nature to the current capital leases. Expenses will be higher in initial years and decline throughout the term of the lease.

Similar to financing leases, operating leases (comparable to operating leases under current guidance) will recognize a right-to-use asset at the present value of the lease payments; however, in subsequent periods the asset will be effectively "remeasured" using the original lease assumptions. The lease liability will be charged to operations as rent expense in a manner that should generally approximate straight-line lease expense.

This update will require St. Francis to identify and assess all existing lease agreements for appropriate accounting treatment. This includes agreements such as building rentals (when St. Francis is the lessee) and leases of space to third-parties (when St. Francis is the lessor). In addition, other potential impacts, such as those related to debt covenants, should be determined and considered prior to the effective date to avoid potential adverse effects.

Additional information on provisions of the new accounting standard can be found at: <http://www.eidebailly.com/services/audit-assurance/fasb-issues-final-standard-on-lease-accounting/>.

ASU Effective Date

For a not-for-profit entity that has issued, or is a conduit debt obligor for, securities that are traded, listed, or quoted on an exchange or over-the-counter market, this standard will be effective for fiscal years beginning after December 15, 2019. This would be the year ended September 30, 2021, for St. Francis. The new standard requires a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the consolidated financial statements. This approach does not require any modifications to leases that expired before the date of initial application of the standard.

This report is intended solely for the information and use of the Board of Directors and management of St. Francis and is not intended to be, and should not be, used by anyone other than these specified parties.

Eide Bailly LLP

Minneapolis, Minnesota