



PEACEHEALTH NETWORKS

Consolidated Financial Statements

June 30, 2019 and 2018

(With Independent Auditors' Report Thereon)

PEACEHEALTH NETWORKS

Table of Contents

	Page(s)
Independent Auditors' Report	1–2
Financial Statements:	
Consolidated Balance Sheets	3–4
Consolidated Statements of Operations and Changes in Net Assets Without Donor Restrictions	5
Consolidated Statements of Changes in Net Assets	6
Consolidated Statements of Cash Flows	7
Notes to Consolidated Financial Statements	8–38
Additional Information	
Consolidating Balance Sheet Information (2019)	39–40
Consolidating Statement of Operations and Changes in Net Assets Without Donor Restrictions Information (2019)	41
Consolidating Statement of Changes in Net Assets Information (2019)	42



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, 2019 and 2018, and the related consolidated statements of operations and changes in net assets without donor restrictions, 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, 2019 and 2018, 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.



Emphasis of Matters

As discussed in notes 2(u) and 3 to the consolidated financial statements, in 2019, PeaceHealth Networks adopted new accounting guidance in Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (Topic 606) and ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities* (Topic 958). Our opinion is not modified with respect to these matters.

Other Matter

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 39 to 42 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 27, 2019

PEACEHEALTH NETWORKS

Consolidated Balance Sheets

June 30, 2019 and 2018

(In thousands)

Assets	2019	2018
Current assets:		
Cash and cash equivalents	\$ 46,885	53,467
Short-term investments	862,785	932,732
Accounts receivable, net of allowance for doubtful accounts of \$1,059 and \$86,994	360,294	336,762
Other receivables	43,699	46,651
Inventory of supplies	44,545	43,403
Prepaid expenses and other	30,520	27,053
Assets whose use is limited that are required for current liabilities	6,907	8,358
Total current assets	1,395,635	1,448,426
Assets whose use is limited:		
Cash and investments	1,336,434	1,221,259
Investments in joint ventures and other	26,881	26,143
Total assets whose use is limited	1,363,315	1,247,402
Less current portion	(6,907)	(8,358)
Net assets whose use is limited	1,356,408	1,239,044
Property, plant, and equipment:		
Land and improvements	142,351	141,984
Buildings, fixed equipment, and other	1,779,651	1,756,173
Moveable equipment	930,732	822,297
Construction in progress	151,440	60,034
Total property, plant, and equipment	3,004,174	2,780,488
Less accumulated depreciation	(1,739,782)	(1,559,368)
Net property, plant, and equipment	1,264,392	1,221,120
Interest in net assets of related foundations	69,338	72,375
Other assets	103,471	36,967
Total assets	\$ 4,189,244	4,017,932

PEACEHEALTH NETWORKS

Consolidated Balance Sheets

June 30, 2019 and 2018

(In thousands)

Liabilities and Net Assets	2019	2018
Current liabilities:		
Accounts payable	\$ 137,944	112,642
Accrued payroll, payroll taxes, and employee benefits	150,420	150,326
Accrued interest payable	4,193	4,328
Other current liabilities	40,612	34,051
Pending trades payable	17,348	77,021
Current portion of long-term debt	24,933	106,282
Total current liabilities	<u>375,450</u>	<u>484,650</u>
Other long-term liabilities	340,913	284,924
Long-term debt, net of current portion	978,886	847,397
Net assets:		
Without donor restrictions, controlling interest	2,399,852	2,301,885
Without donor restrictions, noncontrolling interest	5,229	4,569
With donor restrictions	88,914	94,507
Total net assets	<u>2,493,995</u>	<u>2,400,961</u>
Total liabilities and net assets	<u>\$ 4,189,244</u>	<u>4,017,932</u>

See accompanying notes to consolidated financial statements.

PEACEHEALTH NETWORKS

Consolidated Statements of Operations and Changes in Net Assets Without Donor Restrictions

Years ended June 30, 2019 and 2018

(In thousands)

	<u>2019</u>	<u>2018</u>
Revenues:		
Net patient service revenue	\$ 2,715,953	2,618,321
Provision for bad debts	—	(71,837)
Net patient service revenue	<u>2,715,953</u>	<u>2,546,484</u>
Other operating revenue	<u>67,995</u>	<u>79,792</u>
Total revenues	<u>2,783,948</u>	<u>2,626,276</u>
Expenses:		
Salaries and wages	1,348,644	1,260,688
Payroll taxes and benefits	278,294	256,526
Supplies	422,953	398,375
Purchased services	264,397	221,679
Other	246,452	227,645
Depreciation and amortization	138,672	139,069
Interest and amortization of deferred financing costs	<u>35,196</u>	<u>31,898</u>
Total expenses	<u>2,734,608</u>	<u>2,535,880</u>
Income from operations	<u>49,340</u>	<u>90,396</u>
Other income (expense):		
Investment return, net	103,534	93,030
Net change in interest rate swaps	(40,346)	10,219
Other	<u>(3,924)</u>	<u>(1,501)</u>
Total other income	<u>59,264</u>	<u>101,748</u>
Excess of revenues over expenses from continued operations	<u>108,604</u>	<u>192,144</u>
Discontinued operations (note 14):		
Gain from operations (including gain on disposal of \$0 and \$899, in 2019 and 2018, respectively)	<u>—</u>	<u>4,949</u>
Total gain on discontinued operations	<u>—</u>	<u>4,949</u>
Excess of revenues over expenses	108,604	197,093
Net assets released from restrictions for property, plant, and equipment	7,188	3,095
Change in pension liability	(15,337)	15,216
Other changes in net assets without donor restrictions	<u>(1,828)</u>	<u>(1,742)</u>
Increase in net assets without donor restrictions	\$ <u>98,627</u>	\$ <u>213,662</u>

See accompanying notes to consolidated financial statements.

PEACEHEALTH NETWORKS

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2019 and 2018

(In thousands)

	<u>Without donor restrictions</u>		<u>With donor restrictions</u>	<u>Total</u>
	<u>Controlling interest</u>	<u>Noncontrolling interest</u>		
Net assets at June 30, 2017	\$ 2,089,235	3,557	81,871	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	—	—	9,028	9,028
Change in pension liability	15,216	—	—	15,216
Other changes in net assets	(1,742)	—	4,617	2,875
Change in net assets before discontinued operations	208,025	688	12,636	221,349
Discontinued operations (note 14)	4,625	324	—	4,949
Change in net assets	212,650	1,012	12,636	226,298
Net assets at June 30, 2018	2,301,885	4,569	94,507	2,400,961
Excess of revenues over expenses from continued operations	107,944	660	—	108,604
Other restricted contributions	—	—	7,188	7,188
Net assets released from restrictions	7,188	—	(8,118)	(930)
Change in interest in net assets of related foundations	—	—	(3,037)	(3,037)
Change in pension liability	(15,337)	—	—	(15,337)
Other changes in net assets	(1,828)	—	(1,626)	(3,454)
Change in net assets	97,967	660	(5,593)	93,034
Net assets at June 30, 2019	\$ 2,399,852	5,229	88,914	2,493,995

See accompanying notes to consolidated financial statements.

PEACEHEALTH NETWORKS

Consolidated Statements of Cash Flows

Years ended June 30, 2019 and 2018

(In thousands)

	<u>2019</u>	<u>2018</u>
Cash flows from operating activities:		
Change in net assets	\$ 93,034	226,298
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	138,672	139,069
(Gain) loss on sale of land held for sale and property, plant, and equipment	(1,698)	260
Provision for bad debts	—	71,837
Change in pension liability	15,337	(15,216)
Restricted contributions	(7,188)	(3,274)
Net change in unrealized losses on investments	(36,282)	(1,616)
Realized gains on investments	(24,881)	(55,508)
Valuation adjustments on swap arrangements	31,585	(21,174)
Vesting of Premier Class B units	(8,383)	(5,892)
Change in interest in net assets of related foundations	3,037	(9,028)
Equity earnings on investments, net	(537)	1,404
Loss on sale of discontinued operations	—	899
Gain on refinancing	(732)	—
Changes in operating assets and liabilities:		
Increase (decrease) in:		
Accounts receivable, net	(23,532)	(95,269)
Other assets	(69,069)	(18,756)
Increase (decrease) in:		
Accounts payable	25,302	16,155
Accrued payroll, payroll taxes, and employee benefits	94	(6,454)
Other liabilities	(44,180)	(16,367)
Net cash provided by operating activities	<u>90,579</u>	<u>207,368</u>
Cash flows from investing activities:		
Purchase of property, plant, and equipment	(181,357)	(110,995)
Proceeds from sale of land held for sale and property, plant, and equipment	2,019	96
Purchase of alternative investments	(83,569)	(204,293)
Purchases/Sales of investments, net	108,418	86,722
Net cash used in investing activities	<u>(154,489)</u>	<u>(228,470)</u>
Cash flows from financing activities:		
Principal payments on long-term debt	(525,979)	(34,462)
Proceeds from new financing	576,119	—
Proceeds from restricted contributions	7,188	3,274
Net cash provided by (used in) financing activities	<u>57,328</u>	<u>(31,188)</u>
Net decrease in cash and cash equivalents	(6,582)	(52,290)
Cash and cash equivalents at beginning of year	<u>53,467</u>	<u>105,757</u>
Cash and cash equivalents at end of year	<u>\$ 46,885</u>	<u>53,467</u>

See accompanying notes to consolidated financial statements.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(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, 2019, 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 Medical Center

Systemwide Organizations:

- PeaceHealth Medical Group

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

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

PeaceHealth Networks included the following controlled affiliates at
June 30, 2019:

- PeaceHealth
- Health Ventures
- Pooled Income Funds (including Charitable Life Income Funds)
- PeaceHealth Southwest Medical Center Foundation
- PeaceHealth Networks On Demand (established January 1, 2019)
- 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 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.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(d) Inventory of Supplies

Inventory is valued on weighted average cost.

(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, 2019 and 2018. 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, 2019 and 2018, PeaceHealth recorded payables of \$17,348 and \$77,021, respectively, for investments purchased but not settled as pending trades payable in the accompanying consolidated balance sheets.

(g) Liquidity

Cash and cash equivalents, accounts receivable, and short-term investments are the primary liquid resources used by the Corporation to meet expected expenditure needs within the next year. The Corporation has credit facility programs, as described in note 6, available to meet unanticipated liquidity needs. Although intended to satisfy long-term obligations, management estimates that approximately 88% of assets whose use is limited, as stated at June 30, 2019, could be liquidated within the next year if needed.

(h) 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.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

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, 2019 or 2018.

(i) **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

(j) **Other Assets**

Other assets include intangible assets, primarily trade names, and goodwill. Intangible assets with indefinite lives are evaluated annually for impairment. Impairment reviews are performed of the purchased intangible assets whenever events or changes in circumstances indicate carrying amount of an asset may not be recoverable. There were no impairment losses recognized during the year ended June 30, 2019 or 2018.

(k) **Other Long-Term Liabilities**

Other long-term liabilities consist primarily of the estimated fair value associated with the Corporation's interest rate swaps of \$123,500 and \$91,915 at June 30, 2019 and 2018, respectively; the liability for the PeaceHealth SWHS Frozen DB Pension Plan of \$52,768 and \$42,634 at June 30, 2019 and 2018, respectively; and the long-term portion of the liability for the self-insurance programs of \$73,596 and \$64,055 at June 30, 2019 and 2018, 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 \$20,198 and \$19,898 recorded as other long-term liabilities as of June 30, 2019 and 2018, respectively. The Corporation recognized \$569 and \$564 in 2019 and 2018, 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, 2019 and 2018, the Corporation has recorded the

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

present value of the annuity payments of \$9,769 and \$10,057, respectively, as part of other long-term liabilities. The discount rate ranged from 6.3% to 7.0% at June 30, 2019 and 6.2% to 6.8% at June 30, 2018.

(l) Net Assets

Net assets without donor restrictions are those that are not subject to donor-imposed stipulations. Net assets with donor restrictions are those whose use by the Corporation have been limited by donor-imposed restrictions to a specific time period, in perpetuity, and/or purpose.

Net assets with donor restrictions represent resources subject to donor-imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that are restricted by the donor for a particular purpose and that will be met by the passage of time or other events specified by the donor. Other donor restrictions are perpetual in nature, whereby the donor has stipulated the funds be maintained in perpetuity. When specific donor restrictions are satisfied, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the consolidated statements of operations and the consolidated statements of changes in net assets as net assets released from restrictions.

(m) 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 net assets with donor restrictions. 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 net assets with donor restrictions.

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, net assets with donor restrictions are reclassified to net assets without donor restrictions 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.

(n) 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.

(o) 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.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(p) *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, and other items.

(q) *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 net assets without donor restrictions 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.

(r) *Federal and State Income Taxes*

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

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

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

(s) *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 2019 and 2018, these programs resulted in supplemental payments of \$96,119 and \$90,781, respectively, recorded in net patient service revenue, and assessments of \$83,867 and \$81,873, respectively, recorded in other expenses in the accompanying consolidated statements of operations and changes in net assets without donor restrictions.

(t) *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.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(u) 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 ASU was adopted on July 1, 2018 using the cumulative effect method for those contracts that were not substantially completed as of July 1, 2018. Results for reporting periods after July 1, 2018 are presented under ASC Topic 606, while prior period amounts continue to be presented in accordance with the Corporation's historical accounting under *Revenue Recognition (Topic 605)*. The adoption of the ASU primarily changes the Corporation's presentation of revenues and the provision and allowance for bad debts. The ASU requires that the Corporation recognize revenue based on an estimate of the transaction price expected to be collected as a result of satisfying the performance obligation. Accordingly, for performance obligations satisfied after July 1, 2018, the Corporation no longer separately presents a provision for bad debts on the consolidated statements of operations and changes in net assets without donor restrictions or the related allowance for bad debts on the consolidated balance sheets. The adoption of ASC Topic 606 did not have any impact on the Corporation's recognition of net patient service revenue for any period prior to adoption.

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. ASC Topic 842 is effective for the Corporation beginning on July 1, 2019. In 2018, the FASB updated its guidance allowing entities to adopt the provisions of the standard prospectively without adjusting comparative periods. The Corporation is planning to adopt this option. Management expects to record right-of-use assets and lease liabilities of approximately \$97,636 on its consolidated balance sheet in 2020. The adoption of ASC Topic 842 is not expected to have a significant impact on the results of operations or cash flows. The Corporation will include new disclosures in 2020 in accordance with ASC Topic 842.

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 (NFP) 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 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 implemented ASU No. 2016-14 as of July 1, 2018, which was adopted retrospectively for the years ended June 30, 2019 and 2018.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

The impact of adoption resulted in enhanced disclosures about the classification of expense and management of liquid resources. As a result of adoption, temporarily restricted and permanently restricted net assets in the amounts of \$71,779 and \$22,728, respectively, were combined to create net assets with donor restrictions as stated on the consolidated balance sheet as of June 30, 2018.

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. Upon 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 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.

(3) Revenue Recognition

(a) Net Patient Service Revenues

Net patient service revenue relates to contracts with patients involving third-party payors where the Corporation has an obligation to perform healthcare services. This revenue is recorded at the amount due from patients, third-party payors, and others when the performance obligations are satisfied. The adoption of ASU No. 2014-09, *Revenue from Contracts with Customers (ASC Topic 606)* resulted in changes to the presentation of the consolidated statements of operations and changes in net assets without donor restrictions with the provision of bad debts now being considered implicit price concessions that are recognized as a direct deduction to net patient service revenue rather than the presentation of the provision for bad debts, prior to adoption, as a deduction to arrive at net patient service revenue. For the year ended June 30, 2019, \$70,770 of implicit price concessions was recorded as a direct deduction to net patient service revenue. The Corporation bases the implicit price concessions on historical collectibility data by payor using a portfolio approach to recognize the deductions netted against revenue when it is recognized.

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.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

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, 2019 and 2018 were approximately \$63,108 and \$35,213, respectively.

(b) Disaggregation of Revenue

The Corporation earns the majority of its revenues from contracts with customers. Revenues and adjustments not related to contracts with customers are included in other revenue.

Total revenues from contracts with customers by payor are as follows for the years ended June 30:

	2019	2018
Medicare	\$ 1,089,872	973,630
Medicaid	348,378	350,856
Commercial and other	1,234,312	1,120,139
Private pay	43,391	101,859
Net patient service revenue	2,715,953	2,546,484
Other revenue	67,995	79,792
Total revenue	\$ 2,783,948	2,626,276

(c) Variable Consideration

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.

Net patient service revenue is recognized at the time services are provided to patients. Revenue is recorded in the amount which the Corporation expects to collect, which may include variable components. Variable consideration is included in the transaction price to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with variable consideration is subsequently resolved. 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

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

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 \$10,941 and increase of \$3,309 in 2019 and 2018, 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.

(d) Concentration of Credit Risk

There is a corresponding significant concentration of credit risk in net accounts receivable balances at June 30, 2019 and 2018:

	2019	2018
Medicare	32 %	30 %
Medicaid	10	10
Commercial and other	47	50
Private pay	11	10
	100 %	100 %

(4) 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.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

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 multiplied by shares held 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, real estate 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 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.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(5) Investments

The composition of cash and investments carried at fair value on a recurring basis at June 30, 2019 is set forth in the following table:

	June 30, 2019	Fair value measurements at reporting date using		
		Level 1	Level 2	Level 3
Assets:				
Short-term investments:				
Cash and cash equivalents	\$ 117,240	117,240	—	—
Fixed income:				
Government, municipal, foreign, and other	224,707	161,674	63,033	—
Mortgage and asset-backed securities	108,596	—	108,596	—
Corporate obligations	149,742	—	149,742	—
Mutual funds	139,108	139,108	—	—
Other short-term investments	56,475	17,422	39,053	—
Common/collective trusts	15,356	—	15,356	—
Total	811,224	435,444	375,780	—
Designated for capital acquisition:				
Cash and cash equivalents	28,567	28,567	—	—
Fixed income:				
Government, municipal, foreign, and other	92,017	66	91,951	—
Corporate obligations	289	289	—	—
Mutual funds:				
Fixed income	103,977	103,977	—	—
Domestic equities	399,707	399,707	—	—
International equities	349,240	349,240	—	—
Other long-term equity investments	46,117	45,962	155	—
Common/collective trusts	12,848	—	12,848	—
Hedge funds and other	58,547	—	58,547	—
Total	1,091,309	927,808	163,501	—
Funds designated for 457 plans:				
Cash and short-term investments	57,093	57,093	—	—
Mutual funds	1,531	1,531	—	—
Total	58,624	58,624	—	—

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

	<u>June 30,</u> <u>2019</u>	<u>Fair value measurements</u> <u>at reporting date using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Trustee-held funds:				
Cash and cash equivalents	\$ 71	71	—	—
Total	71	71	—	—
Total assets at fair value	<u>1,961,228</u>	\$ <u>1,421,947</u>	<u>539,281</u>	<u>—</u>
Investments measured at NAV:				
Hedge funds	169,169			
Private equity	23,910			
Real estate limited partnerships	<u>44,912</u>			
Total assets	\$ <u>2,199,219</u>			
Liabilities:				
Interest rate swaps	\$ 123,500	—	123,500	—
Total liabilities	\$ <u>123,500</u>	<u>—</u>	<u>123,500</u>	<u>—</u>

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,</u> <u>2018</u>	<u>Fair value measurements</u> <u>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	—
Total	<u>881,032</u>	<u>212,511</u>	<u>668,521</u>	<u>—</u>

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

	June 30, 2018	Fair value measurements at reporting date using		
		Level 1	Level 2	Level 3
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	—
Hedge funds and other	55,389	—	55,389	—
Total	<u>1,063,057</u>	<u>837,032</u>	<u>226,025</u>	<u>—</u>
Funds designated for 457 plans:				
Cash and short-term investments	1,397	1,397	—	—
Mutual funds	51,565	51,565	—	—
Total	<u>52,962</u>	<u>52,962</u>	<u>—</u>	<u>—</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	1,998,596	\$ <u>1,104,050</u>	<u>894,546</u>	<u>—</u>
Investments measured at NAV:				
Hedge funds	148,908			
Private equity	6,487			
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 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, 2019 and 2018. These partnerships do not

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

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, 2019 and 2018, the Corporation held \$23,910 and \$6,487, respectively, of private equity and distressed debt limited partnerships that had termination dates that ranged from 2019 to 2024.

	<u>2019</u>	<u>2018</u>	<u>Unfunded commitments</u>
Distressed debt	\$ 1,067	1,384	1,899
Private equity	22,843	5,103	11,626
Total	\$ <u>23,910</u>	<u>6,487</u>	<u>13,525</u>

The following table summarizes investments measured at fair value based on NAV per share as of June 30, 2019 and their redemption restrictions:

	<u>Fair value at June 30, 2019</u>	<u>Fair value at June 30, 2018</u>	<u>Lockup terms or redemption restrictions</u>	<u>Redemption frequency</u>	<u>Redemption notice period</u>
Hedge funds	\$ 32,265	33,993	None	Monthly	10 Days
Hedge funds	15,842	15,763	None	Monthly	30 Days
Hedge funds	17,305	15,573	Gate at 20% of total fund net assets	Monthly	60 Days
Hedge funds	2,769	7,229	None	Monthly	75 Days
Hedge funds	28,987	34,285	None	Semimonthly	30 Days
Hedge funds	16,268	15,624	Gate at 50% of total fund net assets	Quarterly	60 Days
Hedge funds	16,075	15,429	Gate at 10%	Quarterly	65 Days
Hedge funds	11,358	11,012	Withdrawal limits across four successive withdrawal dates	Quarterly	90 Days
Hedge funds	12,374	—	None	Monthly	30 Days
Hedge funds	6,957	—	None	Quarterly	90 Days
Hedge funds	8,969	—	None	Quarterly	60 Days
Real estate	22,778	—	First business day of the calendar quarter with 45 days notice.	Quarterly	45 Days
Real estate	22,134	—	Two-year lock up period	N/A	N/A
	\$ <u>214,081</u>	<u>148,908</u>			

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

Investment return is included in other income (expense) as part of nonoperating income in the consolidated statements of operations and changes in net assets without donor restrictions. Investment return comprises the following for the years ended June 30, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Interest and dividend income	\$ 42,371	35,906
Net realized gains on sales of investments	24,881	55,508
Net change in unrealized gains on investments	<u>36,282</u>	<u>1,616</u>
Investment return, net	<u>\$ 103,534</u>	<u>93,030</u>

Other Investments

Health Ventures is a not-for-profit corporation that has entered into joint ventures to provide radiology, oncology, and surgery services. PeaceHealth is the sole member of Health Ventures. Health Ventures is included in the consolidated financial statements but is not part of the obligated group. The majority of these joint ventures are accounted for under the equity method. Health Venture's ownership interest in the joint ventures ranged from approximately 24.2% and 50.0% at both June 30, 2019 and 2018, respectively. As of June 30, 2019 and 2018, the carrying value of the joint ventures was approximately \$15,273 and \$14,518, respectively, and is recorded in investments in joint ventures and other on the consolidated balance sheets. Equity earnings from the joint ventures of \$9,842 and \$9,744 for the years ended June 30, 2019 and 2018, respectively, are included in other operating revenue. The unaudited assets, liabilities, and equity of these joint ventures accounted for under the equity method were \$42,384, \$10,382, and \$32,002, respectively, at June 30, 2019 and \$43,811, \$14,479, and \$29,332, respectively, at June 30, 2018.

At June 30, 2019, Health Ventures had a controlling ownership of 51.02% in Riverbend Ambulatory Surgery Center, which is consolidated within Health Ventures.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(6) Long-Term Debt

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

	Maturing through	Coupon rates		Unpaid principal	
		2019	2018	2019	2018
(In thousands of dollars)					
Master trust debt:					
Fixed rate:					
Series 2008 Washington Bonds, Series A		— %	5.00 %	\$ —	80,650
Series 2009 Oregon Bonds, Series A		— %	3.25–5.00%	—	75,060
Series 2009 Washington Bonds, Series A		— %	3.00–5.00%	—	67,165
2012 Direct Note Obligation to Bank of America	2022	2.32 %	2.32 %	21,235	26,917
2013 Direct Note Obligation to Bank of America	2023	3.23 %	3.23 %	23,679	28,685
2013 Direct Note Obligation to Bank of America	2023	3.92 %	3.92 %	153,221	158,392
2013 Direct Note Obligation to US Bank	2020	3.43 %	3.43 %	—	50,000
Series 2014 Washington Bonds, Series A	2028	2.00–5.00%	2.00–5.00%	30,105	32,385
Series 2014 Oregon Bonds, Series A	2032	4.125%–5.00%	4.125%–5.00%	62,555	64,015
Series 2018 Taxable Bonds	2048	4.79%	— %	355,144	—
Total fixed rate				\$ 645,939	583,269
Variable:					
Series 2008 Oregon Bonds, Series A-B, variable interest rate (A: SIFMA +35 bps and B: SIFMA + 42 bps)		— %	0.02 %	\$ —	145,975
Series 2011 Oregon Bonds, Series A-B, variable interest rate (A: 80%*1ml +62 bps and B: 68%*1ml +57.5 bps),	2047	2.21 %	2.16 %	75,000	150,000
Series 2013 Washington Bonds, Series A, variable interest rate (68%*1ml+ 70 bps),	2034	2.36 %	2.05 %	46,265	47,565
2015 Direct Note Obligation to US Bank, variable interest rate (1ml+ 75 bps),	2020	2.97 %	2.73 %	2,188	4,208
Series 2018 Oregon Bonds, Series A variable interest rate (prevailing market rates),	2034	1.92 %	— %	45,975	—
Series 2018 Oregon Bonds, Series B variable interest rate (prevailing market rates),	2034	1.92 %	— %	100,000	—
Series 2018 Oregon Bonds, Series C variable interest rate (80%1ml+ 62 bps),	2047	2.57 %	— %	75,000	—
Total variable rate				\$ 344,428	347,748

* ML as used in the table above is defined as monthly LIBOR.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

	Maturing through	Coupon rates		Unpaid principal	
		2019	2018	2019	2018
				(In thousands of dollars)	
Unpaid principal, master trust debt				\$ 990,367	931,018
Premium and other on long-term debt				2,571	10,603
Master trust debt, including premiums and discounts, net				992,938	941,621
Other long-term debt				10,881	12,058
Total long-term debt				1,003,819	953,679
Less amounts due within one year				(24,933)	(106,282)
Total long-term debt due after one year				\$ 978,886	847,397

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.

PeaceHealth issued debt in fiscal year 2019 to diversify its debt profile and raise funds for future capital needs. Series 2018 taxable fixed rate bonds with a par amount of \$355,144 were issued to refinance the 2008 Washington Bonds Series A and 2013 direct note obligation with US Bank, defease the 2009 Oregon Bonds Series A and 2009 Washington Bonds Series A and provide \$70,000 of funds for future capital needs. PeaceHealth issued 2018 tax-exempt Oregon variable rate demand bonds Series A-B to refinance the outstanding 2008 Oregon Bonds Series A-B. Additionally, PeaceHealth issued 2018 tax-exempt Oregon Bonds Series C to refinance the 2011 Oregon Bonds Series A.

The Series 2011 Oregon Series A-B Direct Placement Bonds, the Washington 2013(A) Direct Placement Bonds, and the 2018 Oregon Series A-B Variable Rate Demand 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 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 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 2011 and

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

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.

Other long-term debt includes \$10,399 in capital leases and other debt.

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

	<u>Long-term debt</u>	<u>Capitalized leases and other</u>	<u>Total</u>
Year ending June 30:			
2020	\$ 24,780	882	25,662
2021	23,443	1,921	25,364
2022	24,304	475	24,779
2023	22,144	476	22,620
2024	139,914	476	140,390
Thereafter	<u>755,782</u>	<u>9,033</u>	<u>764,815</u>
Total	\$ <u>990,367</u>	13,263	1,003,630
Less amounts representing interest		<u>(2,382)</u>	(2,382)
Present value of net minimum capital lease payments		\$ <u>10,881</u>	
Total long-term debt			\$ <u>1,001,248</u>

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

Cash paid for interest totaled approximately \$35,048 and \$31,898 for the years ended June 30, 2019 and 2018, respectively.

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

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(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 net assets without donor restrictions.

The Corporation has interest rate swap contracts outstanding as of June 30, 2019 and 2018, respectively, with a total current notional amount of approximately \$372,675 and \$376,625. 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 an increase of \$31,585 and a decrease of \$21,174 in the liability for the years ended June 30, 2019 and 2018, respectively. Net cash settlement cost for the interest rate swaps was \$8,762 and \$10,955, for the years ended June 30, 2019 and 2018, respectively. The amortization of the accumulated hedge effectiveness included in net assets was \$78 for both years ended June 30, 2019 and 2018.

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 \$8,310 and \$8,407, as of June 30, 2019 and 2018, respectively. Recording the interest rate swaps at fair value results in a total liability of \$123,500 and \$91,915 as of June 30, 2019 and 2018, respectively, in other long-term liabilities in the accompanying consolidated balance sheets rather than the \$131,810 and \$100,322 that would be paid if all of the swaps were terminated as of June 30, 2019 and 2018, 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 5).

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.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

The following is a summary of the derivative instruments in place as of June 30, 2019 and 2018:

<u>Maturity date</u>	<u>Current notional amounts at June 30, 2019</u>	<u>Current notional amounts at June 30, 2018</u>	<u>Counterparty</u>	<u>Credit value adjustment at June 30, 2019</u>	<u>Liability fair value at June 30, 2019</u>	<u>Credit value adjustment at June 30, 2018</u>	<u>Liability fair value at June 30, 2018</u>
August 01, 2034	\$ 45,000	45,000	Union Bank, N.A.	\$ 504	(13,026)	484	(9,749)
May 24, 2047	75,000	75,000	Deutsche Bank AG	3,152	(33,959)	3,251	(24,946)
May 22, 2047	75,000	75,000	Deutsche Bank AG	3,152	(33,959)	3,250	(24,946)
August 01, 2034	50,000	50,000	U.S. Bank N.A.	586	(15,103)	570	(11,454)
August 01, 2034	50,000	50,000	U.S. Bank N.A.	585	(15,092)	569	(11,443)
September 01, 2034	44,925	46,225	Morgan Stanley Capital Services LLC	279	(8,634)	247	(6,325)
September 01, 2034	32,750	35,400	Morgan Stanley Capital Services LLC	52	(3,727)	36	(3,052)
	<u>\$ 372,675</u>	<u>376,625</u>		<u>\$ 8,310</u>	<u>(123,500)</u>	<u>8,407</u>	<u>(91,915)</u>

(8) Benefit Plans

(a) 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 referred as "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, 2019 and 2018

The following table sets forth disclosures related to the Plans in accordance with FASB ASC Paragraph 715-20-65, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, as of June 30, 2019 and 2018, measured as of January 1, 2019 and January 1, 2018, respectively:

	Years ended June 30	
	2019	2018
Change in projected benefit obligation:		
Projected benefit obligation (PBO) at beginning of period	\$ 230,593	250,060
Service cost	1,370	1,680
Interest cost	8,376	7,728
Actuarial gain on PBO	24,021	(10,848)
Benefits and administrative expenses paid	<u>(11,085)</u>	<u>(18,027)</u>
Projected benefit obligation at June 30	<u>\$ 253,275</u>	<u>230,593</u>
Change in fair value of plan assets:		
Fair value of assets at beginning of period	\$ 187,958	181,009
Actual return on plan assets	18,430	13,776
Employer contribution	5,203	11,200
Benefits paid	(9,576)	(16,200)
Administrative expenses	<u>(1,509)</u>	<u>(1,827)</u>
Fair value of assets at June 30	<u>\$ 200,506</u>	<u>187,958</u>
Reconciliation of funded status:		
Funded status	<u>\$ (52,768)</u>	<u>(42,634)</u>
Net amount recognized	<u>\$ (52,768)</u>	<u>(42,634)</u>
Amounts recognized in the consolidated balance sheets consist of:		
Accrued pension liability	\$ 52,768	42,634
Accumulated change in net assets	(26,109)	(15,975)

Net periodic benefit cost for the years ended June 30, 2019 and 2018 included the following components and is included in changes in net assets without donor restrictions:

	2019	2018
Service cost	\$ 1,370	1,680
Interest cost	8,376	7,728
Expected return on plan assets	(12,721)	(12,432)
Amortization of loss	<u>5,017</u>	<u>6,565</u>
Net periodic pension cost	<u>\$ 2,042</u>	<u>3,541</u>

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(b) Assumptions

The Corporation used the following actuarial assumptions to determine its benefit obligations at June 30, 2019 and 2018 with measurement dates of June 30, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Discount rate	Plan I 3.30% and Plan II 3.26%	Plan I 4.03% and Plan II 3.99%

The Corporation used the following actuarial assumptions to determine its net periodic benefit cost for the years ended June 30, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Discount rate	4.03 %	3.70 %
Expected long-term rate of return on plan assets	6.80	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 9.41% and 11.30% for Plan I and Plan II, respectively, during the year ended June 30, 2019. The actual return on pension plan assets was a gain of approximately 7.30% for both Plan I and Plan II during the year ended June 30, 2018. 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.

(c) Pension Plan Assets

The asset allocation of the Corporation's pension plan at June 30, 2019 and 2018 is as follows:

	<u>2019</u>	<u>2018</u>
Equity securities	\$ 80,712	110,807
Debt securities	119,046	76,057
Other	748	1,094
Total	\$ <u>200,506</u>	<u>187,958</u>

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

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, 2019 and 2018

The following table sets forth by level, within the fair value hierarchy, the Plans' assets at fair value as of June 30, 2019:

<u>Assets</u>	<u>Total fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Mutual funds:				
Equity securities	\$ 48,235	48,235	—	—
Debt securities	32,477	32,477	—	—
Total mutual fund securities	80,712	80,712	—	—
Other securities:				
Cash and money markets	119,046	119,046	—	—
Total other securities	119,046	119,046	—	—
Total plan assets at fair value	199,758	\$ 199,758	—	—
Investments at NAV	748			
Total plan assets	\$ 200,506			

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	76,057	76,057	—	—
Total mutual fund securities	186,864	186,864	—	—
Other securities:				
Cash and money markets	50	50	—	—
Total other securities	50	50	—	—
Total plan assets at fair value	186,914	\$ 186,914	—	—
Investments at NAV	1,044			
Total plan assets	\$ 187,958			

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

The following table provides information regarding redemption of investments where NAV has been used as a practical expedient at June 30, 2019 and June 30, 2018:

	2019	2018
Private equity	\$ 748	1,044
Total	\$ 748	1,044

At June 30, 2019 and 2018, the Plans held \$748 and \$1,044, 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, 2019 and 2018. 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, 2019, the Corporation held \$748 of private equity limited partnerships that had a termination date of June 2020, but may be extended by up to three additional one-year periods.

(d) 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 2020, the Corporation contributed \$8,800 to the Plan for the plan year ended December 31, 2018. In the start of fiscal year 2019, the Corporation contributed \$5,203 to the Plan for the plan year ended December 31, 2017.

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

	Pension benefits
2020	\$ 13,168
2021	12,469
2022	12,878
2023	13,228
2024	13,514
2025–2029	69,716

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

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(9) Defined-Contribution Retirement Plans

PeaceHealth sponsors two defined-contribution retirement plans, the Southwest Washington Health System Retirement Plan and the PeaceHealth Plan. These plans cover substantially all employees of PeaceHealth meeting certain age and length of service requirements. Total defined-contribution retirement plan costs charged to operations were approximately \$77,116 and \$73,327 for the years ended June 30, 2019 and 2018, respectively, which are included in payroll taxes and benefits in the accompanying consolidated statements of operations and changes in net assets without donor restrictions.

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 \$58,624 and \$52,962 at June 30, 2019 and 2018, 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 2019 and 2018 were \$9,235 and \$7,972, respectively, and are included in payroll taxes and benefits in the accompanying consolidated statements of operations and changes in net assets without donor restrictions.

(10) Net Assets with Donor Restrictions

Net assets with donor restrictions are available for the following purposes at June 30:

	<u>2019</u>	<u>2018</u>
Purchase of property, plant, and equipment	\$ 8,009	13,788
Hospice and indigent care	14,643	15,445
Patient care	24,461	25,244
Childrens services	2,246	3,100
Training and education	1,796	3,572
Other	37,759	33,358
	<u>\$ 88,914</u>	<u>94,507</u>

Approximately \$7,188 and \$3,095 was released from restriction for capital expenditures made during 2019 and 2018, respectively.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

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 fundraising activities to several fundraising 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, 2019 and 2018, the following liabilities for annuity contracts issued under the PeaceHealth license and reserve account investments were recorded:

	<u>2019</u>	<u>2018</u>
State of Washington gift annuity liabilities (other long-term liabilities)	\$ 512	495
Gift annuity reserve accounts (other assets whose use is limited, cash, and investments)	587	619

(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, 2019 and 2018

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, 2019 are as follows:

	Operating leases
Year ending June 30:	
2020	\$ 17,896
2021	18,045
2022	17,292
2023	13,449
2024	10,852
Later years, 2025 through 2029	<u>25,632</u>
Total minimum lease payments	<u>\$ 103,166</u>

Rent expense related to all operating leases was \$27,280 and \$23,503 during the years ended June 30, 2019 and 2018, respectively, and was included in purchased services in the consolidated statements of operations and changes in net assets without donor restrictions.

(c) Collective Bargaining Agreements

Approximately 56% and 53% of the Corporation's employees are covered under collective bargaining agreements, including nurses, professional employees, and service employees as of June 30, 2019 and 2018, respectively. The Corporation is currently negotiating certain expired collective bargaining agreements. The Corporation's various collective bargaining agreements expire between March 2019 and September 2021.

(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, 2019, 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 2019 and 2018 was \$5,000 per occurrence and \$17,000 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.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

Based on actuarial studies, the Corporation has recorded an undiscounted liability for all of the self-insurance programs of approximately \$92,762 and \$91,682 at June 30, 2019 and 2018, respectively. The liabilities are classified within other current liabilities and other long-term liabilities based on the historical amounts paid within one year. Total current amounts included in other current liabilities were approximately \$19,166 and \$27,627 at June 30, 2019 and 2018, respectively. Management has recorded amounts receivable from excess insurance carriers totaling approximately \$7,302 and \$7,451 as of June 30, 2019 and 2018, 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, 2019 and 2018, the carrying value of AEIX was approximately \$4,744 and \$3,587, 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 net assets without donor restrictions.

(13) Functional Expenses

The Corporation provides general healthcare services to residents within its geographic location. Operating expenses related to providing these services classified by their natural classification on the consolidated statements of operations and changes in unrestricted net assets are presented by their functional classifications as follows for the year ended June 30:

	2019		
	Patient care	General and administrative	Total expenses
Salaries and wages	\$ 1,287,207	61,437	1,348,644
Payroll taxes and benefits	137,459	140,835	278,294
Supplies	422,468	485	422,953
Purchased services	223,358	41,039	264,397
Other	226,376	20,076	246,452
Depreciation and amortization	96,486	42,186	138,672
Interest and amortization of deferred financing costs	540	34,656	35,196
Total	<u>\$ 2,393,894</u>	<u>340,714</u>	<u>2,734,608</u>

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

	2018		
	Patient care	General and administrative	Total expenses
Salaries and wages	\$ 1,205,374	55,314	1,260,688
Payroll taxes and benefits	128,341	128,185	256,526
Supplies	397,637	738	398,375
Purchased services	190,380	31,299	221,679
Other	221,470	6,175	227,645
Depreciation and amortization	95,715	43,354	139,069
Interest and amortization of deferred financing costs	583	31,315	31,898
Total	\$ <u>2,239,500</u>	<u>296,380</u>	<u>2,535,880</u>

(14) Discontinued Operations – Columbia United Providers

PeaceHealth Networks' majority-owned subsidiary, Columbia United Providers (CUP), entered into an asset purchase agreement to sell certain Medicaid assets to Molina Health Care of Washington, Inc. (Molina) 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, 2019 and 2018. Total from operations of CUP were a gain of \$0 and a gain of \$4,045 for the years ended June 30, 2019 and 2018, respectively. CUP is in the final stages of discontinuation and closed as of June 30, 2019.

(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 27, 2019, which is the date the consolidated financial statements were issued.

ADDITIONAL INFORMATION

PEACEHEALTH NETWORKS

Consolidating Balance Sheet Information

June 30, 2019

(In thousands)

Assets	Obligated group	PeaceHealth Southwest Foundation	Other nonobligated group	Eliminating or consolidating adjustments	PeaceHealth consolidated
Current assets:					
Cash and cash equivalents	\$ 34,517	1,113	11,255	—	46,885
Short-term investments	862,785	—	—	—	862,785
Accounts receivable, net	356,181	—	4,113	—	360,294
Other receivables	43,076	—	623	—	43,699
Inventory of supplies	43,552	—	993	—	44,545
Prepaid expenses and other	30,039	—	481	—	30,520
Assets whose use is limited that are required for current liabilities	77	6,830	—	—	6,907
Total current assets	<u>1,370,227</u>	<u>7,943</u>	<u>17,465</u>	<u>—</u>	<u>1,395,635</u>
Assets whose use is limited:					
Cash and investments	1,314,448	20,015	1,971	—	1,336,434
Investments in joint ventures and other	98,705	5,244	15,273	(92,341)	26,881
Total assets whose use is limited	<u>1,413,153</u>	<u>25,259</u>	<u>17,244</u>	<u>(92,341)</u>	<u>1,363,315</u>
Less current portion	(77)	(6,830)	—	—	(6,907)
Net assets whose use is limited	<u>1,413,076</u>	<u>18,429</u>	<u>17,244</u>	<u>(92,341)</u>	<u>1,356,408</u>
Property, plant, and equipment:					
Land and improvements	142,351	—	—	—	142,351
Buildings, fixed equipment, and other	1,772,058	—	29,940	(22,347)	1,779,651
Moveable equipment	914,902	—	15,830	—	930,732
Construction in progress	151,420	—	20	—	151,440
Total property, plant, and equipment	<u>2,980,731</u>	<u>—</u>	<u>45,790</u>	<u>(22,347)</u>	<u>3,004,174</u>
Less accumulated depreciation	(1,727,795)	—	(18,693)	6,706	(1,739,782)
Net property, plant, and equipment	<u>1,252,936</u>	<u>—</u>	<u>27,097</u>	<u>(15,641)</u>	<u>1,264,392</u>
Interest in net assets of related foundations	95,189	102	—	(25,953)	69,338
Other assets	33,264	—	70,207	—	103,471
Total assets	<u>\$ 4,164,692</u>	<u>26,474</u>	<u>132,013</u>	<u>(133,935)</u>	<u>4,189,244</u>

PEACEHEALTH NETWORKS

Consolidating Balance Sheet Information

June 30, 2019

(In thousands)

Liabilities and Net Assets	Obligated group	PeaceHealth Southwest Foundation	Other nonobligated group	Eliminating or consolidating adjustments	PeaceHealth consolidated
Current liabilities:					
Accounts payable	\$ 135,033	—	2,911	—	137,944
Accrued payroll, payroll taxes, and employee benefits	147,833	—	2,587	—	150,420
Accrued interest payable	4,193	—	—	—	4,193
Other current liabilities	40,319	—	293	—	40,612
Pending trades payable	17,348	—	—	—	17,348
Current portion of long-term debt	26,011	—	—	(1,078)	24,933
Total current liabilities	<u>370,737</u>	<u>—</u>	<u>5,791</u>	<u>(1,078)</u>	<u>375,450</u>
Other long-term liabilities	331,144	—	9,769	—	340,913
Long-term debt, net of current portion	986,474	—	9,791	(17,379)	978,886
Net assets:					
Without donor restrictions, controlling interest	2,386,113	7,254	101,433	(94,948)	2,399,852
Without donor restrictions, noncontrolling interest	—	—	5,229	—	5,229
With donor restrictions	90,224	19,220	—	(20,530)	88,914
Total net assets	<u>2,476,337</u>	<u>26,474</u>	<u>106,662</u>	<u>(115,478)</u>	<u>2,493,995</u>
Total liabilities and net assets	<u>\$ 4,164,692</u>	<u>26,474</u>	<u>132,013</u>	<u>(133,935)</u>	<u>4,189,244</u>

See accompanying independent auditors' report.

PEACEHEALTH NETWORKS

Consolidating Statement of Operations and
Changes in Net Assets Without Donor Restrictions Information

Year ended June 30, 2019

(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	\$ 2,684,609	—	31,344	—	2,715,953
Other operating revenue	57,192	1,484	11,402	(2,083)	67,995
Total revenues	<u>2,741,801</u>	<u>1,484</u>	<u>42,746</u>	<u>(2,083)</u>	<u>2,783,948</u>
Expenses:					
Salaries and wages	1,330,633	—	18,011	—	1,348,644
Payroll taxes and benefits	274,461	—	3,833	—	278,294
Supplies	418,569	—	4,614	(230)	422,953
Purchased services	259,592	—	5,064	(259)	264,397
Other	241,847	1,715	2,890	—	246,452
Depreciation and amortization	135,459	—	3,950	(737)	138,672
Interest and amortization of deferred financing costs	35,791	—	739	(1,334)	35,196
Total expenses	<u>2,696,352</u>	<u>1,715</u>	<u>39,101</u>	<u>(2,560)</u>	<u>2,734,608</u>
Income from operations	<u>45,449</u>	<u>(231)</u>	<u>3,645</u>	<u>477</u>	<u>49,340</u>
Other income (expense):					
Investment income, net	104,395	(123)	—	(738)	103,534
Net change in interest rate swaps	(40,346)	—	—	—	(40,346)
Other	(3,931)	—	7	—	(3,924)
Total other income	<u>60,118</u>	<u>(123)</u>	<u>7</u>	<u>(738)</u>	<u>59,264</u>
Excess of revenues over expenses from continued operations	105,567	(354)	3,652	(261)	108,604
Net assets released from restrictions for property, plan, and equipment	7,188	—	—	—	7,188
Change in interest in net assets of related foundations	751	—	—	(751)	—
Change in pension liability	(15,337)	—	—	—	(15,337)
Other changes in net assets	3,444	—	78,604	(83,876)	(1,828)
Increase in net assets without donor restrictions	<u>\$ 101,613</u>	<u>(354)</u>	<u>82,256</u>	<u>(84,888)</u>	<u>98,627</u>

See accompanying independent auditors' report.

PEACEHEALTH NETWORKS

Consolidating Statement of Changes in Net Assets Information

Year ended June 30, 2019

(In thousands)

	Obligated group	PeaceHealth Southwest Foundation	Other nonobligated group	Eliminating or consolidating adjustments	PeaceHealth consolidated
Net assets at June 30, 2018	\$ 2,381,343	29,254	24,407	(34,043)	2,400,961
Excess of revenues over expenses from continued operations	105,566	(354)	3,654	(262)	108,604
Other restricted contributions	7,188	—	—	—	7,188
Net assets released from restrictions	—	(930)	—	—	(930)
Transfer to related division	(917)	—	917	—	—
Change in interest in net assets of related foundations	(5,770)	30	—	2,703	(3,037)
Change in pension liability	(15,337)	—	—	—	(15,337)
Other changes in net assets	4,263	(1,529)	77,687	(83,875)	(3,454)
Change in net assets	94,993	(2,783)	82,258	(81,434)	93,034
Net assets at June 30, 2019	\$ <u>2,476,336</u>	<u>26,471</u>	<u>106,665</u>	<u>(115,477)</u>	<u>2,493,995</u>

See accompanying independent auditors' report.