



PEACEHEALTH NETWORKS

Consolidated Financial Statements

June 30, 2017 and 2016

(With Independent Auditors' Report Thereon)

PEACEHEALTH NETWORKS

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KPMG LLP
Suite 3800
1300 South West Fifth Avenue
Portland, OR 97201

Independent Auditors' Report

The Board of Directors
PeaceHealth Networks:

We have audited the accompanying consolidated financial statements of PeaceHealth Networks (a Washington not-for-profit corporation), which comprise the consolidated balance sheets as of June 30, 2017 and 2016, and the related consolidated statements of operations, 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 Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of PeaceHealth Networks as of June 30, 2017 and 2016, and the results of its operations, changes in net assets, and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.



Other Matters

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The additional information included on pages 41 to 44 is presented for purposes of additional analysis and is not a required part of the consolidated 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 audit 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 consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Portland, Oregon
September 29, 2017

PEACEHEALTH NETWORKS

Consolidated Balance Sheets

June 30, 2017 and 2016

(In thousands)

Assets	2017	2016
Current assets:		
Cash and cash equivalents	\$ 105,757	245,981
Short-term investments	517,397	341,426
Accounts receivable, net of allowance for doubtful accounts of \$71,981 and \$81,275	313,330	319,660
Other receivables	32,257	31,650
Inventory of supplies	41,382	44,061
Prepaid expenses and other	25,257	24,812
Assets whose use is limited that are required for current liabilities	23,117	25,468
Total current assets	<u>1,058,497</u>	<u>1,033,058</u>
Assets whose use is limited:		
Cash and investments	1,381,923	1,119,841
Investments in joint ventures and other	25,510	25,180
Total assets whose use is limited	<u>1,407,433</u>	<u>1,145,021</u>
Less current portion	<u>(23,117)</u>	<u>(25,468)</u>
Net assets whose use is limited	<u>1,384,316</u>	<u>1,119,553</u>
Property, plant, and equipment:		
Land and improvements	140,111	139,590
Buildings, fixed equipment, and other	1,743,568	1,725,642
Moveable equipment	881,754	853,862
Construction in progress	15,691	39,754
Total property, plant, and equipment	<u>2,781,124</u>	<u>2,758,848</u>
Less accumulated depreciation	<u>(1,532,898)</u>	<u>(1,421,222)</u>
Net property, plant, and equipment	<u>1,248,226</u>	<u>1,337,626</u>
Interest in net assets of related foundations	63,356	57,524
Other assets	37,736	38,979
Total assets	<u>\$ 3,792,131</u>	<u>3,586,740</u>

PEACEHEALTH NETWORKS

Consolidated Balance Sheets

June 30, 2017 and 2016

(In thousands)

Liabilities and Net Assets	2017	2016
Current liabilities:		
Accounts payable	\$ 96,487	106,768
Accrued payroll, payroll taxes, and employee benefits	156,780	174,195
Accrued interest payable	4,356	4,605
Other current liabilities	43,905	56,856
Current portion of long-term debt	33,593	40,814
Total current liabilities	<u>335,121</u>	<u>383,238</u>
Other long-term liabilities	327,799	398,072
Long-term debt, net of current portion	954,548	989,859
Net assets:		
Unrestricted, controlling	2,089,235	1,730,006
Unrestricted, noncontrolling interest	3,557	4,466
Temporarily restricted	59,519	58,760
Permanently restricted	22,352	22,339
Total net assets	<u>2,174,663</u>	<u>1,815,571</u>
Total liabilities and net assets	<u>\$ 3,792,131</u>	<u>3,586,740</u>

See accompanying notes to consolidated financial statements.

PEACEHEALTH NETWORKS
Consolidated Statements of Operations
Years ended June 30, 2017 and 2016
(In thousands)

	2017	2016
Revenues:		
Net patient service revenue before provision for bad debts	\$ 2,434,061	2,328,898
Provision for bad debts	(50,258)	(84,268)
Net patient service revenue	2,383,803	2,244,630
Other operating revenue	88,246	99,046
Total revenues	2,472,049	2,343,676
Expenses:		
Salaries and wages	1,184,906	1,154,317
Payroll taxes and benefits	231,602	217,004
Supplies	358,753	345,479
Purchased services	265,775	272,957
Other	201,360	193,496
Depreciation and amortization of other assets	141,824	143,972
Interest and amortization of deferred financing costs	31,322	31,213
Total expenses	2,415,542	2,358,438
Income loss from operations	56,507	(14,762)
Other income (loss):		
Investment income, net	137,596	7,081
Net change in interest rate swaps	27,685	(60,913)
Other	(69)	300
Total other income (loss):	165,212	(53,532)
Excess (deficit) of revenues over expenses from continued operations	221,719	(68,294)
Discontinued operations (note 14):		
Gain (loss) from operations (including gain on disposal of \$88,771 and \$16,069)	96,916	(2,831)
Total gain (loss) on discontinued operations	96,916	(2,831)
Excess (deficit) of revenues over expenses	318,635	(71,125)
Net assets released from restrictions for property, plant, and equipment	4,448	2,544
Change in interest in net assets of related foundations	(12)	(8,237)
Change in pension liability	26,820	(41,426)
Other changes in unrestricted net assets	8,429	2,640
Increase (decrease) in unrestricted net assets	\$ 358,320	(115,604)

See accompanying notes to consolidated financial statements.

PEACEHEALTH NETWORKS

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2017 and 2016

(In thousands)

	<u>Unrestricted controlling</u>	<u>Unrestricted noncontrolling interest</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Net assets at June 30, 2015	\$ 1,846,087	3,989	44,338	24,418	1,918,832
(Deficit) excess of revenues over expenses from continued operations	(69,104)	810	—	—	(68,294)
Other restricted contributions	—	—	2,555	—	2,555
Net assets released from restrictions	2,544	—	(2,107)	—	437
Change in interest in net assets of related foundations	(8,237)	—	16,122	(2,466)	5,419
Change in pension liability	(41,426)	—	—	—	(41,426)
Other changes in net assets	2,640	—	(2,148)	387	879
Change in net assets before discontinued operations	(113,583)	810	14,422	(2,079)	(100,430)
Discontinued operations (note 14)	(2,498)	(333)	—	—	(2,831)
Change in net assets	(116,081)	477	14,422	(2,079)	(103,261)
Net assets at June 30, 2016	<u>1,730,006</u>	<u>4,466</u>	<u>58,760</u>	<u>22,339</u>	<u>1,815,571</u>
Excess (deficit) of revenues over expenses from continued operations	222,906	(1,187)	—	—	221,719
Other restricted contributions	—	—	3,915	—	3,915
Net assets released from restrictions	4,448	—	(5,376)	—	(928)
Change in interest in net assets of related foundations	(12)	—	5,938	(81)	5,845
Change in pension liability	26,820	—	—	—	26,820
Other changes in net assets	8,429	—	(3,718)	94	4,805
Change in net assets before discontinued operations	262,591	(1,187)	759	13	262,176
Discontinued operations (note 14)	96,638	278	—	—	96,916
Change in net assets	359,229	(909)	759	13	359,092
Net assets at June 30, 2017	<u>\$ 2,089,235</u>	<u>3,557</u>	<u>59,519</u>	<u>22,352</u>	<u>2,174,663</u>

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows

Years ended June 30, 2017 and 2016

(In thousands)

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Change in net assets	\$ 359,092	(103,261)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	142,115	144,222
Loss (gain) on sale of land held for sale and property, plant, and equipment	95	(42)
Provision for bad debts	50,258	84,268
Change in pension liability	(26,820)	41,426
Restricted contributions	(3,915)	(2,555)
Net change in unrealized losses on investments	6,528	42,211
Realized gains on investments	(116,902)	(21,287)
Valuation adjustments on swap arrangements	(40,838)	46,611
Vesting of Premier Class B units	(6,049)	(3,719)
Increase in interest in net assets of related foundations	(5,845)	(5,419)
Distributions of earnings from joint ventures	7,123	7,625
Gain on sale of discontinued operations	(88,771)	(16,069)
Changes in operating assets and liabilities:		
Increase (decrease) in:		
Accounts receivable, net	(43,928)	(49,047)
Other assets	1,866	8,117
Increase (decrease) in:		
Accounts payable	(10,281)	(25,563)
Accrued payroll, payroll taxes, and employee benefits	(17,415)	(1,021)
Other liabilities	(15,815)	(11,770)
Net cash provided by operating activities	<u>190,498</u>	<u>134,727</u>
Cash flows from investing activities:		
Purchase of property, plant, and equipment	(51,540)	(100,816)
Proceeds from sale of discontinued operations	106,503	28,300
Proceeds from sale of land held for sale and property, plant, and equipment	38	143
Purchase of investments	(949,434)	(334,521)
Sales and maturities of investments	<u>602,619</u>	<u>290,352</u>
Net cash used in investing activities	<u>(291,814)</u>	<u>(116,542)</u>
Cash flows from financing activities:		
Proceeds from long-term borrowings	—	300
Principal payments on long-term debt	(42,823)	(39,526)
Proceeds from restricted contributions	3,915	2,555
Net cash used in financing activities	<u>(38,908)</u>	<u>(36,671)</u>
Net decrease in cash and cash equivalents	(140,224)	(18,486)
Cash and cash equivalents at beginning of year	<u>245,981</u>	<u>264,467</u>
Cash and cash equivalents at end of year	<u>\$ 105,757</u>	<u>245,981</u>

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

(1) Organization

(a) Corporate Structure

PeaceHealth Networks is a Washington not-for-profit corporation, recognized as tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code, which is the sole corporate member of PeaceHealth, which is also a Washington not-for-profit corporation, recognized as tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code, with its corporate office located in Vancouver, Washington. PeaceHealth Networks is not affiliated with the Roman Catholic Church, currently has no operations, and currently holds no financial assets in its own name (other than shares of stock in Columbia United Providers), however, it is the member corporation of PeaceHealth, which is a Private Pontifical Juridic Person according to the canon law of the Roman Catholic Church, does have extensive healthcare operations and holds substantial financial assets. Effective January 1, 2014, PeaceHealth Networks and PeaceHealth were reorganized so that the corporate membership relationship between them was reversed from what it had been for the three previous calendar years, as described hereafter. When PeaceHealth affiliated with Southwest Washington Health System in January 2011, PeaceHealth became the sole member of Southwest Washington Health System. In 2014, Southwest Washington Health System became the sole member of PeaceHealth and changed its name to PeaceHealth Networks. PeaceHealth Networks and its associated entities are collectively referred to herein as "the Corporation." PeaceHealth Networks and PeaceHealth are the only members of the Corporation's Obligated Group. At June 30, 2017, the following regional healthcare delivery systems and operating divisions were components of PeaceHealth:

Northwest Network:

- PeaceHealth Ketchikan Medical Center
- PeaceHealth St. Joseph Medical Center
- Peace Island Medical Center
- PeaceHealth United General Medical Center

Columbia Network:

- PeaceHealth St. John Medical Center
- PeaceHealth Southwest Medical Center

Oregon West Network:

- PeaceHealth Sacred Heart Medical Center at University District
- PeaceHealth Sacred Heart Medical Center at RiverBend
- PeaceHealth Cottage Grove Community Medical Center
- PeaceHealth Peace Harbor Hospital

Systemwide Organizations:

- PeaceHealth Medical Group
- PeaceHealth Laboratories (Discontinued Operations as of May 2017)
- PeaceHealth Self-insured Trusts

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Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

These regional healthcare delivery systems and operating divisions provide inpatient, outpatient, primary, and specialty care and home care services in Alaska, Washington, and Oregon. These divisions primarily operate in Ketchikan, Alaska; Bellingham, Friday Harbor, Sedro Woolley, Longview, and Vancouver, Washington; Springfield, Eugene, Florence, and Cottage Grove, Oregon.

PeaceHealth Networks included the following controlled affiliates at

June 30, 2017:

PeaceHealth

Health Ventures

Pooled Income Funds (including Charitable Life Income Funds)

PeaceHealth Southwest Medical Center Foundation

Columbia United Providers (CUP) – owned 91.7% (Discontinued
Operations as of December 2015)

The consolidated financial statements include the accounts of the Corporation. All significant intercompany transactions and balances have been eliminated.

(2) Summary of Significant Accounting Policies

(a) *Estimates*

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates. The significant estimates in the Corporation's consolidated financial statements include accounts receivable allowances, valuation of alternative investments, interest rate swaps, pension obligations, and liabilities related to self-insurance programs.

(b) *Cash and Cash Equivalents*

Cash and cash equivalents consist of petty cash, cash in demand bank accounts, and all highly liquid debt instruments purchased with an original maturity of three months or less other than those amounts included in assets whose use is limited by the board of directors. The Corporation held cash equivalents of approximately \$24,111 and \$120,083 as of June 30, 2017 and 2016, respectively.

The Corporation maintains cash and cash equivalents on deposit at various institutions, which, at times, exceed the insured limits of the Federal Deposit Insurance Corporation. This exposes the Corporation to potential risk of loss in the event the institution becomes insolvent.

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Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

(c) Short-Term Investments

Short-term investments consist primarily of certificates of deposit, U.S. government, and other investment-grade securities, which are carried at fair value. Investment income or loss (including realized and unrealized gains and losses and interest and dividends) is included in the excess of revenues over expenses.

(d) Inventory of Supplies

Inventory is valued on weighted average cost.

(e) Other Receivables

Other receivables primarily consist of amounts receivable from the provider tax, amounts receivable from excess insurance carriers, and other miscellaneous amounts due.

(f) Assets Whose Use is Limited

Certain assets have been set aside by management of the Corporation for future capital improvements, self-insured liabilities and other purposes, over which management retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of the Corporation have been reclassified as current in the consolidated balance sheets at June 30, 2017 and 2016. These items consist primarily of investments in marketable equity and fixed income securities, mutual funds, and investments in joint ventures. Money market funds and all marketable securities have readily determinable market values and are, therefore, carried at fair value. The investments in joint ventures and other are accounted for using the equity or cost method. Investment income or loss (including realized and unrealized gains and losses and interest and dividends) is included in the excess of revenues over expenses.

(g) Property, Plant, and Equipment

Property, plant, and equipment are stated at cost at the date of acquisition or fair value at the date of donation. Improvements and replacements of plant and equipment are capitalized. Maintenance and repairs are expensed as they are incurred. When property, plant, and equipment is sold or retired, the cost and the related accumulated depreciation are removed from the accounts, and the resulting gain or loss is recorded. The Corporation assesses potential impairment of its long-lived assets when there is evidence that events or changes in circumstances have made recovery of the asset's carrying value unlikely. An impairment loss is indicated when the sum of expected undiscounted future net cash flows is less than the carrying amount. The loss recognized is the difference between the fair value and the carrying amount. No impairment losses related to property, plant, and equipment were recognized during the years ended June 30, 2017 and 2016.

In addition to consideration of impairment due to the events or changes in circumstances described above, management regularly evaluates the remaining lives of long-lived assets. If estimates are revised, the carrying value of affected assets is depreciated or amortized over remaining lives. No adjustments were made in fiscal year 2017 and 2016.

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Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

The Corporation capitalized salary and wages along with related benefit costs in the amount of \$2,146 and \$5,775 during 2017 and 2016, respectively, related to the development of software for internal use.

(h) Depreciation

Depreciation on property, plant, and equipment is computed using the straight-line method over the following estimated useful lives:

Land improvements	5–25 years
Buildings and improvements	5–80 years
Fixed equipment	10–75 years
Leasehold improvements	Shorter of remaining length of the lease or useful life
Moveable equipment	3–30 years

(i) Other Assets

Other assets include intangible assets, primarily deferred financing costs, trade names, and goodwill. The deferred financing costs are amortized over the lives of the related debt issuances using the effective interest method. Intangible assets with indefinite lives are evaluated annually for impairment. There were no impairment losses recognized during the years ended June 30, 2017 and 2016.

(j) Other Long-Term Liabilities

Other long-term liabilities consists primarily of the estimated fair value associated with the Corporation's interest rate swaps of \$113,089 and \$153,927 at June 30, 2017 and 2016, respectively; the liability for the PeaceHealth SWHS Frozen DB Pension Plan of \$69,050 and \$104,570 at June 30, 2017 and 2016, respectively; and the long-term portion of the liability for the self-insurance programs of \$64,603 and \$61,868 at June 30, 2017 and 2016, respectively. The remaining balance of other long-term liabilities includes gift annuities, environmental liability, and deferred compensation plan liability.

(k) Contributions and Grants

Contributions and grants are recognized as revenue upon receipt of the donor's pledge to contribute. Contributions and grants are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts pledged that are restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support. Unconditional promises to give that are silent as to the due date are presumed to be time restricted by the donor until received and are reported as temporarily restricted net assets.

A donor restriction expires when an unconditional promise with an implied time restriction is collected or when the purpose for the restriction is accomplished. Upon expiration, temporarily restricted net assets are reclassified to unrestricted net assets and are reported in the consolidated statements of operations as net assets released from restrictions. Restricted contributions received in the same year in which the restrictions are met are recorded as an increase in restricted support at the time of receipt and as net assets released from restrictions at the time restrictions are met.

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Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

Permanently restricted net assets include the principal amount of contributions with the stipulation from the donor that the principal be maintained in perpetuity and only the income is available to be expended for purposes specified by the donor, if any.

(l) Interest in Net Assets of Related Foundations

The Corporation recognizes its interest in its unconsolidated related foundations representing certain net assets that will ultimately benefit the Corporation. The Corporation records an asset on the consolidated balance sheets for its beneficial interest in net assets of related foundations. The Corporation recognizes changes in this beneficial interest in the consolidated statements of changes in net assets.

(m) Pooled Income Funds

The Corporation has created several pooled income funds. These funds are structured such that the Corporation sold and leased back certain properties. Donors make a contribution and receive annuity payments based on the associated rental income. Upon the annuity termination, the remaining interest is transferred to the Corporation. At June 30, 2017 and 2016, the Corporation has recorded the present value of the annuity payments of \$10,051 and \$14,972, respectively, as part of other long-term liabilities. The discount rate ranged from 6.1% to 6.7% at June 30, 2017 and 6% at June 30, 2016.

(n) Net Patient Service Revenue

The Corporation has agreements with third-party payors that provide for payments of amounts different from established charges. The Corporation's net patient service revenue came from the following sources:

	<u>2017</u>	<u>2016</u>
Medicare	39 %	38 %
Medicaid	14	14
Commercial and other	46	47
Private pay	1	1
	<u>100 %</u>	<u>100 %</u>

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Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

There is a corresponding significant concentration of credit risk in net accounts receivable balances at June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Medicare	28 %	28 %
Medicaid	10	14
Commercial and other	61	57
Private pay	1	1
	<u>100 %</u>	<u>100 %</u>

Reimbursement for inpatient and outpatient services rendered to Medicare recipients has been made principally under a prospective pricing system. Services to Medicaid patients are also reimbursed based on a combination of prospectively determined rates and cost reimbursement methodology. Continuation of these reimbursement programs at the present level, and on the present basis, is dependent upon future policies of federal and state governmental agencies. The Corporation operates five critical access hospitals that are reimbursed based on costs for inpatient and outpatient services rendered to Medicare and Medicaid program beneficiaries. Interim reimbursement to critical access hospitals is based upon tentative rates and retroactive adjustment is made to actual cost during final settlement by either the Medicare fiscal intermediary or the applicable state's Medicaid agency.

The Corporation has estimated payments for services rendered to Medicare and Medicaid patients during the year by applying the payment principles of the applicable governmental agencies and believes that an adequate provision has been made in the accompanying consolidated financial statements for final settlement. Estimates of final settlements due to and due from Medicare, Medicaid, and other third-party payors have been reflected net as reimbursement settlement payable in the accompanying consolidated balance sheets. Differences between the net amounts accrued and subsequent settlements are recorded in operations at the time of settlement. The net amount of adjustments from finalization and adjustment of prior years' cost reports and other third-party settlements resulted in an increase in net patient service revenue of approximately \$2,100 and \$6,400 in 2017 and 2016, respectively.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretations. As a result, there is at least a reasonable possibility that recorded estimates associated with these programs will change by a material amount in the near term.

The Corporation has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Corporation under these agreements includes prospectively determined rates per unit of service and discounts from established charges, as well as, risk sharing arrangements. Most arrangements provide for payment or reimbursement to the Corporation at amounts different than established rates. Contractual discounts represent the difference between established rates for services and amounts paid or reimbursed by these third-party payors. Risk sharing arrangements include incentive payments

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June 30, 2017 and 2016

(In thousands of dollars)

for specific quality outcomes, effective management of costs, and other measures and in some cases may result in a penalty.

The Corporation provides for an allowance against patient accounts receivable for amounts that could become uncollectible. The Corporation estimates this allowance based on the aging of accounts receivable, historical collection experience by payor, and other relevant factors. There are various factors that can impact the collection trends, such as changes in the economy, which in turn have an impact on unemployment rates and the number of uninsured and underinsured patients, the increased burden of copayments to be made by patients with insurance coverage and business practices related to collection efforts. These factors continuously change and can have an impact on collection trends and the estimation process used by the Corporation. Net bad debt write-offs during 2017 and 2016 were \$59,553 and \$70,387, respectively.

(o) Premium Revenue and Accrued Healthcare Costs

PeaceHealth Networks' majority-owned subsidiary, CUP, receives premium revenue that consists of premiums paid by the state of Washington for healthcare services.

On December 31, 2013, CUP entered into an agreement with another health plan that had been awarded the contract from the state for the period January 1, 2014 through December 31, 2014. Under this contract, in return for receiving a defined premium amount from the other health plan, CUP was responsible for providing medical, hospital, pharmaceutical, and related medical services to Apple Health members assigned to CUP from the other plan. After the contract expired on December 31, 2014, CUP entered into a contract directly with the Health Care Authority (HCA) for the period January 1, 2015 through December 31, 2015. Under this contract, in return for receiving a defined premium amount from the HCA, CUP was responsible for providing medical, hospital, pharmaceutical, and related medical services to Apple Health members. Under the terms of this contract, CUP continued to perform most of the administrative services for its assigned members, such as claims payment and utilization management, that it performed under its contract with the state. As of January 1, 2015, CUP received this contract back from the HCA. On December 31, 2015, these members were sold to Molina, as described in note 14. The results of CUP and the cash flows from discontinued operations are disclosed under discontinued operations for the year ended June 30, 2017 and the comparative results for 2016 have been restated accordingly. Refer to note 14 for disclosure of discontinued operations.

(p) Other Operating Revenue

Other operating revenue includes revenue from nonpatient care services, clinical space rental revenue, and contributions both unrestricted in nature and those released from restriction to support operating activities, and other miscellaneous revenue.

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Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

(q) Hospital Transformation Performance Plan (HTPP)

The Hospital Transformation Performance Plan (HTPP) is a program through the Oregon Health Authority that uses quality metrics to show how well hospitals are advancing health system transformation, reducing costs, and improving patient safety. The Corporation received \$6,624 and \$13,326 related to the program for the years ended June 30, 2017 and 2016, respectively. The payment is classified in other operating revenue in the consolidated statement of operations.

(r) Income (Loss) from Operations

Income or loss from operations excludes certain items that the Corporation deems outside the scope of its primary business such as investment income, change in valuation of interest rate swaps, changes in defined benefit plan expense, and other items.

(s) Excess (Deficit) of Revenues over Expenses

Excess (deficit) of revenues over expenses includes results from the Corporation's operating and nonoperating investing activities. Investment income includes interest income, dividends, realized and unrealized investment gains and losses, and equity in earnings from joint ventures. Changes in unrestricted net assets not included in excess (deficit) of revenues over expenses include net assets released from restriction for the purchase of property, changes in the Corporation's interest in the net assets of noncontrolled foundations, and certain changes in funded status of the pension plan.

(t) Federal and State Income Taxes

PeaceHealth and PeaceHealth Networks have received determination letters from the Internal Revenue Service stating that they are exempt from federal and state income tax under Section 501(c)(3) of the Internal Revenue Code except for tax on unrelated business income. It is management's belief that none of its activities have produced material unrelated business income.

The Corporation recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that exceeds a 50% probability of being realized. Changes in recognition or measurement are reflected in the period in which the change in estimate occurs.

Certain affiliated entities included in the consolidated financial statements may be subject to taxation. The tax expense and related provision for these entities are not material to the consolidated financial statements.

(u) Oregon State Provider Tax and Washington State Safety Net Assessment

Effective July 1, 2004, the state of Oregon instituted a provider tax on certain patient service revenue at qualifying hospitals. The state of Washington enacted the safety net program in 2009 involving Washington State hospitals to increase funding from other sources and obtain additional federal funds to support increased payments to providers for Medicaid services.

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In 2014, the state of Washington re-enacted legislation that provided for increased Medicaid payments to certain hospitals funded by assessments paid by these hospitals as well as matching federal funds (the safety net program). The safety net program covers the period from July 1, 2013 to June 30, 2017. Providers are assessed and reimbursed on a quarterly basis. During 2015, the state of Washington received approval from CMS related to the managed care portion of the program. Therefore, as of June 30, 2015, the fee-for-service and managed care portions of the program were both approved.

In 2017 and 2016, with the States of Washington and Oregon programs, supplemental payments of \$76,987 and \$82,195, respectively, and assessments of \$66,541 and \$68,909, respectively, were recorded in net patient service revenue and other expenses, in the accompanying consolidated statements of operations and changes in net assets.

(v) Ownership in Group Purchasing Organization

The Corporation was an owner of several of the entities associated within a group purchasing organization (GPO), Premier. In October 2013, Premier restructured its business, including its initial public offering.

As part of the transaction, the Corporation received \$6,053 in cash, and approximately 1,253,000 shares of Class B units in Premier in fiscal year 2014. These shares vest over the next seven years, as long as the Corporation remains a member of Premier. Upon each vesting date, the Corporation has the option to convert these shares into the publically traded securities of Premier or have them repurchased by Premier. The Corporation is recognizing the value of the shares over the vesting period, as a reduction of supplies expense. Upon the annual vesting date, October 31, the vested shares will be accounted for under the fair value option, whereby future changes in share price will be treated as nonoperating investment activity. In fiscal year 2017, 179,055 shares of Class B stock vested. In addition, the Corporation receives quarterly distributions associated with its purchasing volumes and tax benefits associated with the restructuring. These distributions are recognized as a reduction of supplies expense.

In 2017 and 2016, the Corporation recognized approximately \$9,241 and \$8,875, respectively, as a reduction of supplies expense associated with these transactions. The 2017 reduction comprised \$6,170 related to Class B units and \$3,071 in quarterly distributions. The 2016 reduction comprised \$5,689 related to Class B units and \$3,186 in quarterly distributions.

During 2017, the Corporation sold 179,055 shares of Class B units in Premier, which resulted in total proceeds of \$5,782 and a gain on the sale of \$149.

(w) Environmental Liability

Financial Accounting Standards Board (FASB) Accounting Standard Codification (ASC) Subtopic 410-30, *Environmental Obligations*, requires the fair value of a liability for a legal obligation associated with an asset retirement be recorded in the period in which the obligation is incurred. When the liability is initially recorded, the cost of the asset retirement is capitalized. The Corporation had \$19,365 and \$18,905 recorded as other long-term liabilities as of June 30, 2017 and 2016, respectively. The Corporation recognized \$540 and \$805 in 2017 and 2016, respectively, related to amortization. Amortization is recognized over the life of the related asset.

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(x) Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the current year presentation to more consistently present financial information between years.

(y) Recently Adopted or Newly Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), to clarify the principles for recognizing revenue and to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and International Financial Reporting Standards (IFRS). The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in the ASU can be applied either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the update recognized at the date of the initial application along with additional disclosures. The Corporation is currently evaluating the impact of ASU 2014-09, including the methods of implementation, which is effective for the fiscal year beginning on July 1, 2018.

In March 2015, the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. This update changes the presentation of debt issuance costs in the financial statements to present such costs in the balance sheet as a direct deduction from the recognized liability rather than as an asset. Amortization of the costs is reported as interest expense. The Company adopted the standard in fiscal year 2017, and the prior year amount of \$4,660 has been reclassified in accordance with ASU 2015-03.

In May 2015, the FASB issued Accounting Standards Update (ASU) No. 2015-07, *Fair Value Measurement (Topic 820) – Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, which eliminates the requirement to categorize investments in the fair value hierarchy if their fair value is measured at net asset value (NAV) per share, or its equivalent, using the practical expedient in the FASB's fair value measurement guidance. The Corporation has adopted the provision of this standard. The adoption of this ASU did not have a material impact on the Corporation's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases* (Topic 842), which requires lessees to recognize a lease liability and a right of use asset for all lease obligations with exception to short-term leases. The lease liability will represent the lessee's obligation to make lease payments arising from the lease measured on a discounted basis and the right of use asset will represent the lessee's right to use or control the use of a specified asset for a lease term. The lease guidance also simplifies accounting for sale-leaseback transactions. The Corporation is currently evaluating the impact of ASU 2016-02, which is effective for the fiscal year beginning on July 1, 2019 with retrospective application to the earliest presented period.

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, to reduce diversity in reporting practice, reduce complexity, and enhance understandability of Not-for-Profit financial statements. This ASU contains the following key aspects: (A) Reduces the number of net asset classes presented from three to two: *with donor restrictions* and *without donor*

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restrictions; (B) Requires all NFPs to present expenses by their functional and their natural classifications in one location in the financial statements; (C) Requires NFPs to provide quantitative and qualitative information about management of liquid resources and availability of financial assets to meet cash needs within one year of the balance sheet date; and (D) Retains the option to present operating cash flows in the statement of cash flows using either the direct or indirect method. The Corporation is currently evaluating the impact of ASU 2016-14, including the methods of implementation, which is effective for the fiscal year beginning July 1, 2018.

(3) Fair Value of Financial Instruments

ASC Topic 820, *Fair Value Measurement*, requires a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly
- Level 3 inputs are unobservable inputs for the asset or liability

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The fair value of cash and investments, other than those measured using NAV as a practical expedient for fair value, is estimated using quoted market prices or other observable inputs when quoted market prices are unavailable.

The Corporation uses a practical expedient for the estimation of the fair value of investments in funds for which the investment does not have a readily determinable fair value. The practical expedient used by the Corporation is the NAV per share, or its equivalent. In some instances, the NAV may not equal the fair value that would be calculated under fair value accounting standards. Valuations provided by fund administrators consider variables such as the financial performance of underlying investments, recent sales prices of underlying investments, and other pertinent information. In addition, actual market exchanges at year-end provide additional observable market inputs of the exit price. Management reviews the valuations and assumptions provided by fund administrators for reasonableness and believes that the carrying amounts of these financial instruments are reasonable estimates of fair value. The initial valuation is adjusted when changes to inputs and assumptions are corroborated by evidence, such as transactions of similar securities, completed or pending third-party transactions in the underlying security or comparable entities, offerings in the capital markets, and changes in financial results, data, or cash flows. For positions that are not traded in active markets or are subject to notice provisions, valuations are adjusted to reflect such provisions, and such adjustments are generally based on available market evidence.

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The fair value of long-term debt is based on Level 2 inputs, such as the discounted value of the future cash flows using current rates for debt with the same remaining maturities, considering the existing call premium and protection. When available, quoted market prices are also used. The carrying value and fair value of bond debt, was approximately \$972,926 and \$987,898, respectively, as of June 30, 2017, and approximately \$1,008,165 and \$1,037,483, respectively, as of June 30, 2016. Remaining other debt of \$15,216 and \$22,508 as of June 30, 2017 and 2016, respectively, approximates carrying value.

Other financial instruments of the Corporation include cash and cash equivalents and other receivables. The carrying amount of these instruments approximates fair value because these items mature in less than one year. The carrying amount of other long-term investments approximates fair value.

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(4) Investments

The composition of cash and investments carried at fair value on a recurring basis at June 30, 2017 is set forth in the following table:

	<u>June 30, 2017</u>	<u>Fair value measurements at reporting date using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets:				
Short-term investments:				
Fixed income:				
Government, Municipal, foreign, and other	\$ 108,836	—	108,836	—
Mortgage-backed securities	90,218	—	90,218	—
Corporate obligations	247,685	—	247,685	—
Mutual funds	69,934	69,934	—	—
Other short-term investments	724	—	724	—
Total	517,397	69,934	447,463	—
Designated for capital acquisition:				
Cash and money market funds	10,505	10,505	—	—
Fixed income	314,644	—	314,644	—
Mutual funds:				
Fixed income	165,730	165,730	—	—
Domestic equities	473,747	473,747	—	—
International equities	225,592	225,592	—	—
Other long-term equity invest	35,129	34,975	154	—
Total	1,225,347	910,549	314,798	—
Funds designated for 457 plans:				
Cash and short term	1,488	1,488	—	—
Mutual funds	46,009	46,009	—	—
Total	47,497	47,497	—	—
Trustee-held funds:				
Cash and money market funds	13,678	13,678	—	—
Fixed income	4,081	—	4,081	—

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	<u>June 30, 2017</u>	Fair value measurements at reporting date using		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Mutual funds:				
Domestic equities	\$ 64,298	64,298	—	—
International equities	15,260	15,260	—	—
Real estate	3,876	3,876	—	—
Total	<u>101,193</u>	<u>97,112</u>	<u>4,081</u>	<u>—</u>
Total assets at fair value	1,891,434	<u>1,125,092</u>	<u>766,342</u>	<u>—</u>
Investments measured at NAV	<u>7,886</u>			
Total assets	<u>\$ 1,899,320</u>			
Liabilities:				
Interest rate swaps	\$ 113,089	—	113,089	—
Total liabilities	<u>\$ 113,089</u>	<u>—</u>	<u>113,089</u>	<u>—</u>

The composition of cash and investments carried at fair value on a recurring basis at June 30, 2016 is set forth in the following table:

	<u>June 30, 2016</u>	Fair value measurements at reporting date using		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets:				
Short-term investments:				
Fixed income:				
Government, Municipal, foreign, and other	\$ 110,705	—	110,705	—
Mortgage-backed securities	100,849	—	100,849	—
Corporate obligations	71,369	—	71,369	—
Mutual funds	57,779	57,779	—	—
Other short-term investments	724	—	724	—
Total	<u>341,426</u>	<u>57,779</u>	<u>283,647</u>	<u>—</u>
Designated for capital acquisition:				
Cash and money market funds	58,422	58,422	—	—
Fixed income	256,258	—	256,258	—

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	<u>June 30, 2016</u>	Fair value measurements at reporting date using		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Mutual funds:				
Fixed income	\$ 114,956	114,956	—	—
Domestic equities	372,406	372,406	—	—
International equities	150,573	150,573	—	—
Real estate trusts	31,263	31,263	—	—
Other long-term equity invest	3,973	3,973	—	—
Total	<u>987,851</u>	<u>731,593</u>	<u>256,258</u>	<u>—</u>
Funds designated for 457 plans:				
Cash and short term	1,379	1,379	—	—
Mutual funds	40,254	40,254	—	—
Total	<u>41,633</u>	<u>41,633</u>	<u>—</u>	<u>—</u>
Trustee-held funds:				
Cash and money market funds	2,339	2,339	—	—
Fixed income	4,185	—	4,185	—
Mutual funds	74,678	74,678	—	—
Total	<u>81,202</u>	<u>77,017</u>	<u>4,185</u>	<u>—</u>
Total assets at fair value	<u>1,452,112</u>	<u>908,022</u>	<u>544,090</u>	<u>—</u>
Investments measured at NAV	<u>9,155</u>			
Total assets	<u>\$ 1,461,267</u>			
Liabilities:				
Interest rate swaps	\$ 153,927	—	153,927	—
Total liabilities	<u>\$ 153,927</u>	<u>—</u>	<u>153,927</u>	<u>—</u>

The following table provides information regarding redemption of investments where NAV has been used as a practical expedient at June 30, 2017 and June 30, 2016:

	<u>2017</u>	<u>2016</u>	<u>Unfunded commitments</u>
Distressed debt	\$ 1,698	1,841	1,899
Private equity	6,188	7,314	1,059
Total	<u>\$ 7,886</u>	<u>9,155</u>	<u>2,958</u>

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The Corporation holds investments in private equity and distressed debt limited partnerships where NAV is used as a practical expedient to measure fair value at June 30, 2017 and 2016. These partnerships do not allow for periodic redemptions, but rather liquidate upon the termination date as stated in the partnership agreement. Therefore, the private equity investments are considered illiquid investments. At June 30, 2017 and 2016, the Corporation held \$7,886 and \$9,155, respectively, of private equity and distressed debt limited partnerships that had termination dates that ranged from 2017 to 2023.

Investment income is comprised of the following for the years ended June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Interest and dividend income	\$ 27,222	28,019
Net realized gains on sales of investments	116,902	21,287
Net change in unrealized gains on investments	<u>(6,528)</u>	<u>(42,225)</u>
Investment income, net	<u>\$ 137,596</u>	<u>7,081</u>

Other Investments

Health Ventures is a not-for-profit corporation that has entered into joint ventures to provide radiology, oncology, and surgery services. PeaceHealth is the sole member of Health Ventures. Health Ventures is included in the consolidated financial statements but is not part of the obligated group. The majority of these joint ventures are accounted for under the equity method. As of June 30, 2017 and 2016, the carrying value of the joint ventures was approximately \$15,064 and \$13,295, respectively, and is recorded in investments in joint ventures and other on the consolidated balance sheets. Investment income from the joint ventures of \$8,200 and \$7,136 for the years ended June 30, 2017 and 2016, respectively, is included in other operating revenue. The assets, liabilities, and equity of these joint ventures accounted for under the equity method were \$39,743, \$8,179, and \$31,564, respectively, at June 30, 2017 and \$34,652, \$9,522, and \$25,130, respectively, at June 30, 2016.

Health Ventures has a controlling ownership of 54.05% in Riverbend Ambulatory Surgery Center, which is consolidated within Health Ventures.

(5) Charity Care

The Corporation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

The Corporation maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies under its charity care policy. Estimated costs (based on the proportion of overall costs to charges foregone for charity care) for services and supplies furnished under the charity care policy for the years ended June 30, 2017 and 2016 were approximately \$21,153 and \$14,000, respectively.

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(6) Long-Term Debt

Long-term debt at June 30 consisted of the following:

	<u>2017</u>	<u>2016</u>
Series 2008 Washington Bonds, Series A, fixed interest rate of 5% payable on each May 1 and November 1 through November 2018.	\$ 80,650	80,650
Series 2008 Oregon Bonds, Series A-B, variable interest rate (0.92% at June 30, 2017), principal payable each August, due in annual installments from 2030 to 2034 for Series A and B	145,975	145,975
Series 2009 Oregon Bonds, Series A, fixed interest rates of 3.25% to 5.00% payable each May and November, due in installments from 2013 to 2039	80,780	86,310
Series 2009 Washington Bonds, Series A, fixed interest rates of 3.0% to 5.0% payable each in May and November, due in installments through 2028	69,840	72,410
Series 2011 Oregon Bonds, Series A-B, variable interest rates (1.36% at June 30, 2017) principal payable each May, due in installments from 2036 to 2047	150,000	150,000
2011 Direct Note Obligation to Union Bank, matured November 2016.	—	5,417
2012 Direct Note Obligation to Bank of America, fixed interest rate of 2.3%, due on December 1, 2022	32,467	37,889
2013 Washington Bonds, Series A, variable interest rate (1.41% at June 30, 2017), principal payable each September, in annual installments from 2013 to 2034	48,865	50,065
2013 Direct Note Obligation to Bank of America, fixed interest rate of 3.23%, due on October 2, 2023	33,529	38,218
2013 Direct Note Obligation to Bank of America, fixed interest rate of 3.92%, due on October 2, 2023	163,363	168,140
2013 Direct Note Obligation to U.S. Bank, fixed interest rate of 3.43%, due on October 8, 2020	50,000	50,000
Series 2014 Washington Bonds, Series A, fixed interest rates of 2.0% to 5.0% payable each May and November, due in installments through 2028	34,555	36,620

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	<u>2017</u>	<u>2016</u>
Series 2014 Oregon Bonds, Series A, fixed interest rate of 4.125%–5%, payable each May and November, due in installments from 2016 through 2032	\$ 65,385	66,060
2015 Direct Note Obligation to U.S. Bank, variable interest rate (1.80% at June 30, 2017), due on June 30, 2020	6,060	8,080
Long-term debt at par value	961,469	995,834
Premium and other on long-term debt	11,456	12,331
Other long-term debt	15,216	22,508
Total long-term debt	988,141	1,030,673
Less amounts due within one year	<u>(33,593)</u>	<u>(40,814)</u>
Total long-term debt due after one year	\$ <u>954,548</u>	<u>989,859</u>

PeaceHealth Networks and PeaceHealth are the sole members of the PeaceHealth Obligated Group. The assets of the Obligated Group are available for the satisfaction of debts of PeaceHealth and PeaceHealth Networks under the terms of its Master Trust Indenture.

The 2008 Oregon Series A-B Variable Rate Demand Bonds, the Series 2011 Oregon Series A-B Direct Placement Bonds, and the Washington 2013(A) Direct Placement Bonds have variable interest rates that may bear interest at a daily, weekly, 28-day, monthly, semiannual, or annual rates. The rate determination mode may be changed upon request of PeaceHealth and PeaceHealth Networks. The bonds are subject to optional redemption by PeaceHealth and PeaceHealth Networks, in whole or in part at 100% of the principal amount plus accrued interest. The 2008 Oregon Variable Rate Demand Bonds are backed by letters of credit in the amount of approximately \$147,607. The letter of credit for Series A-B of the 2008 Oregon bonds will expire in June 2021. The 2011 Oregon bonds are held directly by two financial institutions subject to continuing covenant agreements, which contain substantially the same credit terms as the letters of credit, but which are not subject to the same remarketing and put risk as the 2008 bonds. The 2011 Oregon bonds and Washington 2013(A) bonds can be converted to publicly held variable rate demand bonds if PeaceHealth and PeaceHealth Networks chooses. The continuing covenant agreements for the Oregon 2011 Direct Placement Bonds expire in February 2020 for Series (A) and August 2021 for Series (B). The continuing covenant agreement for the Washington 2013(A) bonds expires February 2019, and requires a minimum two-year notice period from the bank to PeaceHealth thereafter if the bank chooses to no longer hold the debt, provided that PeaceHealth is in compliance with financial covenants. With the exception of the WHCFA 2013(A) bonds, where subsequent to February 2019 the bank must give a two year notice if it wishes to terminate its holding of PeaceHealth's debt, the letters of credit and the continuing covenant agreements are extendable annually at the option of the bank upon request from PeaceHealth and PeaceHealth Networks for an additional year. The 2008, 2011 and 2013(A) bonds are matched to fixed payor swaps ranging between 3.60% and 4.10% for approximately their par value, the notional amounts of swaps amortizing proportionately to the bonds.

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The Series 2008 Oregon variable rate demand bonds, which have long-term amortization periods, may be put back to the letter of credit bank on any interest rate reset date if the bonds fail to be remarketed. In the event of a failed remarketing, the letter of credit bank is obligated under the terms of the letter of credit agreement to buy the bonds. If the bonds continue to fail to be remarketed, and become a term loan from the letter of credit bank to the Corporation, the payments commence not less than 367 days after the purchase of the bonds by the letter of credit bank, and are payable in equal quarterly installments thereafter for a period of three years.

Other long-term debt includes \$15,216 in capital leases and other debt.

Scheduled principal payments of long-term debt, excluding the premium on bonds, as due according to their original long-term amortization schedule and other debt according to its original maturity schedule for the next five years and thereafter are as follows:

	<u>Long-term debt</u>	<u>Capitalized leases and other</u>	<u>Total</u>
Year ending June 30:			
2018	\$ 30,620	3,568	34,188
2019	103,570	3,452	107,022
2020	30,791	858	31,649
2021	80,993	475	81,468
2022	31,879	475	32,354
Thereafter	<u>683,616</u>	<u>8,937</u>	<u>692,553</u>
Total	\$ <u>961,469</u>	17,765	979,234
Less amounts representing interest		<u>(2,549)</u>	(2,549)
Present value of net minimum capital lease payments		15,216	
Less current installments of obligations under capital leases		<u>(2,973)</u>	
Obligations under capital leases, excluding current installments		\$ <u>12,243</u>	
Total long-term debt			\$ <u>976,685</u>

The PeaceHealth Master Trust Indenture, the loan agreements and other contractual documents under which bonds were issued include covenants which, among others, obligate PeaceHealth and PeaceHealth Networks to: maintain net patient service revenue at levels sufficient to achieve specified debt service coverage ratios; meet certain financial tests before additional debt can be incurred; and meet certain financial tests before there can be any significant disposition of property.

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Cash paid for interest totaled approximately \$31,279 and \$31,357 for the years ended June 30, 2017 and 2016, respectively. Interest totaling approximately \$31 and \$238 was capitalized in connection with construction projects during the years ended June 30, 2017 and 2016, respectively.

(7) Accounting for Derivative Instruments and Hedging Activities

In accordance with the policy adopted by the board of directors, the Corporation may use interest rate swap contracts to manage its net exposure to interest rate changes in attempting to reduce its overall cost of borrowing over time. Interest rate swap contracts generally involve the exchange of fixed and floating interest rate payments without the exchange of underlying principal (the swap of fixed or floating rates are on a notional amount). The Corporation accounts for its interest rate hedging transactions in accordance with FASB ASC 815, *Derivatives and Hedging*. That standard requires that every derivative instrument be recorded on the balance sheet as either an asset or a liability measured at its estimated fair value. The interest rate swaps do not meet the criteria for hedge accounting and all changes in the valuation of the interest rate swaps are recognized in the consolidated statements of operations.

The Corporation has interest rate swap contracts outstanding as of June 30, 2017 and 2016, respectively, with a total current notional amount of approximately \$380,425 and \$384,075. The Corporation uses the fixed payer swaps to convert a portion of the outstanding variable rate bonds to fixed rates ranging from 3.50% to 4.10%. The fixed payer interest rate swaps are associated with the variable rate bonds, but have not been integrated to any of the underlying debt for the purpose of hedge accounting.

Change in valuation of interest rate swaps consists of the noncash change in the liability primarily due to changes in market bond yields, as well as the cash payments and receipts associated with the swaps, and the amortization of the accumulated hedge effectiveness included in net assets. The noncash change in the fair value of the interest rate swaps, was a decrease of \$40,838 and an increase of \$46,611 in the liability for the years ended June 30, 2017 and 2016, respectively. Net cash settlement cost for the interest rate swaps was \$13,074 and \$14,224, for the years ended June 30, 2017 and 2016, respectively. The amortization of the accumulated hedge effectiveness included in net assets was \$78 for both years ended June 30, 2017 and 2016.

Derivative instruments are recorded at fair value taking into consideration the Corporation's nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. The impact of taking into account the nonperformance risk on the estimated fair value of the interest rate swaps was a benefit of approximately \$13,557 and \$22,251, as of June 30, 2017 and 2016, respectively. Recording the interest rate swaps at fair value results in a total liability of \$113,089 and \$153,927 as of June 30, 2017 and 2016, respectively, in other long-term liabilities in the accompanying consolidated balance sheets rather than the \$126,646 and \$176,178 that would be paid if all of the swaps were terminated as of June 30, 2017 and 2016, respectively. The inputs used to determine the impact of the counterparty nonperformance risk are Level 2 inputs; as such derivative liabilities have been recorded as Level 2 in the Corporation's disclosure of fair value instruments, see note 4.

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The Corporation currently has four swap counterparties which minimize counterparty risk and collateral posting requirements. These swap agreements contain various credit thresholds that if breached by the Corporation would constitute an additional termination event whereby the swap counterparties could terminate the swap by either making a payment to, or receiving a payment from the Corporation, depending upon the termination value of the swaps as of the date of termination. The Corporation retains the right to terminate the swaps at any point, which would also require either making or receiving a payment depending on the termination value of the swap as of the termination date.

(8) Benefit Plans

Defined-Benefit Pension Plan

The Corporation sponsors a noncontributory defined-benefit pension plan, the Southwest Washington Health System Retirement Plan, now known as PeaceHealth SWHS Frozen DB Pension Plan (the Plan) effective January 30, 2015, covering all employees at PeaceHealth Southwest Medical Center who meet requirements as specified in the Plan. The assets of the Plan are available to pay the benefits of all eligible employees of the Plan. The Plan has two benefit structures that include a cash balance and a final average pay structure. Effective December 31, 2010, the Plan was frozen. No new participants are admitted to the Plan after this date. This event did not terminate the Plan. Benefits earned before the plan was frozen will continue to be paid as participants qualify to receive benefits.

A plan amendment was made effective December 31, 2016 to spin off a group of participants into PeaceHealth SWHS Frozen DB Pension Plan II. As of that date, the Plan was renamed PeaceHealth SWHS Frozen DB Pension Plan I. The PeaceHealth SWHS Plan I and Plan II are collectively "the Plans." Plan provisions are identical between the Plans. The plan split was effective January 1, 2017.

The following table sets forth disclosures related to the Plans in accordance with FASB ASC 715-20-65, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, as of June 30, 2017 and 2016, measured as of January 1, 2017 and January 1, 2016, respectively:

	Years ended June 30	
	2017	2016
Change in projected benefit obligation:		
Projected benefit obligation (PBO) at beginning of period	\$ 265,238	238,423
Service cost	2,000	1,565
Interest cost	7,445	10,070
Actuarial loss on PBO	(14,354)	27,462
Benefits and administrative expenses paid	(10,269)	(12,282)
Projected benefit obligation at June 30	<u>\$ 250,060</u>	<u>265,238</u>

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

	Years ended June 30	
	2017	2016
Change in fair value of plan assets:		
Fair value of assets at beginning of period	\$ 160,667	175,931
Actual return on plan assets	21,911	(2,982)
Employer contribution	8,700	—
Benefits paid	(7,923)	(10,828)
Administrative expenses	(2,346)	(1,454)
Fair value of assets at June 30	<u>\$ 181,009</u>	<u>160,667</u>
Reconciliation of funded status:		
Funded status	<u>\$ (69,050)</u>	<u>(104,570)</u>
Net amount recognized	<u>\$ (69,050)</u>	<u>(104,570)</u>
Amounts recognized in the consolidated balance sheets consist of:		
Accrued pension liability	\$ 69,050	104,570
Accumulated change in net assets	(42,391)	(77,911)

The accumulated benefit obligation for the Plans was \$250,060 and \$265,238 at June 30, 2017 and 2016, respectively.

Net periodic benefit cost for the years ended June 30, 2017 and 2016 included the following components and is included in payroll taxes and benefits in the accompanying consolidated statements of operations and changes in net assets:

	2017	2016
Service cost	\$ 2,000	1,565
Interest cost	7,445	10,070
Expected return on plan assets	(12,301)	(12,668)
Amortization of loss	7,031	5,056
Net periodic pension cost	<u>\$ 4,175</u>	<u>4,023</u>

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

(a) Assumptions

The Corporation used the following actuarial assumptions to determine its benefit obligations at June 30, 2017 and 2016, with measurement dates of June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Discount rate	Plan I 3.70% and Plan II 3.63%	3.35 %

The Corporation used the following actuarial assumptions to determine its net periodic benefit cost for the years ended June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Discount rate	3.35 %	4.30 %
Expected long-term rate of return on plan assets	7.00	7.25

This discount rate is based on a proprietary yield curve tool used by the Plans' actuary, which uses a composite of high-yield, investment-grade corporate bonds, and the projected payouts from the Plans to develop an equivalent yield rate to use in determining plan liabilities.

The expected long-term rate of return on plan assets was based on the asset allocation mix and the long-term historical return for each asset class, taking into account current and expected market conditions. The actual return on pension plan assets was approximately 13.10% gain and 1.20% loss during the years ended June 30, 2017 and 2016, respectively. In the calculation of pension plan expense, the expected long-term rate of return on plan assets is applied to a calculated value of plan assets that recognizes changes in fair value over a four-year period. This practice is intended to reduce year-to-year volatility in pension expense, but it can have the effect of delaying the recognition of differences between actual returns and expected returns based on the long-term rate of return assumptions.

(b) Pension Plan Assets

The asset allocation of the Corporation's pension plan at June 30, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Equity securities	\$ 107,504	103,616
Debt securities	70,651	55,386
Other	2,854	1,665
Total	<u>\$ 181,009</u>	<u>160,667</u>

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

Pension plan assets are managed according to an investment policy adopted by the Plans' trustees. Professional investment managers are retained to manage specific asset classes and professional consulting is utilized for investment performance reporting. The primary objective of the Plans trustees is to achieve the highest possible total return commensurate with safety and preservation of capital in real, inflation-adjusted terms. The objective includes having funds invested in the long term, which protect the principal and produce returns sufficient to meet future benefit obligations. The investment policy includes an asset allocation that includes equity securities, debt securities, and cash/other investments. The target allocations are 40% bonds and 60% stocks. Assets are rebalanced quarterly when balances fall outside of the approved range for each asset class.

In accordance with FASB ASC 820, financial assets and financial liabilities measured at fair value are grouped in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to estimate fair value. These levels and the adoption of FASB ASC 820 are further discussed in note 3.

Following is a description of the valuation methodologies used for plan assets measured at fair value.

- Mutual funds, foreign stock and emerging market securities: Valued at the NAV of shares held by the Plan at year-end.
- Real Estate Investment Fund and Hedge Fund: Valued at the NAV of the underlying assets as supported by audited financial statements.

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

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

The following table sets forth by level, within the fair value hierarchy, the Plans' assets at fair value as of June 30, 2017:

Assets	Total fair value	Level 1	Level 2	Level 3
Equity securities:				
Mutual funds	\$ 60,726	60,726	—	—
Foreign stock and emerging markets	<u>46,778</u>	<u>46,778</u>	<u>—</u>	<u>—</u>
Total equity securities	<u>107,504</u>	<u>107,504</u>	<u>—</u>	<u>—</u>
Debt securities:				
Mutual funds	<u>70,651</u>	<u>70,651</u>	<u>—</u>	<u>—</u>
Total debt securities	<u>70,651</u>	<u>70,651</u>	<u>—</u>	<u>—</u>
Other securities:				
Cash and money markets	<u>1,697</u>	<u>1,697</u>	<u>—</u>	<u>—</u>
Total other securities	<u>1,697</u>	<u>1,697</u>	<u>—</u>	<u>—</u>
Total plan assets at fair value	179,852	<u><u>179,852</u></u>	<u><u>—</u></u>	<u><u>—</u></u>
Investments at NAV	<u>1,157</u>			
Total plan assets	<u><u>\$ 181,009</u></u>			

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

The following table sets forth by level, within the fair value hierarchy, the Plans' assets at fair value as of June 30, 2016:

<u>Assets</u>	<u>Total fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Equity securities:				
Mutual funds	\$ 58,384	58,384	—	—
Foreign stock and emerging markets	45,232	45,232	—	—
Total equity securities	<u>103,616</u>	<u>103,616</u>	<u>—</u>	<u>—</u>
Debt securities:				
Mutual funds	55,386	55,386	—	—
Total debt securities	<u>55,386</u>	<u>55,386</u>	<u>—</u>	<u>—</u>
Total plan assets at fair value	159,002	<u>159,002</u>	<u>—</u>	<u>—</u>
Investments at NAV	<u>1,665</u>			
Total plan assets	<u>\$ 160,667</u>			

The following table provides information regarding redemption of investments where NAV has been used as a practical expedient at June 30, 2017 and June 30, 2016:

	<u>2017</u>	<u>2016</u>
Private equity	\$ <u>1,157</u>	<u>1,665</u>
Total	\$ <u>1,157</u>	<u>1,665</u>

At June 30, 2017 and 2016, the Plans held \$1,157 and \$1,665, respectively, in alternative investments that are not actively marketed on an open exchange. These investments consist of shares or units in investment funds as opposed to direct interests in the funds' underlying holdings, which may be marketable. Due to the nature of these funds, the NAV is used as a practical expedient to measure fair value at June 30, 2017 and 2016. These private equity partnerships do not allow for periodic redemptions, but rather liquidate upon the termination date as stated in the partnership agreement. Therefore, the private equity investment is considered an illiquid investment. At June 30, 2017, the Corporation held \$1,157 of private equity limited partnerships that had a termination date of June 2019, but may be extended by up to three additional one-year periods.

(c) Cash Flows

The Corporation's policy with respect to funding the Plan is to fund at least the minimum required by the Employee Retirement Income Security Act of 1974, as amended, plus such additional amounts

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

deemed appropriate. In the start of fiscal year 2018, the Corporation contributed \$11,200 to the Plan for the Plan year ended December 31, 2016.

Benefit payments are expected to be paid as follows for the fiscal years ended June 30:

	Pension benefits
2018	\$ 11,496
2019	10,960
2020	11,599
2021	12,098
2022	12,533
2023–2027	67,225

Expected benefit payments presented above are based on actuarial estimates. Actual benefit payments may vary significantly from these estimates.

Management is not aware of any settlements or curtailments that would require additional recognition during 2017.

(9) Defined-Contribution Retirement Plans

PeaceHealth sponsors two defined-contribution retirement plans, the Southwest Washington Health System Retirement Plan and the PeaceHealth Plan. These plans cover substantially all employees of PeaceHealth meeting certain age and length of service requirements. Total defined-contribution retirement plan costs charged to operations were approximately \$74,021 and \$68,215 for the years ended June 30, 2017 and 2016, respectively, which are included in payroll taxes and benefits in the accompanying consolidated statements of operations.

PeaceHealth Deferred Compensation Plans

The estimated fair value associated with the plan assets of PeaceHealth's 457(b) and 457(f) postretirement savings plans, in the amount of approximately \$47,497 and \$41,633 at June 30, 2017 and 2016, respectively, is included in assets whose use is limited, cash and investments, with a corresponding amount included in other long-term liabilities. Contributions associated with these funds in 2017 and 2016 were \$6,812 and \$5,430, respectively, and included in payroll taxes and benefits in the accompanying consolidated statements of operations.

(10) Restricted Net Assets

Restricted net assets are those whose use by the Corporation has been limited by donor-imposed restrictions to a specific time period and/or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

Temporarily restricted net assets are available for the following purposes at June 30:

	<u>2017</u>	<u>2016</u>
Purchase of property, plant, and equipment	\$ 7,501	4,854
Hospice and indigent care	8,374	13,138
Patient care	17,394	16,616
Other	<u>26,250</u>	<u>24,152</u>
	\$ <u>59,519</u>	<u>58,760</u>

The income from permanently restricted net assets is available for the following purposes at June 30:

	<u>2017</u>	<u>2016</u>
Hospice and indigent care	\$ 3,835	3,396
Patient care operating activities	13,949	14,375
Other	<u>4,568</u>	<u>4,568</u>
	\$ <u>22,352</u>	<u>22,339</u>

Approximately \$4,448 and \$2,544 were released from restriction for capital expenditures made during 2017 and 2016, respectively.

Charitable Gift Annuities

PeaceHealth has been granted a license by the state of Washington, Office of Insurance Commissioner, to issue Charitable Gift Annuities in support of its charitable activities. The Corporation has delegated all its charitable fund raising activities to several fund-raising foundations whose net assets, held for the beneficial interest of PeaceHealth, are shown on the consolidated balance sheets of the Corporation. The liability for annuity contracts issued under the PeaceHealth license and the separately maintained reserve accounts are recorded on the books of PeaceHealth. As of June 30, 2017 and 2016, the following liabilities for annuity contracts issued under the PeaceHealth license and reserve account investments were recorded:

	<u>2017</u>	<u>2016</u>
State of Washington gift annuity liabilities (other long-term liabilities)	\$ 562	613
Gift annuity reserve accounts (other assets whose use is limited, cash and investments)	645	685

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

(11) Commitments and Contingent Liabilities

(a) *Litigation*

Various laws and regulations of federal, state, and local governments govern the healthcare industry. These laws and regulations are subject to ongoing government review and interpretation, as well as regulatory actions unknown or unasserted at this time. The Corporation is also involved in litigation and regulatory investigations arising in the normal course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Corporation's future financial position or results of operations.

(b) *Operating Leases*

The Corporation leases, for a nominal amount, the buildings and certain equipment for Ketchikan General Hospital from the City of Ketchikan, Alaska under a 10-year lease that expires in 2023.

The Corporation leases, from Skagit County Public Hospital District No. 304, the buildings and certain equipment for United General Medical Center in Sedro Woolley, Washington under a 30-year lease that expires in 2044.

Rent and lease expense future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) as of June 30, 2017 are as follows:

	Operating leases
Year ending June 30:	
2018	\$ 6,624
2019	5,053
2020	4,092
2021	3,798
2022	3,798
Later years, 2023 through 2027	<u>11,008</u>
Total minimum lease payments	<u>\$ 34,373</u>

Rent expense related to all operating leases was \$24,007 and \$24,167 during the years ended June 30, 2017 and 2016, respectively, and was included in supplies and other expenses in the consolidated statements of operations.

(c) *Collective Bargaining Agreements*

Approximately 43% and 41% of the Corporation's employees are covered under collective bargaining agreements, including nurses, professional employees, and service employees as of June 30, 2017

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

and 2016, respectively. The Corporation's various collective bargaining agreements expire between August 2017 and September 2020.

(d) Construction Commitments

The Corporation has entered into construction commitments related to open projects of approximately \$50,941 as of June 30, 2017.

(12) Insurance Coverages

The Corporation has a self-insurance program for hospital and physician professional and general liability claims under which the Corporation contributes actuarially determined amounts to a trust to fund estimated ultimate losses. In connection with the self-insurance program, the Corporation has accrued estimates for asserted and incurred but not reported claims, including both the expected liability under each claim and the cost to administer the claim. Self-insured professional and general liability retention in 2017 and 2016 was \$5,000, per occurrence and \$15,000, in aggregate. Individual general and professional liability claims in excess of the above self-insured retention levels are insured through claims-made excess insurance policy.

The Corporation also self-insures all or a portion of liabilities for medical and dental benefit plans, unemployment, and workers' compensation claims. Funding levels and liabilities are determined based on actuarial studies.

Based on actuarial studies, the Corporation has recorded a liability for all of the self-insurance programs of approximately \$104,442 and \$104,089 at June 30, 2017 and 2016, respectively. The liabilities are classified within other current liabilities and other long-term liabilities based on the historical amounts paid within one year. Total current amounts included in other current liabilities were approximately \$39,839 and \$42,221 at June 30, 2017 and 2016, respectively. Management has recorded amounts receivable from excess insurance carriers totaling approximately \$7,391 and \$6,332 as of June 30, 2017 and 2016, respectively, which is included in other receivables in the accompanying consolidated balance sheets.

The Corporation is a minority investor in American Excess Insurance Exchange (AEIX). AEIX is a risk retention group owned by a group of healthcare providers and provides them with excess professional liability insurance coverage. The Corporation accounts for its interest in AEIX on the equity method of accounting less mandatory withdrawal penalties and an estimated discount to present value. As of June 30, 2017 and 2016, the carrying value of AEIX was approximately \$3,457 and \$3,556, respectively, and is recorded in investments in joint ventures and other on the consolidated balance sheets. Investment income from AEIX is recorded as an adjustment to supplies and other operating expenses in the accompanying consolidated statements of operations.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

(13) Functional Expenses

The Corporation provides general healthcare services to residents within its geographic location. Expenses related to providing these services are as follows:

	<u>2017</u>	<u>2016</u>
Healthcare services	\$ 2,126,071	2,022,289
General and administrative	<u>289,471</u>	<u>336,149</u>
	<u>\$ 2,415,542</u>	<u>2,358,438</u>

(14) Discontinued Operations

(a) *PeaceHealth Laboratories*

On May 1, 2017, the Corporation sold PeaceHealth Laboratories, an operating division of PeaceHealth, to Quest Diagnostics Incorporated. PeaceHealth Laboratories supplied all PeaceHealth facilities with lab testing and was also a reference lab for external parties.

The results of PeaceHealth Laboratories from discontinued operations are disclosed under discontinued operations for the year ended June 30, 2017 and the comparative results have been restated accordingly. Management fees of \$14,310 and purchased services of \$61,308 for lab operations is included in continuing operations as if the lab services were received from a third-party vendor. These expenses were previously eliminated in the consolidated financial statements prior to the disposal. The significant impacts to cash flows from discontinued operations have been disclosed in the consolidated statement of cash flows.

Total gain from operations of PeaceHealth Laboratories were \$93,443 and \$1,333 for the years ended June 30, 2017 and 2016, respectively, including total gain on disposal of \$88,771 for the year ended June 30, 2017.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

The following is a reconciliation of the major classes constituting the gain from discontinued operations that is presented in the consolidated statement of operations.

	2017	2016
Operating revenues	\$ 111,896	129,508
Salaries and wages	55,160	65,475
Professional fees	23,683	29,101
Other expenses	28,626	33,783
Other income	245	184
Gain of discontinued operations related to major classes of income	4,672	1,333
Gain on the disposal of the discontinued operation	88,771	—
Total gain on discontinued operations	\$ 93,443	1,333

(b) Columbia United Providers

PeaceHealth Networks' majority-owned subsidiary, CUP, entered into an Asset Purchase Agreement to sell certain Medicaid assets to Molina Health Care of Washington, Inc. on December 31, 2015. Molina purchased the right to assume CUP's Medicaid membership in the state of Washington, as well as certain other rights and assets, including the assumption of CUP's assignable provider contracts, related to the operation of the Medicaid business. As of December 31, 2015, CUP discontinued all of its Medicaid and Individual healthcare plan coverages, and subsequently discontinued all ASO services provided to local companies. CUP withdrew its certificate of authority with the Washington State Office of the Insurance Commissioner effective April 30, 2017, and is in the final stages of the dissolution process.

The results of CUP from discontinued operations are disclosed under discontinued operations for the years ended June 30, 2017 and 2016. The significant impacts to cash flows from discontinued operations have been disclosed in the consolidated statement of cash flows. Total from operations of CUP were a gain of \$3,473 and a loss of \$4,164 for the years ended June 30, 2017 and 2016, respectively, including total gain on disposal of \$16,069 for the year ended June 30, 2016.

(15) Subsequent Events

In connection with the preparation of the consolidated financial statements in accordance with FASB ASC Topic 855, *Subsequent Events*, the Corporation has evaluated subsequent events through September 29, 2017, which is the date the consolidated financial statements were issued.

ADDITIONAL INFORMATION

PEACEHEALTH NETWORKS

Consolidating Balance Sheet Information

June 30, 2017

(In thousands)

Assets	Obligated group	PeaceHealth Southwest Foundation	Other nonobligated group	Eliminating or consolidating adjustments	PeaceHealth 2017 consolidated
Current assets:					
Cash and cash equivalents	\$ 99,301	3,417	3,039	—	105,757
Short-term investments	517,397	—	—	—	517,397
Accounts receivable, net	312,320	—	1,010	—	313,330
Other receivables	34,028	—	(22)	(1,749)	32,257
Inventory of supplies	41,147	—	235	—	41,382
Prepaid expenses and other	25,228	—	29	—	25,257
Assets whose use is limited that are required for current liabilities	22,002	1,115	—	—	23,117
Total current assets	<u>1,051,423</u>	<u>4,532</u>	<u>4,291</u>	<u>(1,749)</u>	<u>1,058,497</u>
Assets whose use is limited and indenture agreements:					
Cash and investments	1,364,740	15,868	1,315	—	1,381,923
Investment in affiliates	14,404	—	—	(14,404)	—
Investments in joint ventures and other	13,422	5,370	15,064	(8,346)	25,510
Total assets whose use is limited	<u>1,392,566</u>	<u>21,238</u>	<u>16,379</u>	<u>(22,750)</u>	<u>1,407,433</u>
Less current portion	<u>(22,002)</u>	<u>(1,115)</u>	<u>—</u>	<u>—</u>	<u>(23,117)</u>
Net assets whose use is limited	<u>1,370,564</u>	<u>20,123</u>	<u>16,379</u>	<u>(22,750)</u>	<u>1,384,316</u>
Property, plant, and equipment:					
Land and improvements	140,111	—	—	—	140,111
Buildings, fixed equipment, and other	1,736,230	—	29,685	(22,347)	1,743,568
Moveable equipment	879,077	—	2,677	—	881,754
Construction in progress	15,691	—	—	—	15,691
Total property, plant, and equipment	<u>2,771,109</u>	<u>—</u>	<u>32,362</u>	<u>(22,347)</u>	<u>2,781,124</u>
Less accumulated depreciation	<u>(1,524,043)</u>	<u>—</u>	<u>(14,085)</u>	<u>5,230</u>	<u>(1,532,898)</u>
Net property, plant, and equipment	<u>1,247,066</u>	<u>—</u>	<u>18,277</u>	<u>(17,117)</u>	<u>1,248,226</u>
Interest in net assets of related foundations	87,434	80	—	(24,158)	63,356
Other assets	34,086	—	3,650	—	37,736
Total assets	<u>\$ 3,790,573</u>	<u>24,735</u>	<u>42,597</u>	<u>(65,774)</u>	<u>3,792,131</u>

PEACEHEALTH NETWORKS

Consolidating Balance Sheet Information

June 30, 2017

(In thousands)

Liabilities and Net Assets	Obligated group	PeaceHealth Southwest Foundation	Other nonobligated group	Eliminating or consolidating adjustments	PeaceHealth 2017 consolidated
Current liabilities:					
Accounts payable	\$ 95,757	—	730	—	96,487
Accrued payroll, payroll taxes, and employee benefits	156,716	—	64	—	156,780
Accrued interest payable	4,356	—	—	—	4,356
Other current liabilities	43,902	—	3	—	43,905
Reimbursement settlements payable	34,518	—	—	(925)	33,593
Current portion of long-term debt	—	—	—	—	—
Total current liabilities	335,249	—	797	(925)	335,121
Other long-term liabilities	317,748	—	10,051	—	327,799
Long-term debt, net of current portion	965,679	—	8,346	(19,477)	954,548
Net assets:					
Unrestricted, controlling	2,090,586	6,515	19,846	(27,712)	2,089,235
Unrestricted, noncontrolling interest	3	—	3,557	(3)	3,557
Temporarily restricted	59,162	9,248	—	(8,891)	59,519
Permanently restricted	22,146	8,972	—	(8,766)	22,352
Total net assets	2,171,897	24,735	23,403	(45,372)	2,174,663
Total liabilities and net assets	\$ 3,790,573	24,735	42,597	(65,774)	3,792,131

See accompanying independent auditors' report.

PEACEHEALTH NETWORKS

Consolidating Statement of Operations Information

Year ended June 30, 2017

(In thousands)

	<u>Obligated group</u>	<u>PeaceHealth Southwest Foundation</u>	<u>Other nonobligated group</u>	<u>Eliminating or consolidating adjustments</u>	<u>PeaceHealth 2017 consolidated</u>
Revenues:					
Net patient service revenue before provision for bad debts	\$ 2,427,840	—	6,221	—	2,434,061
Provision for bad debts	<u>(50,238)</u>	—	<u>(20)</u>	—	<u>(50,258)</u>
Net patient service revenue	2,377,602	—	6,201	—	2,383,803
Other operating revenue	<u>87,965</u>	<u>957</u>	<u>10,620</u>	<u>(11,296)</u>	<u>88,246</u>
Total revenues	<u>2,465,567</u>	<u>957</u>	<u>16,821</u>	<u>(11,296)</u>	<u>2,472,049</u>
Expenses:					
Salaries and wages	1,183,205	—	1,701	—	1,184,906
Payroll taxes and benefits	231,228	—	374	—	231,602
Supplies	356,701	—	2,052	—	358,753
Purchased services	264,881	—	894	—	265,775
Other	200,106	1,021	233	—	201,360
Depreciation and amortization of other assets	141,188	—	1,375	(739)	141,824
Interest and amortization of deferred financing costs	<u>32,051</u>	—	<u>739</u>	<u>(1,468)</u>	<u>31,322</u>
Total expenses	<u>2,409,360</u>	<u>1,021</u>	<u>7,368</u>	<u>(2,207)</u>	<u>2,415,542</u>
Income (loss) from operations	<u>56,207</u>	<u>(64)</u>	<u>9,453</u>	<u>(9,089)</u>	<u>56,507</u>
Other income (loss):					
Investment income, net	137,795	539	—	(738)	137,596
Net change in interest rate swaps	27,685	—	—	—	27,685
Other	<u>(69)</u>	—	—	—	<u>(69)</u>
Total other income (loss):	<u>165,411</u>	<u>539</u>	<u>—</u>	<u>(738)</u>	<u>165,212</u>
Excess (deficit) of revenues over expenses from continued operations	<u>221,618</u>	<u>475</u>	<u>9,453</u>	<u>(9,827)</u>	<u>221,719</u>
Discontinued operations (note 14):					
Gain from operations (including gain on disposal of \$88,771)	93,443	—	3,323	150	96,916
Total gain on discontinued operations	<u>93,443</u>	<u>—</u>	<u>3,323</u>	<u>150</u>	<u>96,916</u>
Excess (deficit) of revenues over expenses	315,061	475	12,776	(9,677)	318,635
Net assets released from restrictions for property, plan, and equipment					
Change in interest in net assets of related foundations	4,448	—	—	—	4,448
Change in pension liability	451	—	—	(463)	(12)
Other changes in net assets	26,820	—	—	—	26,820
Other changes in net assets	<u>3,656</u>	—	<u>(24,460)</u>	<u>29,233</u>	<u>8,429</u>
Increase (decrease) in unrestricted net assets	<u>\$ 350,436</u>	<u>475</u>	<u>(11,684)</u>	<u>19,093</u>	<u>358,320</u>

See accompanying independent auditors' report.

PEACEHEALTH NETWORKS

Consolidating Statement of Changes in Net Assets Information

Year ended June 30, 2017

(In thousands)

	<u>Obligated group</u>	<u>PeaceHealth Southwest Foundation</u>	<u>Other nonobligated group</u>	<u>Eliminating or consolidating adjustments</u>	<u>PeaceHealth 2017 consolidated</u>
Net assets at June 30, 2016	\$ 1,816,250	24,350	35,092	(60,121)	1,815,571
Excess (deficit) of revenues over expenses from continued operations	221,618	475	9,453	(9,827)	221,719
Other restricted contributions	3,915	—	—	—	3,915
Net assets released from restrictions	—	(928)	—	—	(928)
Transfer (to) from related division	(232)	—	232	—	—
Change in interest in net assets of related foundations	6,171	—	—	(326)	5,845
Change in pension liability	26,820	—	—	—	26,820
Other changes in net assets	3,911	836	(24,695)	24,753	4,805
Change in net assets before discontinued operations	262,203	383	(15,010)	14,600	262,176
Discontinued operations (note 14)	93,443	—	3,323	150	96,916
Change in net assets	355,646	383	(11,687)	14,750	359,092
Net assets at June 30, 2017	\$ <u>2,171,896</u>	<u>24,733</u>	<u>23,405</u>	<u>(45,371)</u>	<u>2,174,663</u>

See accompanying independent auditors' report.