



STATE OF ILLINOIS
HEALTH FACILITIES AND SERVICES REVIEW BOARD

122 South Michigan Avenue • Chicago, IL 606411 • (312) 814-5418 FAX: (312) 814-1503

June 21, 2012

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Lynn Gordon and Sam Vinson
Ungaretti & Harris LLP
70 West Madison Suite 3500
Chicago, IL 60602

Re: Certificate of Exemption Application for Change of Ownership of Mercer County Hospital, Project E-003-12, Mercer County Nursing Home, Project E-004-12, and Certificate of Need Application for the Mercer County Nursing Home, Project 12-044.

Dear Mr. Gordon and Mr. Vinson:

The Illinois Health Facilities and Services Review Board ("Board") staff received a letter "Attachment A" on May 9, 2012 regarding the Certificate of Exemption ("COE") and Change of Ownership for the Mercer County Nursing Home. First and foremost, thank you for your detailed and thoughtful response. Your May 9, 2012 letter to the Board was in response to an email "Attachment B" from Senior Project Reviewer Michael Constantino. Mr. Constantino requested that you answer five questions, and after reviewing your letter, Board staff has several follow-up questions regarding the COE and the proposed change of ownership.

Also at the June 5, 2012 Board Meeting, the Board referred the investigation of potential compliance matters to Board Legal Counsel. In order to complete our review of the matter please provide the following information:

1. Why did the Mercer County Nursing Home and Genesis Health System ("GHS") enter into an option agreement for a change of ownership without applying for a COE?
2. Please submit an assessment of applicability in regards to the commitment to



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- spend \$11,500,00 in capital improvements.
3. Please provide detailed information regarding the role of GMCM, GSLM, and GHS in relation to the Mercer County Nursing Home? This information should include their roles both prior to and after the execution of the option agreement for a change of ownership.
 4. Please provide information regarding who is in control of operations at the Mercer County Nursing Home.
 5. Please provide any and all documentation regarding the option agreement executed by GHS and the Mercer County Nursing Home.

The Board staff requests that you provide this information, so Board staff can complete its review of the potential compliance matters regarding the proposed COE and change of ownership. Please provide this information within 10 days of receipt of this letter. If you should have any questions, please contact our office at (312) 814-6226.

Sincerely,

A handwritten signature in black ink, appearing to read "Juan Morado Jr.", written in a cursive style.

Juan Morado Jr.
Assistant General Counsel
Health Facilities and Services Review Board

cc: Michael Constantino
Frank Urso
Alexis Kendrick

Attachment

A

UNGARETTI
& HARRIS

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CHICAGO, ILLINOIS
SPRINGFIELD, ILLINOIS
WASHINGTON, D.C.

LYNN GORDON
312.977.4134
lgordon@uhlaw.com

May 9, 2012

VIA EMAIL AND FEDERAL EXPRESS

Michael Constantino
Illinois Department of Public Health
525 West Jefferson
Springfield, Illinois 62761

RECEIVED

MAY 10 2012

HEALTH FACILITIES &
SERVICES REVIEW BOARD

Re: Certificate of Exemption Applications for Change of Ownership of Mercer County Hospital, Project E-003-12, and Mercer County Nursing Home, Project E-004-12

Dear Mr. Constantino:

As you know, our firm represents Genesis Health System ("GHS") and its subsidiaries GMCM and GSLM in connection with their Certificate of Exemption ("COE") applications for the change of ownership of Mercer County Hospital (the "Hospital") and Mercer County Nursing Home (the "Nursing Home"). In response to your email of May 3, 2012, a copy of which is attached for your reference, I am writing to address three of your inquiries (items two, three and five in your email). As I noted in my email to you on May 3rd, we will follow up separately on items one and four.

In item two of your email request, you ask for copies of all schedules and exhibits to the definitive agreements for the change of ownership transaction. All such documents were submitted with our application. With respect to the change of ownership of the Hospital, the three agreements that collectively total the "definitive agreement" for the transaction are the Option Agreement, the Addendum to Option Agreement and finally, the document that then established the agreement to move forward with the change of control, the Exercise of Option. Neither the Addendum to Option Agreement nor the Exercise of Option has any exhibits or schedules. The Option Agreement has four exhibits, each of which was included in the COE application. As is typical, the Option Agreement also provides for a number of schedules to be delivered at closing, none of which could or would have been provided by the parties upon execution of the Option Agreement in 2010 and none of which are or could be available at this time.

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Michael Constantino, Illinois Department of Public Health

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Per Section 3.3(b) of the Option Agreement, and as explained on page 13 of the COE application (in the Narrative Section/Attachment 3), the schedules referenced in the Option Agreement are under development and do not become part of the Agreement until the closing of the change of ownership transaction.

With respect to the change of ownership of the Nursing Home, the Asset Purchase Agreement is the definitive agreement between the parties. It has two exhibits, both of which were provided as part of the COE application. The only schedule to the Asset Purchase Agreement is a Schedule of Patient Trust Accounts which, as is typical, pursuant to Section 23 of the Asset Purchase Agreement cannot be dated more than seven days prior to the closing of the change of ownership transaction, and therefore is not available to provide for your review.

Your May 3, 2012 email also asked for the meaning of the term "significant control," as referenced on page 11 of the COE applications for each of the Hospital and the Nursing Home. GMCM and GSLM, the proposed new owners of the Hospital and the Nursing Home, respectively, have the same corporate structure, in that each is an Illinois not-for-profit corporation applying for federal tax exemption under Section 501(c)(3) of the Internal Revenue Code of 1986, and each has GHS as its sole corporate member. As we detail in the narratives to the COE applications on page 11, GHS "has retained certain significant control over" GMCM and GSLM. The term "significant control" was used indicate the fact that GHS has certain exclusive authority over the actions of GMCM and GSLM and certain approval authority over actions taken by the Boards of Directors of GMCM and GSLM; these types of reserved powers are standard for not-for-profit entities with corporate members, particularly within health systems, and establish control over board appointments, finance, capital, budget, strategic planning matters, etc. To expand on the summary of the reserved powers provided on pages 11 and 12 of the COE applications, GHS has the following exclusive reserved powers over GMCM and GSLM:

- [a] The power to determine the number of directors serving on the GMCM/GSLM Board and to elect, appoint, remove or fill the vacancies of such directors.
- [b] The power to present at any regular or special meeting of the GMCM/GSLM Board (i) one or more amendments to the Articles of Incorporation or bylaws; (ii) a plan of merger or consolidation by GMCM/GSLM into or with any other corporation, organization, or association; (iii) a proposal for any sale, lease, exchange, mortgage, pledge, or other disposition of all, or substantially all, of GMCM/GSLM's assets; or (iv) a proposal for dissolution of GMCM/GSLM and plan of distribution.

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Michael Constantino, Illinois Department of Public Health

May 9, 2012

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- [c] The power to establish system-wide policies and procedures to be followed by GMCM/GSLM and any affiliates regarding: (i) quality of care; (ii) finance, (iii) utilization of resources; (iv) managed care contracting; (v) strategic planning; and (vi) employee benefits;
- [d] The power to assess GMCM/GSLM expenses of the Member attributable to GMCM/GSLM and any affiliates and to assess to GMCM/GSLM its share of the general overhead of GHS established in accordance with policies and procedures adopted by GHS; and
- [e] The power to direct GMCM/GSLM to transfer funds to GHS for the development of system-wide projects in accordance with policies established by GHS.

In addition, GHS also has approval powers over decisions of the GMCM/GSLM Board of Directors with respect to the following:

- [a] the interpretation of or any change in a statement of mission, philosophy, role, or purpose of GMCM/GSLM or any affiliate;
- [b] the adoption of amendments to the Articles of Incorporation, bylaws or other governing documents of GMCM/GSLM or any affiliate;
- [c] the merger, dissolution, consolidation or reorganization of GMCM/GSLM or any affiliate;
- [d] the formation or restructuring of affiliates;
- [e] the acquisition, sale, lease, transfer, encumbrance, or other alienation of property of GMCM/GSLM or any affiliate, other than in the usual and regular course, when such acquisition, sale lease, transfer, encumbrance, or other alienation is above specified financial levels set in accordance with policies established by GHS;
- [f] the adoption or authorization of annual capital and operating budgets of GMCM/GSLM or any affiliate as developed by its Board or management or the making of non-budgeted expenditures in excess of financial levels set in accordance with policies established by GHS;

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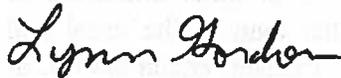
Michael Constantino, Illinois Department of Public Health
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- [g] the incurrence of debt or the guarantee of the debt of another by GMCM/GSLM or an affiliate which is in excess of such limits as are established by GHS;
- [h] the adoption of a plan of distribution or disposition of the assets of GMCM/GSLM or any affiliate at the time of its dissolution;
- [i] the adoption or approval of strategic and long-range financial plans for GMCM/GSLM or any affiliate;
- [j] the adoption of an internal auditing program for GMCM/GSLM or any affiliate which is consistent with the internal auditing program established by GHS;
- [k] the amendment, modification or exercise of any right or power hereunder granted; and
- [l] any action which is reserved as the right and power of GHS in the Articles of Incorporation or the bylaws.

Finally, per your request, attached please find the most recent GHS audited financial statements for the fiscal year ending June 30, 2011. As you know, GHS has an "A-1" bond rating, proof of which was submitted with the COE applications.

Please do not hesitate to contact me directly should you need any further information on these three follow-up inquiries.

Sincerely,



Lynn Gordon

Attachments

cc: Judy Mondello
Ted Rogalski
Claudette P. Miller

Montague, Valerie Breslin

From: Constantino, Mike [Mike.Constantino@Illinois.gov]
Sent: Thursday, May 03, 2012 10:53 AM
To: Gordon, Lynn; Montague, Valerie Breslin
Cc: Roate, George; Avery, Courtney
Subject: Exemption E-003-12, E-004-12

Mr. Gordon:

1. I am reviewing the exemption applications and I see the option agreement was approved in November 2010. We have always considered the change of ownership occurring upon the option approval. It appears to me that you have initiated this change of ownership in November 2010 without State Board approval. This could result in fines and penalties and could delay these exemption applications. We need to know why this transaction occurred without State Board approval.
2. All transaction agreements for change of ownerships must include ALL schedules and exhibits. Please provide all of the schedules and exhibits that have been identified in the agreement.
3. I need to know the meaning of "significant control" as referenced on page 11 of the exemption application.
4. The commitment to spend \$11,500,000 in capital improvements will require the submittal of an assessment of applicability to the State Board Staff.
5. We need Genesis Health System most recent audited financial statements.

Mike Constantino
Illinois Department of Public Health
525 West Jefferson
Springfield, Illinois 62761
Fax:(217) 785-4111
Phone:(217) 785-1557

Genesis Health System and Related Organizations

Consolidated Financial Report
June 30, 2011

Genesis Health System
1000 North 10th Street
Fargo, ND 58102
701.785.1000
www.genesishealth.org

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Independent Auditor's Report

To the Audit and Compliance Committee
Genesis Health System
Davenport, Iowa

We have audited the accompanying consolidated balance sheets of Genesis Health System and related organizations (System) as of June 30, 2011 and 2010, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Misericordia Assurance Company, Ltd., a consolidated subsidiary, which statements reflect total assets and revenue constituting approximately 4% and 1%, respectively, of the related consolidated totals in 2011 and 2010. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Misericordia Assurance Company, Ltd., is based solely on the report of the other auditors.

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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Genesis Health System and related organizations as of June 30, 2011 and 2010, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, effective July 1, 2010 the System adopted the new accounting provisions relating to consolidation of noncontrolling interests in the consolidated financial statements. The adoption of this guidance resulted in a retroactive restatement on the consolidated financial statements.

McGladrey & Pullen, LLP

Davenport, Iowa
October 25, 2011

**Genesis Health System
and Related Organizations**

**Consolidated Balance Sheets
June 30, 2011 and 2010**

Assets	2011	2010
Current Assets:		
Cash and cash equivalents	\$ 76,241,207	\$ 58,099,247
Short-term investments	1,323,897	1,355,211
Receivables:		
Patients, net	79,121,728	81,302,404
Other, including assets limited as to use	14,414,865	12,575,013
Inventories, supplies and materials	13,709,309	12,553,702
Prepaid expenses and deposits	5,766,598	4,551,157
Total current assets	190,577,604	170,436,734
Investments	54,388,983	52,821,697
Assets Limited as to Use:		
Internally designated	157,778,420	136,440,158
Under bond indenture, funds held by trustee	5,899,175	13,855,860
Interest in net assets of Foundation	737,849	654,132
Donor restricted	17,278,889	17,204,300
	181,694,333	168,154,450
Property and Equipment, net	248,326,560	255,657,359
Other Assets:		
Bond issuance costs, net	775,920	750,334
Goodwill	30,730,877	820,444
Other	1,456,314	1,536,851
	32,963,111	3,107,629
	\$ 707,950,591	\$ 650,177,869

See Notes to Consolidated Financial Statements.

Liabilities and Net Assets	2011	2010
Current Liabilities:		
Current maturities of long-term debt	\$ 8,245,803	\$ 7,688,885
Accounts payable	17,530,976	18,512,293
Accrued salaries and wages	14,943,124	13,643,144
Accrued paid leave	16,646,147	15,907,419
Due to third-party payors	5,471,502	2,782,867
Unpaid losses and loss adjustment expenses	15,364,020	13,902,001
Other accrued expenses	5,646,273	5,970,263
Total current liabilities	83,847,845	78,406,872
Long-Term Debt, less current maturities	96,477,661	104,482,761
Unpaid Losses and Loss Adjustment Expenses, Retirement Benefits and Other Long-Term Liabilities	32,837,656	54,837,630
Commitments and Contingent Liabilities (Notes 8 and 11)		
Total liabilities	213,163,162	237,727,263
Net Assets:		
Unrestricted	465,923,057	394,143,518
Noncontrolling interests - unrestricted	10,847,634	448,656
Temporarily restricted	16,112,867	16,206,874
Permanently restricted	1,903,871	1,651,558
	494,787,429	412,450,606
	\$ 707,950,591	\$ 650,177,869