

CONSOLIDATED FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

Phoenix Children's Hospital and Affiliates
Years Ended December 31, 2017 and 2016
With Reports of Independent Auditors

Ernst & Young LLP



Building a better
working world

Phoenix Children’s Hospital and Affiliates

Consolidated Financial Statements and
Supplementary Information

Years Ended December 31, 2017 and 2016

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Report of Independent Auditors

The Board of Directors

Phoenix Children's Hospital and Affiliates

We have audited the accompanying financial statements of Phoenix Children's Hospital and Affiliates, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Phoenix Children's Hospital and Affiliates as of December 31, 2017 and 2016, and the changes in their net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

May 2, 2018

Phoenix Children's Hospital and Affiliates

Consolidated Balance Sheets (In Thousands)

	December 31	
	2017	2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 40,248	\$ 50,501
Short-term investments	525,698	461,010
Accounts receivable, net of allowance for doubtful accounts of \$27,408 and \$21,055 in 2017 and 2016, respectively	121,127	93,689
Contributions receivable, net	6,382	7,430
Inventory	13,095	12,872
Other current assets	17,145	37,002
Total current assets	723,695	662,504
Assets limited as to use:		
Assets held by trustee	39,443	39,926
Other restricted cash and cash equivalents	77,382	76,954
Investments	28,990	22,719
Charitable remainder trust investments	458	1,550
Endowment investments	10,350	8,918
Total assets limited as to use	156,623	150,067
Contributions receivable, less current portion	3,073	3,965
Interest rate swap assets	-	1,797
Property and equipment, net	542,427	535,778
Other long-term assets	39,733	27,940
Total assets	\$ 1,465,551	\$ 1,382,051
Liabilities and net assets		
Current liabilities:		
Accounts payable, accrued liabilities and other	\$ 102,976	\$ 99,490
Margin payable	-	18,500
Current portion of long-term debt	10,826	10,640
Total current liabilities	113,802	128,630
Annuities payable, less current portion	99	40
Interest rate swap obligations	69,903	69,168
Long-term debt, less current portion	551,647	561,024
Other liabilities	89,622	81,481
Total liabilities	825,073	840,343
Net assets:		
Unrestricted	582,421	485,313
Temporarily restricted	42,696	42,936
Permanently restricted	12,760	9,971
Total Phoenix Children's Hospital net assets	637,877	538,220
Unrestricted – noncontrolling interest	2,601	3,488
Total net assets	640,478	541,708
Total liabilities and net assets	\$ 1,465,551	\$ 1,382,051

See accompanying notes.

Phoenix Children's Hospital and Affiliates

Consolidated Statements of Operations

(In Thousands)

	Year Ended December 31	
	2017	2016
Unrestricted revenues:		
Patient service revenue before provision for bad debts	\$ 833,194	\$ 799,066
Provision for bad debts	(21,139)	(18,289)
Net patient service revenue	812,055	780,777
Other operating revenue	26,108	17,472
Donations, gifts, and contributions	15,179	9,161
Net assets released from restrictions used for operations	10,553	9,280
	863,895	816,690
Expenses:		
Employee compensation and benefits	435,699	393,906
Supplies, purchased services, and professional fees	268,375	267,539
Operating and other expenses	41,656	41,057
Depreciation and amortization	44,639	43,319
Interest, net of amounts capitalized	26,221	27,206
	816,590	773,027
Income from operations	47,305	43,663
Other income (loss):		
Net investment income	44,156	32,904
Change in fair value of interest rate swaps	(2,532)	7,246
Gain on acquisition	1,882	—
Total other income	43,506	40,150
Excess of revenues over expenses	90,811	83,813
Less excess of revenues over expenses attributable to non-controlling interest	1,278	3,191
Excess of revenues over expenses attributable to Phoenix Children's Hospital	89,533	80,622
Capital distribution	(2,165)	(2,625)
Net assets released from restrictions used for purchase of property and equipment	7,575	20,310
Increase in unrestricted net assets	\$ 94,943	\$ 98,307

See accompanying notes.

Phoenix Children's Hospital and Affiliates

Consolidated Statements of Changes in Net Assets
(In Thousands)

	Year Ended December 31	
	2017	2016
Unrestricted net assets:		
Excess of revenues over expenses	\$ 89,533	\$ 80,622
Net assets released from restrictions used for purchase of property and equipment	<u>7,575</u>	20,310
Increase in unrestricted net assets	<u>97,108</u>	100,932
Non-controlling interest:		
Excess of revenues over expenses	1,278	3,191
Capital distribution	<u>(2,165)</u>	(2,625)
(Decrease) increase in non-controlling interest	<u>(887)</u>	566
Temporarily restricted net assets:		
Donations, gifts, and contributions	17,359	22,340
Net assets released from restrictions used for operations and purchase of property and equipment	<u>(18,128)</u>	(29,591)
Investment income	529	531
Decrease in temporarily restricted net assets	<u>(240)</u>	(6,720)
Permanently restricted net assets:		
Contributions and other	<u>2,789</u>	463
Increase in permanently restricted net assets	<u>2,789</u>	463
Change in net assets	<u>98,770</u>	95,241
Net assets, beginning of year	<u>541,708</u>	446,467
Net assets, end of year	<u><u>\$ 640,478</u></u>	<u><u>\$ 541,708</u></u>

See accompanying notes.

Phoenix Children's Hospital and Affiliates

Consolidated Statements of Cash Flows (In Thousands)

	Year Ended December 31	
	2017	2016
Operating activities		
Change in net assets	\$ 98,770	\$ 95,241
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Provision for bad debts	21,139	18,289
Provision for contributions receivable	1,286	231
Amortization of bond premium	(1,468)	(1,608)
Investments classified as trading and other restricted cash	(70,761)	(82,754)
Change in fair value of interest rate swaps	2,532	(7,246)
Depreciation and amortization	44,639	43,319
Restricted contributions received	(20,148)	(22,803)
(Increase) decrease in:		
Accounts receivable	(45,737)	(23,633)
Contributions receivable	654	(1,035)
Inventory	(223)	(841)
Other current assets	20,391	40,431
Other long-term assets	(1,024)	(827)
Increase (decrease) in:		
Accounts payable, accrued liabilities, and other	1,001	(15,147)
Other liabilities	8,200	5,350
Net cash provided by operating activities	<u>59,251</u>	<u>46,967</u>
Investing activities		
Purchase of property and equipment	(50,435)	(47,648)
Proceeds from assets held by trustee	31,426	29,815
Purchase of assets held by trustee	(31,909)	(30,551)
Acquisitions	(12,058)	-
Net cash used in investing activities	<u>(62,976)</u>	<u>(48,384)</u>
Financing activities		
Proceeds from restricted contributions	20,148	22,803
Payments of bonds payable	(9,555)	(9,225)
Proceeds from note payable	1,379	12,835
Proceeds from margin account	-	18,500
Payments on margin account	(18,500)	(62,000)
Net cash used in financing activities	<u>(6,528)</u>	<u>(17,087)</u>
Net decrease in cash and cash equivalents	(10,253)	(18,504)
Cash and cash equivalents, beginning of year	50,501	69,005
Cash and cash equivalents, end of year	<u>\$ 40,248</u>	<u>\$ 50,501</u>
Supplemental disclosure of cash flow information		
Cash paid for interest	<u>\$ 25,934</u>	<u>\$ 27,093</u>
Supplemental disclosures of noncash investing and financing activity		
(Decrease) increase of acquisitions of property and equipment included in accounts payable and other liabilities	<u>\$ (906)</u>	<u>\$ 3,601</u>

See accompanying notes.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements

December 31, 2017

1. Organization and Operations

Phoenix Children's Hospital (the Hospital) is Arizona's only licensed nonprofit children's hospital providing care in more than 70 pediatric subspecialties to the state's pediatric patients. Six Centers of Excellence at the Hospital offer interdisciplinary care, including the Center for Cancer and Blood Disorders, the Phoenix Children's Heart Center, the Barrow Neurological Institute at Phoenix Children's Hospital, the Center for Pediatric Orthopedics, Level One Pediatric Trauma Center, and the Neonatal Intensive Care Unit. The Hospital is one of the ten largest freestanding children's hospitals in the United States based on number of beds.

In addition to the Hospital's main campus near downtown Phoenix, Arizona, the Hospital opened a 22-bed pediatric unit at Mercy Gilbert Medical Center (a Dignity Health hospital) in Gilbert, Arizona in October 2014. The Hospital also operates freestanding pediatric clinics in Mesa, Scottsdale, Glendale, Avondale, Yuma, and Flagstaff, Arizona that offer specialty care and advanced urgent care.

In 2017, the Hospital entered into an agreement with Dignity Health for the construction of a women's and children's hospital on the Dignity Health Mercy Gilbert campus. Under the current plans, pediatric services include 48 pediatric beds, 6 pediatric operating rooms, 60 level III NICU beds and a pediatric emergency room with 24 bays with adult services that include 24 labor and delivery rooms and 48 post-partum beds. Dignity Health will fund the construction and the Hospital will lease its portion of the space. In return for Dignity Health's relative contribution of its historic pediatric volume, Dignity Health has the rights to 33.3% interest in the project available free cash flow.

The Phoenix Children's Hospital Foundation (the Foundation) was established to solicit gifts and grants, manage fundraising, and provide other philanthropic support for the Hospital, which is the sole statutory member of the Foundation. Funds raised by the Foundation are used for clinical programs, support services, charitable care coverage, research initiatives, capital programs, facility upgrades, and community outreach.

Cambridge Arizona Insurance Company (the Captive), a wholly owned subsidiary of the Hospital, provides captive insurance coverage to Phoenix Children's Hospital and related affiliates. The Captive specifically provides professional and general liability insurance pursuant to the provisions of Arizona Revised Statutes 20-1098, and has been approved by the State of Arizona Department of Insurance.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

1. Organization and Operations (continued)

The Hospital is a member-based Arizona nonprofit corporation. In 2011, the Hospital approved a strategic affiliation with Dignity Health (Dignity)(see Note 17). At December 31, 2017, the Hospital's members were Children's Healthcare of Arizona, Inc. (the Parent), an Arizona nonprofit holding corporation exempt from income taxes under Internal Revenue Code (the Code) Section 501(c)(3), and Dignity.

Phoenix Children's Care Network (PCCN), a wholly owned networking contracting company, was created by the Hospital to facilitate future efforts to jointly contract, along with other area providers, with payors.

In order to consolidate and expand its cardiology service line, the Hospital and Obstetrix Medical Group of Phoenix, P.C. (OBX) formed an integrated pediatric cardiology practice named Arizona Pediatric Cardiology, LLC (APC). Simultaneously, the Hospital and APC Holdings, LLC, a wholly owned subsidiary of OBX, formed Phoenix Children's Cardiology Diagnostics LLC (PCCD) to manage the cardiology product line for the Hospital. The Hospital originally owned 25% of APC; however, in March 2017, the Hospital purchased the remaining 75% from OBX and integrated the entity into operations (see Note 3). The Hospital owns 62.5% of PCCD, and the financial statements of PCCD are included in the accompanying consolidated financial statements of the Hospital.

Phoenix Children's Property Development, LLC (PCPD) is owned 90% by the Hospital and 10% by the Foundation. The financial statements of PCPD are included in the accompanying consolidated financial statements. PCPD was formed to develop and own the assets associated with the build-out of the ninth floor of the Hospital tower financed pursuant to a New Markets Tax Credit financing, which closed in December 2014.

The Hospital and third party CSSPMI Holdings, LLC formed Chan Soon-Shiong Children's Precision Medicine Institute at Phoenix Children's Hospital, LLC (CSSCMI) to provide state-of-the-art molecular profiling services to include genomic and transcriptome sequencing and proteomic analyses, computational and data management and analysis capabilities and the resulting advancement in pediatric care related thereto. The business venture will serve as a coordinator of omics analysis on behalf of the Hospital and other pediatric facilities across the country in connection with developing a national pediatric consortium. The Hospital owns 49% of the business venture and records its investment using the equity method.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

1. Organization and Operations (continued)

In January 2017, the Hospital entered into an agreement to purchase 100% of the stock in a multi-physician general surgery practice located on the main campus of the Hospital. During 2017, the Hospital integrated the operations of the practice into the Hospital's medical group and subsequently liquidated the legal entity (see Note 3).

2. Significant Accounting Policies

Basis of Consolidation

The accompanying consolidated financial statements include the accounts of the Hospital and its wholly owned subsidiaries, the Foundation, the Captive, PCCN and PCPD. The Hospital also holds a controlling interest in PCCD, and its financial statements are also included within the consolidated financial statements. These entities are collectively referred to as the Company. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States (U.S. GAAP) 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 financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair Value Measurements

The carrying values of financial instruments classified as current assets and current liabilities approximate fair value due to their liquidity and short-term natures. The fair values of other financial instruments are disclosed in their respective notes.

Cash and Cash Equivalents

Cash and cash equivalents include certain highly liquid investments with an original maturity of three months or less at the date of purchase. The Company invests a portion of its surplus operating funds in money market and mutual funds. These funds generally invest in highly liquid U.S. government and U.S. government agency obligations.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are presented at fair value based on quoted market prices in active markets at the balance sheet date. Short-term investments in certificates of deposit are recorded at amortized cost, which approximates market value. The Company designates its investment portfolio as trading. Accordingly, investment income or loss, including realized and unrealized gains and losses on investments, interest, and dividends, is included in the excess of revenues over expenses, unless their use is temporarily or permanently restricted by donor stipulations or by law.

Investment and dividend income is recognized when earned.

Donor-restricted investment income is reported as an increase or decrease in temporarily restricted net assets or permanently restricted net assets, depending on the type of restriction. Realized gains and losses are calculated based upon the specific cost of the investment.

Inventory

Inventory, consisting primarily of medical supplies and pharmaceuticals, is stated at the lower of cost or market value, utilizing the first-in, first-out method of accounting.

Assets Limited as to Use

Assets limited as to use include proceeds from bonds payable held by a trustee in the reserve, debt service reserve, interest and revenue funds as required by the 2012A Loan and Trust Agreements and the 2013A-1, A-2, A-3 and B Loan Agreements.

Assets limited as to use also include charitable remainder trust investments, endowment investments, amounts held by a commercial bank as collateral against mark-to-market adjustments in accordance with the Company's swap agreements and Company-held retirement funds and donor-restricted funds included in short-term investments.

The fair values of assets limited as to use were estimated based on quoted market prices of the investments in active markets.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Derivative Instruments

The Company has various interest rate swaps that are used to manage the overall cost of borrowing. These interest rate swaps do not qualify as hedges. Derivatives that do not qualify as hedges must be adjusted to fair value through the consolidated statements of operations. Therefore, the changes in their fair values are recognized in the consolidated statements of operations within the excess of revenues over expenses. The derivative instruments and related collateral are recorded at gross fair value on the consolidated balance sheets.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations and leasehold improvements are amortized over the shorter period of the lease term or the estimated useful life of the asset. Such amortization is included in depreciation and amortization in the consolidated statements of operations. Interest cost incurred on borrowed funds during the period of construction, less interest income on qualified borrowed funds of capital assets, is capitalized as a component of the cost of acquiring those assets.

Costs incurred in the development and installation of software for internal use are expensed or capitalized, depending on whether they are incurred in the preliminary project stage, application development stage, or post-implementation stage. Amounts capitalized are amortized over the useful life of the developed asset following project completion.

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

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Income Taxes

The Hospital, Foundation, and Captive are not-for-profit corporations that have been recognized as tax-exempt entities pursuant to Section 501(c)(3) of the Code. PCCN is a single-member limited liability company whose sole member is the Hospital. PCCN is disregarded for federal income tax purposes and any activity of PCCN is reported on the tax return of the Hospital. PCPD is a limited liability company and is wholly owned by the Hospital and the Foundation, both not-for-profit corporations. PCCD is a limited liability company whose activities further the charitable purpose of the Hospital. Management is of the opinion that substantially all of the Hospital's, Foundation's, Captive's, PCCN's and PCPD's activities are related to their exempt purposes, and PCCD's activities will not result in taxable income. No material uncertain tax positions have been identified or recorded in the consolidated financial statements at December 31, 2017 or 2016. The Hospital, Foundation, and Captive each currently file a Form 990 in the U.S. federal jurisdiction and comparable forms in the state of Arizona. The Company is not subject to income tax examinations prior to 2014 in major tax jurisdictions.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Company has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Company in perpetuity.

Donor-Restricted Gifts

Unconditional promises to give that are expected to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using risk-free interest rates applicable to the years in which the promises are received. Amortization of the discounts is included in fundraising revenue. Conditional promises to give are not included as revenue until the conditions are substantially met. The promises to give are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, either through the passage of time or fulfillment of purpose, temporarily restricted net assets are reclassified as unrestricted net assets and reported as net assets released from restrictions in the consolidated statements of changes in net assets. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted revenue in the consolidated statements of operations.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Endowments

The Foundation's endowment consists of individual donor-restricted funds established for a variety of purposes. Net assets associated with endowment funds are classified and reported based on donor-imposed restrictions.

Management has interpreted the Uniform Prudent Management of Institutional Funds Act as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. In this regard, the Foundation classifies the following as permanently restricted net assets: (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified in temporarily restricted net assets until those amounts are specifically considered and appropriated for expenditure by the Foundation. Decreases in the fair value of assets associated with endowment balances below the corpus of a donor's original gift are reported as adjustments to unrestricted net assets.

The Foundation's investment and spending policy for endowment assets attempts to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. The Foundation expects its endowment funds, over time, to provide an average rate of return of at least 5% annually. To satisfy its long-term rate-of-return objectives, the Foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation and current yield, thereby targeting a diversified asset allocation strategy that places a greater emphasis on equity-based investments. Actual returns in any given year may vary from the Foundation's estimated rate of return.

Net Patient Service Revenue, Accounts Receivable and Allowance for Doubtful Accounts

The Hospital records revenue in the period health care services are provided based upon the estimated amounts due from patients and third-party payors. The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts before estimates for bad debts from patients, third-party payors, and others

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. If uninsured patients are unable or unwilling to pay for services provided, the Hospital records a provision for bad debts related to the uninsured patients in the period the services are provided. For uninsured patients who do not qualify for charity care, the Hospital recognizes revenue on the basis of standard rates for services provided.

Laws and regulations governing Medicare and the Arizona Health Care Cost Containment System (AHCCCS) programs are complex and subject to interpretation. As a result, there is a reasonable possibility that actual results could differ from recorded estimates by a material amount in the near term. Amounts received from third-party payors in excess of expected reimbursement are reflected as third-party liabilities and included in accounts payable and accrued liabilities in the consolidated balance sheets. Accounts receivable consist principally of amounts due from patient services rendered.

The allowance for doubtful accounts is based on management's assessment of historical and expected net collections of accounts receivable, considering economic conditions, trends in health care coverage, and other collection indicators. Periodically, management assesses the adequacy of the allowance based on historical write-off experience by payor category. The results of these reviews are used to make modifications to the allowance as appropriate. After satisfaction of amounts due from insurance and reasonable collection efforts have been exhausted, accounts receivable are written off and deducted from the allowance. For receivables associated with self-pay patients (which include both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Hospital records a significant provision for bad debts in the period of service on the basis of past experience, which indicates that many patients are unable or unwilling to pay the portion of the bill for which they are financially responsible. The Hospital did not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors in 2017 or 2016.

Charity and Uncompensated Care

The Hospital provides care to patients who meet certain criteria under its charity care policy, either without charge or at amounts less than its established rates. Costs of providing charity care are determined using an estimated cost-to-charge ratio. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are excluded from patient service revenue.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

The Hospital modified its financial assistance policy in 2014, to update the Federal Poverty Level, a component in its financial assistance calculation, and to add the disclosure that the Hospital's policy complied with the Affordable Care Act. In addition, the Hospital's Financial Counseling Policy was modified to incorporate additional disclosures about alternatives for families seeking financial assistance.

The Hospital also provides services to other indigent patients under AHCCCS, which reimburses at amounts less than the cost of the services provided to the recipients. The difference between the cost of services provided to these indigent persons and the expected reimbursement is included in the estimated cost of uncompensated care. In 2012, AHCCCS received approval from the Centers for Medicare & Medicaid Services (CMS) to establish a Safety Net Care Pool to support uncompensated costs incurred by certain AHCCCS providers. Eligibility for the Safety Net Care Pool varied over the years, but the Hospital qualified every year. The current Safety Net Care Pool program ended on December 31, 2017. The Hospital also receives supplemental funding from AHCCCS through disproportionate share hospital and graduate medical education payments. Through the Safety Net Care Pool, disproportionate share hospital and graduate medical education payments (supplemental payments), the Hospital has received AHCCCS funding to offset a significant portion of the shortfall in reimbursement for providing care to AHCCCS patients (see Note 15).

Performance Indicator

The consolidated statements of operations include excess of revenues over expenses. Changes in unrestricted net assets that are included in the consolidated statements of operations, but are excluded from excess of revenues over expenses, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions that, by donor restriction, were to be used for the purposes of acquiring such assets).

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Recently Issued Accounting Pronouncements

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

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Under the New Revenue Standard, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. The Company performed an evaluation over each of its major revenue streams under the New Revenue Standard. In particular, as part of the net patient service revenue stream evaluation, the Company used the portfolio approach as a practical expedient to group payor contracts with similar characteristics, such that revenue for a given portfolio would not be materially different than if it were evaluated on a contract-by-contract basis. The Company also evaluated whether any of the revenue streams included variable consideration as well as any potential constraints to the estimate of the variable consideration. The Company anticipates that for periods subsequent to the adoption, the amounts currently classified as the provision for doubtful accounts on the consolidated statement of operations, will be treated as an implicit price concession factored into patient service revenue on the consolidated statements of operations, consistent with the intent of the standard. The New Revenue Standard also requires enhanced disclosures related to the disaggregation of revenue and other disclosures about contracts with customers, including revenue recognition policies to identify performance obligations and significant judgments in measurement and recognition.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

The Company adopted the New Revenue Standard on January 1, 2018, and has elected to use the modified retrospective method. The modified retrospective adoption method requires a company to record the transition adjustment for the New Revenue Standard, if any, as a cumulative effective adjustment to the beginning unrestricted net assets recorded as of the date of adoption. The Company does not anticipate that the transition adjustment will have a significant impact on the Company's consolidated financial statements. In addition, a provision for doubtful accounts under the New Revenue Standard is expected to be immaterial.

In August 2016, the FASB issued a new financial statement accounting standard for not-for-profit entities. This accounting standard will change the presentation of net assets into two categories, net assets with donor restrictions and net assets without donor restrictions. This accounting standard will also allow companies to elect to use either the direct or indirect cash flow method, and requires additional liquidity disclosures and presentation of expenses by both natural and functional classification. This accounting standard is effective for the Company on January 1, 2018. The accounting standard will primarily revise the presentation of the Company's net assets between net assets with and without donor restrictions and additional disclosure surrounding liquidity and functional expenditures. The Company has elected to continue to use the indirect cash flow method.

In November 2016, the FASB issued a new standard that requires restricted cash and cash equivalents to be included with cash and cash equivalents on the statement of cash flows. The new standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, with early adoption permitted. Accordingly, the new standard is effective for the Company on January 1, 2018, and is required to be adopted using a retrospective approach. Management is currently evaluating the impact of adopting this accounting standard.

In February 2016, the FASB issued a new lease accounting standard. This accounting standard requires companies that lease assets to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in its balance sheet. Lessor accounting remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. This accounting standard will also require additional disclosures about the amount, timing and uncertainty of cash flows arising from leases. This accounting standard is effective for the Company on January 1, 2019. Management is currently evaluating the impact of adopting this accounting standard.

In January 2017, the FASB issued a new intangibles-goodwill accounting standard. The accounting standard simplified the test used to evaluate goodwill and other intangibles for impairment.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Under the new accounting standard, a company will perform its annual goodwill impairment test by comparing the fair value of the reporting unit with its carrying amount. An impairment charge will be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the impairment loss recognized should not exceed the total goodwill allocated to that reporting unit. A company will still have the option to perform the qualitative assessment for a reporting unit. This accounting standard is effective for fiscal years beginning after December 15, 2020. Management is currently evaluating the impact of adopting this accounting standard.

Subsequent Events

The Company evaluates events occurring subsequent to the end of the calendar year and recognizes such events that are material in the consolidated financial statements as required by professional standards. In the preparation of the accompanying consolidated financial statements, the Company has evaluated subsequent events through May 2, 2018, the date the consolidated financial statements were issued, noting no recognized subsequent events or non-recognized subsequent events requiring additional disclosure.

3. Acquisitions

Arizona Pediatric Cardiology, LLC

Arizona Pediatric Cardiology, LLC (APC) was previously 25% owned by the Hospital and recorded as an equity investment. In March 2017, the Hospital purchased the remaining membership interests of APC from OBX for \$5,833,000. The Hospital recognized a gain related to the remeasurement at fair value of the previously held equity interest in other income in the consolidated financial statements, resulting in equity investment balance of approximately \$1,458,000. As a result of the membership transfer agreement, APC is currently a wholly-owned entity of the Hospital. The transaction has been accounted for as an acquisition in accordance with the not-for-profit business combination accounting standards. The fair value assigned to the assets acquired are as follows (in thousands):

Receivables	\$	1,854
Other assets		328
Liabilities		(963)
Intangibles		3,428
Goodwill		2,644
	\$	<u>7,291</u>

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

3. Acquisitions (continued)

Pediatric Surgeons of Phoenix

In January 2017, the Hospital acquired Saguaro Children's Surgery, Ltd., doing business as Pediatric Surgeons of Phoenix (PSP), a multi-physician general surgery practice, which became a wholly-owned entity of the Hospital. Total cash consideration paid for the general physician surgery practice amounted to \$4,343,000. PSP was fully integrated into the Hospital, including transfer of all physicians; subsequently PSP was liquidated. The liquidation of PSP generated a current tax liability of \$1,508,000, which was recorded by the Hospital as of the acquisition date. The transaction has been accounted for as an acquisition in accordance with the not-for-profit business combination accounting standards. The fair value assigned to the assets acquired are as follows (in thousands):

Receivables	\$	1,272
Other assets		306
Tax liability		(1,508)
Intangibles		1,354
Goodwill		2,919
	\$	<u>4,343</u>

4. Concentrations of Credit Risk

The Company's consolidated financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents, restricted cash, short-term investments, assets held by trustee, charitable remainder trust and endowment investments and patient accounts receivable.

The Company's cash and cash equivalents and restricted cash are held by large financial institutions, and the Company's investment policy limits its exposure to concentrations of credit risk. In the normal course of business, the Company maintains cash balances in excess of the Federal Deposit Insurance Corporation's (FDIC) insurance limit. The Company routinely reviews the credit ratings of the financial institutions in which it holds funds; management believes that this related credit risk is minimal.

The Hospital provides health care services and grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. An estimated allowance for doubtful accounts, as well as contractual allowances, are maintained at levels considered adequate to reduce the account balances to net realizable value.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

4. Concentrations of Credit Risk (continued)

The mix of net accounts receivable from patients and third-party payors at December 31 was as follows:

	2017	2016
AHCCCS	43%	46%
Contracted health care agreements	49	44
Other commercial payors	4	6
Patients and other	4	4
	100%	100%

The Hospital's allowance for doubtful accounts increased from \$21,055,000 at December 31, 2016, to \$27,408,000 at December 31, 2017. The 2017 allowance for doubtful accounts was 22.6% of net accounts receivable, increasing from 22.5% of net accounts receivable in 2016. Write-offs of patient accounts decreased from \$19,162,000 in 2016 to \$18,268,000 in 2017. Net patient service revenue increased in 2017 and 2016 by approximately \$12,900,000 and \$13,000,000, respectively, for changes in estimates related primarily to higher than expected collections on transplant related services.

5. Investments and Assets Limited as to Use

Investments and endowment investments were composed of money market funds, mutual funds, and certificates of deposit at December 31, 2017 and 2016.

Net investment income included in other income consisted of the following for the years ended December 31 (in thousands):

	2017	2016
Net investment income (loss):		
Interest and dividend income, net	\$ 19,571	\$ 17,453
Realized losses on sales of securities	(1,691)	(1,362)
Net unrealized gains	26,276	16,813
	\$ 44,156	\$ 32,904

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

5. Investments and Assets Limited as to Use (continued)

An independent third-party trustee, designated in the 2012A Loan and Trust Agreements under which the Hospital's Series 2012A Bonds were issued, is the custodian of certain assets designated under the Hospital's Series 2012A Bonds and the Hospital's Series 2013 A-1, 2013 A-2, 2013 A-3, and 2013B Bonds. At December 31, assets held in trust by the third-party trustee were designated as follows (in thousands):

	2017	2016
2012A Debt Service Reserve Fund	\$ 23,430	\$ 24,076
2013 Reserve Funds	15,237	15,174
2013 Interest Funds	605	506
2013 Revenue Fund	171	170
	\$ 39,443	\$ 39,926

Other restricted cash, investments, endowment and charitable remainder trust investments are designated as follows at December 31 (in thousands):

	2017	2016
Swap collateral	\$ 46,471	\$ 48,788
Donor-restricted	34,706	32,156
Deferred compensation	36,003	29,197
	\$ 117,180	\$ 110,141

The Foundation held approximately \$10,350,000 and \$8,918,000 at December 31, 2017 and 2016, respectively, in endowments that were classified as permanently restricted. The endowment portfolio incurred net unrealized gains of approximately \$499,000 and \$401,000 in 2017 and 2016, respectively.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

6. Contributions Receivable

Contributions receivable consisted of the following at December 31 (in thousands):

	2017	2016
Amounts due in:		
Less than one year	\$ 7,103	\$ 8,584
Greater than one year	4,692	5,440
Total	11,795	14,024
Less allowance for uncollectible contributions and present value discount	(2,340)	(2,629)
Contributions receivable, at net present value	9,455	11,395
Less current portion, at net present value	(6,382)	(7,430)
Long-term contributions receivable, at net present value	\$ 3,073	\$ 3,965

As of December 31, 2017 and 2016, approximately \$1,656,000 and \$2,622,000, respectively, of the contributions receivable at net present value were from parties affiliated with the Company.

7. Property and Equipment

Property and equipment consisted of the following at December 31 (in thousands):

	2017	2016
Land and land improvements	\$ 41,086	\$ 40,202
Buildings and improvements	601,373	553,796
Leasehold improvements	22,399	21,142
Equipment	208,209	188,968
Assets under lease arrangements	15,113	15,113
	888,180	819,221
Less accumulated depreciation and amortization	(370,523)	(326,540)
	517,657	492,681
Construction-in-progress	24,770	43,097
	\$ 542,427	\$ 535,778

Accumulated amortization for property and equipment held under lease arrangements totaled approximately \$12,355,000 and \$12,176,000 at December 31, 2017 and 2016, respectively.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

7. Property and Equipment (continued)

The Hospital capitalizes costs associated with software developed internally or obtained for internal use. Such capitalized costs (included in equipment) totaled approximately \$45.1 million and \$41.5 million as of December 31, 2017 and 2016, respectively. Capitalized software development costs are amortized on a straight-line basis, based upon an estimated useful life of three to ten years for the related asset, beginning when the asset is ready for its intended use. Amortization of capitalized software development costs for the years ended December 31, 2017 and 2016 totaled approximately \$4,073,000 and \$3,024,000, respectively.

8. Accounts Payable, Accrued Liabilities, and Other

Accounts payable, accrued liabilities, and other consisted of the following at December 31 (in thousands):

	<u>2017</u>	<u>2016</u>
Trade accounts payable	\$ 55,646	\$ 52,866
Accrued liabilities	38,614	39,135
Accrued payroll and benefits	8,716	7,489
	<u>\$ 102,976</u>	<u>\$ 99,490</u>

In December 2016, the Company borrowed \$18,500,000 on margin, from Charles Schwab & Co. on a short-term basis using the Company's investments as collateral. The borrowing was fully repaid in January 2017. There was no margin payable outstanding as of December 31, 2017.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt

Long-term debt consisted of long-term bonds payable and long-term notes payable at December 31 as follows (in thousands):

	2017	2016
Series 2012A Bonds	\$ 256,825	\$ 266,380
Series 2013A-1 Bonds	75,000	75,000
Series 2013A-2 Bonds	75,000	75,000
Series 2013A-3 Bonds	75,000	75,000
Series 2013B Bonds	50,000	50,000
Series 2012A Bonds original issue premium	9,143	10,521
Series 2013B Bonds original issue premium	3,001	3,104
Series 2012 unamortized debt issuance costs	(3,752)	(4,042)
Series 2013 unamortized debt issuance costs	(3,880)	(4,043)
Notes payable	26,136	24,744
	562,473	571,664
Less current portion	10,826	10,640
Long-term debt, less current portion	\$ 551,647	\$ 561,024

On September 1, 2012, in connection with a refinancing plan for its Series 2007 Bonds, the Hospital issued \$284.6 million of Series 2012A Revenue Refunding Bonds (Series 2012A Bonds) through the Arizona Health Facilities Authority (the Authority) to repurchase and extinguish \$225.0 million of the then-outstanding Series 2007 Bonds and to reduce the notional amount on three of the Hospital's outstanding interest rate swap arrangements (see Note 10). The Series 2012A Bonds were sold with an original issue premium of \$17.1 million.

The Series 2012A Bonds are collateralized by substantially all of the Hospital's assets under, and pursuant to, a Master Trust Indenture (2012A MTI) dated September 1, 2012. The 2012A Bonds bear interest at a weighted average fixed rate of 4.57%. The Hospital was required to pay interest only until 2015 when principal payments on the Series 2012A Bonds became payable in varying annual installments. On February 1, 2022, the Hospital can call all of the Series 2012A Bonds maturing after February 1, 2023, for par and any accrued interest. The Series 2012A Bonds maturing on February 1, 2042, are also subject to mandatory redemption prior to their stated maturity from the Hospital's sinking fund, in installments ranging from \$7.6 million to \$15.0 million.

The 2012A MTI also requires the Hospital to maintain a debt service reserve fund to be used by the trustee, if required, to make payments on its Series 2012A Bonds. Amounts held in the debt service reserve fund are classified as assets whose use is limited at December 31, 2017 and 2016.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

In February 2013, the Hospital completed the refinancing plan for its Series 2007 Bonds by issuing three series of 2013A Revenue Refunding Bonds (Series A-1, A-2 and A-3, collectively, the Series 2013A Bonds) and issuing Series 2013B Revenue Bonds (the Series 2013B Bonds) (the Series 2013A Bonds and the Series 2013B Bonds are collectively referred to as the Series 2013 Bonds). The 2013A-1, A-2, and A-3 Bonds were issued for \$75 million for each series and the 2013B Bonds were issued for \$50 million. All of the Series 2013 Bonds were issued through the Authority to refund and extinguish the remaining \$225 million of Series 2007 Bonds and to provide funding for new projects, most notably the buy-out of operating leases entered into to furnish and equip the new patient service tower completed in 2011. The Series 2013A Bonds are variable rate and bear interest at the Securities Industry and Financial Markets Association (SIFMA) Index, a rate determined on the basis of the seven-day high-grade market index of tax-exempt variable-rate demand obligations, plus 1.85%. The Series 2013A-1 and A-2 Bonds are subject to mandatory tender in February 2020 and the Series 2013A-3 Bonds are subject to mandatory tender in February 2023. The 2013B Bonds bear interest at a weighted average fixed rate of 4.31%. The Hospital is required to pay interest only until 2021 when principal payments on the Series 2013B Bonds will become payable in varying annual installments, and all of the Series 2013 Bonds mature by February 1, 2048. The Series 2013 Bonds are equally collateralized with the Series 2012A Bonds by substantially all of the Hospital's assets under, and pursuant to, the 2012A MTI as supplemented by the Series 2013A and 2013B loan agreements.

In December 2014, the Hospital completed a transaction whereby it contracted to finance the build-out of its ninth floor for additional medical-surgical capacity, which was completed in 2015. The financing transaction involved New Markets Tax Credits, a program instituted by the Internal Revenue Service and U.S. Treasury to spur additional investment and additional employment in low-income areas. In connection with this financing, the Hospital provided a loan of \$8,400,000 to the sponsoring community development entity to partially fund the transaction, resulting in a note receivable for the Hospital of \$8,400,000. Two notes payable were recorded by PCPD: a \$3,840,000, 30-year note at a fixed interest rate of 1.79% with initial principal payment due 2022 and an \$8,410,000, 7-year note at a fixed interest rate of 1.79% with payment due upon maturity. Notes payable had unamortized issuance costs of \$328,000 and \$341,000 as of December 31, 2017 and 2016, respectively.

In February 2016, the Hospital exercised its option to purchase the facility in Avondale, Arizona, where it operates an ambulatory clinic and urgent care center, for \$12,835,000. The option was part of the operating lease agreement executed in 2013. In May 2017, the Hospital used \$1,379,000 to fund the buyout of several equipment operating leases. The purchases were funded with proceeds from a \$50,000,000 non-revolving line of credit issued by Bank of Arizona, N.A.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

The interest rate on this line of credit is the London Interbank Offered Rate (LIBOR) plus 0.90% and matures on February 1, 2020. The related long-term note payable was \$14,214,000 at December 31, 2017.

Future maturities of long-term debt, which includes unamortized net premium of \$12,144,000 and net issuance costs of \$7,960,000, are as follows (in thousands):

2018	\$	10,826
2019		11,238
2020		11,606
2021		18,125
2022		10,211
Thereafter		500,467
	\$	<u>562,473</u>

The Master Trust Indenture and the Loan and Trust Agreements for the Series 2012A Bonds and Series 2013 Bonds contain certain restrictive covenants, including, but not limited to, the following: restriction of the incurrence of additional borrowings; maintenance of defined liquidity ratios, such as maximum annual debt service coverage ratio and days cash on hand ratio; maintenance of tax-exempt status; and the delivery of audited financial statements within 150 days of the Company's fiscal year-end. The Company is in compliance with all covenants as of December 31, 2017.

10. Interest Rate Swaps

In 2006, the Company entered into four forward-dated interest rate swaps to economically hedge a variable rate of interest to be paid in connection with the January 1, 2007 issuance of the Series 2007 Bonds. In conjunction with the Series 2012A Bond financing, the Hospital paid \$52.7 million to amend and reduce the first, second, and third swaps' notional amounts by \$112.5 million, \$75.0 million, and \$50.0 million, respectively. Concurrent with the issuance of the Series 2013 Bonds, the first three swap agreements were further amended to change the variable receiving rate component from LIBOR to the SIFMA Municipal Swap Index and increase the fixed payment rate for seven years. This change performed was to better align the economics of these remaining swaps with the Series 2013 Bonds. At the end of seven years, the payment rates for all amended swaps revert to the rates in effect prior to the amendment.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

10. Interest Rate Swaps (continued)

The first swap agreement hedges a notional amount of \$112.5 million (the First Swap). Until the amendment concurrent with the issuance of the Series 2013 Bonds, the Hospital paid a 4.728% fixed rate and received 64.5% of the one-month LIBOR plus 1.145% from the counterparty. As of the date of issuance of the Series 2013 Bonds, the fixed-rate portion was changed to 4.997%.

The second swap agreement hedges a notional amount of \$62.5 million (the Second Swap). Until the amendment concurrent with the issuance of the Series 2013 Bonds, the Hospital paid a 4.577% fixed rate and received 64.5% of the one-month LIBOR plus 0.995% from the counterparty. As of the date of the issuance of the Series 2013 Bonds, the fixed-rate portion was changed to 4.844%.

The third swap hedges a notional amount of \$50.0 million (the Third Swap). Until the amendment concurrent with the issuance of the Series 2013 Bonds, the Hospital paid a 4.519% fixed rate and receives 64.5% of the one-month LIBOR plus 1.145% from the counterparty. As of the date of the issuance of the Series 2013 Bonds, the fixed-rate portion of the swaps was changed to 4.785%.

The fourth swap is a basis swap with an initial notional amount of \$225.0 million (the Basis Swap). The Hospital pays 67.0% of the one-month LIBOR plus 0.50% and receives 67.0% of the five-year USD ISDA Swap Rate plus 0.234% from the counterparty. The notional amount of the Basis Swap decreases over the term of the agreement.

The First Swap, Second Swap, and Third Swap all expire on February 1, 2042. The Basis Swap expires on January 5, 2041. All four of the Hospital's interest rate swap agreements require the Company to post collateral when the combined mark-to-market values of the swaps exceed a net liability threshold as determined by the Company's credit rating and the Company's days cash on hand ratio, up to a maximum posting threshold of \$80.0 million. The threshold was \$25.0 million and \$20.0 million, respectively, at December 31, 2017 and 2016. At December 31, 2017 and 2016, the Hospital had collateral outstanding with a counterparty of \$46.5 million and \$48.8 million, respectively, which is included in assets limited as to use as other restricted cash and cash equivalents.

The fair value of the swaps is determined based on contractual terms and discounted at the prevailing swap curve on the respective valuation date. The mark-to-market adjustment for these swaps during 2017 and 2016 totaled approximately \$2.5 million unfavorable and \$7.2 million favorable, respectively, as presented in the accompanying consolidated statements of operations. The net effect of the interest rate swaps recorded in interest expense was to increase the overall cost of borrowing in 2017 and 2016 by approximately \$6.0 million and \$7.1 million, respectively. All of the Company's derivative instruments were in liability positions except for the Basis Swap, which was in an asset position at December 31, 2017 and 2016.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

11. Fair Value of Financial Instruments

Fair value is defined as an exit price and represents the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the Company utilizes the following three-tier hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical instruments that are accessible at the measurement date for assets or liabilities.

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

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

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

11. Fair Value of Financial Instruments (continued)

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

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

The tables below provide information about the Company's financial assets and liabilities measured at fair value on a recurring basis at December 31, 2017 and 2016 (in thousands):

	December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b, c)
Assets					
Cash and cash equivalents	\$ 81,491	\$ 81,491	\$ -	\$ -	a
Mutual funds – domestic	370,071	370,071	-	-	a
Mutual funds – foreign	101,029	101,029	-	-	a
Common stock	9,676	9,676	-	-	a
Government mortgage-backed securities	24,348	-	24,348	-	a
Corporate bonds	29,135	-	29,135	-	a
Foreign government obligations	1,034	-	1,034	-	a
U.S. government agency obligations	65,537	-	65,537	-	a
Total assets	<u>\$ 682,321</u>	<u>\$ 562,267</u>	<u>\$ 120,054</u>	<u>\$ -</u>	
Liabilities					
Interest rate swaps	\$ 69,903	\$ -	\$ 69,903	\$ -	c
Total liabilities	<u>\$ 69,903</u>	<u>\$ -</u>	<u>\$ 69,903</u>	<u>\$ -</u>	

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

11. Fair Value of Financial Instruments (continued)

	December 31, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b, c)
Assets					
Cash and cash equivalents	\$ 107,815	\$ 107,815	\$ —	\$ —	a
Mutual funds – domestic	305,725	305,725	—	—	a
Mutual funds – foreign	81,671	81,671	—	—	a
Government mortgage-backed securities	17,521	—	17,521	—	a
Corporate bonds	22,883	—	22,883	—	a
Foreign government obligations	282	—	282	—	a
U.S. government agency obligations	75,180	—	75,180	—	a
Interest rate swap	1,797	—	1,797	—	c
Total assets	<u>\$ 612,874</u>	<u>\$ 495,211</u>	<u>\$ 117,663</u>	<u>\$ —</u>	
Liabilities					
Interest rate swaps	\$ 69,168	\$ —	\$ 69,168	\$ —	c
Total liabilities	<u>\$ 69,168</u>	<u>\$ —</u>	<u>\$ 69,168</u>	<u>\$ —</u>	

The Foundation received contributions amounting to approximately \$7,956,000 and \$9,686,000 for the years ended December 31, 2017 and 2016, respectively, that were subject to fair value measurement on a nonrecurring basis. The restricted contributions were measured based on the actual cash received or, for pledge receivables, using discounted cash flow projections (Level 2), as outlined in the income valuation approach.

As of December 31, 2017 and 2016, the estimated fair value of the Company's debt was \$560.3 million and \$564.1 million, respectively. The estimated fair value of the Company's debt was based on quoted market prices in inactive markets (Level 2).

There are no financial instruments subject to Level 3 fair value measurements in either 2017 or 2016.

Transfers to/from Levels 1, 2 and 3 are recognized at the end of the reporting period. There were no transfers between levels for either of the years ended December 31, 2017 or 2016. As of December 31, 2017 and 2016, the fair value of the swap assets and liabilities was primarily determined using techniques that are consistent with the income approach. Significant observable inputs include municipal bonds, market credit reports, treasury yields and maturity dates.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

12. Retirement Plans

401(k) Plan

The Company sponsors a defined contribution 401(k) plan (the Plan). For employees meeting certain eligibility requirements, the Plan permits each participant to contribute up to 30% of eligible compensation on a pretax basis, subject to federally mandated dollar maximums. Under the terms of the Plan, the Company is required to provide a matching contribution for employees who meet service eligibility requirements equal to a portion of the employee's contribution each year, up to a maximum of 4% of the employee's eligible compensation. Contributions by the Company totaled approximately \$9,609,000 and \$8,892,000 in 2017 and 2016, respectively.

The increase in contributions was primarily due to an increase in employees participating in the Plan and higher compensation levels resulting in higher matches. All participants are fully vested in the Plan.

SERP

The Hospital provides a deferred compensation plan (the SERP) for the exclusive benefit of certain employees who are among a select group of management or highly compensated employees. The board of directors selects those employees who are eligible to become participants in the SERP. The Hospital contributes to the SERP an amount equal to a percentage of the compensation paid to each participant during the plan year, as indicated in the SERP documents. Each participant may make compensation reduction contributions in accordance with rules set forth in the SERP documents. A participant becomes fully vested in his or her account upon one of the following events: retirement date, disability before separation from service, involuntary separation from service (other than for cause), or death, as described in the SERP documents.

Employer contributions during 2017 and 2016 were approximately \$616,000 and \$784,000, respectively. At December 31, 2017 and 2016, the SERP investment and liability balances were approximately \$2,691,000 and \$2,456,000, respectively.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

12. Retirement Plans (continued)

Deferred Compensation Plan

The Hospital provides a deferred compensation plan (the 457 Plan) for a select group of management or highly compensated employees. The Hospital contributes, for the benefit of each participant under the 457 Plan, an amount equal to a percentage of the compensation paid to each participant during the plan year, as identified in the 457 Plan document or as determined, as it may be from time to time, by action of the board of directors. The Hospital's contribution for a plan year shall not exceed the lesser of \$15,000 (or such greater dollar limit as may be in effect under Section 457(e) of the Code; the levels for 2017 and 2016 were \$18,000 or 100% of the participant's includable compensation for the year). All participants are fully vested in the 457 Plan. Hospital contributions during 2017 and 2016 were approximately \$4,281,000 and \$3,428,000, respectively. At December 31, 2017 and 2016, the 457 Plan investments and liabilities were approximately \$32,249,000 and \$26,133,000, respectively.

13. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets were available for the following purposes at December 31 (in thousands):

	<u>2017</u>	<u>2016</u>
Health care services:		
Patient care programs	\$ 35,952	\$ 30,165
Purchase of property and equipment	6,416	11,317
Charitable remainder trusts, net	328	1,454
	<u>\$ 42,696</u>	<u>\$ 42,936</u>

Permanently restricted net assets, including pledges, of approximately \$12,760,000 and \$9,971,000 at December 31, 2017 and 2016, respectively, are restricted to investments to be held in perpetuity, certain income from which is expendable to support various pediatric hospital programs.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

14. Net Patient Service Revenue

Approximately 51.0% and 50.5% of patient service revenue before provision for bad debts in 2017 and 2016, respectively, was derived from AHCCCS. Under this program, payment for certain services rendered to AHCCCS patients is reimbursed on a basis other than billed charges. The Hospital also provides services to the beneficiaries of certain other payors at amounts other than published rates. The difference between charges generated by patients and the amount reimbursable is recorded as a contractual adjustment.

Patient service revenue, net of contractual allowances and discounts and before the provision for bad debts, recognized from major payor sources for the years ended December 31 is as follows (in thousands):

	2017	2016
AHCCCS	\$ 425,331	\$ 403,688
Contracted health care agreements	330,537	324,387
Other commercial payors	10,222	16,468
Patients and other	67,104	54,523
	\$ 833,194	\$ 799,066

For the years ended December 31, 2017 and 2016, the Hospital was paid approximately \$82,000 and \$368,000, respectively, in disproportionate share payments from AHCCCS. The Hospital also received funds for graduate medical education for children's hospitals (a federal program) for the years ended December 31, 2017 and 2016, of \$2,723,000 and \$2,876,000, respectively. The Hospital recorded \$29,192,000 in AHCCCS graduate medical education funding during the year ended December 31, 2017; no funding was recorded in 2016. The non-federal share of these amounts was funded by the University of Arizona and Maricopa Integrated Health System through an intergovernmental agreement with AHCCCS in accordance with Arizona Revised Statute § 36-2903.01(G)(9)(f).

CMS originally approved the AHCCCS Safety Net Care Pool in 2012 to provide support for uncompensated costs incurred by three safety net health systems, including the Hospital. The University of Arizona provided intergovernmental transfers to fund these payments for the Hospital, pursuant to Senate Bill 1357, First Regular Session 2011.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

14. Net Patient Service Revenue (continued)

CMS terminated AHCCCS' authority to make Safety Net Care Pool payments to most providers as of December 31, 2013, but the Arizona legislature authorized the extension of the Safety Net Care Pool for the Hospital. Subsequently, CMS approved multiple extensions of the Safety Net Care Pool for the Hospital, ultimately through December 31, 2017.

In 2014, the city of Phoenix (the City) adopted the Pediatric Health Care Initiative through which it established a special fund to accept donations (other than non-bona fide provider-related donations) intended to benefit care at freestanding children's hospitals in the City. Donated funds are transferred by the City to AHCCCS to be used as the non-federal share of Safety Net Care Pool payments to the Hospital. The initiative received approximately \$1,407,000 in 2016, resulting in funding to the Hospital through the Safety Net Care Pool of approximately \$4,574,000 in 2016. No funding was received during 2017 through this fund.

In total, the Hospital recorded Safety Net Care Pool funding of \$92,478,000 and \$125,331,000 during the years ended December 31, 2017 and 2016, respectively, including payments funded through the City of Phoenix Pediatric Health Care Initiative, as well as through intergovernmental transfers from the University of Arizona and Maricopa Integrated Health System. All of the 2017 funding was received before December 31, 2017. A receivable of \$18,700,000 was recorded at December 31, 2016 related to 2016 funding, which was received in January 2017.

The policy of the Hospital is to reflect disproportionate share funds, graduate medical education funding, and other AHCCCS supplemental payments as offsets to contractual adjustments. Accordingly, these amounts have been included in net patient service revenue. The estimation of funding levels to be received from the Safety Net Care Pool is uncertain and subject to change until such time as CMS and AHCCCS have reviewed required filings for completeness and propriety of expenditures. Management has made estimates and assumptions based on its past experience in these programs to determine the recorded funding levels, but actual results may differ from the estimates.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

15. Charity and Uncompensated Care

The shortfall of reimbursements received from AHCCCS for the cost of providing medical care to AHCCCS patients is classified by the Hospital as uncompensated care, after applying proceeds of supplemental payments, generally funded through intergovernmental transfer agreements, to partially offset the costs not directly reimbursed. Unreimbursed costs for services and supplies provided under the Hospital's charity care policy, including uncompensated care, for the years ended December 31 are as follows (in thousands):

	2017	2016
Charity care	\$ 4,186	\$ 1,728
AHCCCS uncompensated cost of care	169,688	163,349
	173,874	165,077
Supplemental payments for current year	(74,346)	(124,253)
Net charity and uncompensated care	\$ 99,528	\$ 40,824

In addition to the funding included in the table above, the Hospital received approximately \$47,406,000 and \$15,810,000 of funding during the years ended December 31, 2017 and 2016, respectively, which related to supplemental payments from AHCCCS for prior years.

16. Functional Expenses

The Company provides comprehensive health care services to children within its geographical location. Expenses related to providing these services were as follows as of December 31 (in thousands):

	2017	2016
Health care services	\$ 604,019	\$ 570,821
Nonclinical and support services, including general and administrative	204,791	196,119
Fundraising	7,780	6,087
	\$ 816,590	\$ 773,027

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

17. Strategic Affiliation with Dignity Health

In 2011, the Company entered into a contribution agreement (the Contribution Agreement) with Dignity wherein Dignity agreed, upon execution of a subsequent affiliation agreement, to transfer and contribute its Maricopa County, Arizona-based pediatric services business to the Company in return for a 20% membership interest in the Company. Commensurate with the execution of the Contribution Agreement, the Company changed from a non-member-based Arizona nonprofit corporation to a member-based Arizona nonprofit corporation. Simultaneously with this change, the Company's sole member became Children's Healthcare of Arizona Inc. (the Parent), an Arizona nonprofit holding corporation exempt from income taxes under Code Section 501(c)(3).

Effective June 1, 2011, the Parent and the Company entered into an affiliation agreement (the Affiliation Agreement) whereby the Parent agreed to assign and transfer to Dignity a 20% member interest in the Company consistent with the terms of the Contribution Agreement. The Company agreed to make future distributions of its available free cash flow, if any, in proportion to the Parent's and Dignity's membership interests, to the extent such distributions would not result in a violation of any Hospital debt covenants and subject further to the Company's board approval of all distributions. The Affiliation Agreement enables the Company to request capital contributions from its members. The Affiliation Agreement also specifies certain actions of the Company that require approval of the members. No distributions or capital contributions were made or required to be made during 2017 or 2016.

Beginning on the fifteenth anniversary of the Affiliation Agreement, and each five-year anniversary thereafter, each member has the right to put/call to the other member its outstanding membership interest based on the then fair market value of the Company, as defined in the Affiliation Agreement. The put/call rights can also be exercised in the event of adverse changes at either member. Such put/call rights are considered to be embedded financial instruments in the Company's membership interests but do not meet the definition of a derivative and, therefore, have not been accounted for separately.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

18. Commitments and Contingencies

Lease Commitments

The Hospital leases office facilities, outpatient clinics, and equipment under noncancelable capital and operating leases.

In 2007, under a long-term lease agreement, the Hospital leased 3.73 acres of land that is used for the Hospital's operations (the Thomas Street Expansion). The initial lease term is 75 years, with a 24-year optional extension. Additionally, the Hospital has a 20-year operating lease agreement for its East Valley Ambulatory and Urgent Care facility that opened in December 2007.

Rental expense under operating leases for the years ended December 31, 2017 and 2016, totaled approximately \$8,844,000 and \$8,214,000, respectively.

Future minimum rental commitments under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of December 31, 2017, were as follows (in thousands):

2018	\$ 6,777
2019	5,815
2020	5,807
2021	4,980
2022	3,337
Thereafter	71,077
Total minimum lease payments	<u>\$ 97,793</u>

Self-Insurance Liabilities

Prior to January 1, 2008, the Hospital maintained insurance coverage on an occurrence basis for professional malpractice claims and general liability, with no deductible, through an external insurance company. Excess professional and general liability insurance coverage was maintained for claims exceeding per-occurrence limits.

Beginning in January 2008, the Hospital obtained insurance through a combination of purchased and self-insurance programs for professional malpractice, general liability and employee health insurance claims. Under its self-insured professional malpractice and general liability programs, the Hospital contributes actuarially determined amounts to the Captive to fund estimated ultimate losses.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

18. Commitments and Contingencies (continued)

The self-insured, claims-made professional malpractice and general liability coverage has a limit of \$3 million per claim and a \$12 million annual aggregate. Claims in excess of this self-insured retention are insured through excess liability policies up to an aggregate of \$50 million. The Company has accrued the estimated cost of professional liability that is known and that has been incurred but not reported at December 31, 2017 and 2016, based on amounts determined by independent actuarial consultants. The Company has recorded approximately \$27,682,000 and \$26,262,000 as of December 31, 2017 and 2016, respectively, for this estimated professional liability. As of December 31, 2017 and 2016, the Company has recorded a receivable from excess insurance carriers for claims in excess of retained limits of \$2,362,000 and \$1,909,000, respectively. The Company discounts its liability at 4% to reflect the ultimate payments pattern of claims.

The Company purchases claims-made insurance to cover workers' compensation claims. The Company is involved in litigation arising during the normal course of business. There are known claims and incidents that may result in assertion of additional claims, as well as claims from unknown incidents arising from services provided to patients that may be asserted. However, management does not believe that the asserted or unasserted claims will exceed the total amount of insurance coverage.

Industry and Regulatory Environment

The health care industry is subject to numerous laws and regulations of federal state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, governmental health care program participation requirements, reimbursement for patient services, and Medicare fraud and abuse. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Company is in compliance with fraud and abuse and other applicable government laws and regulations.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

19. Income Taxes

The Tax Cuts and Jobs Act (Act) was enacted on December 22, 2017. The Act reduces the US federal corporate tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that was previously tax deferred and creates new taxes on certain foreign sourced earnings. For tax-exempt entities, the Act also requires organizations to categorize certain fringe benefit expenses as a source of unrelated business income, pay an excise tax on remuneration above certain thresholds that is paid to executives by the organization, and report income or loss from unrelated business activities on an activity-by-activity basis, among other provisions. Certain regulatory guidance provides for a measurement period of up to one year during which the accounting for the tax effects of the Act may be completed. The Company may record further adjustments in future periods upon obtaining, preparing, or analyzing additional information about facts and circumstances that existed as of the date of enactment that would have affected the income tax effects initially reported. The Company does not believe there to be a material impact and will continue to revise and refine the calculations as additional IRS guidance is issued.

Supplementary Information



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Report of Independent Auditors on Supplementary Information

The Board of Directors
Phoenix Children's Hospital and Affiliates

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements of Phoenix Children's Hospital and Affiliates as of December 31, 2017 and 2016, and for the years then ended, taken as a whole. The accompanying 2017 and 2016 consolidating balance sheets, statements of operations, and statements of changes in net assets are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the 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. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Ernst + Young LLP

May 2, 2018

Phoenix Children's Hospital and Affiliates

Consolidating Balance Sheets
(In Thousands)

	December 31, 2017							December 31, 2016						
	PCH	Captive	Foundation	PCCD	PCPD	Eliminations	Total	PCH	Captive	Foundation	PCCD	PCPD	Eliminations	Total
Assets														
Current assets:														
Cash and cash equivalents	\$ 35,416	\$ 1,429	\$ 2,131	\$ 48	\$ 1,224	\$ -	\$ 40,248	\$ 43,731	\$ 1,424	\$ 2,123	\$ 2,951	\$ 272	\$ -	\$ 50,501
Short-term investments	525,194	-	504	-	-	-	525,698	459,821	-	1,189	-	-	-	461,010
Accounts receivable, net	121,127	-	-	-	-	-	121,127	93,689	-	-	-	-	-	93,689
Contributions receivable, net	-	-	6,382	-	-	-	6,382	-	-	7,430	-	-	-	7,430
Inventory	13,095	-	-	-	-	-	13,095	12,872	-	-	-	-	-	12,872
Other current assets	13,318	3,249	541	37	-	-	17,145	33,858	2,725	390	29	-	-	37,002
Due (to) from affiliate	(89,436)	25,431	56,686	7,471	(152)	-	-	(79,504)	21,219	51,841	6,754	(310)	-	-
Total current assets	618,714	30,109	66,244	7,556	1,072	-	723,695	564,467	25,368	62,973	9,734	(38)	-	662,504
Assets limited as to use:														
Assets held by trustee	39,443	-	-	-	-	-	39,443	39,926	-	-	-	-	-	39,926
Other restricted cash and cash equivalents	55,586	-	21,796	-	-	-	77,382	57,152	-	19,802	-	-	-	76,954
Investments	26,887	-	2,103	-	-	-	28,990	20,833	-	1,886	-	-	-	22,719
Charitable remainder trust investments	-	-	458	-	-	-	458	-	-	1,550	-	-	-	1,550
Endowment investments	-	-	10,350	-	-	-	10,350	-	-	8,918	-	-	-	8,918
Total assets limited as to use	121,916	-	34,707	-	-	-	156,623	117,911	-	32,156	-	-	-	150,067
Contributions receivable, less current portion	-	-	3,073	-	-	-	3,073	-	-	3,965	-	-	-	3,965
Interest rate swap assets	-	-	-	-	-	-	-	1,797	-	-	-	-	-	1,797
Property and equipment, net	530,686	-	-	399	11,342	-	542,427	522,896	-	-	557	12,325	-	535,778
Other long-term assets	43,105	-	149	-	-	(3,521)	39,733	31,312	-	149	-	-	(3,521)	27,940
Total assets	\$ 1,314,421	\$ 30,109	\$ 104,173	\$ 7,955	\$ 12,414	\$ (3,521)	\$ 1,465,551	\$ 1,238,383	\$ 25,368	\$ 99,243	\$ 10,291	\$ 12,287	\$ (3,521)	\$ 1,382,051

Phoenix Children's Hospital and Affiliates

Consolidating Balance Sheets (continued)
(In Thousands)

	December 31, 2017							December 31, 2016						
	PCH	Captive	Foundation	PCCD	PCPD	Eliminations	Total	PCH	Captive	Foundation	PCCD	PCPD	Eliminations	Total
Liabilities and net assets														
Current liabilities:														
Accounts payable, accrued liabilities and other	\$ 97,769	\$ 4,217	\$ 110	\$ 880	\$ -	\$ -	\$ 102,976	\$ 93,490	\$ 5,057	\$ 94	\$ 849	\$ -	\$ -	\$ 99,490
Margin payable	-	-	-	-	-	-	-	18,500	-	-	-	-	-	18,500
Current portion of long-term debt	10,826	-	-	-	-	-	10,826	10,640	-	-	-	-	-	10,640
Total current liabilities	108,595	4,217	110	880	-	-	113,802	122,630	5,057	94	849	-	-	128,630
Annuities payable, less current portion	-	-	99	-	-	-	99	-	-	40	-	-	-	40
Interest rate swap obligations	69,903	-	-	-	-	-	69,903	69,168	-	-	-	-	-	69,168
Long-term debt, less current portion	539,726	-	-	-	11,921	-	551,647	549,115	-	-	-	11,909	-	561,024
Other liabilities	71,139	17,945	-	-	538	-	89,622	65,659	15,725	-	-	97	-	81,481
Total liabilities	789,363	22,162	209	880	12,459	-	825,073	806,572	20,782	134	849	12,006	-	840,343
Net assets (deficit):														
Unrestricted	512,581	7,947	60,985	4,474	(45)	(3,521)	582,421	422,067	4,586	55,946	5,954	281	(3,521)	485,313
Temporarily restricted	12,477	-	30,219	-	-	-	42,696	9,744	-	33,192	-	-	-	42,936
Permanently restricted	-	-	12,760	-	-	-	12,760	-	-	9,971	-	-	-	9,971
Total Phoenix Children's Hospital net assets (deficit)	525,058	7,947	103,964	4,474	(45)	(3,521)	637,877	431,811	4,586	99,109	5,954	281	(3,521)	538,220
Unrestricted – noncontrolling interest	-	-	-	2,601	-	-	2,601	-	-	-	3,488	-	-	3,488
Total net assets (deficit)	525,058	7,947	103,964	7,075	(45)	(3,521)	640,478	431,811	4,586	99,109	9,442	281	(3,521)	541,708
Total liabilities and net assets	\$ 1,314,421	\$ 30,109	\$ 104,173	\$ 7,955	\$ 12,414	\$ (3,521)	\$ 1,465,551	\$ 1,238,383	\$ 25,368	\$ 99,243	\$ 10,291	\$ 12,287	\$ (3,521)	\$ 1,382,051

Phoenix Children's Hospital and Affiliates

Consolidating Statements of Operations
(In Thousands)

	Year Ended December 31, 2017							Year Ended December 31, 2016						
	PCH	Captive	Foundation	PCCD	PCPD	Eliminations	Total	PCH	Captive	Foundation	PCCD	PCPD	Eliminations	Total
Unrestricted revenues:														
Patient service revenue before provision for bad debts	\$ 833,194	\$ –	\$ –	\$ –	\$ –	\$ –	\$ 833,194	\$ 799,066	\$ –	\$ –	\$ –	\$ –	\$ –	\$ 799,066
Provision for bad debts	(21,139)	–	–	–	–	–	(21,139)	(18,289)	–	–	–	–	–	(18,289)
Net patient service revenue	812,055	–	–	–	–	–	812,055	780,777	–	–	–	–	–	780,777
Other operating revenue	26,735	6,556	–	5,592	1,568	(14,343)	26,108	18,089	6,786	–	10,669	1,568	(19,640)	17,472
Donations, gifts, and contributions	–	–	15,179	–	–	–	15,179	–	–	9,161	–	–	–	9,161
Net assets released from restrictions used for operations	10,553	–	–	–	–	–	10,553	9,280	–	–	–	–	–	9,280
	849,343	6,556	15,179	5,592	1,568	(14,343)	863,895	808,146	6,786	9,161	10,669	1,568	(19,640)	816,690
Expenses:														
Employee compensation and benefits	428,421	–	5,276	2,002	–	–	435,699	387,456	–	4,435	2,015	–	–	393,906
Supplies, purchased services, and professional fees	271,376	85	2,494	11	–	(5,591)	268,375	276,173	82	1,940	2	–	(10,658)	267,539
Operating and other expenses	44,033	3,110	2,571	16	678	(8,752)	41,656	43,430	4,376	1,545	11	677	(8,982)	41,057
Depreciation and amortization	43,488	–	–	157	994	–	44,639	42,206	–	–	132	981	–	43,319
Interest, net of amounts capitalized	25,999	–	–	–	222	–	26,221	26,983	–	–	–	223	–	27,206
	813,317	3,195	10,341	2,186	1,894	(14,343)	816,590	776,248	4,458	7,920	2,160	1,881	(19,640)	773,027
Income (loss) from operations	36,026	3,361	4,838	3,406	(326)	–	47,305	31,898	2,328	1,241	8,509	(313)	–	43,663
Other income (loss):														
Net investment income	43,955	–	201	–	–	–	44,156	32,840	–	64	–	–	–	32,904
Change in fair value of interest rate swaps	(2,532)	–	–	–	–	–	(2,532)	7,246	–	–	–	–	–	7,246
Gain on acquisition	1,882	–	–	–	–	–	1,882	–	–	–	–	–	–	–
Total other income	43,305	–	201	–	–	–	43,506	40,086	–	64	–	–	–	40,150
Excess (deficiency) of revenues over expenses	79,331	3,361	5,039	3,406	(326)	–	90,811	71,984	2,328	1,305	8,509	(313)	–	83,813
Less excess of revenues over expenses attributable to non-controlling interest	–	–	–	1,278	–	–	1,278	–	–	–	3,191	–	–	3,191
Excess (deficiency) of revenues over expenses attributable to Phoenix Children's Hospital	79,331	3,361	5,039	2,128	(326)	–	89,533	71,984	2,328	1,305	5,318	(313)	–	80,622
Capital distribution	3,608	–	–	(5,773)	–	–	(2,165)	4,375	–	–	(7,000)	(1,980)	1,980	(2,625)
Net assets released from restrictions used for purchase of property and equipment	7,575	–	–	–	–	–	7,575	20,310	–	–	–	–	–	20,310
Increase (decrease) in unrestricted net assets	\$ 90,514	\$ 3,361	\$ 5,039	\$ (3,645)	\$ (326)	\$ –	\$ 94,943	\$ 96,669	\$ 2,328	\$ 1,305	\$ (1,682)	\$ (2,293)	\$ 1,980	\$ 98,307

Phoenix Children's Hospital and Affiliates

Consolidating Statements of Changes in Net Assets
(In Thousands)

	Year Ended December 31, 2017							Year Ended December 31, 2016						
	PCH	Captive	Foundation	PCCD	PCPD	Eliminations	Total	PCH	Captive	Foundation	PCCD	PCPD	Eliminations	Total
Unrestricted net assets:														
Excess (deficiency) of revenues over expenses	\$ 79,331	\$ 3,361	\$ 5,039	\$ 2,128	\$ (326)	\$ -	\$ 89,533	\$ 71,984	\$ 2,328	\$ 1,305	\$ 5,318	\$ (313)	\$ -	\$ 80,622
Capital distribution	-	-	-	-	-	-	-	-	-	-	-	(1,980)	1,980	-
Net assets released from restrictions used for purchase of property and equipment	7,575	-	-	-	-	-	7,575	20,310	-	-	-	-	-	20,310
Increase (decrease) in unrestricted net assets	86,906	3,361	5,039	2,128	(326)	-	97,108	92,294	2,328	1,305	5,318	(2,293)	1,980	100,932
Non-controlling interest:														
Excess of revenues over expenses	-	-	-	1,278	-	-	1,278	-	-	-	3,191	-	-	3,191
Capital distribution	3,608	-	-	(5,773)	-	-	(2,165)	4,375	-	-	(7,000)	-	-	(2,625)
Increase (decrease) in non-controlling interest	3,608	-	-	(4,495)	-	-	(887)	4,375	-	-	(3,809)	-	-	566
Temporarily restricted net assets:														
Donations, gifts, and contributions	4,896	-	12,463	-	-	-	17,359	4,519	-	17,821	-	-	-	22,340
Net assets released from restrictions used for operations and purchase of property and investment income	(2,163)	-	(15,965)	-	-	-	(18,128)	(1,626)	-	(27,965)	-	-	-	(29,591)
Investment income	-	-	529	-	-	-	529	-	-	531	-	-	-	531
Increase (decrease) in temporarily restricted net assets	2,733	-	(2,973)	-	-	-	(240)	2,893	-	(9,613)	-	-	-	(6,720)
Permanently restricted net assets:														
Contributions and other	-	-	2,789	-	-	-	2,789	-	-	463	-	-	-	463
Increase in permanently restricted net assets	-	-	2,789	-	-	-	2,789	-	-	463	-	-	-	463
Change in net assets	93,247	3,361	4,855	(2,367)	(326)	-	98,770	99,562	2,328	(7,845)	1,509	(2,293)	1,980	95,241
Net assets, beginning of year	431,811	4,586	99,109	9,442	281	(3,521)	541,708	332,249	2,258	106,954	7,933	2,574	(5,501)	446,467
Net assets, end of year	\$ 525,058	\$ 7,947	\$ 103,964	\$ 7,075	\$ (45)	\$ (3,521)	\$ 640,478	\$ 431,811	\$ 4,586	\$ 99,109	\$ 9,442	\$ 281	\$ (3,521)	\$ 541,708

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