



**PEACEHEALTH NETWORKS**

Consolidated Financial Statements

June 30, 2018 and 2017

(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, 2018 and 2017, and the related consolidated statements of operations and changes in unrestricted net assets, 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, 2018 and 2017, 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 audits were 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 24, 2018

**PEACEHEALTH NETWORKS**

Consolidated Balance Sheets

June 30, 2018 and 2017

(In thousands)

<b>Assets</b>	<b>2018</b>	<b>2017</b>
Current assets:		
Cash and cash equivalents	\$ 53,467	105,757
Short-term investments	932,732	517,397
Accounts receivable, net of allowance for doubtful accounts of \$86,994 and \$71,981	336,762	313,330
Other receivables	46,651	32,257
Inventory of supplies	43,403	41,382
Prepaid expenses and other	27,053	25,257
Assets whose use is limited that are required for current liabilities	8,358	23,117
Total current assets	1,448,426	1,058,497
Assets whose use is limited:		
Cash and investments	1,221,259	1,381,923
Investments in joint ventures and other	26,143	25,510
Total assets whose use is limited	1,247,402	1,407,433
Less current portion	(8,358)	(23,117)
Net assets whose use is limited	1,239,044	1,384,316
Property, plant, and equipment:		
Land and improvements	141,984	140,111
Buildings, fixed equipment, and other	1,756,173	1,743,568
Moveable equipment	822,297	881,754
Construction in progress	60,034	15,691
Total property, plant, and equipment	2,780,488	2,781,124
Less accumulated depreciation	(1,559,368)	(1,532,898)
Net property, plant, and equipment	1,221,120	1,248,226
Interest in net assets of related foundations	72,375	63,356
Other assets	36,967	37,736
Total assets	\$ 4,017,932	3,792,131

**PEACEHEALTH NETWORKS**

Consolidated Balance Sheets

June 30, 2018 and 2017

(In thousands)

<b>Liabilities and Net Assets</b>	<b>2018</b>	<b>2017</b>
Current liabilities:		
Accounts payable	\$ 112,642	96,487
Accrued payroll, payroll taxes, and employee benefits	150,326	156,780
Accrued interest payable	4,328	4,356
Other current liabilities	34,051	43,905
Pending trades payable	77,021	—
Current portion of long-term debt	106,282	33,593
Total current liabilities	<u>484,650</u>	<u>335,121</u>
Other long-term liabilities	284,924	327,799
Long-term debt, net of current portion	847,397	954,548
Net assets:		
Unrestricted, controlling	2,301,885	2,089,235
Unrestricted, noncontrolling interest	4,569	3,557
Temporarily restricted	71,779	59,519
Permanently restricted	22,728	22,352
Total net assets	<u>2,400,961</u>	<u>2,174,663</u>
Total liabilities and net assets	<u>\$ 4,017,932</u>	<u>3,792,131</u>

See accompanying notes to consolidated financial statements.

**PEACEHEALTH NETWORKS**

Consolidated Statements of Operations and Changes in Unrestricted Net Assets

Years ended June 30, 2018 and 2017

(In thousands)

	<u>2018</u>	<u>2017</u>
Revenues:		
Net patient service revenue before provision for bad debts	\$ 2,618,321	2,434,061
Provision for bad debts	<u>(71,837)</u>	<u>(50,258)</u>
Net patient service revenue	2,546,484	2,383,803
Other operating revenue	<u>79,792</u>	<u>88,246</u>
Total revenues	<u>2,626,276</u>	<u>2,472,049</u>
Expenses:		
Salaries and wages	1,260,688	1,184,906
Payroll taxes and benefits	256,526	231,602
Supplies	398,375	358,753
Purchased services	221,679	265,775
Other	227,645	201,360
Depreciation and amortization of other assets	139,069	141,824
Interest and amortization of deferred financing costs	<u>31,898</u>	<u>31,322</u>
Total expenses	<u>2,535,880</u>	<u>2,415,542</u>
Income from operations	<u>90,396</u>	<u>56,507</u>
Other income (expense):		
Investment return, net	93,030	137,596
Net change in interest rate swaps	10,219	27,685
Other	<u>(1,501)</u>	<u>(69)</u>
Total other income:	<u>101,748</u>	<u>165,212</u>
Excess of revenues over expenses from continued operations	<u>192,144</u>	<u>221,719</u>
Discontinued operations (note 14):		
Gain from operations (including gain on disposal of \$899 and \$88,771, in 2018 and 2017, respectively)	<u>4,949</u>	<u>96,916</u>
Total gain on discontinued operations	<u>4,949</u>	<u>96,916</u>
Excess of revenues over expenses	197,093	318,635
Net assets released from restrictions for property, plant, and equipment	3,095	4,448
Change in interest in net assets of related foundations	—	(12)
Change in pension liability	15,216	26,820
Other changes in unrestricted net assets	<u>(1,742)</u>	<u>8,429</u>
Increase in unrestricted net assets	<u>\$ 213,662</u>	<u>358,320</u>

See accompanying notes to consolidated financial statements.

**PEACEHEALTH NETWORKS**

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2018 and 2017

(In thousands)

	<b>Unrestricted controlling</b>	<b>Unrestricted noncontrolling interest</b>	<b>Temporarily restricted</b>	<b>Permanently restricted</b>	<b>Total</b>
Net assets at June 30, 2016	\$ 1,730,006	4,466	58,760	22,339	1,815,571
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	2,089,235	3,557	59,519	22,352	2,174,663
Excess of revenues over expenses from continued operations	191,456	688	—	—	192,144
Other restricted contributions	—	—	3,274	—	3,274
Net assets released from restrictions	3,095	—	(4,283)	—	(1,188)
Change in interest in net assets of related foundations	—	—	9,002	26	9,028
Change in pension liability	15,216	—	—	—	15,216
Other changes in net assets	(1,742)	—	4,267	350	2,875
Change in net assets before discontinued operations	208,025	688	12,260	376	221,349
Discontinued operations (note 14)	4,625	324	—	—	4,949
Change in net assets	212,650	1,012	12,260	376	226,298
Net assets at June 30, 2018	\$ 2,301,885	4,569	71,779	22,728	2,400,961

See accompanying notes to consolidated financial statements.

**PEACEHEALTH NETWORKS**

Consolidated Statements of Cash Flows

Years ended June 30, 2018 and 2017

(In thousands)

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:		
Change in net assets	\$ 226,298	359,092
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	139,384	142,115
Loss on sale of land held for sale and property, plant, and equipment	260	95
Provision for bad debts	71,837	50,258
Change in pension liability	(15,216)	(26,820)
Restricted contributions	(3,274)	(3,915)
Net change in unrealized losses on investments	(1,616)	6,528
Realized gains on investments	(55,508)	(116,902)
Valuation adjustments on swap arrangements	(21,174)	(40,838)
Vesting of Premier Class B units	(5,892)	(6,049)
Increase in interest in net assets of related foundations	(9,028)	(5,845)
Equity earnings on investments, net	1,404	(1,297)
Gain on sale of discontinued operations	899	(88,771)
Changes in operating assets and liabilities:		
Increase (decrease) in:		
Accounts receivable, net	(95,269)	(43,928)
Other assets	(18,756)	1,866
Increase (decrease) in:		
Accounts payable	16,155	(10,281)
Accrued payroll, payroll taxes, and employee benefits	(6,454)	(17,415)
Other liabilities	(16,367)	(15,815)
Net cash provided by operating activities	<u>207,683</u>	<u>182,078</u>
Cash flows from investing activities:		
Purchase of property, plant, and equipment	(111,310)	(51,540)
Proceeds from sale of discontinued operations	—	106,503
Proceeds from sale of land held for sale and property, plant, and equipment	96	38
Purchase of alternative investments	(204,293)	—
Purchases/Sales of investments, net	<u>86,722</u>	<u>(338,395)</u>
Net cash used in investing activities	<u>(228,785)</u>	<u>(283,394)</u>
Cash flows from financing activities:		
Principal payments on long-term debt	(34,462)	(42,823)
Proceeds from restricted contributions	<u>3,274</u>	<u>3,915</u>
Net cash used in financing activities	<u>(31,188)</u>	<u>(38,908)</u>
Net decrease in cash and cash equivalents	(52,290)	(140,224)
Cash and cash equivalents at beginning of year	<u>105,757</u>	<u>245,981</u>
Cash and cash equivalents at end of year	\$ <u>53,467</u>	<u>105,757</u>

See accompanying notes to consolidated financial statements.

## PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(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; 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. 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, 2018, the following regional healthcare delivery systems and operating divisions are 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

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

## PEACEHEALTH NETWORKS

### Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

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, 2018:

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.

### (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. The Corporation held cash equivalents of approximately \$53,467 and \$24,111 as of June 30, 2018 and 2017, 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.

### (c) *Short-Term Investments*

Short-term investments consist primarily of certificates of deposit, U.S. government, and other investment-grade securities. The maturities of these related securities can exceed one year. Management anticipates the securities will be liquidated within one year. 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.

## PEACEHEALTH NETWORKS

### Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

#### **(e) Other Receivables**

Other receivables primarily consist of amounts receivable from the Oregon Hospital Assessment Program and the Washington State Safety Net Assessment Program, 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, 2018 and 2017. These items consist primarily of investments in marketable equity and fixed income securities. Investment income or loss (including realized and unrealized gains and losses and interest and dividends) is included in the excess of revenues over expenses.

PeaceHealth accounts for its investments on a trade-date basis. Investment sales and purchases initiated prior to the consolidated balance sheet date and settled subsequent to the consolidated balance sheet date result in amounts due from and to brokers. Changes in these assets and liabilities represent noncash investing activities excluded from the consolidated statement of cash flows. As of June 30, 2018, PeaceHealth recorded payables of \$77,021 for investments purchased but not settled as pending trades payable in the accompanying consolidated balance sheets.

#### **(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 are 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 year ended June 30, 2018 or 2017.

The Corporation capitalized salary and wages along with related benefit costs in the amount of \$721 and \$2,146 during 2018 and 2017, respectively, related to the development of software for internal use.

The Corporation has entered into construction commitments related to open projects of approximately \$76,592 as of June 30, 2018.

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### Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

#### **(h) Depreciation**

Depreciation on property, plant, and equipment are 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 trade names and goodwill. Intangible assets with indefinite lives are evaluated annually for impairment. There were no impairment losses recognized during the year ended June 30, 2018 or 2017.

#### **(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 \$91,915 and \$113,089 at June 30, 2018 and 2017, respectively; the liability for the PeaceHealth SWHS Frozen DB Pension Plan of \$42,634 and \$69,050 at June 30, 2018 and 2017, respectively; and the long-term portion of the liability for the self-insurance programs of \$64,055 and \$64,603 at June 30, 2018 and 2017, respectively. The remaining balance of other long-term liabilities includes environmental liability, gift annuities, and deferred compensation plan 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 \$19,898 and \$19,365 recorded as other long-term liabilities as of June 30, 2018 and 2017, respectively. The Corporation recognized \$564 and \$540 in 2018 and 2017, respectively, related to amortization. Amortization is recognized over the life of the related asset.

The Corporation has created several pooled income funds. 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, 2018 and 2017, the Corporation has recorded the present value of the annuity payments of \$10,057 and \$10,051, respectively, as part of other long-term liabilities. The discount rate ranged from 6.2% to 6.8% at June 30, 2018 and 6.1% to 6.7% at June 30, 2017.

## PEACEHEALTH NETWORKS

### Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

#### **(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.

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) 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>2018</u>	<u>2017</u>
Medicare	38 %	39 %
Medicaid	14	14
Commercial and other	44	46
Private pay	4	1
	<u>100 %</u>	<u>100 %</u>

**PEACEHEALTH NETWORKS**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

There is a corresponding significant concentration of credit risk in net accounts receivable balances at June 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Medicare	28 %	28 %
Medicaid	11	10
Commercial and other	60	61
Private pay	<u>1</u>	<u>1</u>
	<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 a decrease in net patient service revenue of approximately \$3,309 and increase of \$2,100 in 2018 and 2017, 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 for specific quality outcomes, effective management of costs, and other measures, and in some cases may result in a penalty.

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### Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

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 co-payments 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 2018 and 2017 were \$56,824 and \$59,553, respectively.

The Corporation's allowance for doubtful accounts increased from 8.1% of total accounts receivable at June 30, 2017 to 8.4% of accounts receivable at June 30, 2018. The Corporation does not maintain a material allowance for doubtful accounts from third-party payors nor did it incur significant write-offs related to third-party payors.

#### **(n) 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.

#### **(o) Income from Operations**

Income 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.

#### **(p) Excess of Revenues over Expenses**

Excess of revenues over expenses includes results from the Corporation's operating and nonoperating investing activities. Investment income includes interest income, dividends, and realized and unrealized investment gains and losses. Changes in unrestricted net assets not included in excess 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.

#### **(q) 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.

## PEACEHEALTH NETWORKS

### Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

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.

**(r) Oregon Hospital Assessment Program and Washington State Safety Net Assessment Program**

In the States of Oregon and Washington, PeaceHealth is subject to a provider tax program on certain patient service revenues at qualifying hospitals to increase funding from other sources and obtain additional Federal funds to support increased payments to providers for Medicaid services. These programs resulted in assessments paid to the States and enhanced supplemental payments paid to PeaceHealth in the way of lump-sum payment and per claim increases. In 2018 and 2017, these programs resulted in supplemental payments of \$90,781 and \$76,987, respectively, recorded in net patient service revenue, and assessments of \$81,873 and \$66,541, respectively, recorded in other expenses in the accompanying consolidated statements of operations and changes in unrestricted net assets.

**(s) 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.

**(t) Recently Adopted or Newly Issued Accounting Standards**

In May 2014, the 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. generally accepted accounting principles and International Financial Reporting Standards. 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 has evaluated the impact of ASU No. 2014-09, including the methods of implementation, which is effective for the fiscal year beginning on July 1, 2018. Management will include new disclosures for the fiscal year beginning on July 1, 2018 in accordance with ASC Topic 606. The adoption of ASC Topic 606 will not have a significant impact on the Corporation's results of operations.

In February 2016, the FASB issued ASU No. 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 No. 2016-02, which is effective for the fiscal year beginning on July 1, 2019 with retrospective application to the earliest presented period.

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In August 2016, the FASB issued ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities (Topic 958)*, 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 restrictions*; (B) requires all Not for Profit entities (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 has evaluated the impact of ASU No. 2016-14, including the methods of implementation, which will be implemented in the fiscal year beginning July 1, 2018. The impact of adoption will result in enhanced disclosures about the classifications of expenses and management of liquid resources.

In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. This ASU contains the following key aspects relevant to not-for-profit entities: (A) entities must measure equity investments with readily determinable fair values at fair value and recognize changes in fair value in net income; (B) entities have the option to either measure equity investments without readily determinable fair values at fair value or at cost adjusted for changes in observable prices minus impairment. Changes in measurement under either alternative must be recognized in net income; and (C) entities that elect the fair value option for financial liabilities must recognize changes in fair value related to instrument-specific credit risk in other comprehensive income. In addition, the standard allows not-for-profit entities to early adopt a provision that eliminates previously required disclosures of the fair values of financial instruments measured at amortized cost. The Corporation has evaluated the full impact of ASU No. 2016-001, including the methods of implementation, which is effective for the year beginning July 1, 2018. The Corporation adopted the provision which exempts all not-for-profit entities from the requirement to disclose the fair value of financial instruments measured at amortized cost effective for the year beginning on July 1, 2017. The adoption of this provision resulted in an amendment of the disclosure for the year ended June 30, 2017, as the elimination of the fair value of debt has been retrospectively applied. The other provisions of the ASU will not have a significant impact on the Corporation's financial assets and liabilities.

In March 2017, the FASB issued ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, which requires a company to present service cost separately from the other components of net benefit cost. This ASU is effective for the Corporation's year beginning July 1, 2019, with early adoption permitted. The Corporation is currently evaluating the extent of the anticipated impact of the adoption of ASU No. 2017-07. As a result of the adoption of the ASU, the Corporation will modify its financial statements and disclosures, including a retrospective reclassification of prior year balances.

In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which requires that a statement of cash flows explain the change during the reporting period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the

## PEACEHEALTH NETWORKS

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beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments in this update are effective for the Corporation's fiscal year beginning July 1, 2019. Early adoption is permitted. The Corporation is currently evaluating the extent of the anticipated impact of the adoption of ASU No. 2016-18.

### (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 value measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety. In accordance with ASU No. 2015-07 *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, investments valued utilizing net asset value (NAV) as a practical expedient are excluded from the hierarchy.

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.

Registered mutual funds and money market funds are classified in Level 1 of the fair value hierarchy as defined above because their fair values are based on quoted prices for identical securities.

The common/collective trusts have been determined to trade daily on an active private exchange at NAV as the trading price and are classified in Level 1 of the fair value hierarchy as defined above because their fair values are based on quoted prices for identical securities.

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. Investments in hedge funds, pooled investment funds, and private equity investments are carried at estimated fair value using NAV as a practical expedient as determined by the external investment manager. 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

## **PEACEHEALTH NETWORKS**

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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.

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, excluding joint ventures, which are accounted for under the equity method of accounting

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**(4) Investments**

The composition of cash and investments carried at fair value on a recurring basis at June 30, 2018 is set forth in the following table:

	<u>June 30, 2018</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:				
Cash and cash equivalents	\$ 70,697	70,697	—	—
Fixed income:				
Government, municipal, foreign and other	412,852	—	412,852	—
Mortgage and asset backed securities	53,286	—	53,286	—
Corporate obligations	175,948	—	175,948	—
Mutual funds:				
Equity	141,814	141,814	—	—
Common/collective trusts	25,711	—	25,711	—
Other short-term investments	724	—	724	—
<b>Total</b>	<b>881,032</b>	<b>212,511</b>	<b>668,521</b>	<b>—</b>
Designated for capital acquisition:				
Cash and cash equivalents	7,322	7,322	—	—
Fixed income:				
Government, municipal, foreign and other	87,556	—	87,556	—
Mortgage and asset backed securities	28,247	—	28,247	—
Corporate obligations	54,679	—	54,679	—
Mutual funds:				
Fixed income	25,037	25,037	—	—
Domestic equities	450,402	450,402	—	—
International equities	343,414	343,414	—	—
Other long-term equity investments	11,011	10,857	154	—
<b>Total</b>	<b>1,007,668</b>	<b>837,032</b>	<b>170,636</b>	<b>—</b>
Funds designated for 457 plans:				
Cash and short term investments	1,397	1,397	—	—
Mutual funds	51,565	51,565	—	—
<b>Total</b>	<b>52,962</b>	<b>52,962</b>	<b>—</b>	<b>—</b>

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	<u>June 30, 2018</u>	<b>Fair value measurements at reporting date using</b>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Trustee-held funds:				
Cash and cash equivalents	\$ 1,545	1,545	—	—
Total	<u>1,545</u>	<u>1,545</u>	<u>—</u>	<u>—</u>
Total assets at fair value	1,943,207	1,104,050	839,157	—
Investments measured at NAV:				
Hedge funds	155,812			
Pooled investment funds – other	48,485			
Private equity	<u>6,487</u>			
Total assets	\$ <u>2,153,991</u>			
Liabilities:				
Interest rate swaps	\$ 91,915	—	91,915	—
Total liabilities	\$ <u>91,915</u>	<u>—</u>	<u>91,915</u>	<u>—</u>

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>	<b>Fair value measurements at reporting date using</b>		
		<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	<u>724</u>	<u>—</u>	<u>724</u>	<u>—</u>
Total	<u>517,397</u>	<u>69,934</u>	<u>447,463</u>	<u>—</u>
Designated for capital acquisition:				
Cash and cash equivalents	10,505	10,505	—	—
Fixed income	<u>314,644</u>	<u>—</u>	<u>314,644</u>	<u>—</u>

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	<u>June 30, 2017</u>	<b>Fair value measurements at reporting date using</b>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Mutual funds:				
Fixed income	\$ 165,730	165,730	—	—
Domestic equities	473,747	473,747	—	—
International equities	225,592	225,592	—	—
Other long-term equity investments	35,129	34,975	154	—
Total	<u>1,225,347</u>	<u>910,549</u>	<u>314,798</u>	<u>—</u>
Funds designated for 457 plans:				
Cash and short term investments	1,488	1,488	—	—
Mutual funds	46,009	46,009	—	—
Total	<u>47,497</u>	<u>47,497</u>	<u>—</u>	<u>—</u>
Trustee-held funds:				
Cash and cash equivalents	13,678	13,678	—	—
Fixed income	4,081	—	4,081	—
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	<u>1,891,434</u>	<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 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, 2018 and 2017. 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, 2018

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and 2017, the Corporation held \$6,487 and \$7,886, respectively, of private equity and distressed debt limited partnerships that had termination dates that ranged from 2017 to 2023.

	<b>2018</b>	<b>2017</b>	<b>Unfunded commitments</b>
Distressed debt	\$ 1,384	1,698	1,899
Private equity	5,103	6,188	938
Total	\$ 6,487	7,886	2,837

The following table summarizes investments measured at fair value based on NAV per share as of June 30, 2018 and their redemption restrictions:

	<b>Fair value at June 30, 2018</b>	<b>Lockup terms or redemption restrictions</b>	<b>Redemption frequency</b>	<b>Redemption notice period</b>
Hedge funds	\$ 6,904	Minimum redemption \$1,000,000	Monthly	3 days
Pooled investment funds	48,485	None	Monthly	5 days
Hedge funds	33,993	None	Monthly	10 days
Hedge funds	15,763	None	Monthly	30 days
Hedge funds	15,573	Gate at 20% of total fund net assets	Monthly	60 days
Hedge funds	7,229	None	Monthly	75 days
Hedge funds	34,285	None	Semi-monthly	30 days
Hedge funds	15,624	Gate at 50% of total fund net assets	Quarterly	60 days
Hedge funds	15,429	Gate at 10%	Quarterly	65 days
		Withdrawal limits across four successive withdrawal dates	Quarterly	90 days
Hedge funds	11,012			
	\$ 204,297			

Investment income is comprised of the following for the years ended June 30, 2018 and 2017:

	<b>2018</b>	<b>2017</b>
Interest and dividend income	\$ 35,906	27,222
Net realized gains on sales of investments	55,508	116,902
Net change in unrealized gains on investments	1,616	(6,528)
Investment income, net	\$ 93,030	137,596

#### *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. Health Venture's ownership interest in the joint ventures ranged from approximately 24.2% to 50.0% at both June 30, 2018 and 2017, respectively. As

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of June 30, 2018 and 2017, the carrying value of the joint ventures was approximately \$14,518 and \$15,064, respectively, and is recorded in investments in joint ventures and other on the consolidated balance sheets. Equity earnings from the joint ventures of \$9,744 and \$8,200 for the years ended June 30, 2018 and 2017, respectively, is included in other operating revenue. The unaudited assets, liabilities, and equity of these joint ventures accounted for under the equity method were \$43,811, \$14,479, and \$29,332, respectively, at June 30, 2018 and \$39,743, \$8,179, and \$31,564, respectively, at June 30, 2017.

At June 30, 2018, Health Ventures had a controlling ownership of 51.02% 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, 2018 and 2017 were approximately \$35,293 and \$21,153, respectively.

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**(6) Long-Term Debt**

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

	<u>Maturing through</u>	<u>Coupon rates</u>	<u>Unpaid principal</u>	
			<u>2018</u>	<u>2017</u>
(In thousands of dollars)				
Master trust debt:				
Fixed rate:				
Series 2008 Washington Bonds, Series A	2018	5.00 %	\$ 80,650	80,650
Series 2009 Oregon Bonds, Series A	2039	3.25–5.00%	75,060	80,780
Series 2009 Washington Bonds, Series A	2028	3.00–5.00%	67,165	69,840
2012 Direct Note Obligation to Bank of America	2022	2.32 %	26,917	32,467
2013 Direct Note Obligation to Bank of America	2023	3.23 %	28,685	33,529
2013 Direct Note Obligation to Bank of America	2023	3.92 %	158,392	163,363
2013 Direct Note Obligation to US Bank	2020	3.43 %	50,000	50,000
Series 2014 Washington Bonds, Series A	2028	2.00–5.00%	32,385	34,555
Series 2014 Oregon Bonds, Series A	2032	4.125%–5.00%	64,015	65,385
Total fixed rate			<u>583,270</u>	<u>610,570</u>
Variable:				
Series 2008 Oregon Bonds, Series A-B, variable interest rate (A: SIFMA +35 bps and B: SIFMA + 42 bps)	2034	1.52 %	145,975	145,975

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	Maturing through	Coupon rates	Unpaid principal	
			2018	2017
			(In thousands of dollars)	
Series 2011 Oregon Bonds, Series A-B, variable interest rate (A: 80%*1ml +62 bps and B: 68%*1ml +57.5 bps),	2047	2.16 %	\$ 150,000	150,000
Series 2013 Washington Bonds, Series A, variable interest rate (68%*1ml+ 70 bps),	2034	2.05 %	47,565	48,864
2015 Direct Note Obligation to US Bank, variable interest rate (1ml+ 75 bps),	2020	2.73 %	4,208	6,060
Total variable rate			347,748	350,899
Unpaid principal, master trust debt			931,018	961,469
Premium and other on long-term debt			10,603	11,456
Master trust debt, including premiums and discounts, net			941,621	972,925
Other long-term debt			12,058	15,216
Total long-term debt			953,679	988,141
Less amounts due within one year			(106,282)	(33,593)
Total long-term debt due after one year			\$ 847,397	954,548

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 \$147,600. 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 requires a minimum two year notice period prior to any anniversary of the date of issue occurring on or after February 27, 2016 to be given from the bank to PeaceHealth if the bank chooses to no longer hold the debt, provided that

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PeaceHealth is in compliance with financial covenants. With the exception of the Washington 2013(A) bonds, where 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.

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 \$12,058 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:

	<b>Long-term debt</b>	<b>Capitalized leases and other</b>	<b>Total</b>
Year ending June 30:			
2019	\$ 103,738	3,256	106,994
2020	30,791	858	31,649
2021	80,993	475	81,468
2022	31,879	475	32,354
2023	31,128	476	31,604
Thereafter	652,489	8,948	661,437
Total	\$ 931,018	14,488	945,506
Less amounts representing interest		(2,430)	(2,430)
Present value of net minimum capital lease payments		\$ 12,058	
Total long-term debt			\$ 943,076

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 \$31,898 and \$31,279 for the years ended June 30, 2018 and 2017, respectively.

Deferred financing costs are amortized over the lives of the related debt issuances using the effective interest method.

#### **(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 Topic 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 and changes in unrestricted net assets.

The Corporation has interest rate swap contracts outstanding as of June 30, 2018 and 2017, respectively, with a total current notional amount of approximately \$376,625 and \$380,425. The Corporation uses the fixed payor swaps to convert a portion of the outstanding variable rate bonds to fixed rates ranging from 3.50% to 4.10%. The fixed payor 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 \$21,174 and \$40,838 in the liability for the years ended June 30, 2018 and 2017, respectively. Net cash settlement cost for the interest rate swaps was \$10,955 and \$13,074, for the years ended June 30, 2018 and 2017, respectively. The amortization of the accumulated hedge effectiveness included in net assets was \$78 for both years ended June 30, 2018 and 2017.

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 \$8,407 and \$13,557, as of June 30, 2018 and 2017, respectively. Recording the interest rate swaps at fair value results in a total liability of \$91,915 and \$113,089 as of June 30, 2018 and 2017, respectively, in other long-term liabilities in the accompanying consolidated balance sheets rather than the \$100,322 and \$126,646 that would be paid if all of the swaps were terminated as of June 30, 2018 and 2017, 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 (note 4).

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(In thousands of dollars)

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.

The following is a summary of the derivative instruments in place as of June 30, 2018 and 2017:

Maturity date	Current notional amounts at June 30, 2018	Current notional amounts at June 30, 2017	Counterparty	Credit value adjustment at June 30, 2018	Liability fair value at June 30, 2018	Credit value adjustment at June 30, 2017	Liability fair value at June 30, 2017
08/01/34	\$ 45,000	45,000	Union Bank, N.A.	\$ 484	(9,749)	762	(12,655)
05/24/47	75,000	75,000	Deutsche Bank AG	3,251	(24,946)	5,308	(28,853)
05/22/47	75,000	75,000	Deutsche Bank AG	3,250	(24,946)	5,304	(28,844)
08/01/34	50,000	50,000	U.S. Bank N.A.	570	(11,454)	879	(14,560)
08/01/34	50,000	50,000	U.S. Bank N.A.	569	(11,443)	879	(14,549)
09/01/34	46,225	47,475	Morgan Stanley Capital Services LLC	247	(6,325)	384	(8,868)
09/01/34	35,400	37,950	Morgan Stanley Capital Services LLC	36	(3,052)	41	(4,760)
	\$ 376,625	380,425		\$ 8,407	(91,915)	13,557	(113,089)

### (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.

**PEACEHEALTH NETWORKS**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

The following table sets forth disclosures related to the Plans in accordance with FASB ASC Section 715-20-65, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, as of June 30, 2018 and 2017, measured as of January 1, 2018 and January 1, 2017, respectively:

	<b>Years ended June 30</b>	
	<b>2018</b>	<b>2017</b>
Change in projected benefit obligation:		
Projected benefit obligation (PBO) at beginning of period	\$ 250,060	265,238
Service cost	1,680	2,000
Interest cost	7,728	7,445
Actuarial gain on PBO	(10,848)	(14,354)
Benefits and administrative expenses paid	(18,027)	(10,269)
Projected benefit obligation at June 30	<u>\$ 230,593</u>	<u>250,060</u>
	<b>Years ended June 30</b>	
	<b>2018</b>	<b>2017</b>
Change in fair value of plan assets:		
Fair value of assets at beginning of period	\$ 181,009	160,667
Actual return on plan assets	13,776	21,911
Employer contribution	11,200	8,700
Benefits paid	(16,200)	(7,923)
Administrative expenses	(1,827)	(2,346)
Fair value of assets at June 30	<u>\$ 187,958</u>	<u>181,009</u>
Reconciliation of funded status:		
Funded status	<u>\$ (42,634)</u>	<u>(69,050)</u>
Net amount recognized	<u>\$ (42,634)</u>	<u>(69,050)</u>
Amounts recognized in the consolidated balance sheets consist of:		
Accrued pension liability	\$ 42,634	69,050
Accumulated change in net assets	(15,975)	(42,391)

**PEACEHEALTH NETWORKS**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

Net periodic benefit cost for the years ended June 30, 2018 and 2017 included the following components and is included in changes in unrestricted net assets:

	<u>2018</u>	<u>2017</u>
Service cost	\$ 1,680	2,000
Interest cost	7,728	7,445
Expected return on plan assets	(12,432)	(12,301)
Amortization of loss	<u>6,565</u>	<u>7,031</u>
Net periodic pension cost	<u>\$ 3,541</u>	<u>4,175</u>

**(a) Assumptions**

The Corporation used the following actuarial assumptions to determine its benefit obligations at June 30, 2018 and 2017 with measurement dates of June 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Discount rate	Plan I 4.03% and Plan II 3.99%	Plan I 3.70% and Plan II 3.63%

The Corporation used the following actuarial assumptions to determine its net periodic benefit cost for the years ended June 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Discount rate	3.70 %	3.35 %
Expected long-term rate of return on plan assets	7.00	7.00

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 a gain of approximately 7.30% and 13.10% during the years ended June 30, 2018 and 2017, 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.

## PEACEHEALTH NETWORKS

### Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

#### **(b) Pension Plan Assets**

The asset allocation of the Corporation's pension plan at June 30, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
Equity securities	\$ 110,807	107,504
Debt securities	76,057	70,651
Other	<u>1,094</u>	<u>2,854</u>
Total	<u>\$ 187,958</u>	<u>181,009</u>

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% equity. Assets are rebalanced quarterly when balances fall outside of the approved range for each asset class.

In accordance with FASB ASC Topic 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 Topic 820 are further discussed in note 3.

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

- The fair value of cash, money market funds, and mutual funds is estimated using quoted market prices or other observable inputs when quoted market prices are unavailable.
- Private equity fund: Valued at the NAV as a practical expedient 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, 2018 and 2017

(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, 2018:

<u>Assets</u>	<u>Total fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Mutual funds				
Equity securities	\$ 110,807	110,807	—	—
Debt securities	<u>76,057</u>	<u>76,057</u>		
Total mutual fund securities	<u>186,864</u>	<u>186,864</u>	—	—
Other securities:				
Cash and money markets	<u>50</u>	<u>50</u>	—	—
Total other securities	<u>50</u>	<u>50</u>	—	—
Total plan assets at fair value	186,914	<u>186,914</u>	—	—
Investments at NAV	<u>1,044</u>			
Total plan assets	\$ <u>187,958</u>			

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

<u>Assets</u>	<u>Total fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Mutual funds				
Equity securities	\$ 107,504	107,504	—	—
Debt securities	<u>70,651</u>	<u>70,651</u>		
Total mutual fund securities	<u>178,155</u>	<u>178,155</u>	—	—
Other securities:				
Cash and money markets	<u>1,697</u>	<u>1,697</u>	—	—
Total other securities	<u>1,697</u>	<u>1,697</u>	—	—
Total plan assets at fair value	179,852	<u>179,852</u>	—	—
Investments at NAV	<u>1,157</u>			
Total plan assets	\$ <u>181,009</u>			

**PEACEHEALTH NETWORKS**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

The following table provides information regarding redemption of investments where NAV has been used as a practical expedient at June 30, 2018 and June 30, 2017:

	<u>2018</u>	<u>2017</u>
Private equity	\$ <u>1,044</u>	<u>1,157</u>
Total	\$ <u>1,044</u>	<u>1,157</u>

At June 30, 2018 and 2017, the Plans held \$1,044 and \$1,157, 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, 2018 and 2017. 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, 2018, the Corporation held \$1,044 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 deemed appropriate. In the start of fiscal year 2019, the Corporation contributed \$5,203 and \$11,200 to the Plan for the Plan year ended December 31, 2017 and December 31, 2016, respectively.

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

	<u>Pension benefits</u>
2019	\$ 12,362
2020	11,736
2021	12,228
2022	12,629
2023	12,984
2024–2028	67,912

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

**(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 NETWORKS**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

PeaceHealth meeting certain age and length of service requirements. Total defined-contribution retirement plan costs charged to operations were approximately \$73,327 and \$74,021 for the years ended June 30, 2018 and 2017, respectively, which are included in payroll taxes and benefits in the accompanying consolidated statements of operations and changes in unrestricted net assets.

*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 \$52,962 and \$47,497 at June 30, 2018 and 2017, 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 2018 and 2017 were \$7,972 and \$6,812, respectively, and are included in payroll taxes and benefits in the accompanying consolidated statements of operations and changes in unrestricted net assets.

**(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.

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

	<u>2018</u>	<u>2017</u>
Purchase of property, plant, and equipment	\$ 13,788	7,501
Hospice and indigent care	11,610	8,374
Patient care	10,940	16,145
Childrens Services	3,100	3,892
Training and education	3,572	2,754
Other	<u>28,769</u>	<u>20,853</u>
	\$ <u>71,779</u>	<u>59,519</u>

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

	<u>2018</u>	<u>2017</u>
Hospice and indigent care	\$ 3,835	3,835
Patient care operating activities	14,304	13,949
Other	<u>4,589</u>	<u>4,568</u>
	\$ <u>22,728</u>	<u>22,352</u>

Approximately \$3,095 and \$4,448 was released from restriction for capital expenditures made during 2018 and 2017, respectively.

## PEACEHEALTH NETWORKS

### Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

#### *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, 2018 and 2017, the following liabilities for annuity contracts issued under the PeaceHealth license and reserve account investments were recorded:

	<u>2018</u>	<u>2017</u>
State of Washington gift annuity liabilities (other long-term liabilities)	\$ 495	562
Gift annuity reserve accounts (other assets whose use is limited, cash and investments)	619	645

#### **(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.

## PEACEHEALTH NETWORKS

### Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

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, 2018 are as follows:

	<b>Operating leases</b>
Year ending June 30:	
2019	\$ 17,793
2020	15,249
2021	13,645
2022	9,873
2023	4,317
Later years, 2024 through 2028	<u>7,099</u>
Total minimum lease payments	<u>\$ 67,976</u>

Rent expense related to all operating leases was \$23,503 and \$24,007 during the years ended June 30, 2018 and 2017, respectively, and was included in purchased services in the consolidated statements of operations and changes in unrestricted net assets.

#### **(c) Collective Bargaining Agreements**

Approximately 53% and 43% of the Corporation's employees are covered under collective bargaining agreements, including nurses, professional employees, and service employees as of June 30, 2018 and 2017, respectively. The Corporation's various collective bargaining agreements expire between March 2019 and September 2020.

#### **(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. During the year ended June 30, 2018, the Corporation dissolved the trust. 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 2018 and 2017 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 an undiscounted liability for all of the self-insurance programs of approximately \$105,137 and \$104,442 at June 30, 2018 and 2017, respectively. The liabilities are classified within other current liabilities and other long-term liabilities based on the

## PEACEHEALTH NETWORKS

### Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

historical amounts paid within one year. Total current amounts included in other current liabilities were approximately \$41,081 and \$39,839 at June 30, 2018 and 2017, respectively. Management has recorded amounts receivable from excess insurance carriers totaling approximately \$7,451 and \$7,391 as of June 30, 2018 and 2017, 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, 2018 and 2017, the carrying value of AEIX was approximately \$3,587 and \$3,457, 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 and change in unrestricted net assets.

#### (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>2018</u>	<u>2017</u>
Healthcare services	\$ 2,249,643	2,126,071
General and administrative	286,237	289,471
	<u>\$ 2,535,880</u>	<u>2,415,542</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. 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 was \$904 and \$93,443 for the years ended June 30, 2018 and 2017, respectively, including total gain on disposal of \$899 and \$88,771 for the years ended June 30, 2018 and 2017, respectively.

**PEACEHEALTH NETWORKS**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(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 and changes in unrestricted net assets:

	<b>2018</b>	<b>2017</b>
Operating revenues	\$ —	111,896
Salaries and wages	—	55,160
Professional fees	—	23,683
Other expenses	—	28,626
Other income	5	245
Gain of discontinued operations related to major classes of income	5	4,672
Gain on the disposal of the discontinued operation	899	88,771
Total gain on discontinued operations	\$ 904	93,443

**(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 administrative services only (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, 2018 and 2017. Total from operations of CUP were a gain of \$4,045 and a gain of \$3,473 for the years ended June 30, 2018 and 2017, respectively. CUP is in the final stages of discontinuation and closed as of June 30, 2018.

**(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 24, 2018, which is the date the consolidated financial statements were issued.

## **ADDITIONAL INFORMATION**

**PEACEHEALTH NETWORKS**

Consolidating Balance Sheet Information

June 30, 2018

(In thousands)

<b>Assets</b>	<b>Obligated group</b>	<b>PeaceHealth Southwest Foundation</b>	<b>Other nonobligated group</b>	<b>Eliminating or consolidating adjustments</b>	<b>PeaceHealth consolidated</b>
Current assets:					
Cash and cash equivalents	\$ 47,864	1,024	4,579	—	53,467
Short-term investments	932,732	—	—	—	932,732
Accounts receivable, net	334,930	—	1,832	—	336,762
Other receivables	47,080	—	(429)	—	46,651
Inventory of supplies	43,157	—	246	—	43,403
Prepaid expenses and other	27,024	—	29	—	27,053
Assets whose use is limited that are required for current liabilities	1,184	7,174	—	—	8,358
Total current assets	<u>1,433,971</u>	<u>8,198</u>	<u>6,257</u>	<u>—</u>	<u>1,448,426</u>
Assets whose use is limited:					
Cash and investments	1,197,875	21,741	1,643	—	1,221,259
Investment in affiliates	119	—	—	(119)	—
Investments in joint ventures and other	13,552	6,418	14,518	(8,345)	26,143
Total assets whose use is limited	<u>1,211,546</u>	<u>28,159</u>	<u>16,161</u>	<u>(8,464)</u>	<u>1,247,402</u>
Less current portion	<u>(1,184)</u>	<u>(7,174)</u>	<u>—</u>	<u>—</u>	<u>(8,358)</u>
Net assets whose use is limited	<u>1,210,362</u>	<u>20,985</u>	<u>16,161</u>	<u>(8,464)</u>	<u>1,239,044</u>
Property, plant, and equipment:					
Land and improvements	141,984	—	—	—	141,984
Buildings, fixed equipment, and other	1,748,738	—	29,782	(22,347)	1,756,173
Moveable equipment	819,566	—	2,731	—	822,297
Construction in progress	59,926	—	108	—	60,034
Total property, plant, and equipment	<u>2,770,214</u>	<u>—</u>	<u>32,621</u>	<u>(22,347)</u>	<u>2,780,488</u>
Less accumulated depreciation	<u>(1,550,310)</u>	<u>—</u>	<u>(15,026)</u>	<u>5,968</u>	<u>(1,559,368)</u>
Net property, plant, and equipment	<u>1,219,904</u>	<u>—</u>	<u>17,595</u>	<u>(16,379)</u>	<u>1,221,120</u>
Interest in net assets of related foundations	100,959	71	—	(28,655)	72,375
Other assets	33,656	—	3,311	—	36,967
Total assets	<u>\$ 3,998,852</u>	<u>29,254</u>	<u>43,324</u>	<u>(53,498)</u>	<u>4,017,932</u>

**PEACEHEALTH NETWORKS**

Consolidating Balance Sheet Information

June 30, 2018

(In thousands)

<b>Liabilities and Net Assets</b>	<b>Obligated group</b>	<b>PeaceHealth Southwest Foundation</b>	<b>Other nonobligated group</b>	<b>Eliminating or consolidating adjustments</b>	<b>PeaceHealth consolidated</b>
Current liabilities:					
Accounts payable	\$ 112,163	—	479	—	112,642
Accrued payroll, payroll taxes, and employee benefits	150,291	—	35	—	150,326
Accrued interest payable	4,328	—	—	—	4,328
Other current liabilities	34,051	—	—	—	34,051
Pending trades payable	77,021	—	—	—	77,021
Current portion of long-term debt	107,277	—	—	(995)	106,282
Total current liabilities	<u>485,131</u>	<u>—</u>	<u>514</u>	<u>(995)</u>	<u>484,650</u>
Other long-term liabilities	274,867	—	10,057	—	284,924
Long-term debt, net of current portion	857,511	—	8,346	(18,460)	847,397
Net assets:					
Unrestricted, controlling	2,284,492	7,606	19,838	(10,051)	2,301,885
Unrestricted, noncontrolling interest	10	—	4,569	(10)	4,569
Temporarily restricted	71,809	12,326	—	(12,356)	71,779
Permanently restricted	25,032	9,322	—	(11,626)	22,728
Total net assets	<u>2,381,343</u>	<u>29,254</u>	<u>24,407</u>	<u>(34,043)</u>	<u>2,400,961</u>
Total liabilities and net assets	<u>\$ 3,998,852</u>	<u>29,254</u>	<u>43,324</u>	<u>(53,498)</u>	<u>4,017,932</u>

See accompanying independent auditors' report.

**PEACEHEALTH NETWORKS**

Consolidating Statement of Operations and  
Changes in Unrestricted Net Assets Information

Year ended June 30, 2018

(In thousands)

	<u>Obligated group</u>	<u>PeaceHealth Southwest Foundation</u>	<u>Other nonobligated group</u>	<u>Eliminating or consolidating adjustments</u>	<u>PeaceHealth consolidated</u>
Revenues:					
Net patient service revenue before provision for bad debts	\$ 2,609,615	—	8,706	—	2,618,321
Provision for bad debts	(71,815)	—	(22)	—	(71,837)
Net patient service revenue	2,537,800	—	8,684	—	2,546,484
Other operating revenue	67,855	2,283	11,630	(1,976)	79,792
Total revenues	2,605,655	2,283	20,314	(1,976)	2,626,276
Expenses:					
Salaries and wages	1,258,836	—	1,852	—	1,260,688
Payroll taxes and benefits	256,042	—	484	—	256,526
Supplies	395,606	—	3,006	(237)	398,375
Purchased services	220,719	—	963	(3)	221,679
Other	226,033	1,341	271	—	227,645
Depreciation and amortization of other assets	138,466	—	1,342	(739)	139,069
Interest and amortization of deferred financing costs	32,554	—	739	(1,395)	31,898
Total expenses	2,528,256	1,341	8,657	(2,374)	2,535,880
Income from operations	77,399	942	11,657	398	90,396
Other income (expense):					
Investment income, net	93,618	150	—	(738)	93,030
Net change in interest rate swaps	10,219	—	—	—	10,219
Other	(1,501)	—	—	—	(1,501)
Total other income:	102,336	150	—	(738)	101,748
Excess of revenues over expenses from continued operations	179,735	1,092	11,657	(340)	192,144
Discontinued operations (note 14):					
Gain from operations (including gain on disposal of \$899)	904	—	3,913	132	4,949
Total gain on discontinued operations	904	—	3,913	132	4,949
Excess of revenues over expenses	180,639	1,092	15,570	(208)	197,093
Net assets released from restrictions for property, plan, and equipment					
Net assets released from restrictions for property, plan, and equipment	3,095	—	—	—	3,095
Transfer to related division	(16,905)	—	871	16,034	—
Change in interest in net assets of related foundations	(1,829)	—	—	1,829	—
Change in pension liability	15,216	—	—	—	15,216
Other changes in net assets	13,698	—	(15,440)	—	(1,742)
Increase in unrestricted net assets	\$ 193,914	1,092	1,001	17,655	213,662

See accompanying independent auditors' report.

**PEACEHEALTH NETWORKS**

Consolidating Statement of Changes in Net Assets Information

Year ended June 30, 2018

(In thousands)

	<u>Obligated group</u>	<u>PeaceHealth Southwest Foundation</u>	<u>Other nonobligated group</u>	<u>Eliminating or consolidating adjustments</u>	<u>PeaceHealth consolidated</u>
Net assets at June 30, 2017	\$ 2,171,896	24,733	23,405	(45,371)	2,174,663
Excess of revenues over expenses from continued operations	179,735	1,092	11,657	(340)	192,144
Other restricted contributions	3,274	—	—	—	3,274
Net assets released from restrictions	—	(1,188)	—	—	(1,188)
Transfer to related division	(16,905)	—	871	16,034	—
Change in interest in net assets of related foundations	13,526	—	—	(4,498)	9,028
Change in pension liability	15,216	—	—	—	15,216
Other changes in net assets	13,697	4,617	(15,439)	—	2,875
Change in net assets before discontinued operations	208,543	4,521	(2,911)	11,196	221,349
Discontinued operations (note 14)	904	—	3,913	132	4,949
Change in net assets	209,447	4,521	1,002	11,328	226,298
Net assets at June 30, 2018	\$ <u>2,381,343</u>	<u>29,254</u>	<u>24,407</u>	<u>(34,043)</u>	<u>2,400,961</u>

See accompanying independent auditors' report.