

CONSOLIDATED FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

Hawai'i Pacific Health
Years Ended June 30, 2018 and 2017
With Report of Independent Auditors

Ernst & Young LLP



Hawai'i Pacific Health
Consolidated Financial Statements and
Supplementary Information
Years Ended June 30, 2018 and 2017

Contents

Report of Independent Auditors.....	1
Consolidated Financial Statements	
Consolidated Balance Sheets	3
Consolidated Statements of Unrestricted Revenues, Expenses and Other Changes in Net Assets	5
Consolidated Statements of Cash Flows.....	7
Notes to Consolidated Financial Statements.....	9
Supplementary Information	
Members of the Hawai'i Pacific Health Obligated Group:	
Combined Balance Sheets.....	62
Combined Statements of Unrestricted Revenues, Expenses and Other Changes in Net Assets	64
Combined Statements of Cash Flows	66
Note to Supplementary Information	68



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Report of Independent Auditors

The Board of Directors
Hawai'i Pacific Health

We have audited the accompanying consolidated financial statements of Hawai'i Pacific Health, which comprise the consolidated balance sheets as of June 30, 2018 and 2017, and the related consolidated statements of unrestricted revenues, expenses and other changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's 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. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's 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 auditor considers 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 consolidated financial position of Hawai'i Pacific Health at June 30, 2018 and 2017, and the consolidated results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying Members of the Hawai'i Pacific Health Obligated Group combined financial statements are presented for purposes of additional analysis and are 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits 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 financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Ernst + Young LLP

October 23, 2018

Hawai'i Pacific Health
Consolidated Balance Sheets

	June 30	
	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 235,240,000	\$ 173,211,819
Patient accounts receivable, less allowance for uncollectible accounts (2018 – \$5,079,000; 2017 – \$7,212,000)	167,311,384	161,432,708
Due from third-party payors	23,858,099	13,459,316
Other receivables	20,866,891	20,296,989
Inventories	20,289,561	18,262,247
Funds held by trustee under bond indenture agreement	9,713,013	19,922,004
Escrow funds held for bond defeasance	2,620,000	–
Prepaid expenses and other	10,195,038	11,590,674
Total current assets	490,093,986	418,175,757
Assets whose use is limited or restricted:		
Board-designated	278,086,378	257,865,754
Funds held by trustee under bond indenture agreement	–	15,605,698
Escrow funds held for bond defeasance	164,808,262	–
Restricted by donor or grantor	16,290,642	16,170,215
Total assets whose use is limited or restricted	459,185,282	289,641,667
Investments	296,060,655	277,649,190
Property and equipment, net	559,941,133	552,017,375
Due from third-party payors	4,385,467	6,417,047
Other assets:		
Investments in joint ventures	15,967,619	15,421,488
Other	51,628,416	46,012,644
	67,596,035	61,434,132
Total assets	\$ 1,877,262,558	\$ 1,605,335,168

	June 30	
	2018	2017
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 46,348,486	\$ 43,846,675
Payroll and related liabilities	87,738,257	79,729,459
Accrued expenses	39,334,817	37,960,719
Due to third-party payors	12,843,509	9,663,074
Current portion of long-term debt	7,773,803	6,346,970
Total current liabilities	<u>194,038,872</u>	<u>177,546,897</u>
Long-term debt, less current portion	534,791,379	340,914,270
Other long-term liabilities	98,676,191	85,863,288
Due to third-party payors	9,243,840	10,105,787
Accrued pension liability	18,853,802	100,023,997
Net assets:		
Unrestricted	979,162,286	853,518,917
Temporarily restricted	29,018,983	24,019,026
Permanently restricted	13,477,205	13,342,986
Total net assets	<u>1,021,658,474</u>	<u>890,880,929</u>
Total liabilities and net assets	<u><u>\$ 1,877,262,558</u></u>	<u><u>\$ 1,605,335,168</u></u>

See accompanying notes.

Hawai'i Pacific Health

Consolidated Statements of Unrestricted Revenues, Expenses and Other Changes in Net Assets

	Year Ended June 30	
	2018	2017
Unrestricted revenues		
Net patient service revenue	\$ 1,299,476,577	\$ 1,253,414,966
Provision for bad debts	<u>(18,212,064)</u>	<u>(20,319,285)</u>
Net patient service revenue less provision for bad debts	1,281,264,513	1,233,095,681
Premium revenue	25,210,843	12,856,941
Other revenues	29,657,644	27,160,907
Temporarily restricted net assets released from restrictions for operations	<u>15,700,645</u>	<u>16,893,408</u>
Total unrestricted revenues	<u>1,351,833,645</u>	<u>1,290,006,937</u>
Expenses		
Salaries and employee benefits	756,549,000	725,928,326
Services	159,200,275	157,336,253
Supplies	182,008,390	175,368,101
Other purchases	79,581,667	68,136,814
Depreciation and amortization	54,211,365	55,220,500
Specific purpose projects/donations	15,700,645	16,893,408
Interest	20,895,701	18,790,552
Other	<u>16,152,561</u>	<u>15,000,737</u>
Total expenses	<u>1,284,299,604</u>	<u>1,232,674,691</u>
Operating income	67,534,041	57,332,246
Joint venture investment income	3,091,876	3,073,147
Other nonoperating income	341,863	495,734
Investment income	39,730,531	29,761,132
Gain on sale of joint venture, net of taxes	<u>516,385</u>	<u>6,532,674</u>
	<u>43,680,655</u>	<u>39,862,687</u>
Excess of revenues over expenses	111,214,696	97,194,933
Change in net unrealized gains on investments	605,433	14,487,454
Temporarily restricted net assets released from restrictions for purchase of property and equipment	1,116,472	34,991,823
Change in funded status of pension plan	12,808,053	31,313,343
Change in interest rate swap value	246,548	3,897,171
Other changes in net assets	<u>(347,833)</u>	<u>(464,453)</u>
Increase in unrestricted net assets	<u>125,643,369</u>	<u>181,420,271</u>

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Hawai'i Pacific Health

Consolidated Statements of Unrestricted Revenues, Expenses and Other Changes in Net Assets (continued)

	Year Ended June 30	
	2018	2017
Temporarily restricted net assets		
Restricted grants and contributions	\$ 20,752,560	\$ 21,719,296
Investment income	917,869	713,582
Change in net unrealized gains on investments	328,098	819,514
Net assets released from restrictions	(16,817,117)	(51,885,231)
Other changes in temporarily restricted net assets	(181,453)	(66,000)
Increase (decrease) in temporarily restricted net assets	4,999,957	(28,698,839)
Permanently restricted net assets		
Restricted grants and contributions	73,500	171,740
Change in beneficial interest in perpetual trusts	60,719	258,016
Increase in permanently restricted net assets	134,219	429,756
Increase in net assets	130,777,545	153,151,188
Net assets at beginning of year	890,880,929	737,729,741
Net assets at end of year	\$ 1,021,658,474	\$ 890,880,929

See accompanying notes.

Hawai'i Pacific Health

Consolidated Statements of Cash Flows

	Year Ended June 30	
	2018	2017
Operating activities		
Increase in net assets	\$ 130,777,545	\$ 153,151,188
Adjustments to reconcile the increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	54,211,365	55,220,500
Provision for bad debts	18,212,064	20,319,285
Joint venture investment income	(3,091,876)	(3,073,147)
Gain on sale of joint venture, net of taxes	(516,385)	(6,532,674)
Net gains on alternative investments	(15,268,482)	(21,185,486)
Change in net unrealized gains on investments	(933,531)	(15,306,968)
Net realized gains on investments	(15,161,847)	(2,183,962)
Temporarily and permanently restricted contributions	(20,826,060)	(21,891,036)
Changes in operating assets and liabilities:		
Patient accounts receivable	(24,090,740)	(7,259,538)
Due to/from third-party payors	(6,048,715)	(7,976,805)
Other receivables	(569,902)	245,858
Inventories and other assets	(6,247,450)	(9,719,705)
Restricted pledges receivable	550,454	5,990,537
Accounts payable and accrued expenses	10,057,868	(20,111,879)
Other long-term liabilities	12,812,903	(3,637,821)
Accrued pension liability	(81,170,195)	(49,078,435)
Net cash provided by operating activities	<u>52,697,016</u>	<u>66,969,912</u>
Investing activities		
Purchases of property and equipment	(60,308,284)	(76,845,131)
Net distributions from joint venture partnerships	3,062,130	5,993,568
Purchases of investment securities	(85,449,320)	(182,394,690)
Sales and maturities of investment securities	81,519,048	162,089,892
Assets whose use is limited or restricted:		
Decrease (increase) in funds held by trustee under bond indenture agreement	25,814,689	(76,369)
Net (increase) decrease in cash and cash equivalents	(512,555)	24,474,011
Purchases of investment securities	(68,332,007)	(146,066,317)
Sales and maturities of investment securities	64,835,724	142,058,470
Net cash used in investing activities	<u>(39,370,575)</u>	<u>(70,766,566)</u>

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Hawai'i Pacific Health

Consolidated Statements of Cash Flows (continued)

	Year Ended June 30	
	2018	2017
Financing activities		
Payment of long-term debt	\$ (6,290,256)	\$ (6,158,845)
Proceeds from long-term debt	201,594,198	–
Increase in escrow funds held for bonds	(167,428,262)	–
Temporarily and permanently restricted contributions	20,826,060	21,891,036
Net cash provided by financing activities	48,701,740	15,732,191
Increase in cash and cash equivalents	62,028,181	11,935,537
Cash and cash equivalents at beginning of year	173,211,819	161,276,282
Cash and cash equivalents at end of year	\$ 235,240,000	\$ 173,211,819
Non-cash activity		
Property and equipment and accrued expenses	\$ 4,445,651	\$ 2,595,270

See accompanying notes.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements

June 30, 2018

1. Organization and Summary of Accounting Policies

Hawai'i Pacific Health (HPH) is the sole member of Kapi'olani Medical Center for Women and Children (KMCWC), Pali Momi Medical Center (PMMC), Pali Momi Foundation, Kapi'olani Medical Specialists, Providers Insurance Corporation (PIC), Kapi'olani Health Foundation (KHF), Straub Clinic & Hospital (SCH), Straub Foundation, Wilcox Memorial Hospital (WMH), Kauai Medical Clinic, Wilcox Health Foundation, Hawai'i Pacific Health Partners, Inc., Hawai'i Health Partners and other smaller healthcare-related entities (some of which are for-profit) located in Hawaii. HPH and the above affiliates are collectively referred to as "the Company" and are consolidated in the accompanying consolidated financial statements. All inter-organizational transactions and balances have been eliminated in consolidation.

Except with regard to unrelated business income (UBI), which is taxed at corporate income tax rates, the Company's not-for-profit organizations are (a) exempt from federal and state income taxes pursuant to Internal Revenue Code Section 501(a) and applicable state laws and (b) generally exempt from Hawaii general excise tax on revenue related to their tax-exempt purpose.

The taxable affiliates of the Company utilize the liability method of accounting for income taxes. Under this method, deferred income tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities and are measured using the currently enacted tax rates and laws. Valuation allowances are used to reduce deferred tax assets to their estimated net realizable values and are established by management when it is more likely than not that a deferred tax asset will not be realized.

The accounting principles followed by the Company and the methods of applying those principles comply with accounting principles generally accepted in the United States and general practice within the healthcare industry. The significant policies are summarized below.

Cash Equivalents

Highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents.

Inventories

Inventories, consisting of medical, surgical and other supplies, are stated at the lower of cost (first-in, first-out method) or net realizable value.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, ranging from 2 to 75 years for buildings and improvements, and 3 to 20 years for equipment.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support and are excluded from the excess of revenues over expenses. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used, and gifts of cash or other assets that must be used to acquire long-lived assets, are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported within unrestricted net assets when the donated or acquired long-lived assets are placed in service.

Investments

Investments in equity securities with readily determinable fair values, and all investments in debt securities, are measured at fair value in the consolidated balance sheets. Fair value is established based on quoted prices from established securities exchanges or based on quoted market prices of similar instruments. The Company determined that all marketable securities held at June 30, 2018 and 2017, are designated as other than trading. Accordingly, unrealized gains and losses on investments, except for other-than-temporary declines in fair value, are excluded from the excess of revenues over expenses.

The Company also holds investments in fund of funds and direct funds, which include private equities and limited partnerships that are classified as alternative investments. These alternative investments seek positive returns regardless of market direction and are not restricted to any particular asset class. At the investment managers' direction, these alternative investments may invest in both registered and non-registered securities in the U.S. and globally, with exposure to both emerging and developed markets. The investment managers employ a range of investment strategies, including but not limited to long/short equity positions, derivatives, forward and futures contracts, and currency hedges.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

The Company accounts for its ownership interests in these alternative investments under the equity method of accounting based on the shares held in the fund. The net asset value is determined based on the estimated fair value of the underlying investments. However, the fair value of such investments may have been estimated by its fund managers in the absence of readily ascertainable fair values. Due to the inherent uncertainty of these estimates, these values may differ from the values that would have been used had an active market for these investments existed. The investment income recorded is based on the Company's proportionate share of the fund's portfolio net asset value and included in investment income within the consolidated statements of unrestricted revenues, expenses and other changes in net assets.

As of June 30, 2018 and 2017, the alternative investments comprised approximately 28% and 31%, respectively, of the Company's total investments, including assets whose use is limited or restricted.

Money market funds held in the Company's investment portfolio are classified as investments.

Investment income (including realized gains and losses on investments, gains and losses on alternative investments, interest and dividends) is included in the excess of revenues over expenses unless restricted by donor or law. Income (loss) on investments of donor-restricted funds and endowment funds is recorded as an increase (decrease) in unrestricted net assets, unless restricted by the donor or law.

The Company determines whether a decline in the fair market value of investments below the cost basis is other-than-temporary based on objective evidence as well as subjective factors, including knowledge of recent events and assumptions of future events. If the decline in fair value is judged to be other-than-temporary, the cost basis of the individual security is written down to fair value. The Company recorded other-than-temporary losses of approximately \$1,000,000 in 2018. There were no other-than-temporary losses recorded in 2017.

The Company uses multiple investment managers to diversify its investment portfolios.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

Investments in joint ventures that are 20%–50% owned or where the Company has the ability to exercise significant influence over the operating and financial activities of the joint venture are recorded under the equity method of accounting, which approximates the Company's equity in its underlying net book values. Investments in joint ventures that are more than 50% owned and where the Company can exert control are consolidated in the accompanying consolidated financial statements.

At June 30, the investments in joint ventures that are accounted for using the equity method of accounting, include ownership in the following organizations:

	Ownership Percentage	
	2018	2017
Pacific ASC, LLC	50.00 %	50.00%
Invision LLC	40.00	40.00
The Cancer Center of Hawaii, LLC	30.56	30.56
Pacific Medical Collections, Inc.	33.33	33.33
United Holdings, LLC	17.38	17.38

The carrying value of the investment in Pacific ASC, LLC, as reported in the accompanying consolidated balance sheets, is approximately \$9,924,000 as of June 30, 2018. Included in the carrying value is approximately \$8,639,000 in equity method goodwill representing the difference between the Company's carrying value and its share of Pacific ASC, LLC equity. Management evaluates the investment for impairment and has not recorded an impairment loss as of June 30, 2018.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

Summarized financial information (unaudited) for significant, unconsolidated joint ventures is as follows:

	June 30	
	2018	2017
Current assets	\$ 13,316,000	\$ 12,210,000
Non-current assets	20,793,000	18,552,000
Total assets	\$ 34,109,000	\$ 30,762,000
Current liabilities	\$ 3,495,000	\$ 2,607,000
Non-current liabilities	11,003,000	9,626,000
Capital	19,611,000	18,529,000
Total liabilities and capital	\$ 34,109,000	\$ 30,762,000
	Year Ended June 30	
	2018	2017
Excess of revenues over expenses	\$ 11,335,000	\$ 68,041,000

Board-Designated Assets

Board-designated assets consist of unrestricted investments and accumulated income which have been designated by the Board of Directors for expansion and support of fundraising activities. The Board of Directors can redesignate these assets at its discretion.

Contributions

Contributions received, including unconditional promises to give, are recognized as revenue at fair value in the period received. Fair value is measured as the present value of estimated cash flows using a discount rate commensurate with the risks involved. Pledges receivable are stated at their estimated net realizable value and are included in other receivables and assets whose use is limited or restricted – restricted by donor or grantor in the accompanying consolidated balance sheets.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

The pledges receivable are as follows:

	June 30	
	2018	2017
Receivable in less than one year	\$ 3,285,428	\$ 4,098,480
Receivable in one to five years	2,887,804	3,843,024
Thereafter	638,361	1,102,683
	6,811,593	9,044,187
Less: present value discount	37,726	264,889
Less: allowance for uncollectible pledges	990,611	1,005,655
	\$ 5,783,256	\$ 7,773,643

Temporarily and Permanently Restricted Net Assets

Restricted net assets consist of donations and other funds where donor restrictions have been imposed as to their use for specific purposes. Temporarily restricted net assets consist of those net assets whose use by the Company has been limited by donors to a specific purpose or time period. When a donor-stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of unrestricted revenues, expenses and other changes in net assets as net assets released from restrictions. Permanently restricted net assets consist of the principal amount of net assets whose use by donors has been restricted in perpetuity. Investment income related to permanently restricted net assets is reported as temporarily restricted in the consolidated statements of unrestricted revenues, expenses and other changes in net assets in accordance with donor designation.

Net Patient Service Revenue, Provision for Bad Debts, Premium Revenue, and Patient Accounts Receivable

Net patient service revenue associated with services provided to patients who have third-party coverage is recognized on the basis of contractual rates for services rendered, including retroactive adjustments in accordance with third-party payor agreements. For uninsured patients that do not qualify for charity, net patient service revenues is recognized on the basis of its standard rates less financial assistance policy discounts.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), is as follows.

	Year Ended June 30	
	2018	2017
Medicare	\$ 322,107,418	\$ 298,546,846
Medicaid/QUEST Integration	263,422,720	246,811,994
Commercial and other	702,191,256	697,113,768
Self-pay	11,755,183	10,942,358
	<u>\$ 1,299,476,577</u>	<u>\$ 1,253,414,966</u>

The provision for bad debts expense is based upon management's assessment of historical and expected net collections, taking into consideration historical business and economic trends, trends in healthcare coverage and other collection indicators. Bad debts consist of services for which the Company anticipated but did not receive payment because of patients' unwillingness to pay. Bad debts also include services for medically indigent and/or uninsured patients who are unable to pay and who might have qualified for charity care had the patients self-identified themselves as medically indigent along with providing information so that proper means testing could have been accomplished to qualify the patients for charity care.

Patient accounts receivable are reduced by an allowance for uncollectible accounts. The allowance for uncollectible accounts is the expected uncollectible portion of accounts receivable for which the patient is financially responsible. Management regularly reviews past history and trends for each of its major payors in evaluating the sufficiency of the allowance for uncollectible accounts and provision for bad debts.

The Company has agreements with various health maintenance organizations (HMOs) to provide medical services to subscribing participants. For the majority of its HMO business, the Company receives fee-for-service payments which are recorded as net patient service revenue in the consolidated statements of unrestricted revenues, expenses and other changes in net assets.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

Significant concentrations of patient accounts receivable include Hawaii Medical Service Association (HMSA) – 19% and 22%, Medicaid and QUEST Integration programs – 30% and 26%, and Medicare and Medicare Advantage – 28% and 29% as of June 30, 2018 and 2017, respectively.

HPH entered into an Accountable Care Agreement (ACA) with HMSA for its commercial HMO and preferred provider organization (PPO) product lines covering the 5-year period January 1, 2014 to December 31, 2018. One of the main contract principles is to lower the medical cost trend of the lives attributed to HPH's accountable care organization (Hawai'i Health Partners, LLC) without compromising quality and to transition the organization from a payor reimbursement model based on volume to one based on measured value. Various payment mechanisms are included in the arrangement: fee-for-service, hospital quality payments, ambulatory physician quality program fees, primary care patient-centered medical home payments, provider organization fees, shared savings/shared risk, and patient management fees. The shared risk component of the ACA is determined based on a defined medical cost trend formula that is measured on patient services rendered to HPH's attributed members for the period from January 1 to December 31. Based on criteria met during the years ended June 30, 2018 and 2017, HPH recorded revenues of approximately \$2,876,000 and \$1,245,000, respectively, reflected in other operating revenue within the consolidated statements of unrestricted revenues, expenses and other changes in net assets, and approximately \$1,148,000 and \$4,478,000, respectively, reflected in premium revenue within the consolidated statements of unrestricted revenues, expenses and other changes in net assets, which includes risk share adjustments for the contract settlement periods from January 1, 2015 to December 31, 2016. No risk share settlement has been recorded for the period January 1, 2017 to June 30, 2018, as the risk share, if any, cannot be estimated at this time as the settlement information has not yet been fully developed for that period. The Company has deferred revenue of approximately \$1,954,000 and \$2,887,000 at June 30, 2018 and 2017, respectively, of which approximately \$1,954,000 and \$2,054,000, respectively, is reflected in accrued expenses and approximately \$0 and \$833,000, respectively, is reflected in other long-term liabilities within the consolidated balance sheet.

Government Reimbursement Programs

The Company renders services to patients under contractual arrangements with the Medicare and Medicaid programs. Medicare acute inpatient services are reimbursed based on clinical, diagnostic, and other factors. Medicaid services are reimbursed based on a per diem rate for routine

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

services and a per discharge rate for ancillary services. Outpatient services and defined capital costs related to Medicare and Medicaid beneficiaries are paid based upon a prospective payment system, fee schedules or a cost reimbursement method.

The Company is reimbursed for certain portions of the Medicare program, primarily disproportionate share and bad debt, at an interim rate during the year; final settlement is determined after annual cost reports submitted by the Company are audited by the Medicare contractors. Differences between final cost report settlements and amounts accrued in previous years, due to audit adjustments recorded by the fiscal intermediary, are reported as current year changes to net patient service revenues. The Company has the ability to appeal the adjustments based on a process established by Medicare and Medicaid.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigation involving allegations of potential wrongdoing that would have a material impact on the consolidated financial statements that have not been recorded. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

The Company entered into several agreements with health plans to provide healthcare services to plan members who are eligible to participate in the State of Hawaii's QUEST Integration program and Section 1115 Medicaid waiver programs. The Company negotiates with health plans contracted by Medicaid for the provision of the healthcare services.

The State of Hawai'i uses a provider fee to help finance the State's share of Medicaid expenditures. The Hospital Sustainability Program Act (HSPA) began in 2012 and made direct payments to hospitals through federal fiscal year 2016. Beginning with federal fiscal year 2017, the HSPA was amended to make payments to private hospitals through three payment types; 1) additional payments based on enhanced rates received through Medicaid Managed Care Plans; 2) additional payments received under the State of Hawai'i pay-for-performance program incentivizing quality care measured on a calendar year basis; and 3) additional payments made for Medicaid disproportionate share hospital portions of payments as compared to levels of uncompensated care measured on a federal fiscal year basis.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

For HSPA years 2018 and 2017, the Company recorded approximately \$19,695,000 and \$8,620,000 in net patient service revenues related to HSPA payments, respectively, and \$18,022,000 and \$6,083,000 of provider fee payments, respectively, recorded within other purchases as tax payments.

In addition, the Company recorded a change in estimate of approximately \$7,980,000 as an increase in net patient service revenues relating to the HSPA monies received during 2018 relating to prior year program revenues. The change was due to updated uncompensated care cost data for 2016 and 2017 which support an increase in Medicaid disproportionate share hospital payments.

Charity Care

The Company will treat patients regardless of their ability to pay. An established charity care policy sets guidelines to determine which patients qualify for care given at no charge. Since the Company does not pursue collection from qualified charity care patients, related charges are not reported as revenue. Recorded charity care provided in both 2018 and 2017 was less than 1% of total net patient service revenue, as measured by applying the cost to gross charges ratio to gross uncompensated charges associated with providing charity care to patients.

Collective Bargaining Agreements (Unaudited)

The Company has several collective bargaining agreements covering approximately 38% of its labor force. As of June 30, 2018, four collective bargaining agreements with three unions, or approximately 10% of the Company's labor force, will expire within one year.

Advertising Expense

The Company expenses advertising costs as incurred. Advertising expense was approximately \$4,107,000 in 2018 and \$4,599,000 in 2017 and was recorded in services expense in the consolidated statements of unrestricted revenues, expenses and other changes in net assets.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

Deferred Financing Costs

Costs incurred in obtaining long-term financing are deferred and amortized over the terms of the related obligations using the effective-interest method.

Accounting for the Impairment or Disposal of Long-Lived Assets

The Company accounts for the impairment or disposal of long-lived assets using a future cash flow model to determine whether assets have been impaired. The Company reviews long-lived assets for circumstances which could indicate that carrying values may not be recoverable. Management determined that no long-lived assets were impaired as of June 30, 2018 and 2017.

Excess of Revenues Over Expenses

The consolidated statements of unrestricted revenues, expenses and other changes in net assets include the excess of revenues over expenses. Changes in unrestricted net assets, which are excluded from the excess of revenues over expenses, include unrealized gains and losses on investments in other than trading securities, contributions of long-lived assets (including assets acquired using contributions which by donor restrictions were to be used for the purposes of acquiring such assets), changes in funded status of the pension plan and changes in the interest rate swap value associated with derivatives that qualify as effective cash flow hedges.

Subsequent Events

Subsequent events have been evaluated through October 23, 2018, the date these consolidated financial statements were issued.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles generally (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

Adoption of New Accounting Standards

In July 2015, the Financial Accounting Standards Board (FASB) issued a new accounting standard, *Inventory: Simplifying the Measurement of Inventory*. This accounting standard applies to companies that measure inventory using the first-in first-out method or average cost, with inventory being measured at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the normal course of business, less predictable costs for completion, disposal or transportation. This accounting standard is effective for fiscal years beginning after December 15, 2016. The Company adopted this standard effective July 1, 2017 and there was no impact to its consolidated financial statements.

Accounting Standards Pending Adoption

In May 2014, the FASB issued a new revenue accounting standard, together along with subsequent amendments, updates and an extension of the effective date, (collectively the New Revenue Standard), which supersedes most existing revenue recognition guidance, including industry-specific health care guidance. The New Revenue Standard provides for a single comprehensive principles-based standard for the recognition of revenue across all industries through the application of the following five-step process:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Under the New Revenue Standard, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. The Company performed an evaluation over each of its major revenue streams under the New Revenue Standard. In particular, as part of the net patient service revenue stream evaluation, the Company used the portfolio approach as a practical expedient to group payor contracts with similar characteristics, such that revenue for a given portfolio would not be materially different than if it were evaluated on a contract-by-contract

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

basis. The Company also evaluated whether any of the revenue streams included variable consideration as well as any potential constraints to the estimate of the variable consideration. The Company anticipates that for periods subsequent to adoption, the amounts currently classified as the provision for bad debts on the consolidated statements of unrestricted revenues, expenses and other changes in net assets, will be treated as an implicit price concession factored into net patient service revenue on the consolidated statements of unrestricted revenues, expenses and other changes in net assets, consistent with the intent of the standard. The New Revenue Standard also requires enhanced disclosures related to the disaggregation of revenue and other disclosures about contracts with customers, including revenue recognition policies to identify performance obligations and significant judgments in measurement and recognition.

The Company adopted the New Revenue Standard on July 1, 2018 and has elected to use the modified retrospective adoption method. The modified retrospective adoption method requires a company to record the transition adjustment for the New Revenue Standard, if any, as a cumulative effect adjustment to the beginning unrestricted net assets recorded as of the date of adoption. The Company has determined that the transition adjustment is not material to the consolidated financial statements. In addition, a provision for bad debts under the New Revenue Standard is expected to be immaterial.

In February 2016, the FASB issued a new accounting standard, *Leases*. This accounting standard requires companies that lease assets to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in its balance sheet. Lessor accounting remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. This accounting standard will also require additional disclosures about the amount, timing and uncertainty of cash flows arising from leases. This accounting standard is effective for fiscal years, and interim periods, beginning after December 15, 2018. Management is currently evaluating the impact of adopting this accounting standard.

In January 2016, the FASB issued a new accounting standard, *Financial Instruments—Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*. This accounting standard will require equity investments, except those accounted for using the equity method of accounting, to be measured at fair value with changes in fair value recognized in net income. This accounting standard is effective for fiscal years beginning after December 15, 2017. Management is currently evaluating the impact of adopting this accounting standard.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

In August 2016, the FASB issued a new accounting standard, *Not-for-Profit Entities: Presentation of Financial Statements of Not-for-Profit Entities*. This accounting standard will change the presentation of net assets into two categories, net assets with donor restrictions and net assets without donor restrictions. This accounting standard will also allow companies to elect to use either the direct or indirect cash flow method, and requires additional liquidity disclosures and presentation of expenses by both natural and functional classification. This accounting standard is effective for fiscal years beginning after December 15, 2017. Management adopted this accounting standard on July 1, 2018 and the required changes to the financial statement presentation and disclosures will be reflected in the Company's June 30, 2019 consolidated financial statements.

In August 2016, the FASB issued a new accounting standard, *Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments*. This accounting standard clarifies presentation requirements of certain cash receipts and cash payments, including debt prepayments and extinguishment costs, proceeds from company-owned life insurance policies and distributions from equity method investees. This accounting standard is effective for fiscal years, and interim periods, beginning after December 15, 2017. Management does not expect this new standard to have a material impact to the financial statements.

In November 2016, the FASB issued a new accounting standard, *Statement of Cash Flows (Topic 230), Restricted Cash (a consensus of the Emerging Issues Task Force)*. This accounting standard will require entities to present cash receipts and cash payments from cash equivalents and restricted cash accounts within the statements of cash flows. This accounting standard is effective for fiscal years, and interim periods, beginning after December 15, 2017. Management does not expect this new standard to have a material impact to the financial statements.

In March 2017, the FASB issued a new accounting standard, *Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This accounting standard will require that employers report the service cost component of net benefit cost in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period and the other components of net benefit cost in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. This accounting standard is effective for fiscal years, and interim periods, beginning after December 15, 2017. The Company adopted this accounting standard on July 1, 2018 and will classify approximately \$19,813,000 of service costs within salaries and benefits and \$6,600,000 of non-service pension components within non-operating income in its June 30, 2019 consolidated statements of unrestricted revenues, expenses and other changes in net assets.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

In August 2017, the FASB issued a new accounting standard, *Derivatives and Hedging*. This will allow an entity that holds a financial instrument which hedges cash flow interest rate risk of a variable rate instrument, to designate the hedged risk based on the variability in cash flows attributable to the contractually specified interest rate. By eliminating the concept of benchmark interest rates for hedges of variable-rate instruments, the amendment removes the requirement to designate only the overall variability in cash flows as the hedged risk in a cash flow hedge of a variable rate instrument indexed to a non-benchmark interest rate. This accounting standard is effective for fiscal years beginning after December 15, 2018. Management is currently evaluating the impact of adopting this standard.

In June 2018, the FASB issued a new accounting standard, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. This clarifies how organizations should account for contributions received and made. The accounting standard provides additional clarification as to whether a contribution is a non-reciprocal transaction, and therefore should be reported under the not-for-profit contribution guidance, or an exchange transaction, which would be reported under the New Revenue Standard. This accounting standard is effective for fiscal years beginning after June 15, 2018. Management does not expect this new standard to have a material impact to the financial statements.

In August 2018, the FASB issued a new accounting standard, *Compensation – Retirement Benefits – Defined Benefit Plans – General (Topic 715-20)*. This accounting standard modifies the disclosure requirements for plan sponsors of defined benefit plans, including disclosure of weighted-average interest crediting rates for cash balance plans and explanations of significant gains and losses related to changes in benefit obligation. This accounting standard is effective for fiscal years ending after December 15, 2020. Management is currently evaluating the impact of adopting this standard.

In August 2018, the FASB issued a new accounting standard, *Fair Value Measurement (Topic 820)*. This accounting standard modifies fair value disclosure requirements required by Topic 820, including transfers between levels within the fair value hierarchy. This accounting standard is effective for fiscal years beginning after December 15, 2019. Management is currently evaluating the impact of adopting this standard.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

2. Assets Whose Use Is Limited or Restricted and Investments

Assets whose use is limited or restricted and investments consist of the following:

	June 30	
	2018	2017
Board-designated:		
Money market funds	\$ 1,032,434	\$ 1,280,401
Equity securities	139,683,662	151,416,703
Alternative investments	105,396,246	88,390,650
Cash surrender value of life insurance policies	17,895,527	16,778,000
Debt securities	14,078,509	–
	278,086,378	257,865,754
Funds held by trustee under bond indenture agreement:		
Money market funds	9,713,013	21,270,226
Debt securities	–	14,257,476
	9,713,013	35,527,702
Escrow funds held for bond defeasance:		
Debt securities	167,428,262	–
Restricted by donor or grantor:		
Cash and cash equivalents	653,344	140,789
Pledges receivable, net	2,235,329	2,785,783
Certificate of deposit	600,000	600,000
Money market funds	27,184	35,726
Equity securities	4,403,293	4,950,777
Beneficial interest in perpetual trusts (comprised of fixed income and equity securities)	4,866,190	4,805,471
Alternative investments	2,775,013	2,466,316
Debt securities	653,205	305,762
Charitable remainder trust assets	77,084	79,591
	16,290,642	16,170,215
Unrestricted – undesignated investments:		
Equity securities	146,983,830	158,572,709
Debt securities	37,750,172	24,518,290
Alternative investments	106,923,120	89,605,774
Money market funds	1,047,392	1,298,003
Cash surrender value of life insurance policies	3,356,141	3,654,414
	296,060,655	277,649,190
	\$ 767,578,950	\$ 587,212,861

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

2. Assets Whose Use Is Limited or Restricted and Investments (continued)

Investment income for assets limited or restricted as to use, cash equivalents, and other investments is composed of the following:

	Year Ended June 30			
	2018		2017	
	Unrestricted	Temporarily Restricted	Unrestricted	Temporarily Restricted
Dividends and interest	\$ 9,954,577	\$ 263,494	\$ 6,872,532	\$ 232,734
Realized gains	14,830,914	330,933	2,121,895	62,067
Net gains on alternative investments	14,945,040	323,442	20,766,705	418,781
	<u>\$ 39,730,531</u>	<u>\$ 917,869</u>	<u>\$ 29,761,132</u>	<u>\$ 713,582</u>

	Year Ended June 30	
	2018	2017
	Unrealized gains – change in:	
Unrestricted net assets	\$ 605,433	\$ 14,487,454
Temporarily restricted net assets	328,098	819,514
	<u>\$ 933,531</u>	<u>\$ 15,306,968</u>

The following table summarizes the unrealized losses on investments held at June 30:

Description	2018					
	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Equity securities	\$ 15,908,233	\$ 697,114	\$ 23,633,105	\$ 1,285,387	\$ 39,541,338	\$ 1,982,501
Debt securities	53,062,235	1,189,324	28,731,650	944,707	81,793,885	2,134,031
Total	<u>\$ 68,970,468</u>	<u>\$ 1,886,438</u>	<u>\$ 52,364,755</u>	<u>\$ 2,230,094</u>	<u>\$ 121,335,223</u>	<u>\$ 4,116,532</u>

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

2. Assets Whose Use Is Limited or Restricted and Investments (continued)

Description	2017					
	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Equity securities	\$ —	\$ —	\$ 5,799,462	\$ 134,628	\$ 5,799,462	\$ 134,628
Debt securities	71,705,587	1,142,802	—	—	71,705,587	1,142,802
Total	\$ 71,705,587	\$ 1,142,802	\$ 5,799,462	\$ 134,628	\$ 77,505,049	\$ 1,277,430

Management has concluded that the current economic environment will enable the Company to recover the unrealized losses. This conclusion was based on a number of factors, including (1) the significance of the difference between cost and fair value of the investment and (2) the time period for which fair value was lower than cost.

3. Fair Value

The Company's investments are recorded at fair value based on an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, ASC 820, *Fair Value Measurement*, establishes a three-tier fair value hierarchy and prioritizes the inputs used in measuring fair value as follows:

Level 1 – Pricing inputs are based on quoted prices, unadjusted, for identical assets or liabilities, in active markets.

Level 2 – Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full contractual term of the assets or liabilities.

Level 3 – Pricing inputs are generally unobservable and include situations where there is little, if any, market activity for the instrument. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. Level 3 fair values are therefore determined using factors that involve considerable judgment and interpretations, including but not limited to private and public comparable, discounted cash flow models and fund manager estimates.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

3. Fair Value (continued)

Assets and liabilities measured at fair value are based on one or more of the three valuation techniques. The three valuation techniques are identified in the tables below. Where more than one technique is noted, individual assets or liabilities were valued using one or more of the noted techniques. The valuation techniques are as follows:

- (a) Market approach – Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
- (b) Cost approach – Amount that would be required to replace the service capacity of an asset (replacement cost).
- (c) Income approach – Techniques to convert future amounts to a single present value amount based on market expectations (including present value techniques, option-pricing and excess earnings models for intangibles).

As of June 30, 2018 and 2017, the Company's alternative investments amounting to approximately \$215,094,000 and \$180,463,000, respectively, are accounted for using the equity method of accounting. Since alternative investments are accounted for using the equity method of accounting, which is not a fair value measure, they are omitted from the following tables.

The Company has unfunded capital commitments under alternative investment private equity funds totaling approximately \$23,185,000 as of June 30, 2018. The unfunded capital commitments can be funded through June 2023.

As of June 30, 2018 and 2017, the Company's investments in cash surrender values of life insurance policies amounting to approximately \$21,252,000 and \$20,432,000, respectively, are omitted from the following table as they are accounted for as life insurance contracts.

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, receivables, accounts payable and accrued expenses approximate fair value due to the short-term nature of these instruments.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

3. Fair Value (continued)

Fair values for long-term debt are estimated using quoted market prices of similar types of borrowings (see Note 7).

The tables below present the Company's fair value measurements on a recurring basis as of June 30:

Description	2018				Valuation Technique
	Total	Level 1	Level 2	Level 3	
Board-designated investments:					
Money market funds	\$ 1,032,434	\$ 1,032,434	\$ —	\$ —	a
Equity securities:					
Large blend	18,571,577	18,571,577	—	—	a
Global equity	31,373,958	31,373,958	—	—	a
Multi-alternative	7,550,119	7,550,119	—	—	a
Fixed income	37,580,717	37,580,717	—	—	a
Equity energy	12,289,304	12,289,304	—	—	a
Large cap	20,401,142	20,401,142	—	—	a
Natural resources	4,719,800	4,719,800	—	—	a
Emerging markets	7,197,045	7,197,045	—	—	a
Debt securities:					
U.S. Treasury obligations	4,693,512	4,693,512	—	—	a
Asset backed securities	3,700,305	—	3,700,305	—	a
Corporate and municipal bonds	4,993,472	—	4,993,472	—	a
Foreign bonds	691,220	—	691,220	—	a
Funds held by trustee under bond indenture agreement:					
Money market funds	9,713,013	9,713,013	—	—	a
Escrow funds held under bond defeasance:					
Debt securities – U.S. Treasury obligations	167,428,262	167,428,262	—	—	a
Investments restricted by donor or grantor:					
Equity securities:					
Large blend	1,156,020	1,156,020	—	—	a
Global equity	881,725	881,725	—	—	a
Multi-alternative	198,012	198,012	—	—	a
Fixed income	997,650	997,650	—	—	a
Equity energy	322,304	322,304	—	—	a
Large cap	535,047	535,047	—	—	a
Natural resources	123,783	123,783	—	—	a
Emerging markets	188,752	188,752	—	—	a

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

3. Fair Value (continued)

Description	2018				Valuation Technique
	Total	Level 1	Level 2	Level 3	
Investments restricted by donor or grantor (continued):					
Debt securities:					
Asset-backed securities	\$ 224,062	\$ —	\$ 224,062	\$ —	a
Corporate bonds	300,041	—	300,041	—	a
Foreign bonds	31,675	—	31,675	—	a
U.S. Treasury obligations	97,427	97,427	—	—	
Charitable remainder trust assets	77,084	77,084	—	—	a
Certificate of deposit	600,000	—	600,000	—	a
Money market funds	27,184	27,184	—	—	a
Beneficial interest in perpetual trusts	4,866,190	—	—	4,866,190	c
Unrestricted investments:					
Money market funds	1,047,392	1,047,392	—	—	a
Equity securities:					
Global equity	32,458,371	32,458,371	—	—	a
Multi-alternative	7,767,828	7,767,828	—	—	a
Fixed income	39,310,628	39,310,628	—	—	a
Large blend	21,553,450	21,553,450	—	—	a
Equity energy	12,643,669	12,643,669	—	—	a
Large cap	20,989,414	20,989,414	—	—	a
Natural resources	4,855,897	4,855,897	—	—	a
Emerging markets	7,404,573	7,404,573	—	—	a
Debt securities:					
U.S. Treasury obligations	10,553,151	10,553,151	—	—	a
Asset-backed securities	5,000,143	—	5,000,143	—	a
U.S. Commercial paper	4,155,605	4,155,605	—	—	a
Corporate bonds	16,524,469	—	16,524,469	—	a
Foreign bonds	1,516,804	—	1,516,804	—	a
Total	528,344,230	489,895,849	33,582,191	4,866,190	
Alternative investments	215,094,379				
Cash surrender value of life insurance policies	21,251,668				
Pledge receivables, net	2,235,329				
Cash and cash equivalents	653,344				
Total	<u>\$ 767,578,950</u>				
2004 interest rate swaps	<u>\$ (6,511,834)</u>	<u>\$ —</u>	<u>\$ (6,511,834)</u>	<u>\$ —</u>	c

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

3. Fair Value (continued)

Description	2017				Valuation Technique
	Total	Level 1	Level 2	Level 3	
Board-designated investments:					
Money market funds	\$ 1,280,401	\$ 1,280,401	\$ —	\$ —	a
Equity securities:					
Large blend	22,361,433	22,361,433	—	—	a
Global equity	28,273,585	28,273,585	—	—	a
Multi-alternative	7,412,984	7,412,984	—	—	a
Fixed income	50,779,814	50,779,814	—	—	a
Equity energy	9,996,833	9,996,833	—	—	a
Large cap	21,545,575	21,545,575	—	—	a
Natural resources	3,870,924	3,870,924	—	—	a
Emerging markets	7,175,555	7,175,555	—	—	a
Funds held by trustee under bond indenture agreement:					
Money market funds	21,270,226	21,270,226	—	—	a
Debt securities – municipals	14,257,476	—	14,257,476	—	a
Investments restricted by donor or grantor:					
Equity securities:					
Large blend	1,271,133	1,271,133	—	—	a
Global equity	852,412	852,412	—	—	a
Multi-alternative	207,802	207,802	—	—	a
Fixed income	1,425,567	1,425,567	—	—	a
Equity energy	280,233	280,233	—	—	a
Large cap	603,970	603,970	—	—	a
Natural resources	108,511	108,511	—	—	a
Emerging markets	201,149	201,149	—	—	a

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

3. Fair Value (continued)

Description	2017				Valuation Technique
	Total	Level 1	Level 2	Level 3	
Investments restricted by donor or grantor (continued):					
Debt securities:					
Asset-backed securities	\$ 89,853	\$ —	\$ 89,853	\$ —	a
Corporate bonds	197,368	—	197,368	—	a
Foreign bonds	18,541	—	18,541	—	a
Charitable remainder trust assets	79,591	79,591	—	—	a
Certificate of deposit	600,000	—	600,000	—	a
Money market funds	35,726	35,726	—	—	a
Beneficial interest in perpetual trusts	4,805,471	—	—	4,805,471	c
Unrestricted investments:					
Money market funds	1,298,003	1,298,003	—	—	a
Equity securities:					
Global equity	29,286,288	29,286,288	—	—	a
Multi-alternative	7,633,729	7,633,729	—	—	a
Fixed income	52,546,669	52,546,669	—	—	a
Large blend	25,248,916	25,248,916	—	—	a
Equity energy	10,294,520	10,294,520	—	—	a
Large cap	22,187,162	22,187,162	—	—	a
Natural resources	3,986,192	3,986,192	—	—	a
Emerging markets	7,389,233	7,389,233	—	—	a
Debt securities:					
U.S. Treasury obligations	5,703,249	5,703,249	—	—	a
Asset-backed securities	1,242,698	—	1,242,698	—	a
U.S. Commercial paper	4,586,807	4,586,807	—	—	a
Corporate bonds	12,209,128	—	12,209,128	—	a
Foreign bonds	776,408	—	776,408	—	a
Total	383,391,135	349,194,192	29,391,472	4,805,471	
Alternative investments	180,462,740				
Cash surrender value of life insurance policies	20,432,414				
Pledge receivables, net	2,785,783				
Cash and cash equivalents	140,789				
Total	<u>\$ 587,212,861</u>				
2004 interest rate swaps	\$ (9,025,714)	\$ —	\$ (9,025,714)	\$ —	c

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

3. Fair Value (continued)

The Company received restricted pledges amounting to approximately \$6,804,000 in 2018 and \$8,996,000 in 2017, which are recorded within temporarily restricted grants and contributions in the consolidated statements of unrestricted revenues, expenses and other changes in net assets, that were subject to fair value measurement upon initial measurement. The restricted pledges were measured using discounted cash flow projections as outlined in the income approach. Pledges receivable, net of the present value discount, using discount rates from 0.36% to 3.77%, and allowance for uncollectible pledges, were approximately \$5,783,000 and \$7,774,000 as of June 30, 2018 and 2017, respectively.

As of June 30, 2018 and 2017, the uncollateralized portion of the Company's swaps subject to nonperformance risk was approximately \$6,512,000 and \$9,026,000, respectively. The resulting reduction in unrealized loss on interest swaps due to this nonperformance risk, arising from the Company's own credit risk, was not material and, no adjustment was recorded in the excess of revenue over expenses for the years ended June 30, 2018 and 2017.

4. Property and Equipment

Property and equipment are summarized as follows:

	June 30	
	2018	2017
Land and land improvements	\$ 45,976,182	\$ 45,199,597
Buildings and improvements	710,386,867	689,570,670
Equipment	405,292,584	393,103,612
Construction in progress	37,361,179	32,365,354
	1,199,016,812	1,160,239,233
Less: amortization and accumulated depreciation	639,075,679	608,221,858
Property and equipment, net	\$ 559,941,133	\$ 552,017,375

In 2018 and 2017, the Company wrote off fully depreciated equipment with cost and accumulated depreciation totaling approximately \$23,190,000 and \$19,358,000, respectively.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

5. Employee Benefit Plans

Eligible employees of the Company are covered under the Hawai'i Pacific Health Retirement Plan (the Plan), a noncontributory defined benefit pension plan. Benefits are based on years of service and a percentage of the employee's compensation. The Company's policy is to accrue actuarially determined net periodic pension costs and to annually contribute an amount within regulatory guidelines.

In May 2015, the HPH Board of Directors approved a plan to change the Plan to a cash balance defined benefit pension plan (cash balance plan) with an effective date of January 1, 2016. Most of the Company's bargaining units ratified the plan change in fiscal year 2015, and remaining bargaining units ratified the plan change in November 2015. For all active, eligible participants in the Plan on January 1, 2016, the current accrued benefit was converted to a cash balance account using actuarial factors and this account will be credited at a rate of 3.5% per year. After the effective date, cash balance credits ranging from 3% to 6.5% of eligible compensation are allocated to active eligible participant accounts based on the participant's age and years of service. Participant accounts are also credited at an annual interest rate of 3.5%.

As part of an ongoing de-risking strategy, the plan completed a non-cancellable group annuity purchase with a third-party in October 2017, whereby all future benefits to certain retirees will be assumed by the third-party. Approximately 630 retirees in pay status were sold to the third party for a premium of \$20,693,800 with benefit payments commencing on January 1, 2018. Accordingly, the projected benefit obligation was reduced by an actuarially determined amount consistent with the premium paid.

Included in net assets at June 30, 2018, are the following amounts that have not yet been recognized in net periodic pension cost: unrecognized prior service credits of approximately \$79,626,000 and unrecognized actuarial losses of approximately \$175,449,000. The unrecognized prior service credit and actuarial loss included in net assets and expected to be recognized in net periodic pension cost during the year ended June 30, 2019, is approximately \$7,695,000. At June 30, 2017, approximately \$87,363,000 in unrecognized prior service credits and \$195,959,000 in unrecognized actuarial losses had not yet been recognized in net periodic pension cost. The unrecognized prior service credit and actuarial loss included in net assets and recognized in net periodic pension cost during the year ended June 30, 2018, was approximately \$3,848,000.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

5. Employee Benefit Plans (continued)

The following is a summary of the changes in the projected benefit obligation and the fair value of plan assets for the fiscal years ended June 30 and the accumulated benefit obligation at June 30:

	Year Ended June 30	
	2018	2017
Projected benefit obligation		
Benefit obligation, at beginning of year	\$ 402,576,972	\$ 409,254,474
Service cost	17,756,914	17,995,973
Interest cost	12,257,691	13,388,055
Actuarial return	(13,098,689)	(21,501,265)
Annuity purchase	(20,693,800)	–
Benefits paid	(16,492,286)	(16,560,265)
Benefit obligation at end of year	\$ 382,306,802	\$ 402,576,972
	Year Ended June 30	
	2018	2017
Fair value of plan assets		
Fair value of plan assets, at beginning of year	\$ 302,552,975	\$ 260,152,042
Contributions	80,500,000	37,662,000
Actual return on plan assets	17,586,111	21,299,198
Annuity purchase	(20,693,800)	–
Benefits paid	(16,492,286)	(16,560,265)
Fair value of plan assets at end of year	363,453,000	302,552,975
Accrued pension liability, end of year	\$ 18,853,802	\$ 100,023,997
Accumulated benefit obligation	\$ 382,306,802	\$ 402,576,972

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

5. Employee Benefit Plans (continued)

The underfunded status of the plan of approximately \$18,854,000 and \$100,024,000 at June 30, 2018 and 2017, respectively, is recognized in the accompanying consolidated balance sheets as accrued pension liability. No plan assets are expected to be returned to the Company during the year ending June 30, 2019.

Components of Net Periodic Benefit Cost

	Year Ended June 30	
	2018	2017
Service cost	\$ 17,756,914	\$ 17,995,973
Interest cost	12,257,691	13,388,055
Expected return on plan assets	(21,759,298)	(18,072,439)
Recognized prior service credit	(7,736,469)	(7,775,931)
Recognized net loss	11,584,373	14,350,287
Net periodic benefit cost	\$ 12,103,211	\$ 19,885,945

Weighted Average Assumptions Used to Determine Benefit Obligations

	June 30	
	2018	2017
Discount rate	4.11%	3.75%

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

5. Employee Benefit Plans (continued)

Weighted Average Assumptions Used to Determine Net Periodic Benefit Cost

	Year Ended June 30	
	2018	2017
Discount rate	3.75%	3.38%
Expected return on plan assets	6.25	6.75
Rate of compensation increase	3.50	3.50

Asset Allocations

The assets of the plan are held by the plan trustee in the HPH combined pension fund. Oversight of the combined pension fund assets is provided by the HPH Investment Advisory Group and the HPH Finance Committee of the Board of Directors. The long-term financial objectives of the combined pension fund are to comply with regulatory funding requirements and balance liquidity needs to meet benefit and expense obligations when due with long-term investment return goals to satisfy future plan obligations.

The long-term investment objective is to earn an average, real return of 5%, after adjusting for inflation and management fees, over long time periods. In order to achieve this objective, the fund needs to exceed the investment objectives in certain periods in order to compensate for shortfalls in other periods. This implies a higher average allocation to equity securities. The HPH Investment Committee's investment policy sets a target for the weighted average asset allocation of 70% equity securities and 30% fixed income securities and cash.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

5. Employee Benefit Plans (continued)

The expected return on plan assets of 6.25% was developed based upon analysis of historical market returns, current market conditions, targeted future asset allocations, the plan assets' past performance, and expectations on potential future market returns. The expected return represents a long-term average view of the performance of the plan assets which may not be achieved during a given plan year.

The weighted average target asset allocations compared to actual asset allocations at June 30, by major asset category, are as follows:

	Target Allocation 2018	Percentage of Actual Plan Assets at June 30	
		2018	2017
Major asset category			
Global equity	45%	52%	56%
Fixed income	30	30	28
Marketable alternative and private investments	22	11	12
Real estate	–	3	3
Cash and cash equivalents	3	4	1
	100%	100%	100%

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

5. Employee Benefit Plans (continued)

The table below presents the plan's assets measured at fair value on a recurring basis as of June 30:

	2018				Valuation Technique
	Total	Level 1	Level 2	Level 3	
Equity securities:					
Value	\$ 18,138,216	\$ 18,138,216	\$ —	\$ —	a
Opportunistic	45,581	45,581	—	—	a
Global	23,903,513	23,903,513	—	—	a
Fixed income	24,460,526	24,460,526	—	—	a
Emerging markets	5,069,694	5,069,694	—	—	a
Global macro	7,177,030	7,177,030	—	—	a
U.S. equity growth	10,476,985	10,476,985	—	—	a
Debt securities:					
U.S. Treasury obligations	24,007,502	24,007,502	—	—	a
Corporate bonds	13,021,663	—	13,021,663	—	a
Real estate	11,230,000	—	11,230,000	—	a
Cash and cash equivalents	12,861,893	12,861,893	—	—	a
	<u>150,392,603</u>	<u>\$ 126,140,940</u>	<u>\$ 24,251,663</u>	<u>\$ —</u>	

Investments measured at net asset value:

Closely held securities	36,829,966
Collective funds	39,972,203
Limited partnerships	65,130,626
Limited liability companies	71,127,602
Total	<u>\$ 363,453,000</u>

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

5. Employee Benefit Plans (continued)

	2017				Valuation Technique
	Total	Level 1	Level 2	Level 3	
Equity securities:					
Value	\$ 19,464,469	\$ 19,464,469	\$ —	\$ —	a
Opportunistic	38,479	38,479	—	—	a
Global	18,265,154	18,265,154	—	—	a
Fixed income	21,151,646	21,151,646	—	—	a
Inflation hedging	5,929,330	5,929,330	—	—	a
Emerging markets	3,871,433	3,871,433	—	—	a
Global macro	7,100,560	7,100,560	—	—	a
U.S. equity growth	13,530,102	13,530,102	—	—	a
Real estate	9,850,000	—	9,850,000	—	a
Cash and cash equivalents	4,527,763	4,527,763	—	—	a
	103,728,936	\$ 93,878,936	\$ 9,850,000	\$ —	

Investments measured at net asset value:

Closely held securities	31,748,451
Collective funds	36,879,497
Limited partnerships	60,408,084
Limited liability companies	69,788,007
Total	<u>\$ 302,552,975</u>

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

5. Employee Benefit Plans (continued)

The plan has classified its common stock, mutual funds, money market funds and U.S. agency securities which are considered highly liquid and easily tradable as Level 1 within the fair value hierarchy. These securities are valued using inputs observable in active markets for identical securities. The plan's investments in real estate are classified as Level 2. Real estate is valued based on an appraisal using inputs observable in active markets for similar properties.

The plan's alternative investments are reported at net asset value per share as a practical expedient or its equivalent. The following tables and explanations identify attributes relating to the nature and risk of such investments at June 30:

	2018			
Fair Value	Redemption Frequency (If Currently Eligible)	Redemption Notice Period (If Currently Eligible)	Redemption Restrictions and Expiration of Restriction	
Fixed income	\$ 46,935,247	Daily	2 business days	–
Global ex-U.S. equity	42,352,941	Daily, monthly	1 or 10 days	–
U.S. equity growth	39,343,547	Daily, monthly	3 or 31 days	–
Emerging markets equity	19,111,173	Daily, monthly	2, 5 or 30 days	Gates
Diversified arbitrage/ event-driven	17,404,998	Quarterly, annually Every 24 months,	44–65 days	Side pockets, soft lockup
Distressed	6,555,478	25% quarterly	60-65 days	Side pockets, gates
Global long/short equity	9,954,229	Quarterly, annually	45–65 days	Side pockets, gates
U.S. long/short equity	19,821,054	Quarterly, monthly	30-60 days	Gates
Global macro	9,024,747	Monthly	2 or 14 days	–
Private equity	2,524,566	–	–	–
Opportunistic	32,417	Every 24 months	90 days	–
	<u>\$ 213,060,397</u>			

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

5. Employee Benefit Plans (continued)

	2017			
Fair Value	Redemption Frequency (If Currently Eligible)	Redemption Notice Period (If Currently Eligible)	Redemption Restrictions and Expiration of Restriction	
Fixed income	\$ 62,474,176	Daily	2 business days	–
Global ex-U.S. equity	38,979,449	Daily, monthly	1 or 10 days	–
U.S. equity growth	38,219,288	Daily, monthly	31 days	–
Emerging markets equity	17,247,421	Daily, monthly	2, 5 or 30 days	Gates
Diversified arbitrage/ event-driven	13,240,252	Quarterly, annually Every 24 months,	44–65 days	Side pockets, gates
Distressed	6,199,817	25% quarterly Quarterly, annually,	60-65 days	Side pockets, gates, hard lock-up 3/31/18
Global long/short equity	12,218,313	25% quarterly	45–90 days	Side pockets, gates
U.S. long/short equity	1,851,468	Quarterly	60 days	Gates
Global macro	7,400,665	Monthly	2 or 14 days	–
Private equity	866,766	–	–	–
Opportunistic	126,424	Every 24 months	90 days	–
	<u>\$ 198,824,039</u>			

Global ex-U.S. equity: This category invests in portfolios consisting of a core group of long stock positions and stock indexes in global ex.-U.S. equity markets. These managers do not focus on a single sector or geographic region, instead employing a broad, global ex.-US mandate.

U.S. equity growth: This category has an emphasis on equities of companies with rapid earnings growth and high multiples of earnings, dividends, and book values.

Emerging markets equity: This category has products investing in the equity securities of companies located in emerging and frontier market countries.

Diversified arbitrage: This category has multi-strategy portfolios that have broad investment parameters, seeking to profit from mispricings across asset classes and strategies.

Event-driven: This category has multi-strategy portfolios that seek to exploit security mispricings caused by mergers and acquisitions, spin-offs, tracking stocks, accounting write-offs, reorganizations, bankruptcies, share buybacks and special dividends.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

5. Employee Benefit Plans (continued)

Distressed: This category has portfolios consisting primarily of investments in debt securities of companies that are experiencing business, financial, market or legal uncertainties, attempting to capture the difference between the market price of security or debt obligations and their underlying intrinsic value.

Global long/short equity: This category has portfolios consisting of a core group of long stock positions with short sales of stock and stock indexes in global and global ex. U.S. equity markets.

U.S. long/short equity: This category has portfolios consisting of a core group of long stock positions with short sales of stock and stock indexes in U.S. equity markets.

Global macro: This category has broad, top-down strategies that seek to capitalize on perceived macroeconomic and political and shifts in investor behavior and market positions. This category is unconstrained by asset class or geography and implemented through long and short positions and means of cash, asset purchases (including physical commodities), futures, options, and other instruments. Leverage is often applied, and return and volatility targets may vary sharply.

Private-equity: Private equity is capital that is not traded on a public exchange. Private equity is composed of funds and investors that directly invest in private companies, or that engage in buyouts of public companies, resulting in the delisting of public equity. The plan has unfunded capital commitments for private equity funds totaling approximately \$10,604,000 as of June 30, 2018. The unfunded capital commitments can be funded through June 2023.

Opportunistic: This category has multi-strategy portfolios that have a broad mandate and employ an opportunistic investment approach, shifting capital across asset classes and strategies depending on their profitability.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

5. Employee Benefit Plans (continued)

The Company expects to make contributions to the Plan amounting to approximately \$30,000,000 in 2019.

Benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

Year ending June 30:	
2019	\$ 32,147,785
2020	35,804,025
2021	24,603,480
2022	26,107,634
2023	27,495,496
Years 2024–2028	139,599,076

The Company has defined contribution retirement plans (Retirement Plans) that cover substantially all employees and provide participants the ability to make pretax payroll deduction contributions for deposit into retirement savings accounts. The participants' contributions are matched at a percentage of their total contributions up to annual dollar limits per participant as defined by the Retirement Plans. The Company may also make discretionary contributions. The total expense related to the above Retirement Plans was approximately \$19,791,000 in 2018 and \$21,099,000 in 2017.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

6. Line and Letters of Credit

The Company has a \$35,000,000 unsecured revolving line of credit available, expiring March 1, 2019. The interest rate on the line is based on the lender's prime rate or three-month LIBOR rate plus an applicable margin. There were no outstanding draws on this facility as of June 30, 2018 and 2017.

As of June 30, 2018, the Company's available letters of credit were as follows:

<u>Coverage</u>	<u>Amount</u>	<u>Expiration Date</u>	<u>Interest Rate</u>
Malpractice insurance policies:			
PIC	\$ 2,000,000	February 17, 2019	1%
Workers' compensation insurance policies:			
HPH	1,000,000	February 1, 2019	*

* Interest rate would be determined if drawn upon

There were no draws on the above letters of credit as of June 30, 2018 and 2017.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt

Long-term debt is summarized as follows:

	June 30	
	2018	2017
Series 2018B Taxable Refunding Revenue Bonds, interest payable semi-annually at rates ranging from 2.58% to 4.27% (3.94% at June 30, 2018), principal payments in varying annual amounts ranging from \$1,670,000 to \$2,605,000 due July 2019 through 2032; \$2,715,000 to \$3,610,000 due July, 2033 through July, 2040	\$ 53,421,531	\$ —
Series 2018A Taxable Refunding Revenue Bonds, interest payable semi-annually at rates ranging from 2.58% to 4.27% (4.11% at June 30, 2018), principal payments in varying annual amounts ranging from \$435,000 to \$2,395,000 due July 2019 through 2032; \$1,210,000 to \$11,605,000 due July, 2033 through July, 2040	91,865,561	—
Prudential 3.81% Series A Senior Note due September, 2042, annual amortizing principal payments due in September and semi-annual interest payments due in March and September	56,363,819	—
Series 2013C Special Purpose Variable Rate Revenue Bonds, principal payments in varying annual amounts ranging from \$1,900,000 to \$4,200,000 due July 2018 through 2033 (interest rate of 2.14% at June 30, 2018)	44,200,458	46,085,239
Series 2013B Special Purpose Revenue Bonds, interest payable semi-annually at rates ranging from 3.00% to 5.25% (4.83% at June 30, 2018), principal payments in varying annual amounts ranging from \$265,000 to \$3,105,000 due July 2018 through 2033	30,892,087	32,365,633
Series 2013A Special Purpose Revenue Bonds, interest payable semi-annually at rates ranging from 5.00% to 6.00% (5.49% at June 30, 2018), principal payments in varying annual amounts ranging from \$1,200,000 to \$1,930,000 due July 2018 through 2028; \$1,795,000 to \$5,385,000 due July 2029 through 2033; \$2,520,000 to \$3,120,000 due July 2034 through 2038, \$3,295,000 to \$23,995,000 due July 2039 through 2043	116,802,484	117,978,451

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt (continued)

	June 30	
	2018	2017
Series 2010B Special Purpose Revenue Bonds, interest payable semi-annually at rates ranging from 5.00% to 5.75% (5.65% at June 30, 2018), principal payments in varying annual amounts ranging from \$1,285,000 to \$1,410,000 due July 2018 through 2020; \$1,480,000 to \$2,425,000 due July 2021 through 2030; \$2,560,000 to \$4,245,000 due July 2031 through 2040	\$ 54,762,642	\$ 55,938,215
Series 2010A Special Purpose Revenue Bonds, interest payable semi-annually at rates ranging from 4.125% to 5.50% (5.39% at June 30, 2018), principal payments in varying annual amounts ranging from \$1,335,000 to \$2,275,000 due July 2018 through 2021; \$335,000 to \$1,640,000 due July 2022 through 2030; \$1,280,000 to \$12,705,000 due July 2031 through 2040	94,256,600	94,893,702
Total long-term debt	542,565,182	347,261,240
Less current portion	7,773,803	6,346,970
Noncurrent portion	\$ 534,791,379	\$ 340,914,270

In April 2018, the Company issued Series 2018A and 2018B Taxable Refunding Bonds in the amounts of \$93,025,000 and \$54,090,000 respectively. The proceeds of the Series 2018A&B Bonds will be used to refund the Series 2010 A&B Department of Budget and Finance of the State of Hawai'i Special Purpose Revenue Bonds. Proceeds received from the Series 2018A&B Taxable Refunding Bonds were placed in an escrow fund to be used for the Series 2010A&B bond defeasance.

In September 2017, the Company executed a shelf note arrangement (Prudential Note) which allows the Company to issue Senior notes up to an aggregate of \$93,500,000 through September 2020. Contemporaneously, senior notes payable totaling \$56,500,000 were issued with interest at 3.81% due September 2042. Principal is payable annually, and interest is payable semi-annually. The proceeds from the notes were used to fund additional contributions to the Plan in fiscal year 2018.

In October 2013, the Company issued Series 2013A, 2013B and 2013C Bonds in the amounts of \$122,240,000, \$36,740,000 and \$50,000,000, respectively. The Series 2013A Bonds established a project fund to finance construction of a healthcare facility and equipment. The 2013A Bonds are a combination of serial and term bonds. The serial bonds have maturity dates that started July 1, 2015 through 2028, with interest rates ranging from 3.00% to 5.00%. The term bonds have

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt (continued)

maturity dates of July 1, 2033, July 1, 2038, and July 1, 2043, with fixed interest rates of 6.00%, 5.50% and 5.50%, respectively. The Series 2013B Bonds were used to refund the Series 1998 Bonds and Series 2004A Bonds. The 2013B Bonds have maturity dates that started July 1, 2014 through 2033 with interest rates ranging from 2.00% to 5.25%. The Series 2013C Bonds were used to refund the Series 2004B Bonds. The Series 2013C Bonds are a direct bank purchase bonds bearing interest at 67% of one-month LIBOR plus 0.80%. Principal payments in varying amounts ranging from \$1,900,000 to \$4,200,000 have maturity dates starting July 1, 2015 through 2033.

The Prudential Note, 2018 Series Taxable Refunding Bond, 2013 and 2010 Series Special Purpose Revenue Bonds are collateralized by a security interest in the gross receipts and pledged assets of the Obligated Group (comprised of HPH – parent company only, KMCWC, PMMC, SCH and WMH) as defined in the Master Indenture. The 2018A&B Bonds are subject to optional redemption prior to their stated maturities at the option of the Obligated Group at a redemption price equal to a Make-Whole Redemption Price. The 2018A&B Bonds are also subject to Extraordinary Optional Redemption at the direction of the Obligated Group. The 2018B Bonds are subject to mandatory redemption on or after July 1, 2033, payable in annual sinking fund installments from \$2,715,000 to \$3,610,000. The 2018A Bonds are subject to mandatory redemption on or after July 1, 2033, payable in annual sinking fund installments from \$1,210,000 to \$11,605,000. The 2013C Bonds are subject to optional redemption at various terms and to mandatory redemption on or after July 1, 2015, payable in annual amounts of \$1,900,000 to \$4,200,000. The 2013A & B Bonds are subject to optional redemption on or after July 2, 2023, at a redemption price equal to 100% of the principal amount plus accrued interest to the date of redemption without premium. In addition, the 2013A Bonds maturing on July 1, 2033, July 1, 2038, and July 1, 2043, are subject to redemption prior to their stated maturity on or after July 1, 2029, in varying amounts of \$1,795,000 to \$23,995,000 without premium. The 2010B Bonds are subject to optional redemption on or after July 1, 2020, at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the date of redemption, without premium. The 2010B Bonds are subject to mandatory redemption on or after July 1, 2021, payable in annual sinking fund installments from \$1,480,000 to \$4,245,000. The 2010A Bonds are subject to optional redemption on or after July 2, 2020, at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the date of redemption, without premium. The 2010A Bonds are subject to mandatory redemption on or after July 1, 2022, payable in annual sinking fund installments from \$335,000 to \$12,705,000.

As of June 30, 2018 and 2017, approximately \$9,713,000 and \$19,922,000, respectively, included in current assets, was held by the bond trustee to fund principal maturities and accrued interest payable.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt (continued)

Certain bond agreements require the Obligated Group of the Company to comply with various covenants, including the maintenance of a minimum long-term debt service coverage rates. As of June 30, 2018, the Obligated Group was in compliance with all bond covenants.

Long-term debt maturities for the years succeeding June 30, 2018, are as follows.

Year ending June 30:	
2019	\$ 7,773,803
2020	11,938,196
2021	12,474,938
2022	13,076,982
2023	11,568,776
Thereafter	485,732,487
	<u>\$ 542,565,182</u>

Interest paid was approximately \$14,896,679 in 2018 and \$18,847,000 in 2017.

The fair value of long-term debt as of June 30, 2018 and 2017, was approximately \$411,213,723 and \$389,109,000, respectively. The June 30, 2018 valuation excludes the Series 2010A&B bond which will be defeased with the proceeds from the Series 2018A&B bonds that have been placed in escrow as of June 30, 2018.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

8. Leases

As Lessee

Leases on various types of office and storage space, office equipment and furniture are classified as operating leases.

Future minimum lease payments under noncancelable operating leases as of June 30, 2018, are as follows:

Year ending June 30:	
2019	\$ 10,533,000
2020	10,111,000
2021	9,554,000
2022	9,026,000
2023	8,721,000
Thereafter	<u>64,659,000</u>
	<u>\$ 112,604,000</u>

Minimum rent payments have not been reduced by minimum sublease rentals of approximately \$10,213,000 due in the future under noncancelable subleases.

The composition of total rental expense for all operating leases except those with terms of a month or less is as follows:

	Year Ended June 30	
	2018	2017
Minimum rentals	\$ 12,340,000	\$ 12,072,000
Less: sublease rentals	1,385,000	1,744,000
	<u>\$ 10,955,000</u>	<u>\$ 10,328,000</u>

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

8. Leases (continued)

As Lessor

Future minimum rental income to be received under noncancelable operating leases for office space as of June 30, 2018, is as follows:

Year ending June 30:	
2019	\$ 1,713,000
2020	1,715,000
2021	605,000
2022	405,000
2023	399,000
Thereafter	<u>13,104,000</u>
	<u>\$ 17,941,000</u>

9. Income Taxes

Some of the Company's not-for-profit organizations have generated net operating losses (NOL) attributable to revenue-generating activities that are not related to their respective tax-exempt purposes. The Company has unused federal and Hawaii NOL carryforwards as of June 30, 2018, of approximately \$5,509,000. The NOL carryforwards begin to expire in 2020. The deferred tax asset associated with these NOL carryforwards are offset by a full valuation allowance in the consolidated balance sheets as management has determined it is more likely than not that the NOLs will not be utilized.

On December 22, 2017, the Tax Cuts and Jobs Act was enacted (Tax Act), which significantly revised U.S. corporate income tax law by, among other things, reducing the corporate statutory income tax rate from 34% to 21%, beginning January 1, 2018. This reduction in the corporate statutory income tax rate required the Company to re-evaluate certain of its deferred tax assets, as of the date of the Tax Act, to reflect the revised income tax rates applicable to future periods. For tax-exempt entities, the Tax Act also requires organizations to categorize certain fringe benefit expenses as a source of unrelated business income, pay an excise tax on remuneration above certain thresholds that is paid to executives by the organization, and report income or loss from unrelated business activities on an activity-by-activity basis, among other provisions.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

9. Income Taxes (continued)

As of June 30, 2018, the Company has made provisional estimates of the tax effects of the Tax Act, including remeasuring its deferred tax balances at the new tax rate. The Company will continue to revise and refine its calculations as it receives additional guidance from the Internal Revenue Service on how the new provisions apply to exempt organizations and taxable subsidiaries.

The Company has not recorded any expense or accrued for any related expense for any uncertain tax positions. The Company's 2015 through 2017 tax years remain subject to examination for federal income tax purposes, whereas the 2014 through 2017 tax years remain subject to examination for state taxing jurisdictions in which the Company operates.

10. Functional Classification of Expenses

The functional classification of expenses by major classes of program services and supporting activities are summarized as follows:

	Year Ended June 30	
	2018	2017
Patient services	\$ 929,872,688	\$ 908,758,935
Management and general	354,426,916	323,915,756
	<u>\$ 1,284,299,604</u>	<u>\$ 1,232,674,691</u>

11. Commitments and Contingencies

Workers' Compensation Claims

The Company is self-insured for workers' compensation claims. The Company has an available letter of credit in favor of the State of Hawaii (as described in Note 6), as required by self-insurance regulations of the State of Hawaii. The Company provides its actuary with estimated claims payments and accrues workers' compensation expense based on an actuarial determined amount. Workers' compensation accruals included in payroll and related liabilities in the consolidated balance sheets totaled approximately \$4,397,000 and \$4,597,000 as of June 30, 2018 and 2017, respectively, and were recorded using a 1.68% and 1.36% discount factor as of June 30, 2018 and 2017, respectively. The aforementioned amounts include accruals for known and incurred but not reported workers' compensation claims.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

11. Commitments and Contingencies (continued)

Medical Malpractice Insurance

In June 2002, the Company formed PIC, a captive insurance company covering professional (medical malpractice) and general liability risks. PIC is a not-for-profit Hawaii-domiciled pure captive whose sole corporate member is HPH. PIC operates under a Certificate of Authority from the State of Hawaii (Insurance Division) and began operations on July 1, 2002. PIC is a regulated insurance company with reserve, investment, reporting and audit requirements. The Company is covered for professional and general liability claims under a combined single limit of \$102,000,000 through PIC. The professional and general liability coverage from PIC is claims-made, with PIC providing tail coverage (with certain limitations) to the Company with claims-made policies prior to July 1, 2002. The amount of premiums charged by PIC to the Company's entities was based on the expected case of \$3,600,000 to \$5,000,000 in premiums.

For the years ended June 30, 2004 through 2018, PIC renewed its reinsurance coverages. The PIC risk retention and total coverage amounts, including reinsurance, by policy year are as follows:

Policy year ending June 30	<u>PIC Retention</u> <u>Total Coverage</u>	
2004–2007	\$ 1,000,000	\$ 51,000,000
2008–2014	1,000,000	76,000,000
2015–2016	1,000,000	101,000,000
2017-2018	2,000,000	102,000,000

For the years ended June 30, 2004 through 2016, PIC entered into a retrospective rating program for the first reinsurance layer of \$10,000,000. Depending on actual claims experience, the premium is adjusted either down to a minimum of \$2,000,000 or up to a maximum of \$8,000,000. Under the retrospective rating program, the Company estimates that it will pay additional premiums to the reinsurer of approximately \$7,137,000, which has been recorded within accrued expenses within the consolidated balance sheets, and adjustments have been made to premiums earned from each of the Company's entities as of June 30, 2018. The Company does not have a deductible for coverage provided by PIC. PIC's total costs are allocated through a premium charge to the Company based on actuarial information derived from historical loss experience and expected losses.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

11. Commitments and Contingencies (continued)

Medical malpractice expense totaled approximately \$16,883,000 in 2018 and \$16,528,000 in 2017. Medical malpractice accruals, including claims expected to be paid by reinsurance, totaled approximately \$66,918,000 and \$61,929,000 and reinsurance recoverable totaled approximately \$32,195,000 and \$33,198,000 as of June 30, 2018 and 2017, respectively, and were recorded using a 1.94% and 1.77% discount factor at June 30, 2018 and 2017, respectively, within deposits and other in the consolidated balance sheets. Undiscounted medical malpractice accruals and reinsurance recoverable totaled approximately \$71,537,000 and \$34,494,000, respectively, as of June 30, 2018.

Interest Rate Swap Agreements

During the second quarter of fiscal year 2004, the Company issued \$30,000,000 of fixed rate and \$50,000,000 of variable rate bonds for a total of \$80,000,000 of 2004 Bonds. In order to hedge future variability in cash flows associated with variable rate debt, two tranches of floating-to-fixed amortizing interest rate swaps of \$25,000,000 each in notional amounts were entered into at the time the variable rate debt was issued. The variable rate debt from the 2004 Bonds was refunded by the 2013C Bonds. The 2013C Bonds were structured to match the terms of the 2004 Bonds so that the existing interest rate swaps could continue to be designated as a hedge against the variability in the cash flows of the current variable rate debt. The Company pays fixed rates ranging between 3.842% and 3.849% and receives a variable rate tied to LIBOR. A component of the fixed rate on these two swaps includes the financing of the loss on a previous, but now terminated \$30,000,000 forward starting amortizing interest rate swap on the date of termination. As of June 30, 2018 and 2017, the Company recorded an accumulated loss of approximately \$5,300,000 and \$7,700,000, respectively, in unrestricted net assets related to the current amortizing interest rate swaps outstanding. The balance of the unamortized loss as of June 30, 2018 and 2017, amounted to approximately \$1,110,000 and \$1,190,000, respectively.

The mark-to-market loss position on the swap arrangements related to the 2004 and 2013 Bonds was approximately \$6,512,000 and \$9,026,000 as of June 30, 2018 and 2017, respectively.

Companies are allowed to offset derivative fair value and cash collateral amounts executed with the same counterparty under a master netting arrangement. The Company has chosen to adopt the netting of such amounts under its master agreement with its counterparties. The Company did not have the right to reclaim cash collateral or obligation to return cash collateral for derivatives under master netting arrangements that have not been offset against net derivative positions as of June 30, 2018 and 2017.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

11. Commitments and Contingencies (continued)

The following discloses information requirements regarding offsetting liabilities. The Company did not hold offsetting assets as of June 30, 2018 and 2017.

Offsetting of Financial Liabilities and Derivative Liabilities (\$ in millions)

As of June 30, 2018						
Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Consolidated Balance Sheet	Net Amounts of Liabilities Presented in the Consolidated Balance sheet	Gross Amounts Not Offset in the Consolidated Balance Sheet	Cash Collateral Pledged	Net Amount
Derivatives	\$ 6.5	\$ –	\$ 6.5	\$ –	\$ –	\$ 6.5
Total	\$ 6.5	\$ –	\$ 6.5	\$ –	\$ –	\$ 6.5
As of June 30, 2017						
Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Consolidated Balance Sheet	Net Amounts of Liabilities Presented in the Consolidated Balance sheet	Gross Amounts Not Offset in the Consolidated Balance Sheet	Cash Collateral Pledged	Net Amount
Derivatives	\$ 9.0	\$ –	\$ 9.0	\$ –	\$ –	\$ 9.0
Total	\$ 9.0	\$ –	\$ 9.0	\$ –	\$ –	\$ 9.0

Certain of the Company's derivative instruments contain provisions that require an investment grade credit rating from the major credit rating agencies. If the Company's credit rating was to change or if an event of default was to occur and continue, the counterparties to the derivative instruments could demand full collateralization on the derivative instruments in net liability positions. The aggregate fair value of all derivative instruments with credit risk related contingent features that are in a liability position as of June 30, 2018, is approximately \$6,512,000 for which the Company has posted zero collateral in the normal course of business. If the credit-risk-related contingent features underlying these agreements were triggered on June 30, 2018, the Company could be required to post up to \$6,512,000 of additional collateral to its counterparty.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

11. Commitments and Contingencies (continued)

The combined tables below present the location and amounts of derivative fair values in the accompanying consolidated balance sheets and derivative gains and losses in the consolidated statements of unrestricted revenues, expenses and other changes in net assets.

Fair Values of Derivative Instruments

Derivatives Designated as Hedging Instruments Under ASC 815	Asset Derivatives				Liability Derivatives			
	June 30, 2018		June 30, 2017		June 30, 2018		June 30, 2017	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Interest rate contracts	Other noncurrent assets	\$ —	Other noncurrent assets	\$ —	Other long-term liabilities	\$ 6,511,834	Other long-term liabilities	\$ 9,025,714
Total		<u>\$ —</u>		<u>\$ —</u>		<u>\$ 6,511,834</u>		<u>\$ 9,025,714</u>

The Effect of Derivative Instruments on the Statement of Financial Performance

Derivatives in ASC 815 Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in Other Change in Net Assets on Derivative (Effective Portion)		Amount of Gain (Loss) Reclassified From Unrestricted Net Assets Into Excess of Revenues Over Expenses (Effective Portion)		Amount of Gain (Loss) Recognized in Excess of Revenues Over Expenses on Derivative (Ineffective Portion) and Amount Excluded from Effectiveness Testing	
	Year Ended June 30		Year Ended June 30		Year Ended June 30	
	2018	2017	2018	2017	2018	2017
Interest rate contracts	\$ 246,548	\$ 3,897,171	\$ —	\$ —	\$ —	\$ —
Total	<u>\$ 246,548</u>	<u>\$ 3,897,171</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Litigation

The Company is involved in legal actions in the normal course of business, some of which seek monetary damages, including punitive damages, which are not covered by insurance. These actions, when finally concluded and determined, will not, in the opinion of management and the Company's general counsel, have a material adverse effect on the Company's financial position, results of operations, or cash flows.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

11. Commitments and Contingencies (continued)

Other (Unaudited)

The Company has outstanding construction commitments of approximately \$38,263,000 as of June 30, 2018.

12. Related-Party Transactions

A joint venture investment of the Company provides collection services to the Company. Payments to the joint venture totaled approximately \$1,200,000 in 2018 and \$1,181,000 in 2017.

SCH leased land from the Plan for \$696,000 in lease rent for both 2018 and 2017. The lease terminates in 2042, and rental payments are renegotiated every five years based on an appraisal of the land. Future annual lease payments are \$696,000 through December 31, 2021, at which point the lease agreement will be up for renegotiation and lease terms subject to change. The Office of Pension and Welfare Benefit Programs granted the Plan an exemption from prohibitions for the aforementioned lease arrangement.

As of June 30, 2018, future minimum lease payments under this lease agreement are as follows:

Year ending June 30:	
2019	\$ 696,000
2020	696,000
2021	696,000
2022	696,000
2023	696,000
Thereafter	12,876,000
	<u>\$ 16,356,000</u>

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

13. Restricted Net Assets

Temporarily restricted net assets are summarized as follows:

	June 30	
	2018	2017
Health and hospital care	\$ 12,527,332	\$ 11,067,424
Plant expansion and equipment replacement	6,559,551	6,062,407
Research and grants	8,240,814	5,667,732
Education and scholarships	1,691,286	1,221,463
	\$ 29,018,983	\$ 24,019,026

Permanently restricted net assets are summarized as follows:

	June 30	
	2018	2017
Health and hospital care	\$ 9,643,298	\$ 9,551,579
Plant expansion and equipment replacement	71,000	62,500
Research and grants	3,261,470	3,229,470
Education and scholarships	501,437	499,437
	\$ 13,477,205	\$ 13,342,986

14. Endowment

The Company's endowment consists of approximately 48 individual funds established for a variety of purposes. The endowment includes both donor-restricted funds and funds designated by the Board of Directors to function as endowments. Net assets associated with the endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

14. Endowment (continued)

Interpretation of Relevant Law

In June 2009, Hawai'i Revised Statute 517E was signed into law, enacting UPMIFA. UPMIFA became effective on July 1, 2009, replacing the Uniform Management of Institutional Funds Act. UPMIFA applies to institutional funds created after July 1, 2009, and to decisions made after July 1, 2009, for existing institutional funds. UPMIFA eliminates the concept of "historic dollar value" and allows an institution to spend or accumulate as the board determines is prudent for the uses, benefits, purposes and duration of the endowment fund unless the gift instrument states a particular rate or formula.

The Company has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Company classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment and (3) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is characterized as temporarily restricted net assets until those amounts are appropriated for expenditure by the Company in a manner consistent with the standard for expenditure prescribed by UPMIFA. In accordance with UPMIFA, the Company considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund.
2. The general purposes of the Company and the donor-restricted endowment fund.
3. General economic conditions.
4. The possible effect of inflation and deflation.
5. The expected total return from income and the appreciation of investments.
6. Other resources of the Company.
7. The investment policies of the Company.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

14. Endowment (continued)

Funds With Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires the Company to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were approximately \$85,000 and \$121,000 as of June 30, 2018 and 2017, respectively.

Return Objectives and Risk Parameters

The Company has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity. Under this policy, the endowment assets are invested in a manner that is intended to produce results that equal or exceed a mix of the Russell 3000, MSCI All Country World, consumer price index plus 5%, Hedge Fund Research, Inc. and Barclays Capital benchmarks. The Company expects its endowment funds to provide an annual real return, net of inflation and management fees, of approximately 5% over long time periods. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the Company relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Company targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Company has a policy of appropriating for distribution each year 4.5% of its endowment fund's average fair value using quarter-end values for the preceding three years. The amount of the distribution is subject to a 6% cap and 3% floor applied to the most recent quarter-end value to account for market volatility. In establishing this policy, the Company considered the long-term expected return on its endowment. Accordingly, the Company expects the current spending policy

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

14. Endowment (continued)

to allow its endowment to grow over long time periods, which is consistent with the Company's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment returns.

The endowment net asset composition by type of fund consists of the following at June 30:

		2018			
		Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted funds		\$ (84,970)	\$ 6,483,274	\$ 13,477,205	\$ 19,875,509
Board-designated funds		278,086,378	–	–	278,086,378
		\$ 278,001,408	\$ 6,483,274	\$ 13,477,205	\$ 297,961,887
		2017			
		Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted funds		\$ (121,053)	\$ 5,656,881	\$ 13,342,986	\$ 18,878,814
Board-designated funds		257,865,754	–	–	257,865,754
		\$ 257,744,701	\$ 5,656,881	\$ 13,342,986	\$ 276,744,568

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

14. Endowment (continued)

Changes in endowment net assets for the years ended June 30 consist of the following:

	2018			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 257,744,701	\$ 5,656,881	\$ 13,342,986	\$ 276,744,568
Investment income:				
Investment income	3,514,453	234,072	–	3,748,525
Net appreciation (realized and unrealized)	16,706,171	828,707	–	17,534,878
Total investment gain	20,220,624	1,062,779	–	21,283,403
Contributions	–	–	73,500	73,000
Appropriation of endowment assets for expenditure	–	(123,684)	–	(123,684)
Beneficial interest in perpetual trust	–	–	60,719	60,719
Transfers	36,083	(112,702)	–	(76,619)
Endowment net assets, end of year	<u>\$ 278,001,408</u>	<u>\$ 6,483,274</u>	<u>\$ 13,477,205</u>	<u>\$ 297,961,887</u>
	2017			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 234,541,785	\$ 4,668,577	\$ 12,913,230	\$ 252,123,592
Investment income:				
Investment income	2,726,451	195,128	–	2,921,579
Net appreciation (realized and unrealized)	20,412,300	1,111,662	–	21,523,962
Total investment gain	23,138,751	1,306,790	–	24,445,541
Contributions	–	–	171,740	171,740
Appropriation of endowment assets for expenditure	–	(226,960)	–	(226,960)
Beneficial interest in perpetual trust	–	–	258,016	258,016
Transfers	64,165	(91,526)	–	(27,361)
Endowment net assets, end of year	<u>\$ 257,744,701</u>	<u>\$ 5,656,881</u>	<u>\$ 13,342,986</u>	<u>\$ 276,744,568</u>

Supplementary Information

Members of the Hawai'i Pacific Health Obligated Group

Combined Balance Sheets

	June 30	
	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 188,368,986	\$ 141,031,350
Patient accounts receivable, less allowance for uncollectible accounts (2018 – \$4,892,000; 2017 – \$6,998,000)	161,744,383	156,064,947
Due from third-party payors	23,225,111	13,459,316
Other receivables	10,334,119	9,307,332
Due from affiliates	2,770,707	5,818,024
Inventories	19,873,741	17,846,427
Funds held by trustee under bond indenture agreement	9,713,013	19,922,004
Escrow funds held for bond defeasance	2,620,000	–
Prepaid expenses and other	6,354,779	5,918,213
Total current assets	425,004,839	369,367,613
Assets whose use is limited or restricted:		
Board-designated	203,519,368	188,766,083
Funds held by trustee under bond indenture agreement	–	15,605,698
Escrow funds held for bond defeasance	164,808,262	–
Restricted by donor or grantor	34,319,033	31,824,502
Total assets whose use is limited or restricted	402,646,663	236,196,283
Investments	265,312,676	246,447,770
Property and equipment, net	546,736,253	537,649,078
Due from third-party payors	4,385,467	6,417,047
Other assets:		
Investment in unconsolidated subsidiaries	49,044,641	46,682,049
Investments in joint ventures	25,000	25,000
Beneficial interest in net assets of foundations	63,996,984	60,166,674
Other	18,401,151	13,459,917
Total other assets	131,467,776	120,333,640
Total assets	\$ 1,775,553,674	\$ 1,516,411,431

	June 30	
	2018	2017
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 43,846,639	\$ 41,890,037
Payroll and related liabilities	80,187,645	73,646,931
Accrued expenses	22,855,008	22,059,611
Due to third party payors	12,843,509	10,198,583
Current portion of long-term debt	7,773,803	6,346,970
Total current liabilities	<u>167,506,604</u>	154,142,132
Long-term debt, less current portion	534,791,379	340,914,270
Other long-term liabilities	42,723,063	36,711,286
Due to third party payors	9,243,840	10,105,787
Accrued pension liability	18,853,802	100,023,997
Net assets:		
Unrestricted	959,968,215	837,181,544
Temporarily restricted	28,989,566	23,989,429
Permanently restricted	13,477,205	13,342,986
Total net assets	<u>1,002,434,986</u>	874,513,959
Total liabilities and net assets	<u><u>\$ 1,775,553,674</u></u>	<u><u>\$ 1,516,411,431</u></u>

Members of the Hawai'i Pacific Health Obligated Group

Combined Statements of Unrestricted Revenues, Expenses and Other Changes in Net Assets

	Year Ended June 30	
	2018	2017
Unrestricted revenues		
Net patient service revenue	\$ 1,232,015,677	\$ 1,189,482,020
Provision for bad debts	<u>(17,153,612)</u>	<u>(19,272,660)</u>
Net patient service revenue less provision for bad debts	1,214,862,065	1,170,209,360
Premium revenue	16,074,616	3,387,972
Other revenues	43,866,815	42,289,847
Temporarily restricted net assets released from restrictions for operations	<u>13,906,486</u>	<u>14,067,815</u>
Total unrestricted revenues	<u>1,288,709,982</u>	<u>1,229,954,994</u>
Expenses		
Salaries and employee benefits	674,959,116	648,994,863
Services	166,612,697	162,484,139
Supplies	176,531,308	170,448,609
Other purchases	70,269,970	60,790,263
Depreciation and amortization	51,798,095	52,752,605
Specific purpose projects/donations	13,906,486	14,067,815
Interest	20,831,489	18,789,740
Other	<u>6,799,860</u>	<u>5,080,095</u>
Total expenses	<u>1,181,709,021</u>	<u>1,133,408,129</u>
Operating income	107,000,961	96,546,865
Equity in income of unconsolidated subsidiaries	33,562	7,710,235
Investment income	<u>33,736,583</u>	<u>25,258,726</u>
	<u>33,770,145</u>	<u>32,968,961</u>
Excess of revenues over expenses	140,771,106	129,515,826
Transfers to affiliates	(36,078,052)	(47,673,937)
Change in interest in foundations	3,830,310	18,630,114
Change in net unrealized gains on investments	434,097	12,027,898
Temporarily restricted net assets released from restrictions for purchase of property and equipment	1,116,472	34,991,823
Change in funded status of pension plan	12,808,053	31,313,343
Change in interest rate swap value	246,548	3,897,171
Other changes in net assets	<u>(341,863)</u>	<u>—</u>
Increase in unrestricted net assets	<u>122,786,671</u>	<u>182,702,238</u>

Continued to next page.

Members of the Hawai'i Pacific Health Obligated Group

Combined Statements of Unrestricted Revenues,
Expenses and Other Changes in Net Assets (continued)

	Year Ended June 30	
	2018	2017
Temporarily restricted net assets		
Restricted grants and contributions	\$ 17,303,053	\$ 49,127,668
Investment income	281,261	395,273
Change in interest in foundations	2,360,312	(29,332,446)
Net assets released from restrictions	(15,022,959)	(49,059,638)
Other changes in temporarily restricted net assets	78,470	171,758
Increase (decrease) in temporarily restricted net assets	<u>5,000,137</u>	<u>(28,697,385)</u>
Permanently restricted net assets		
Change in interest in foundations	73,500	171,740
Change in beneficial interest in perpetual trusts	60,719	258,016
Increase in permanently restricted net assets	<u>134,219</u>	<u>429,756</u>
Increase in net assets	127,921,027	154,434,609
Net assets at beginning of year	874,513,959	720,079,350
Net assets at end of year	<u>\$ 1,002,434,986</u>	<u>\$ 874,513,959</u>

Members of the Hawai'i Pacific Health Obligated Group

Combined Statements of Cash Flows

	Year Ended June 30	
	2018	2017
Operating activities		
Increase in net assets	\$ 127,921,027	\$ 154,434,609
Adjustments to reconcile the increase in net assets to net cash provided by operating activities:		
Change in interest in foundations	(6,264,122)	10,530,592
Depreciation and amortization	51,798,095	52,752,605
Provision for bad debts	17,153,612	19,272,660
Equity in income of unconsolidated subsidiaries	(33,562)	(7,710,235)
Net gains on alternative investments	(12,733,649)	(17,855,618)
Change in net unrealized gains on investments	(434,097)	(12,027,898)
Realized gains on investments	(12,818,143)	(1,760,214)
Temporarily and permanently restricted contributions	(17,376,553)	(49,299,408)
Changes in operating assets and liabilities:		
Patient accounts receivable	(22,833,048)	(6,624,721)
Due to/from third-party payors, net	(5,951,236)	(8,002,011)
Other receivables	(1,026,787)	563,969
Inventories and other assets	(7,405,114)	(5,561,059)
Accounts payable and accrued expenses	7,368,066	(11,032,709)
Other long-term liabilities	6,011,777	(3,652,549)
Accrued pension liability	(81,170,195)	(49,078,435)
Net cash provided by operating activities	<u>42,206,071</u>	<u>64,949,578</u>
Investing activities		
Purchases of property and equipment	(58,960,623)	(74,618,945)
Decrease in due to affiliates, net	3,047,317	(6,302,888)
Net contributions to unconsolidated subsidiaries	(2,329,030)	-
Purchases of investment securities	(70,502,263)	(157,666,176)
Sales and maturities of investment securities	65,321,309	136,702,133
Assets whose use is limited or restricted:		
Increase in funds held by trustee under bond indenture agreements	25,814,689	(76,369)
Purchases of investment securities	(48,766,793)	(104,667,591)
Sales and maturities of investment securities	46,254,726	101,346,529
Net cash used in investing activities	<u>(40,120,668)</u>	<u>(105,283,307)</u>

Continued to next page.

Members of the Hawai'i Pacific Health Obligated Group

Combined Statements of Cash Flows (continued)

	Year Ended June 30	
	2018	2017
Financing activities		
Payment of long-term debt	\$ (6,290,256)	\$ (6,158,845)
Proceeds from long-term debt	201,594,198	—
Increase in escrow funds held for bonds	(167,428,262)	—
Temporarily and permanently restricted contributions	17,376,553	49,299,408
Net cash provided by financing activities	<u>45,252,233</u>	<u>43,140,563</u>
Increase in cash and cash equivalents	47,337,636	2,806,834
Cash and cash equivalents at beginning of year	141,031,350	138,224,516
Cash and cash equivalents at end of year	<u>\$ 188,368,986</u>	<u>\$ 141,031,350</u>
Non-cash activity		
Property and equipment and accrued expenses	<u>\$ 4,433,124</u>	<u>\$ 2,484,935</u>

Hawai'i Pacific Health

Note to Supplementary Information – Members of the Hawai'i Pacific Health Obligated Group

June 30, 2018

1. Combined Financial Statements

The combined financial statements present the financial position, results of operations, and cash flows of the Obligated Group members.

The members of the Obligated Group comprise:

- Hawai'i Pacific Health (parent company only)
- Kapi'olani Medical Center for Women and Children
- Pali Momi Medical Center
- Straub Clinic & Hospital
- Wilcox Memorial Hospital

As prescribed in The Hawai'i Pacific Health (HPH) Master Trust Indenture, except as noted below, the accompanying combined financial statements include only the Members of the Obligated Group. All significant intercompany transactions within the Obligated Group have been eliminated upon combination. Non-Obligated Group subsidiaries are presented in the combined financial statements using the equity method of accounting. Non-Obligated Group entities controlled through sole corporate membership and their subsidiaries are excluded from the special-purpose combined financial statements. Accounting principles generally accepted in the United States require that all majority-owned subsidiaries be consolidated and all controlled affiliates be combined with the financial statements of HPH.

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