

CONSOLIDATED FINANCIAL STATEMENTS AND  
SUPPLEMENTARY INFORMATION

Hawai'i Pacific Health  
Years Ended June 30, 2019 and 2018  
With Report of Independent Auditors

Ernst & Young LLP



Hawai'i Pacific Health  
Consolidated Financial Statements and  
Supplementary Information  
Years Ended June 30, 2019 and 2018

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Ernst & Young LLP  
1003 Bishop Street  
Suite 2600  
Honolulu, HI 96813

Tel: +1 808 531 2037  
Fax: +1 808 548 7744  
ey.com

## 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, 2019 and 2018, 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, 2019 and 2018, 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*

November 5, 2019

Hawai'i Pacific Health  
Consolidated Balance Sheets

	June 30	
	2019	2018
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 230,525,380	\$ 235,240,000
Patient accounts receivable, less allowance for uncollectible accounts (2018 – \$5,079,000)	170,430,706	167,311,384
Due to/from third-party payors	22,869,048	23,858,099
Other receivables	21,397,724	20,866,891
Inventories	20,109,299	20,289,561
Funds held by trustee under bond indenture agreement	13,169,892	9,713,013
Escrow funds held for bond defeasance	5,747,688	2,620,000
Prepaid expenses and other	10,845,307	10,195,038
Total current assets	495,095,044	490,093,986
Assets whose use is limited or restricted:		
Board-designated	293,253,566	278,086,378
Escrow funds held for bond defeasance	156,332,027	164,808,262
Restricted by donor or grantor	21,600,261	16,290,642
Total assets whose use is limited or restricted	471,185,854	459,185,282
Investments	373,062,477	296,060,655
Property and equipment, net	572,598,432	559,941,133
Due to/from third-party payors	4,270,752	4,385,467
Other assets:		
Investments in joint ventures	15,490,508	15,967,619
Other	52,110,271	51,628,416
	67,600,779	67,596,035
Total assets	\$ 1,983,813,338	\$ 1,877,262,558

	<b>June 30</b>	
	<b>2019</b>	<b>2018</b>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 57,516,261	\$ 46,348,486
Payroll and related liabilities	92,003,523	87,738,257
Accrued expenses	37,455,193	39,334,817
Due to third-party payors	16,105,428	12,843,509
Current portion of long-term debt	10,199,737	7,773,803
Total current liabilities	<u>213,280,142</u>	194,038,872
Long-term debt, less current portion	529,935,734	534,791,379
Other long-term liabilities	98,209,984	98,676,191
Due to third-party payors	4,676,162	9,243,840
Accrued pension liability	78,844,973	18,853,802
Net assets:		
Net assets without donor restrictions	1,007,006,381	979,162,286
Net assets with donor restrictions	51,859,962	42,496,188
Total net assets	<u>1,058,866,343</u>	1,021,658,474
Total liabilities and net assets	<u><u>\$ 1,983,813,338</u></u>	<u><u>\$ 1,877,262,558</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	
	2019	2018
<b>Unrestricted revenues</b>		
Net patient service revenue	\$ 1,333,411,757	\$ 1,299,476,577
Provision for bad debts	–	(18,212,064)
Net patient service revenue after provision for bad debts	<u>1,333,411,757</u>	<u>1,281,264,513</u>
Premium revenue	27,984,075	25,210,843
Other revenues	26,573,361	29,657,644
Gain on disposal of property and equipment	751,839	–
Net assets released from restrictions for operations	14,399,298	15,700,645
Total unrestricted revenues	<u>1,403,120,330</u>	<u>1,351,833,645</u>
<b>Expenses</b>		
Salaries and employee benefits	794,613,493	762,202,704
Services	164,245,402	159,200,275
Supplies	196,360,889	182,008,390
Other purchases	81,121,758	79,581,667
Depreciation and amortization	52,844,980	54,211,365
Specific purpose projects/donations	14,399,298	15,700,645
Interest	22,733,866	20,895,701
Other	14,628,454	14,522,220
Total expenses	<u>1,340,948,140</u>	<u>1,288,322,967</u>
Operating income	62,172,190	63,510,678
Joint venture investment income	2,862,313	3,091,876
Other non-operating income	18,731	341,863
Investment income	32,493,519	38,100,190
Loss on extinguishment of debt	(88,154)	–
Pension non-operating (expense) income	(1,931,448)	5,653,704
Gain on sale of joint venture, net of taxes	–	516,385
	<u>33,354,961</u>	<u>47,704,018</u>
Excess of revenues over expenses	95,527,151	111,214,696
Change in net unrealized gains on investments	4,016,681	605,433
Net assets released from restrictions for purchase of property and equipment	1,595,799	1,116,472
Change in funded status of pension plan	(71,835,533)	12,808,053
Change in interest rate swap value	(171,146)	246,548
Other changes in net assets	(1,288,857)	(347,833)
Increase in net assets without donor restrictions	<u>27,844,095</u>	<u>125,643,369</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	
	2019	2018
<b>Net assets with donor restrictions</b>		
Restricted grants and contributions	\$ 25,054,800	\$ 20,826,060
Investment income	636,068	917,869
Change in net unrealized (losses) gains on investments	(179,510)	328,098
Net assets released from restrictions	(15,995,097)	(16,817,117)
Change in beneficial interest in perpetual trusts	(58,798)	60,719
Other changes in net assets with donor restrictions	(93,689)	(181,453)
Increase in net assets with donor restrictions	9,363,774	5,134,176
Increase in net assets	37,207,869	130,777,545
Net assets at beginning of year	1,021,658,474	890,880,929
Net assets at end of year	\$ 1,058,866,343	\$ 1,021,658,474

*See accompanying notes.*

# Hawai'i Pacific Health

## Consolidated Statements of Cash Flows

	<b>Year Ended June 30</b>	
	<b>2019</b>	<b>2018</b>
<b>Operating activities</b>		
Increase in net assets	\$ 37,207,869	\$ 130,777,545
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	52,844,980	54,211,365
Joint venture investment income	(2,862,313)	(3,091,876)
Gain on sale of joint venture, net of taxes	—	(516,385)
Net gains on alternative investments	(16,644,100)	(15,268,482)
Change in net unrealized gains on investments	(3,837,171)	(933,531)
Net realized losses (gains) on investments	82,517	(15,161,847)
Net gains on equity investments	(6,469,741)	—
Restricted contributions	(25,054,800)	(20,826,060)
Changes in operating assets and liabilities:		
Patient accounts receivable	(3,119,322)	(5,878,676)
Due to/from third-party payors	(201,993)	(6,048,715)
Other receivables	(530,833)	(569,902)
Inventories and other assets	(951,862)	(6,247,450)
Restricted pledges receivable	(3,776,336)	550,454
Accounts payable and accrued expenses	16,981,325	10,057,868
Other long-term liabilities	(466,207)	12,812,903
Accrued pension liability	59,991,171	(81,170,195)
Net cash provided by operating activities	<u>103,193,184</u>	<u>52,697,016</u>
<b>Investing activities</b>		
Purchases of property and equipment	(68,930,187)	(60,308,284)
Net distributions from joint venture partnerships	3,339,424	3,062,130
Purchases of investment securities	(118,998,638)	(85,449,320)
Sales and maturities of investment securities	57,249,336	81,519,048
Assets whose use is limited or restricted:		
(Decrease) increase in funds held by trustee under bond indenture agreement	(3,456,879)	25,814,689
Net decrease in cash and cash equivalents	(1,597,947)	(512,555)
Purchases of investment securities	(45,715,171)	(68,332,007)
Sales and maturities of investment securities	42,228,622	64,835,724
Net cash used in investing activities	<u>(135,881,440)</u>	<u>(39,370,575)</u>

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## Hawai'i Pacific Health

### Consolidated Statements of Cash Flows (continued)

	<b>Year Ended June 30</b>	
	<b>2019</b>	<b>2018</b>
<b>Financing activities</b>		
Payment of long-term debt	\$ (50,157,446)	\$ (6,290,256)
Proceeds from long-term debt	47,727,735	201,594,198
Increase (decrease) in escrow funds held for bonds	5,348,547	(167,428,262)
Restricted contributions	25,054,800	20,826,060
Net cash provided by financing activities	<u>27,973,636</u>	<u>48,701,740</u>
(Decrease) increase in cash and cash equivalents	(4,714,620)	62,028,181
Cash and cash equivalents at beginning of year	235,240,000	173,211,819
Cash and cash equivalents at end of year	<u>\$ 230,525,380</u>	<u>\$ 235,240,000</u>
<b>Noncash activity</b>		
Property and equipment and accrued expenses	<u>\$ 1,017,743</u>	<u>\$ 4,445,651</u>

*See accompanying notes.*

# Hawai'i Pacific Health

## Notes to Consolidated Financial Statements

June 30, 2019

### **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 health care-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 (U.S. generally accepted accounting standards) and general practice within the health care 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 net assets without donor restriction 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 within net assets with donor restriction. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported within net assets without donor restrictions 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, 2019 and 2018, are designated as other than trading.

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. As of June 30, 2019 and 2018, the alternative investments comprised approximately 33% and 28%, respectively, of the Company's total investments, including assets whose use is limited or restricted.

Investment income, including interest and dividends received gains and losses on investments, and net gains on alternative investments, is included in excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on debt and equity securities, except for other-than-temporary declines in fair value, are excluded from the excess of revenue over expenses through June 30, 2018. On July 1, 2018, the Company adopted the *Financial Instruments – Overall Recognition and Measurement of Financial Assets and Financial Liabilities* accounting standard which requires unrealized gains and losses on equity securities to be included in excess of revenues over expenses (see Note 3).

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 in 2019.

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)

#### Equity method investments

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 interest in the joint ventures' 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:

	<b>Ownership Percentage</b>	
	<b>2019</b>	<b>2018</b>
Pacific ASC, LLC	<b>50.00%</b>	50.00%
Invision LLC	<b>40.00</b>	40.00
The Cancer Center of Hawaii, LLC	<b>30.56</b>	30.56
Pacific Medical Collections, Inc.	<b>33.33</b>	33.33
United Holdings, LLC	<b>17.38</b>	17.38

The carrying value of the investment in Pacific ASC, LLC, as reported in the accompanying consolidated balance sheets, is approximately \$10,105,000 as of June 30, 2019. 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 equity method investments for impairment and has not recorded an impairment loss as of June 30, 2019.

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 1. Organization and Summary of Accounting Policies (continued)

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

	<b>June 30</b>	
	<b>2019</b>	<b>2018</b>
Current assets	<b>\$ 10,832,000</b>	\$ 13,316,000
Non-current assets	<b>19,210,000</b>	20,793,000
Total assets	<b>\$ 30,042,000</b>	\$ 34,109,000
Current liabilities	<b>\$ 3,942,000</b>	\$ 3,495,000
Non-current liabilities	<b>8,416,000</b>	11,003,000
Capital	<b>17,684,000</b>	19,611,000
Total liabilities and capital	<b>\$ 30,042,000</b>	\$ 34,109,000
	<b>Year Ended June 30</b>	
	<b>2019</b>	<b>2018</b>
Excess of revenues over expenses	<b>\$ 7,771,000</b>	\$ 11,335,000

#### 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:

	<b>June 30</b>	
	<b>2019</b>	<b>2018</b>
Receivable in less than one year	<b>\$ 3,221,583</b>	\$ 3,285,428
Receivable in one to five years	<b>5,442,541</b>	2,887,804
Thereafter	<b>2,372,300</b>	638,361
	<b>11,036,424</b>	6,811,593
Less: present value discount	<b>726,501</b>	37,726
Less: allowance for uncollectible pledges	<b>823,956</b>	990,611
	<b>\$ 9,485,967</b>	\$ 5,783,256

#### Net Assets With Donor Restrictions

Net assets with donor restrictions are used to differentiate resources, the use of which is restricted by donors or grantors to a specific time period or purpose, from resources on which no restrictions have been placed or that arise from the general operations of the Company. Donor-restricted gifts and bequests are recorded as an addition to net assets with donor restrictions in the period received. Donor-restricted gifts include amounts held in perpetuity or for terms designated by donors. Earnings on donor-restricted gifts are recorded as investment income in net assets with donor restrictions and subsequently used in accordance with the donor's designation. Net assets with donor restrictions are primarily restricted for health and hospital care, plant expansion and equipment replacement and research and grants.

#### Net Patient Service Revenue, and Patient Accounts Receivable

Net patient accounts receivable and net patient revenue have been adjusted to the estimated amounts expected to be received based on contractual rates for services rendered, inclusive of the estimated price concessions and retroactive adjustments. The Company has entered into agreements with third-party payors, including government programs and managed care health plans, under which the facilities are paid based upon established charges, the cost of providing services, predetermined rates per diagnosis, fixed per diem rates or discounts from established charges.

# Hawai'i Pacific Health

## Notes to Consolidated Financial Statements (continued)

### 1. Organization and Summary of Accounting Policies (continued)

On July 1, 2018, the Company adopted the new revenue standard, *Revenue From Contracts With Customers (Topic 606)*, and elected to use the modified retrospective adoption method. As a practical expedient, the Company utilizes a portfolio approach to group contracts with similar characteristics. Under the new revenue standard, the majority of what was previously classified as the provision for bad debts in the consolidated financial statements of unrestricted revenues, expenses and other changes in net assets is now reflected as implicit price concessions and is included as a reduction to net patient service revenue for the year ended June 30, 2019. Prior to the adoption of the new revenue standard, the provision for bad debts was presented consistent with the previous revenue recognition standards that required such provision to be presented separately as a component of net patient service revenue.

The Company uses a portfolio approach to estimate the transaction price that reflects the amount of consideration the Company expects to collect in exchange for satisfying its service performance obligations. The portfolios consist of various payor classes and patient types for inpatient and outpatient revenue, including the identification of uninsured, under-insured and patient coinsurance and deductible as a separate portfolio. Based on historical collection trends and other analyses, the Company believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach were used.

The transaction price, which involves significant estimates, is determined based on the Company's established charges, with a reduction recorded for price concessions. The Company estimates the transaction price associated with services provided to patients who have third-party payor coverage based on the reimbursement terms outlined in contractual agreements and historical experience and includes estimated retroactive revenue adjustments under the agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as final settlements are determined. For self-pay patients who do not qualify for charity care, the Company determines the transaction price associated with services on the basis of charges reduced by implicit price concessions. Implicit price concessions included in the estimate of the transaction price are based on the Company's historical collection experience, changes in collection patterns, composition of patient accounts by patient type and general economic condition. Management regularly reviews payment data for each major payor in evaluating the sufficiency of the estimated allowance for price concessions.

# Hawai'i Pacific Health

## Notes to Consolidated Financial Statements (continued)

### 1. Organization and Summary of Accounting Policies (continued)

Net patient service revenue is recognized as performance obligations are satisfied. Inpatient service performance obligations are satisfied over time and revenue is recognized based on actual charges incurred in relation to total expected or actual charges. Unsatisfied or partially satisfied performance obligations for inpatient services primarily relate to patients in-house at the end of each reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period. Outpatient services are performance obligations satisfied over a period of time which is often less than one day and revenue is recognized when services are provided.

Net patient service revenue for the year ended June 30, 2019, by payor, under the new revenue standard effective July 1, 2018, and net patient service revenue for the year ended June 30, 2018, under the accounting revenue standard prior to July 1, 2018, in which the net patient service revenue is presented net of the provision for bad debts, is as follows:

	<b>Year Ended June 30</b>	
	<b>2019</b>	<b>2018</b>
Medicare	\$ 344,919,746	\$ 320,514,683
Medicaid/QUEST integration	252,706,647	263,084,973
Commercial	680,420,151	645,880,003
Self-pay and other	55,365,213	51,784,854
	<u>\$ 1,333,411,757</u>	<u>\$ 1,281,264,513</u>

Significant concentrations of patient accounts receivable include Hawaii Medical Service Association (HMSA) – 21% and 19%, Medicaid and QUEST Integration programs – 26% and 30%, and Medicare and Medicare Advantage – 31% and 28% as of June 30, 2019 and 2018, respectively.

HPH entered into an Accountable Care Agreement (ACA) with HMSA for its commercial HMO and preferred provider organization (PPO) product lines covering the five-year period January 1, 2014 to December 31, 2018. An Amended and Restated ACA Agreement with HMSA was effective as of January 1, 2019 and will remain in effect through December 31, 2021. 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

# Hawai'i Pacific Health

## Notes to Consolidated Financial Statements (continued)

### 1. Organization and Summary of Accounting Policies (continued)

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, 2019 and 2018, HPH recorded a loss of approximately \$2,142,000 and a gain of \$2,876,000, respectively, reflected in other operating revenue within the consolidated financial statements of unrestricted revenues, expenses and other changes in net assets, and approximately \$1,306,000 and \$1,148,000, respectively, reflected in premium revenue within the consolidated financial statements of unrestricted revenues, expenses and other changes in net assets, which includes risk share adjustments for the contract settlement periods from January 1, 2018 to December 31, 2018. No risk share settlement has been recorded for the period January 1, 2019 to June 30, 2019, as the aligned objectives obligation, 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 reported in accrued expenses of approximately \$1,209,000 and \$1,954,000 at June 30, 2019 and 2018, respectively.

### 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 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 Medicare contractor, are reported as current year changes to net patient service revenue. The Company has the ability to appeal the adjustments based on a process established by Medicare and Medicaid.

# Hawai'i Pacific Health

## Notes to Consolidated Financial Statements (continued)

### **1. Organization and Summary of Accounting Policies (continued)**

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 health care services to plan members who are eligible to participate in the state of Hawai'i's QUEST Integration program and Section 1115 Medicaid waiver programs. The Company negotiates with the health plans contracted by Medicaid for the provision of the health care 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 increased 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.

For HSPA years 2019 and 2018, the Company recorded approximately \$24,370,000 and \$19,695,000 in net patient service revenues related to HSPA payments, respectively, and \$16,704,000 and \$18,022,000 in other purchases related to provider tax payments, respectively.

In addition, the Company recorded a change in estimate of approximately \$4,805,000 as an increase in net patient service revenues relating to the HSPA monies received during 2019 relating to prior year program revenues. The change was due to updated uncompensated care cost data for 2017 and 2018 received in the current year which support an increase in Medicaid disproportionate share hospital payments.

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### **1. Organization and Summary of Accounting Policies (continued)**

##### **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 2019 and 2018 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 37% of its labor force. As of June 30, 2019, four collective bargaining agreements with two unions, or approximately 15% of the Company's labor force, will expire within one year.

##### **Advertising Expense**

The Company expenses advertising costs as incurred. Advertising expense was approximately \$4,485,000 in 2019 and \$4,107,000 in 2018 and was recorded in services expense in the consolidated financial statements of unrestricted revenues, expenses and other changes in net assets.

##### **Deferred Financing Costs**

Costs incurred in obtaining long-term financing, reported within long-term debt, 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 or during the fiscal years ended June 30, 2019 and 2018.

# Hawai'i Pacific Health

## Notes to Consolidated Financial Statements (continued)

### 1. Organization and Summary of Accounting Policies (continued)

#### Excess of Revenues Over Expenses

The consolidated financial statements of unrestricted revenues, expenses and other changes in net assets include the excess of revenues over expenses. Changes in net assets without donor restriction, which are excluded from the excess of revenues over expenses, include changes in unrealized gains and losses on investments in other than trading securities, net assets released from restriction for purchase of property and equipment, 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 November 5, 2019, the date these consolidated financial statements were issued.

#### Use of Estimates

The preparation of consolidated 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.

#### New Accounting Standards

In February 2016, the Financial Accounting Standards Board (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. The Company adopted the accounting standard on July 1, 2019. The primary effect of the new standard will be to record right-of-use assets and obligations for current operating leases which will have a material impact on the consolidated financial statements. The standard did not have a material adverse effect on the Company's 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 2016, the FASB issued a new accounting standard, *Not-for-Profit Entities: Presentation of Financial Statements of Not-for-Profit Entities*. This accounting standard changed 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. Management adopted this accounting standard effective June 30, 2019 and was retrospectively applied to all periods presented. The impact of adoption changed the classification of net assets on the consolidated balance sheets to two classes of net assets. The Company also added disclosure for the liquidity and availability of financial assets at the balance sheet date to meet cash needs for general expenditures within one year and disaggregated functional expense classifications by their natural expense classification. The Company recorded investment fees of approximately \$1,554,000 and \$1,630,000 as of June 30, 2019 and 2018, respectively, within investment income on the statements of unrestricted revenues, expenses and other changes in net assets. The adoption of this accounting standard had no impact to the consolidated financial statement total, unrestricted revenues, excess of revenues over expenses or total net assets.

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 requires 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. This resulted in approximately \$1,931,000 of non-service benefit loss and approximately \$5,654,000 of non-service benefit credits moving from salaries and employee benefits to other non-operating income for the years ended June 30, 2019 and 2018, respectively, in the consolidated financial 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 2018, the FASB issued a new accounting standard, *Compensation – Retirement Benefits – Defined Benefit Plans – General*. 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, 2021. Management is currently evaluating the impact of adopting this standard.

In August 2018, the FASB issued a new accounting standard, *Fair Value Measurement*. This accounting standard modifies fair value disclosure requirements required, 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.

In June 2016, the FASB issued a new accounting standard, *Financial Instruments – Credit Losses*, which requires the use of an “expected loss” model on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The expected loss model requires consideration of a broader range of reasonable and supportable information to calculate credit loss estimates. This accounting standard is effective for fiscal years beginning after December 15, 2020, with early adoption permitted. Management is currently evaluating the impact of adopting this standard.

### Reclassifications

Certain reclassifications related to the adoption of new accounting standards updates have been made to the 2018 consolidated financial statements to conform with classifications used in 2019.

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 2. Liquidity and Availability

Financial assets available for general expenditures within one year of the balance sheet date, comprise the following at June 30, 2019:

Cash and cash equivalents	\$ 230,525,380
Patient accounts receivable	170,430,706
Assets whose use is limited or restricted:	
Board designated investments	85,612,941
Unrestricted investments	<u>316,093,357</u>
Financial assets available to meet general expenditures within one year	<u>\$ 802,662,384</u>

The Company has certain board-designated assets limited to use which are available for general expenditure within one year in the normal course of operations. Accordingly, these assets have been included in the qualitative information above.

As part of the Company's liquidity management plan, it maintains a \$35,000,000 line of credit as discussed in more detail in Note 6. As of June 30, 2019, \$35,000,000 is available to draw upon.

#### 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, the *Fair Value Measurements and Disclosures* accounting standard, 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.

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 3. Fair Value (continued)

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.

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. 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, 2019 and 2018, the Company's alternative investments amounting to approximately \$285,060,000 and \$215,094,000, 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 \$20,917,000 as of June 30, 2019. The unfunded capital commitments can be funded through May 2024.

As of June 30, 2019 and 2018, the Company's investments in cash surrender values of life insurance policies amounting to approximately \$21,452,000 and \$21,252,000, 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	2019				Valuation Technique
	Total	Level 1	Level 2	Level 3	
Board-designated investments:					
Money market funds	\$ 1,460,312	\$ 1,460,312	\$ —	\$ —	a
Equity securities:					
Large blend	22,607,639	22,607,639	—	—	a
Global equity	27,845,862	27,845,862	—	—	a
Multi-alternative	4,037,081	4,037,081	—	—	a
Fixed income	34,501,172	34,501,172	—	—	a
Equity energy	13,597,749	13,597,749	—	—	a
Large cap	20,090,323	20,090,323	—	—	a
Emerging markets	7,809,847	7,809,847	—	—	a
Debt securities:					
U.S. Treasury obligations	7,063,711	7,063,711	—	—	a
Asset backed securities	3,385,344	—	3,385,344	—	a
Corporate and municipal bonds	5,685,829	—	5,685,829	—	a
Foreign bonds	1,296,566	—	1,296,566	—	a
Funds held by trustee under bond indenture agreement:					
Money market funds	13,169,892	13,169,892	—	—	a
Escrow funds held under bond defeasance:					
Debt securities – U.S. Treasury obligations	162,079,715	162,079,715	—	—	a
Investments restricted by donor or grantor:					
Equity securities:					
Large blend	937,364	937,364	—	—	a
Global equity	923,646	923,646	—	—	a
Multi-alternative	99,783	99,783	—	—	a
Fixed income	861,633	861,633	—	—	a
Equity energy	336,091	336,091	—	—	a
Large cap	496,566	496,566	—	—	a
Emerging markets	193,033	193,033	—	—	a

# Hawai'i Pacific Health

## Notes to Consolidated Financial Statements (continued)

### 3. Fair Value (continued)

Description	2019				Valuation Technique
	Total	Level 1	Level 2	Level 3	
Investments restricted by donor or grantor (continued):					
Debt securities:					
Asset-backed securities	\$ 311,411	\$ —	\$ 311,411	\$ —	a
Corporate bonds	322,125	—	322,125	—	a
Foreign bonds	41,876	—	41,876	—	a
U.S. Treasury obligations	84,632	84,632	—	—	a
Charitable remainder trust assets	71,219	—	71,219	—	a
Certificate of deposit	600,000	—	600,000	—	a
Money market funds	36,507	36,507	—	—	a
Beneficial interest in perpetual trusts	4,807,392	—	—	4,807,392	c
Unrestricted investments:					
Money market funds	1,811,548	1,811,548	—	—	a
Equity securities:					
Global equity	35,591,601	35,591,601	—	—	a
Multi-alternative	5,051,953	5,051,953	—	—	a
Fixed income	44,407,103	44,407,103	—	—	a
Large blend	29,715,354	29,715,354	—	—	a
Equity energy	17,016,053	17,016,053	—	—	a
Large cap	25,140,780	25,140,780	—	—	a
Emerging markets	9,773,145	9,773,145	—	—	a
Debt securities:					
U.S. Treasury obligations	16,582,017	16,582,017	—	—	a
Asset-backed securities	4,199,584	—	4,199,584	—	a
U.S. Commercial paper	7,276,548	7,276,548	—	—	a
Corporate bonds	15,435,135	—	15,435,135	—	a
Foreign bonds	1,634,896	—	1,634,896	—	a
Total	<u>548,390,037</u>	<u>\$ 510,598,660</u>	<u>\$ 32,983,985</u>	<u>\$ 4,807,392</u>	
Alternative investments	285,060,710				
Cash surrender value of life insurance policies	21,452,208				
Pledge receivables, net	6,011,665				
Cash and cash equivalents	2,251,291				
Total	<u>\$ 863,165,911</u>				

# 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	
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	—	
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	—	—	a
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, recorded within other long-term liabilities	<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)

The Company received restricted pledges and contributions amounting to approximately \$14,245,000 in 2019 and \$6,804,000 in 2018, which are recorded within net assets with donor restrictions grants and contributions in the consolidated financial 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. Pledges receivable, net of the present value discount, using discount rates from 0.36% to 3.77%, and allowance for uncollectible pledges, were approximately \$9,486,000 and \$5,783,000 as of June 30, 2019 and 2018, respectively.

As of June 30, 2018, the uncollateralized portion of the Company's swaps subject to nonperformance risk was approximately \$6,512,000. 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 year ended June 30, 2018. The swaps terminated in May 2019 (see Note 11).

Investment income is composed of the following:

	<b>Year Ended June 30</b>			
	<b>2019</b>		<b>2018</b>	
	<b>Without Donor Restrictions</b>	<b>With Donor Restrictions</b>	<b>Without Donor Restrictions</b>	<b>With Donor Restrictions</b>
Dividends and interest	\$ 11,365,287	\$ 286,756	\$ 9,954,577	\$ 263,494
Realized (losses) gains	(77,958)	(4,559)	14,830,914	330,933
Net gains on alternative investments	16,290,229	353,871	14,945,040	323,442
Net unrealized gains on equity securities	6,469,742	-	-	-
Investment fees	(1,553,781)	-	(1,630,341)	-
	<b>\$ 32,493,519</b>	<b>\$ 636,068</b>	<b>\$ 38,100,190</b>	<b>\$ 917,869</b>

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 3. Fair Value (continued)

The following table summarizes the unrealized losses on investments held at June 30, 2018. There were no unrealized losses on debt securities at June 30, 2019.

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>

#### 4. Property and Equipment

Property and equipment are summarized as follows:

	June 30	
	2019	2018
Land and land improvements	\$ 45,992,882	\$ 45,976,182
Buildings and improvements	729,152,876	710,386,867
Equipment	434,352,415	405,292,584
Construction in progress	46,699,976	37,361,179
	<u>1,256,198,149</u>	<u>1,199,016,812</u>
Less: amortization and accumulated depreciation	<u>683,599,717</u>	<u>639,075,679</u>
Property and equipment, net	<u>\$ 572,598,432</u>	<u>\$ 559,941,133</u>

In 2019 and 2018, the Company wrote off fully depreciated equipment with cost and accumulated depreciation totaling approximately \$8,486,000 and \$23,190,000, 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, 2019, are the following amounts that have not yet been recognized in net periodic pension cost: unrecognized prior service credits of approximately \$71,931,000 and unrecognized actuarial losses of approximately \$239,527,000. 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, 2020, is approximately \$7,160,000. 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 \$175,387,000.



## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 5. Employee Benefit Plans (continued)

The underfunded status of the plan of approximately \$78,845,000 and \$18,854,000 at June 30, 2019 and 2018, 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, 2020.

#### Components of Net Periodic Benefit Cost

	<b>Year Ended June 30</b>	
	<b>2019</b>	<b>2018</b>
Service cost	\$ 16,285,927	\$ 17,756,914
Interest cost	16,880,867	12,257,691
Expected return on plan assets	(22,855,030)	(21,759,298)
Recognized prior service credit	(7,695,411)	(7,736,469)
Recognized net loss	15,601,022	11,584,373
Net periodic benefit cost	\$ 18,217,375	\$ 12,103,211

#### Weighted-Average Assumptions Used to Determine Benefit Obligations

	<b>June 30</b>	
	<b>2019</b>	<b>2018</b>
Discount rate	3.57%	4.11%

#### Weighted-Average Assumptions Used to Determine Net Periodic Benefit Cost

	<b>Year Ended June 30</b>	
	<b>2019</b>	<b>2018</b>
Discount rate	4.11%	3.75%
Expected return on plan assets	6.25	6.25
Rate of compensation increase	3.50	3.50

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 5. Employee Benefit Plans (continued)

##### 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.

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:

	<b>Target Allocation 2019</b>	<b>Percentage of Actual Plan Assets at June 30</b>	
	<b>2019</b>	<b>2019</b>	<b>2018</b>
<b>Major asset category</b>			
Global equity	45%	51%	52%
Fixed income	30	31	30
Marketable alternative and private investments	22	12	11
Real estate	–	3	3
Cash and cash equivalents	3	3	4
	<b>100%</b>	<b>100%</b>	<b>100%</b>

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:

	2019				Valuation Technique
	Total	Level 1	Level 2	Level 3	
Equity securities:					
Value	\$ 19,655,189	\$ 19,655,189	\$ —	\$ —	a
Opportunistic	38,428	38,428	—	—	a
Global	21,465,026	21,465,026	—	—	a
Fixed income	22,720,562	22,720,562	—	—	a
Emerging markets	3,871,714	3,871,714	—	—	a
Global macro	4,425,077	4,425,077	—	—	a
U.S. equity growth	11,570,975	11,570,975	—	—	a
Real estate	11,870,000	—	11,870,000	—	a
Cash and cash equivalents	11,826,686	11,826,686	—	—	a
Total investments at fair value	107,443,657	\$ 95,573,657	\$ 11,870,000	\$ —	
Investments measured at net asset value:					
Closely held securities	40,305,010				
Collective funds	74,536,046				
Limited partnerships	72,537,725				
Limited liability companies	83,922,562				
Total investments	\$ 378,745,000				

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 5. Employee Benefit Plans (continued)

	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
Total investments at fair value	150,392,603	<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 investments	<u>\$ 363,453,000</u>				

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.

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 5. Employee Benefit Plans (continued)

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:

2019				
	Fair Value	Redemption Frequency (If Currently Eligible)	Redemption Notice Period (If Currently Eligible)	Redemption Restrictions and Expiration of Restriction
Fixed income	\$ 94,315,135	Daily	2-5 business days	–
Global ex-U.S. equity	35,135,674	Daily, monthly	1 or 10 days	–
U.S. equity growth	39,938,851	Daily, monthly	3 or 31 days	–
Emerging markets equity	17,350,623	Daily, monthly	2, 5 or 30 days	Gates
Diversified arbitrage/ event-driven	15,815,145	Quarterly, annually Every 24 months,	44–65 days	Side pockets, gates
Distressed	6,800,050	25% quarterly Monthly, quarterly,	60-65 days	Side pockets, gates
Global long/short equity	10,085,359	annually	15, 45–65 days	Side pockets, gates
U.S. long/short equity	27,986,324	Quarterly, monthly	5, 30-60 days	Gates
Global macro	15,898,219	Monthly, quarterly	2, 14 or 120 days	Gates
Private equity	7,954,410	–	–	–
Opportunistic	21,553	Every 24 months	90 days	Side pockets
	<u>\$ 271,301,343</u>			
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)

**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.

**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 indices 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 indices 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.

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 5. Employee Benefit Plans (continued)

**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 \$9,407,000 as of June 30, 2019. The unfunded capital commitments can be funded through May 2024.

**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.

**Fixed income:** Portfolios which seek to exploit mispricings in fixed income securities, utilizing a variety of investment instruments, including corporate and municipal bonds, sovereign debt, mortgage-backed securities, swaps and options. These managers often utilize leverage to magnify their returns.

The Company expects to make contributions to the Plan amounting to approximately \$36,000,000 in 2020.

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

Year ending June 30:	
2020	\$ 30,143,270
2021	24,134,078
2022	25,617,753
2023	26,319,218
2024	26,762,459
Years 2025–2029	149,043,988

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 \$20,892,000 in 2019 and \$19,791,000 in 2018.

## 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, 2024. The interest rate on the line is based on the lender's prime rate or three-month LIBOR plus an applicable margin. There were no outstanding draws on this facility as of June 30, 2019 and 2018.

As of June 30, 2019, 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, 2020	*
Workers' compensation insurance policies:			
HPH	1,000,000	February 1, 2020	*

\* Interest rate would be determined if drawn upon

There were no draws on the above letters of credit as of June 30, 2019 and 2018.

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 7. Long-Term Debt

Long-term debt, net of issuance costs, is summarized as follows:

	June 30	
	2019	2018
Series 2019 Special Purpose Revenue Bonds, interest payable monthly at fixed rate 2.71%, principal payments in varying annual amounts ranging from \$410,000 to \$4,424,880 due July 2019 through 2033	\$ 47,597,655	\$ —
Series 2018B Taxable Refunding Revenue Bonds, interest payable semi-annually at rates ranging from 2.58% to 4.27% (3.94% at June 30, 2019), 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	53,530,043	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, 2019), 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	92,015,120	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	54,981,532	56,363,819
Series 2013C Special Purpose Variable Rate Revenue Bonds, refunded with the Series 2019 in May 2019	—	44,200,458
Series 2013B Special Purpose Revenue Bonds, interest payable semi-annually at rates ranging from 3.00% to 5.25% (4.83% at June 30, 2019), principal payments in varying annual amounts ranging from \$265,000 to \$3,105,000 due July 2019 through 2033	29,871,817	30,892,087
Series 2013A Special Purpose Revenue Bonds, interest payable semi-annually at rates ranging from 5.00% to 6.00% (5.49% at June 30, 2019), principal payments in varying annual amounts ranging from \$1,280,000 to \$1,930,000 due July 2019 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	115,581,225	116,802,484

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 7. Long-Term Debt (continued)

	<b>June 30</b>	
	<b>2019</b>	<b>2018</b>
Series 2010B Special Purpose Revenue Bonds, interest payable semi-annually at rates ranging from 5.00% to 5.75% (5.67% at June 30, 2019), principal payments in varying annual amounts ranging from \$1,345,000 to \$1,410,000 due July 2019 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	<b>\$ 53,536,529</b>	\$ 54,762,642
Series 2010A Special Purpose Revenue Bonds, interest payable semi-annually at rates ranging from 4.125% to 5.50% (5.41% at June 30, 2019), principal payments in varying annual amounts ranging from \$1,930,000 to \$2,275,000 due July 2019 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	<b>93,021,550</b>	94,256,600
Total long-term debt	<b>540,135,471</b>	542,565,182
Less current portion	<b>10,199,737</b>	7,773,803
Noncurrent portion	<b>\$ 529,935,734</b>	\$ 534,791,379

In May 2019, the Company issued Series 2019 Bonds in the amount of \$48,079,910. The proceeds of the Series 2019 Bonds were used to refund the Series 2013C variable rate bonds.

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.

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### **7. Long-Term Debt (continued)**

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 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, 2019, 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, PPMC, SCH and WMH) as defined in the Master Indenture. The 2019 Bonds are subject to scheduled principal payments on or after July 1, 2019, payable in annual sinking fund installments from \$410,000 to \$4,192,610. In addition, the 2019 Bonds are subject to a prepayment fee if any principal amounts are made prior to their scheduled maturity. 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,

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 7. Long-Term Debt (continued)

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 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 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, 2019 and 2018, approximately \$13,170,000 and \$9,713,000, respectively, included in current assets, was held by the bond trustee to fund principal maturities and accrued interest payable.

Certain bond agreements require the Obligated Group, as defined in the Company's Master Trust Indenture, to comply with various covenants, including the maintenance of a minimum long-term debt service coverage ratio. As of June 30, 2019, the Obligated Group was in compliance with all bond covenants.

Long-term debt maturities for the years succeeding June 30, 2019 are as follows.

Year ending June 30:	
2020	\$ 10,199,737
2021	13,166,297
2022	13,749,309
2023	12,222,191
2024	12,819,785
Thereafter	477,978,152
	<u>\$ 540,135,471</u>

Interest paid was approximately \$17,919,000 in 2019 and \$14,897,000 in 2018.

The fair value of long-term debt as of June 30, 2019 and 2018, was approximately \$423,488,000 and \$411,213,000, respectively. The 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.

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 8. Leases

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, 2019 are as follows:

Year ending June 30:	
2020	\$ 14,144,000
2021	13,196,000
2022	11,838,000
2023	11,105,000
2024	10,362,000
Thereafter	75,694,000
	\$ 136,339,000

Future minimum lease rent payments have not been reduced by minimum sublease rentals of approximately \$10,059,000 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:

	<b>Year Ended June 30</b>	
	<b>2019</b>	<b>2018</b>
Minimum rentals	<b>\$ 14,224,000</b>	\$ 12,340,000
Less: sublease rentals	<b>1,141,000</b>	1,385,000
	<b>\$ 13,083,000</b>	\$ 10,955,000

# Hawai'i Pacific Health

## Notes to Consolidated Financial Statements (continued)

### 8. Leases (continued)

Future minimum rental income to be received under noncancelable operating leases for office space as of June 30, 2019 is as follows:

Year ending June 30:	
2020	\$ 1,726,000
2021	547,000
2022	328,000
2023	321,000
2024	315,000
Thereafter	14,761,000
	<u>\$ 17,998,000</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 state NOL carryforwards as of June 30, 2019 of approximately \$4,403,000 each. The NOL carryforwards begin to expire in 2021. 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, changing the rules for NOLs generated in tax years beginning after January 1, 2018 so that now these NOLs don't expire, they may not be carried back to prior years for deduction and their use is limited to offsetting up to 80% of taxable income. In addition, it reduced 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, 2019, 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 2016 through 2019 tax years remain subject to examination for federal income tax purposes, whereas the 2015 through 2019 tax years remain subject to examination for state taxing jurisdictions in which the Company operates.

#### 10. Functional Expenses

The functional classification of expenses by major classes of program services and supporting activities for the years ended June 30, 2019 and 2018 are summarized as follows:

	2019		
	Patient Services	Philanthropic and Support Services	Total
Salaries and employee benefits	\$ 680,491,645	\$ 114,121,848	\$ 794,613,493
Services	132,191,731	32,053,671	164,245,402
Supplies	195,422,473	938,416	196,360,889
Other purchases	57,169,650	23,952,108	81,121,758
Depreciation and amortization	43,615,881	9,229,099	52,844,980
Specific purpose projects/donations	4,612	14,394,686	14,399,298
Interest	21,647,176	1,086,690	22,733,866
Other	8,760,107	5,868,347	14,628,454
<b>Total expenses</b>	<b>\$ 1,139,303,275</b>	<b>\$ 201,644,865</b>	<b>\$ 1,340,948,140</b>

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 10. Functional Expenses (continued)

	2018		
	Patient Services	Philanthropic and Support Services	Total
Salaries and employee benefits	\$ 655,579,364	\$ 106,623,340	\$ 762,202,704
Services	126,314,193	32,886,082	159,200,275
Supplies	180,994,901	1,013,489	182,008,390
Other purchases	53,700,274	25,881,393	79,581,667
Depreciation and amortization	43,279,724	10,931,641	54,211,365
Specific purpose projects/donations	7,756	15,692,889	15,700,645
Interest	19,644,711	1,250,990	20,895,701
Other	9,435,061	5,087,159	14,522,220
Total expenses	\$ 1,088,955,984	\$ 199,366,983	\$ 1,288,322,967

#### 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 7), 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 \$4,711,000 and \$4,397,000 as of June 30, 2019 and 2018, respectively, and were recorded using a 2.23% and 1.68% discount factor as of June 30, 2019 and 2018, 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 limit of \$102,000,000 per claim and in aggregate through PIC and purchase of excess insurance coverage. The professional liability coverage from PIC is claims-made and general liability is occurrence based coverage, with PIC providing tail coverage (with certain limitations) to the Company with claims-made policies prior to July 1, 2002.

The PIC risk retention and total coverage amounts, including reinsurance, by policy year are as follows:

	<u>PIC Retention</u>	<u>Total Coverage</u>
<b>Policy year ending June 30</b>		
2004–2007	\$ 1,000,000	\$ 51,000,000
2008–2014	1,000,000	76,000,000
2015–2016	1,000,000	101,000,000
2017-2019	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 \$3,240,000, 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, 2019. 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. 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.

# Hawai'i Pacific Health

## Notes to Consolidated Financial Statements (continued)

### 11. Commitments and Contingencies (continued)

Medical malpractice expense totaled approximately \$13,319,000 in 2019 and \$16,883,000 in 2018. Medical malpractice accruals, including claims expected to be paid by reinsurance, totaled approximately \$63,784,000 and \$66,918,000 as of June 30, 2019 and 2018, respectively, and primarily are recorded within other long-term liabilities in the consolidated balance sheets. Reinsurance recoverable totaled approximately \$26,389,000 and \$32,195,000 as of June 30, 2019 and 2018, respectively, and are recorded within other assets in the consolidated balance sheets. The medical malpractice accruals have been discounted using a 2.33% and 1.94% factor at June 30, 2019 and 2018 respectively. Undiscounted medical malpractice accruals and reinsurance recoverable totaled approximately \$68,793,000 and \$28,655,000, respectively, as of June 30, 2019.

#### 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 paid fixed rates ranging between 3.842% and 3.849% and received a variable rate tied to LIBOR.

In May 2019, the Company refunded the 2013C Bonds with the Series 2019 fixed rate bonds and terminated the interest rate swap. As of June 30, 2019 and 2018, the Company recorded an accumulated loss of approximately \$6,769,000 and \$5,300,000, respectively, in net assets without donor restrictions related to the interest rate swaps that have been terminated. The balance will be amortized over the original term of the swap.

The mark-to-market loss position on the swap arrangements related to the 2013 Bonds was approximately \$0 and \$6,512,000 as of June 30, 2019 and 2018, respectively.

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 11. Commitments and Contingencies (continued)

##### 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 consolidated financial position, results of operations, or cash flows.

##### Other

The Company has outstanding construction commitments of approximately \$38,154,000 as of June 30, 2019.

#### 12. Related-Party Transactions

A joint venture investment of the Company provides collection services to the Company. Payments to the joint venture totaled approximately \$967,000 in 2019 and \$1,200,000 in 2018.

SCH leased land from the Plan for \$696,000 in lease rent for both 2019 and 2018. 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, 2019, future minimum lease payments under this lease agreement are as follows:

Year ending June 30:	
2020	\$ 696,000
2021	696,000
2022	696,000
2023	696,000
2024	696,000
Thereafter	12,180,000
	<u>\$ 15,660,000</u>

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 13. Net Assets

The Company receives contributions from individuals and organizations that support certain programs and services. Net assets with donor restrictions are summarized as follows:

	<b>June 30</b>	
	<b>2019</b>	<b>2018</b>
Health and hospital care	<b>\$ 27,344,487</b>	\$ 22,170,630
Plant expansion and equipment replacement	<b>12,678,057</b>	6,630,551
Research and grants	<b>9,787,787</b>	11,502,284
Education and scholarships	<b>2,049,631</b>	2,192,723
	<b><u>\$ 51,859,962</u></b>	<u>\$ 42,496,188</u>

From time to time, the Company's board will designate certain unrestricted funds to be used in the future for specific projects. Board-designated funds included in net assets without donor restrictions were maintained for the following purposes at June 30, 2019:

Health and hospital care	\$ 131,964,105
Plant expansion and equipment replacement	<u>161,289,461</u>
	<u><u>\$ 293,253,566</u></u>

#### 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)**

##### **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 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.

## Hawai'i Pacific Health

### Notes to Consolidated Financial Statements (continued)

#### 14. Endowment (continued)

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

	2019		
	Without Donor Restrictions	With Donor Restrictions	Total
Donor-restricted funds	\$ –	\$ 20,128,247	\$ 20,128,247
Board-designated funds	293,253,566	–	293,253,566
	\$ 293,253,566	\$ 20,128,247	\$ 313,381,813
	2018		
	Without Donor Restrictions	With Donor Restrictions	Total
Donor-restricted funds	\$ –	\$ 19,875,509	\$ 19,875,509
Board-designated funds	278,086,378	–	278,086,378
	\$ 278,086,378	\$ 19,875,509	\$ 297,961,887

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

	2019		
	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets, beginning of year	\$ 278,086,378	\$ 19,875,509	\$ 297,961,887
Investment income:			
Investment income	3,321,505	261,233	3,582,738
Net appreciation (realized and unrealized)	11,845,683	91,887	11,937,570
Total investment gain	15,167,188	353,120	15,520,308
Contributions	–	250,235	250,235
Appropriation of endowment assets for expenditure	–	(204,736)	(204,736)
Beneficial interest in perpetual trust	–	(58,798)	(58,798)
Transfers	–	(87,083)	(87,083)
Endowment net assets, end of year	\$ 293,253,566	\$ 20,128,247	\$ 313,381,813

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

**14. Endowment (continued)**

	<b>2018</b>		
	<b>Without Donor Restrictions</b>	<b>With Donor Restrictions</b>	<b>Total</b>
Endowment net assets, beginning of year	\$ 257,744,701	\$ 18,999,861	\$ 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	73,500
Appropriation of endowment assets for expenditure	–	(123,684)	(123,684)
Beneficial interest in perpetual trust	–	60,719	60,719
Transfers	121,053	(197,666)	(76,619)
Endowment net assets, end of year	<u>\$ 278,086,378</u>	<u>\$ 19,875,509</u>	<u>\$ 297,961,887</u>

# Supplementary Information

## Members of the Hawai'i Pacific Health Obligated Group

### Combined Balance Sheets

	June 30	
	2019	2018
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 181,034,492	\$ 188,368,986
Patient accounts receivable, less allowance for uncollectible accounts (2018 – \$4,892,000)	165,078,910	161,744,383
Due from third-party payors	22,067,757	23,225,111
Other receivables	12,336,694	10,334,119
Due from affiliates	1,445,306	2,770,707
Inventories	19,691,750	19,873,741
Funds held by trustee under bond indenture agreement	13,169,892	9,713,013
Escrow funds held for bond defeasance	5,747,688	2,620,000
Prepaid expenses and other	6,564,258	6,354,779
Total current assets	427,136,747	425,004,839
Assets whose use is limited or restricted:		
Board-designated	214,417,329	203,519,368
Escrow funds held for bond defeasance	156,332,027	164,808,262
Restricted by donor or grantor	42,985,253	34,319,033
Total assets whose use is limited or restricted	413,734,609	402,646,663
Investments	341,676,670	265,312,676
Property and equipment, net	557,652,321	546,736,253
Due from third-party payors	4,270,752	4,385,467
Other assets:		
Investment in unconsolidated subsidiaries	43,410,990	49,044,641
Investments in joint ventures	25,000	25,000
Beneficial interest in net assets of foundations	66,667,486	63,996,984
Other	22,545,738	18,401,151
Total other assets	132,649,214	131,467,776
Total assets	\$ 1,877,120,313	\$ 1,775,553,674

	<b>June 30</b>	
	<b>2019</b>	<b>2018</b>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 50,626,344	\$ 43,846,639
Payroll and related liabilities	84,834,395	80,187,645
Accrued expenses	23,160,632	22,855,008
Due to third-party payors	16,105,428	12,843,509
Current portion of long-term debt	10,199,737	7,773,803
Total current liabilities	<u>184,926,536</u>	167,506,604
Long-term debt, less current portion	529,935,734	534,791,379
Other long-term liabilities	42,082,670	42,723,063
Due to third-party payors	4,676,162	9,243,840
Accrued pension liability	78,844,973	18,853,802
Net assets:		
Net assets without donor restrictions	984,820,949	959,968,215
Net assets with donor restrictions	51,833,289	42,466,771
Total net assets	<u>1,036,654,238</u>	1,002,434,986
Total liabilities and net assets	<u><u>\$ 1,877,120,313</u></u>	<u><u>\$ 1,775,553,674</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	
	2019	2018
<b>Unrestricted revenues</b>		
Net provision service revenue	\$ 1,267,903,679	\$ 1,232,015,677
Provision for bad debts	–	(17,153,612)
Net patient service revenue, after provision for bad debts	1,267,903,679	1,214,862,065
Premium revenue	18,566,561	16,074,616
Other revenues	45,372,863	43,866,815
Gain on disposal of property and equipment	750,271	–
Net assets released from restrictions	12,253,676	13,906,486
Total unrestricted revenues	1,344,847,050	1,288,709,982
<b>Expenses</b>		
Salaries and employee benefits	709,667,967	680,422,593
Services	171,738,907	166,612,697
Supplies	190,708,015	176,531,308
Other purchases	73,426,070	70,269,970
Depreciation and amortization	50,756,929	51,798,095
Specific purpose projects/donations	12,253,676	13,906,486
Interest	22,645,114	20,831,489
Other	4,412,732	5,438,396
Total expenses	1,235,609,410	1,185,811,034
Operating income	109,237,640	102,898,948
Equity (loss) income of unconsolidated subsidiaries	(4,319,761)	33,562
Investment income	27,313,661	32,375,119
Loss on extinguishment of debt	(88,154)	–
Pension non-operating (expense) income	(2,166,118)	5,463,477
	20,739,628	37,872,158
Excess of revenues over expenses	129,977,268	140,771,106
Transfers to affiliates	(39,520,460)	(36,078,052)
Change in interest in foundations	2,670,502	3,830,310
Change in net unrealized gains on investments	3,450,204	434,097
Net assets released from restrictions for purchase of property and equipment	1,595,799	1,116,472
Change in funded status of pension plan	(71,835,533)	12,808,053
Change in interest rate swap value	(171,146)	246,548
Other changes in net assets	(1,313,900)	(341,863)
Increase in net assets without donor restrictions	24,852,734	122,786,671

*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	
	2019	2018
<b>Net assets with donor restrictions</b>		
Restricted grants and contributions	\$ 14,674,858	\$ 17,303,053
Investment income	127,852	95,783
Change in net unrealized (losses) gains on investments	(271,389)	185,478
Change in interest in foundations	8,725,019	2,433,812
Net assets released from restrictions	(13,849,476)	(15,022,959)
Change in beneficial interest in perpetual trusts	(58,798)	60,719
Other changes in net assets with donor restrictions	18,452	78,470
Increase in net assets with donor restrictions	<u>9,366,518</u>	<u>5,134,356</u>
Increase in net assets	34,219,252	127,921,027
Net assets at beginning of year	1,002,434,986	874,513,959
Net assets at end of year	<u>\$ 1,036,654,238</u>	<u>\$ 1,002,434,986</u>

# Members of the Hawai'i Pacific Health Obligated Group

## Combined Statements of Cash Flows

	Year Ended June 30	
	2019	2018
<b>Operating activities</b>		
Increase in net assets	\$ 34,219,252	\$ 127,921,027
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Change in interest in foundations	(11,395,520)	(6,264,122)
Depreciation and amortization	50,756,929	51,798,095
Equity losses (income) of unconsolidated subsidiaries	4,319,761	(33,562)
Net gains on alternative investments	(14,040,837)	(12,733,649)
Change in net unrealized gains on investments	(3,178,815)	(434,097)
Realized losses (gains) on investments	47,814	(12,818,143)
Net gains on equity investments	(5,558,215)	-
Restricted contributions	(14,674,858)	(17,303,053)
Changes in operating assets and liabilities:		
Patient accounts receivable	(3,334,527)	(5,679,436)
Due to/from third-party payors, net	(33,690)	(5,951,236)
Other receivables	(2,002,575)	(1,026,787)
Inventories and other assets	(4,172,075)	(7,405,114)
Accounts payable and accrued expenses	7,067,399	7,368,066
Other long-term liabilities	(640,393)	6,011,777
Accrued pension liability	59,991,171	(81,170,195)
Net cash provided by operating activities	<u>97,370,821</u>	<u>42,279,571</u>
<b>Investing activities</b>		
Purchases of property and equipment	(57,008,317)	(58,960,623)
Decrease in due to affiliates, net	1,325,401	3,047,317
Net decrease (increase) to unconsolidated subsidiaries	1,313,890	(2,329,030)
Purchases of investment securities	(110,994,936)	(70,502,263)
Sales and maturities of investment securities	49,065,889	65,321,309
Assets whose use is limited or restricted:		
Increase in funds held by trustee under bond indenture agreements	(3,456,879)	25,814,689
Purchases of investment securities	(32,670,520)	(48,766,793)
Sales and maturities of investment securities	30,126,463	46,254,726
Net cash used in investing activities	<u>(122,299,009)</u>	<u>(40,120,668)</u>

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Members of the Hawai'i Pacific Health Obligated Group

Combined Statements of Cash Flows (continued)

	<b>Year Ended June 30</b>	
	<b>2019</b>	<b>2018</b>
<b>Financing activities</b>		
Payment of long-term debt	\$ (50,157,446)	\$ (6,290,256)
Proceeds from long-term debt	47,727,735	201,594,198
Decrease (increase) in escrow funds held for bonds	5,348,547	(167,428,262)
Restricted contributions	14,674,858	17,303,053
Net cash provided by financing activities	<u>17,593,694</u>	<u>45,178,733</u>
(Decrease) increase in cash, cash equivalents and restricted cash	(7,334,494)	47,337,636
Cash, cash equivalents and restricted cash at beginning of year	188,368,986	141,031,350
Cash, cash equivalents and restricted cash at end of year	<u>\$ 181,034,492</u>	<u>\$ 188,368,986</u>
<b>Non-cash activity</b>		
Property and equipment and accrued expenses	<u>\$ 231,556</u>	<u>\$ 4,433,124</u>

## Hawai'i Pacific Health

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

June 30, 2019

#### **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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