

CONSOLIDATED FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

Phoenix Children's Hospital and Affiliates
Years Ended December 31, 2018 and 2017
With Reports of Independent Auditors

Ernst & Young LLP



Phoenix Children’s Hospital and Affiliates

Consolidated Financial Statements and
Supplementary Information

Years Ended December 31, 2018 and 2017

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Ernst & Young LLP
Ernst & Young Tower
One Renaissance Square
Suite 2300
2 North Central Avenue
Phoenix, AZ 85004

Tel: +1 602 322 3000
Fax: +1 602 322 3023
ey.com

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, 2018 and 2017, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Phoenix Children's Hospital and Affiliates as of December 31, 2018 and 2017, and the consolidated results of their 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

April 23, 2019

Phoenix Children's Hospital and Affiliates

Consolidated Balance Sheets

(In Thousands)

	December 31	
	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 45,328	\$ 40,248
Short-term investments	508,015	525,698
Accounts receivable, net	143,976	121,127
Contributions receivable, net	6,583	6,382
Inventory	14,868	13,095
Other current assets	25,813	17,145
Total current assets	<u>744,583</u>	<u>723,695</u>
Assets limited as to use:		
Assets held by trustee	40,461	39,443
Other restricted cash and cash equivalents	70,054	77,382
Investments	31,169	28,990
Charitable remainder trust investments	391	458
Endowment investments	12,609	10,350
Total assets limited as to use	<u>154,684</u>	<u>156,623</u>
Long-term contributions receivable, net	3,740	3,073
Property and equipment, net	538,727	542,427
Other long-term assets	40,035	39,733
Total assets	<u>\$ 1,481,769</u>	<u>\$ 1,465,551</u>
Liabilities and net assets		
Current liabilities:		
Accounts payable, accrued liabilities and other	\$ 98,542	\$ 102,976
Current portion of long-term debt	11,341	10,826
Total current liabilities	<u>109,883</u>	<u>113,802</u>
Interest rate swap obligations	59,406	69,903
Long-term debt, less current portion	540,338	551,647
Other liabilities	85,312	89,721
Total liabilities	<u>794,939</u>	<u>825,073</u>
Net assets:		
Without donor restrictions:		
Controlling interest	615,918	582,421
Noncontrolling interest	4,206	2,601
Total without donor restrictions	<u>620,124</u>	<u>585,022</u>
With donor restrictions	66,706	55,456
Total net assets	<u>686,830</u>	<u>640,478</u>
Total liabilities and net assets	<u>\$ 1,481,769</u>	<u>\$ 1,465,551</u>

See accompanying notes.

Phoenix Children's Hospital and Affiliates

Consolidated Statements of Operations and Changes in Net Assets
(In Thousands)

	Year Ended December 31	
	2018	2017
Revenues:		
Patient service revenue	\$ 856,713	\$ 833,194
Provision for bad debts	–	(21,139)
Net patient service revenue	856,713	812,055
Other operating revenue	28,745	26,108
Donations, gifts, and contributions	14,592	15,179
Net assets released from restrictions used for operations	9,346	10,553
	909,396	863,895
Expenses:		
Employee compensation and benefits	480,834	435,699
Supplies, purchased services, and professional fees	255,457	268,375
Operating and other expenses	44,367	41,656
Depreciation and amortization	49,438	44,639
Interest, net of amounts capitalized	26,757	26,221
	856,853	816,590
Income from operations	52,543	47,305
Other (loss) income:		
Net investment (loss) income	(30,727)	44,156
Change in fair value of interest rate swaps	10,497	(2,532)
Gain on acquisition	–	1,882
Total other (loss) income	(20,230)	43,506
Excess of revenues over expenses	32,313	90,811
Less excess of revenues over expenses attributable to noncontrolling interest	1,605	1,278
Excess of revenues over expenses attributable to Phoenix Children's Hospital and Affiliates	30,708	89,533

See accompanying notes.

Phoenix Children's Hospital and Affiliates

Consolidated Statements of Operations and Changes in Net Assets (continued)
(In Thousands)

	Year Ended December 31	
	2018	2017
Net assets without donor restrictions:		
Controlling interest:		
Excess of revenues over expenses	\$ 30,708	\$ 89,533
Net assets released from restriction for purchase of property and equipment	2,337	7,575
Other	500	—
Change in controlling interest	<u>33,545</u>	97,108
Noncontrolling interest:		
Excess of revenues over expenses attributable to noncontrolling partners	1,605	1,278
Capital distribution to noncontrolling partners	—	(2,165)
Change in noncontrolling interest	<u>1,605</u>	(887)
Net assets with donor restrictions:		
Donations, gifts, and contributions	22,488	20,148
Net assets released from restrictions used for operations and purchase of property and equipment	(11,683)	(18,128)
Investment income	397	529
Change in net assets with donor restrictions	<u>11,202</u>	2,549
Change in net assets	46,352	98,770
Net assets, beginning of year	640,478	541,708
Net assets, end of year	<u>\$ 686,830</u>	<u>\$ 640,478</u>

See accompanying notes.

Phoenix Children's Hospital and Affiliates

Consolidated Statements of Cash Flows

(In Thousands)

	Year Ended December 31	
	2018	2017
Operating activities		
Change in net assets	\$ 46,352	\$ 98,770
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Provision for bad debts	–	21,139
Provision for contributions receivable	(27)	1,286
Amortization of bond premium	(1,254)	(1,468)
Change in net unrealized gains and losses	69,046	(26,276)
Change in fair value of interest rate swaps	(10,497)	2,532
Depreciation and amortization	49,438	44,639
Restricted contributions received	(22,488)	(20,148)
Change in:		
Accounts receivable	(23,690)	(45,083)
Short-term investments	(48,406)	(44,485)
Inventory and other current assets	(10,441)	20,168
Other long-term assets	(302)	(1,024)
Accounts payable, accrued liabilities, and other	(5,504)	1,001
Other liabilities	(5,289)	8,200
Net cash provided by operating activities	36,938	59,251
Investing activities		
Purchase of property and equipment	(43,333)	(50,435)
Proceeds from assets held by trustee	31,288	31,426
Purchase of assets held by trustee	(32,306)	(31,909)
Acquisitions	–	(12,058)
Net cash used in investing activities	(44,351)	(62,976)
Financing activities		
Proceeds from restricted contributions	22,488	20,148
Payments of bonds payable	(9,995)	(9,555)
Proceeds from note payable	–	1,379
Payments on margin account	–	(18,500)
Net cash provided by (used in) financing activities	12,493	(6,528)
Increase (decrease) in cash and cash equivalents	5,080	(10,253)
Cash and cash equivalents, beginning of year	40,248	50,501
Cash and cash equivalents, end of year	\$ 45,328	\$ 40,248
Supplemental disclosure of cash flow information		
Cash paid for interest	\$ 26,699	\$ 25,934
Supplemental disclosures of non-cash investing and financing activity		
Increase (decrease) in acquisitions of property and equipment included in accounts payable and other liabilities	\$ 1,950	\$ (906)

See accompanying notes.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements

December 31, 2018

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 operates freestanding pediatric clinics in Mesa, Gilbert, 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 (Dignity) for the construction of a women's and children's hospital on the Dignity Health Mercy Gilbert Medical Center campus. Under the current plans, pediatric services will 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, Dignity Health has the rights to 33% interest in the available free cash flow of the project.

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 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 (see Note 17). At December 31, 2018, 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. 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 serves 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.

2. Significant Accounting Policies

Basis of Consolidation

The accompanying consolidated financial statements include the accounts of the Hospital and its affiliates, the Foundation, the Captive, PCCN, PCPD and PCCD. 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 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. 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 restricted by the donor or by law.

Investment and dividend income is recognized when earned.

Donor restricted investment income is reported as a change in net assets with donor restrictions in the consolidated statements of operations. 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 net realizable 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.

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 net assets without donor restrictions 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 net assets with donor restrictions. 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, 2018 or 2017. 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.

Net Assets

Net assets are classified based on the existence or absence of donor imposed restrictions. Revenue and gains that are not restricted are included in net assets without donor restrictions.

Net assets with donor restrictions are those whose use by the Company has been limited by donors to a specific time period or purpose. Net assets with donor restrictions also consist of endowment fund donations that have been restricted by donors to be maintained by the Foundation in perpetuity.

Contributions Receivable and 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. Conditional promises to give are not included as revenue until the conditions are substantially met. The promises to give are reported as net assets with donor restrictions 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, those net assets are reclassified as net assets without donor restriction and reported as net assets released from

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

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 revenue in the consolidated statements of operations.

Endowments

The Foundation's endowment consists of individual donor restricted funds established for a variety of purposes. 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 net assets with donor restrictions: (1) the original value of gifts donated to the endowment, (2) the original value of subsequent gifts to the endowment, and (3) accumulations to the 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 classified as net assets with donor restrictions until those amounts are specifically considered and appropriated for expenditure by the Foundation.

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. 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

The Company adopted Accounting Standards Update (ASU) 2014-19, *Revenue from Contracts with Customers (Topic 606)* on January 1, 2018, and elected to use the modified retrospective method. As a result, upon adoption, the Company is required to record a transition adjustment for the new revenue standard, if any, as a cumulative effective adjustment to the beginning net assets without donor restrictions. The adoption of the standard did not result in a transition adjustment to the Company's consolidated financial statements.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Upon adoption, the majority of what was previously classified as the provision for bad debts in the consolidated statements of operations is now reflected as implicit price concessions (as defined in Topic 606) and, therefore, is included as a reduction to net patient service revenue for the year ended December 31, 2018. Prior to the adoption of Topic 606, the provision for bad debts has been presented consistent with the previous revenue recognition standard that required such provision to be presented separately as a component of net patient service revenue. Additionally, upon adoption of Topic 606, the allowance for doubtful accounts of approximately \$21,000,000 was reclassified as a component of net patient accounts receivable as of December 31, 2018. Other than the changes in presentation on the consolidated statement of operations and consolidated balance sheet, the adoption of Topic 606 did not have a material impact on the consolidated results of operations for the year ended December 31, 2018, and the Company does not expect it to have a material impact on its consolidated results of operations on a prospective basis.

The Hospital records revenue over the period performance obligations are satisfied. Inpatient services are performance obligations satisfied over time. Unsatisfied or partially unsatisfied performance obligations relate to inpatient services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period. Outpatient services are performance obligations satisfied over time, which is typically less than one day. 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. Upon adoption of the new revenue standard, net patient service revenue is reported at the estimated transaction price to reflect the total consideration expected to be received from patients, third-party payors, and others 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 an implicit price concession to the uninsured patients in the period the services are provided based on historical collection.

The Hospital uses a portfolio approach to estimate the transaction price for categories of patient contracts as a collective group rather than recognizing revenue on an individual contract basis. The portfolios consist of major payor classes for inpatient revenue and outpatient revenue. Based on historical collection trends and other analyses, the Hospital believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach were used.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

The transaction price which involves significant estimates is determined based on the Hospital's established charges with a reduction recorded for price concessions. The Hospital estimates the transaction price associated with services provided to patients who have third-party payor coverage based on the reimbursement terms outlined in contractual agreements and historical experience and includes estimated retroactive revenue adjustments under the agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and such amounts are adjusted in future periods as final settlements are determined. For uninsured and under-insured patients who do not qualify for charity care, the Hospital determines the transaction price associated with services on the basis of charges reduced by implicit price concessions. Implicit price concessions included in the estimate of the transaction price are based on the Hospital's historical collection experience for applicable patient portfolios. Patients who meet the Hospital's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue.

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 for patient services rendered.

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 2018 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 and Medicaid Services (CMS) to establish a Safety Net Care Pool to support uncompensated costs incurred by certain AHCCCS providers. The Hospital qualified every year for this program, which ended on December 31, 2017. The Hospital also receives supplemental funding from AHCCCS through disproportionate share hospital and graduate medical education payments.

Performance Indicator

The consolidated statements of operations and changes in net assets include the performance indicator as excess of revenues over expenses, which includes all the changes in net assets without donor restrictions other than 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).

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The ASU requires the rights and obligations arising from the lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheets. The ASU will require disclosures to help the financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. The ASU is effective for the Company beginning January 1, 2019 and will be applied using a modified retrospective approach. The Company is currently in the process of evaluating its lease contracts as well as certain service contracts that may include embedded leases. The primary effect of the new standard will be to record right-of-use assets and obligations for current operating leases, which is estimated to increase assets and liabilities by approximately \$115,000,000 to \$135,000,000 on the consolidated balance sheet. The transition adjustment is not expected to have a material impact on the statement of operations.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

In August 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-14, *Not for Profit Entities (Topic 958): Presentation of Financial Statements of Not for Profit Entities*. This accounting standard changed the presentation of net assets into two categories, net assets with donor restrictions and net assets without donor restrictions. This accounting standard also allowed companies to elect to use either the direct or indirect cash flow method, and required additional liquidity disclosures and presentation of expenses by both natural and functional classification. The Company adopted the accounting standard for the year ended December 31, 2018, and the Company has elected to continue to use the indirect cash flow method.

In August 2016, the FASB issued ASU No. 2016-15, *Statements of Cash Flows – Classification of Certain Cash Receipts and Cash Payments*. This ASU addresses the presentation of certain cash flows with the objective of reducing the existing diversity in practice. This accounting standard is effective for fiscal years beginning after December 15, 2018. Management is currently evaluating the impact of adopting this accounting standard.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which 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, 2018, with early adoption permitted. Accordingly, the new standard is effective for the Company for the year ended December 31, 2019 and will be required to be adopted using a retrospective approach. Management does not expect the adoption of this standard to have a material impact on the financial statements.

In January 2017, the FASB issued ASU 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test of Goodwill Impairment*. The accounting standard simplified the test used to evaluate goodwill and other intangibles for impairment. 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 does not expect the adoption of this standard to have a material impact on financial statements.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. This ASU intends to clarify and improve current accounting guidance to determine when a transaction should be accounted for as contribution or as an exchange transaction and provides additional guidance about how to determine whether a contribution is conditional. The accounting standard is effective for the Company for annual reporting periods beginning after June 15, 2018 for contributions received and after December 15, 2018 for contributions made, and interim periods beginning after December 31, 2019 with early adoption permitted. Management is currently evaluating the impact of adopting this accounting standard.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement, Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. This ASU intends to improve the effectiveness of disclosures in the notes to financial statements by modifying disclosure requirements for fair value measurements. The ASU is effective for the Company for annual and interim reporting periods beginning after December 15, 2019 with early adoption permitted. 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 April 23, 2019, the date the consolidated financial statements were issued, noting no recognized subsequent events or non-recognized subsequent events requiring additional disclosure.

3. 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

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

3. Concentrations of Credit Risk (continued)

Federal Deposit Insurance Corporation's 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 mix of net accounts receivable from patients and third-party payors at December 31 was as follows:

	2018	2017
AHCCCS	43%	43%
Contracted health care agreements	49	49
Other commercial payors	5	4
Patients and other	3	4
	100%	100%

As a result of certain changes required by the new revenue standard, all of the Hospital's provision for uncollectible accounts is recorded as a direct reduction to net patient service revenue. Net patient service revenue increased related to higher than expected collections in 2018 and 2017 by approximately \$1,270,000 and \$12,900,000, respectively.

4. Liquidity and Availability

Financial assets available for general expenditure within one year of the balance sheet date comprise the following at December 31 (in thousands):

	2018
Cash and cash equivalents	\$ 45,328
Accounts receivable	143,976
Contributions receivable, net	851
Short-term investments	508,015
	\$ 698,170

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

4. Liquidity and Availability (continued)

The Company has the ability to structure its financial assets to be available as its general expenditures and other obligations come due. Accordingly, these assets have been included in the information above. The Company also maintains a margin account collateralized by investments. As of December 31, 2018, no balance was drawn against the margin account.

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, 2018 and 2017.

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

	2018	2017
Net investment (loss) income:		
Interest and dividend income, net	\$ 18,412	\$ 19,571
Realized gains (losses) on sales of securities	19,907	(1,691)
Change in net unrealized gains and losses	(69,046)	26,276
	\$ (30,727)	\$ 44,156

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):

	2018	2017
2012A Debt Service Reserve Fund	\$ 24,023	\$ 23,430
2013 Reserve Funds	15,614	15,237
2013 Interest Funds	651	605
2013 Revenue Fund	173	171
	\$ 40,461	\$ 39,443

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

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

Assets limited as to use are designated as follows at December 31 (in thousands):

	2018	2017
Assets held by trustee	\$ 40,461	\$ 39,443
Swap collateral	36,469	46,471
Donor restricted	41,367	34,706
Deferred compensation	36,387	36,003
	\$ 154,684	\$ 156,623

The Foundation held approximately \$12,609,000 and \$10,350,000 at December 31, 2018 and 2017, respectively, in endowments that were classified as restricted. The endowment portfolio incurred net unrealized losses of approximately \$2,044,000 in 2018, and net unrealized gains of approximately \$499,000 in 2017.

6. Contributions Receivable

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

	2018	2017
Amounts due in:		
Less than one year	\$ 6,904	\$ 7,103
Greater than one year	5,562	4,692
Total	12,466	11,795
Less allowance for uncollectible contributions and present value discount	(2,143)	(2,340)
Contributions receivable, at net present value	10,323	9,455
Less current portion, at net present value	(6,583)	(6,382)
Long-term contributions receivable, at net present value	\$ 3,740	\$ 3,073

As of December 31, 2018 and 2017, approximately \$1,160,000 and \$1,656,000, respectively, of the contributions receivable at net present value were from related parties of the Company.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

7. Property and Equipment

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

	2018	2017
Land and land improvements	\$ 41,086	\$ 41,086
Buildings and improvements	617,368	601,373
Leasehold improvements	32,674	22,399
Equipment	235,371	208,209
Assets under lease arrangements	15,113	15,113
	941,612	888,180
Less accumulated depreciation and amortization	(418,742)	(370,523)
	522,870	517,657
Construction-in-progress	15,857	24,770
	\$ 538,727	\$ 542,427

Accumulated amortization for property and equipment held under lease arrangements totaled approximately \$12,533,000 and \$12,355,000 at December 31, 2018 and 2017, respectively.

The Hospital capitalizes costs associated with software developed internally or obtained for internal use. Such capitalized costs (included in equipment) totaled approximately \$46,300,000 and \$45,100,000 as of December 31, 2018 and 2017, 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, 2018 and 2017, totaled approximately \$4,121,000 and \$4,073,000, respectively.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

8. Accounts Payable, Accrued Liabilities, and Other

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

	2018	2017
Trade accounts payable	\$ 45,387	\$ 55,646
Accrued liabilities	42,759	38,614
Accrued payroll and benefits	10,396	8,716
	\$ 98,542	\$ 102,976

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):

	2018	2017
Series 2012A Bonds	\$ 246,830	\$ 256,825
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	7,992	9,143
Series 2013B Bonds original issue premium	2,898	3,001
Series 2012 unamortized debt issuance costs	(3,472)	(3,752)
Series 2013 unamortized debt issuance costs	(3,716)	(3,880)
Notes payable	26,147	26,136
	551,679	562,473
Less current portion	11,341	10,826
Long-term debt, less current portion	\$ 540,338	\$ 551,647

In September 2012, the Hospital issued \$284,600,000 of Series 2012A Revenue Refunding Bonds (Series 2012A Bonds) through the Arizona Health Facilities Authority (the Authority) to repurchase and extinguish \$225,000,000 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 \$17,100,000.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

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 \$7,600,000 to \$15,000,000.

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, 2018 and 2017.

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) through the Authority. (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 \$75,000,000 for each series and the 2013B Bonds were issued for \$50,000,000. All of the Series 2013 Bonds were issued through the Authority to refund and extinguish the remaining \$225,000,000 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.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

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 \$316,000 and \$328,000 as of December 31, 2018 and 2017, 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.

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, 2018.

Future maturities of long-term debt, which includes unamortized net premium of \$10,890,000 and net issuance costs of \$7,505,000, are as follows (in thousands):

2019	\$	11,341
2020		11,606
2021		18,125
2022		10,211
2023		10,609
Thereafter		489,787
	\$	<u>551,679</u>

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

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, 2018.

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 \$52,700,000 to amend and reduce the first, second, and third swaps' notional amounts by \$112,500,000, \$75,000,000, and \$50,000,000, 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 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.

The first swap agreement hedges a notional amount of \$112,500,000 (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 \$62,500,000 (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 \$50,000,000 (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%.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

10. Interest Rate Swaps (continued)

The fourth swap is a basis swap with an initial notional amount of \$225,000,000 (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 \$80,000,000. The threshold was \$25,000,000 at December 31, 2018 and 2017. At December 31, 2018 and 2017, the Hospital had collateral outstanding with a counterparty of \$36,500,000 and \$46,500,000, 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 2018 and 2017 totaled approximately \$10,500,000 favorable and \$2,500,000 unfavorable, 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 2018 and 2017 by approximately \$4,800,000 and \$6,000,000, respectively. All of the Company's derivative instruments were in liability positions at December 31, 2018 and 2017.

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.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

11. Fair Value of Financial Instruments (continued)

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.

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).

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

11. Fair Value of Financial Instruments (continued)

The tables below provide information about the Company's financial assets, included in short-term investments and assets limited as to use, and liabilities measured at fair value on a recurring basis at December 31, 2018 and 2017 (in thousands):

	December 31, 2018	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	\$ 80,941	\$ 80,941	\$ –	\$ –	a
Mutual funds – domestic	351,940	351,940	–	–	a
Mutual funds – foreign	100,518	100,518	–	–	a
Common stock	8,968	8,968	–	–	a
Government mortgage-backed securities	20,744	–	20,744	–	a
Corporate bonds	20,109	–	20,109	–	a
U.S. government agency obligations	79,479	–	79,479	–	a
Total assets	<u>\$ 662,699</u>	<u>\$ 542,367</u>	<u>\$ 120,332</u>	<u>\$ –</u>	
Liabilities					
Interest rate swaps	\$ 59,406	\$ –	\$ 59,406	\$ –	c
Total liabilities	<u>\$ 59,406</u>	<u>\$ –</u>	<u>\$ 59,406</u>	<u>\$ –</u>	

	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)

The Foundation received contributions amounting to approximately \$11,775,000 and \$7,956,000 for the years ended December 31, 2018 and 2017, 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, 2018 and 2017, the estimated fair value of the Company's debt was \$543,776,000 and \$560,300,000, 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 2018 or 2017.

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, 2018 or 2017. As of December 31, 2018 and 2017, 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.

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 \$11,240,000 and \$9,609,000 in 2018 and 2017, 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.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

12. Retirement Plans (continued)

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. 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 2018 and 2017 were approximately \$682,000 and \$616,000, respectively. At December 31, 2018 and 2017, the SERP investments, included within assets limited as to use, and liabilities, included within other liabilities, were approximately \$1,680,000 and \$2,691,000, respectively.

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 2018 and 2017 were \$18,500 and \$18,000, respectively or 100% of the participant's includable compensation for the year). All participants are fully vested in the 457 Plan. Hospital contributions during 2018 and 2017, were approximately \$4,646,000 and \$4,281,000, respectively. At December 31, 2018 and 2017, the 457 Plan investments, included within assets limited as to use, and liabilities, included within other liabilities, were approximately \$33,833,000 and \$32,249,000, respectively.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

13. Restricted Net Assets

Net assets with donor restrictions were available for the following purposes at December 31 (in thousands):

	2018	2017
Subject to expenditure for a specified purpose:		
Patient care programs	\$ 44,977	\$ 35,952
Purchase of property and equipment	7,299	6,416
Charitable remainder trusts, net	232	328
	52,508	42,696
Subject to Company spending policy and appropriation:		
Investments in perpetuity, which, once appropriated, are expendable to support various hospital programs	14,198	12,760
Total net assets with donor restrictions	\$ 66,706	\$ 55,456

14. Net Patient Service Revenue

Approximately 45.0% and 51.0% of patient service revenue as of December 31, 2018 and 2017, 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 reflected in net patient service revenue.

The Hospital has determined that the nature, amount, timing and uncertainty of revenue and cash flows are affected by the payors, the lines of business that render services to patients and the timing of when revenue is recognized and billed. Net patient service revenue for the year ended December 31, 2018, by payor, under the new revenue standard, effective January 1, 2018, and net

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

14. Net Patient Service Revenue (continued)

patient revenue for the year ended December 31, 2017, under the accounting revenue standards prior to January 1, 2018, is as follows (in thousands):

	<u>2018</u>	<u>2017</u>
AHCCCS	\$ 385,925	\$ 410,546
Contracted health care agreements	381,284	326,003
Other commercial payors	15,017	10,286
Patients and other	74,487	65,220
	<u>\$ 856,713</u>	<u>\$ 812,055</u>

Net patient service revenue recorded by patient type for the years ended December 31 is as follows (in thousands):

	<u>2018</u>	<u>2017</u>
Inpatient	\$ 425,013	\$ 441,178
Outpatient	308,389	275,178
Physician	123,311	95,699
	<u>\$ 856,713</u>	<u>\$ 812,055</u>

For the years ended December 31, 2018 and 2017, the Hospital was paid approximately \$91,000 and \$82,000, respectively, in disproportionate share payments from AHCCCS. The Hospital recognized approximately \$1,983,000 of additional disproportionate revenue in 2018 related to funding that had previously been deferred. The Hospital also received funds for graduate medical education for children's hospitals (a federal program) for the years ended December 31, 2018 and 2017, of \$3,114,000 and \$2,723,000, respectively. The Hospital recorded \$30,833,000 and \$29,192,000 in AHCCCS graduate medical education funding during the year ended December 31, 2018 and 2017, respectively. 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).

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

14. Net Patient Service Revenue (continued)

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.

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 total, the Hospital recorded Safety Net Care Pool funding of approximately \$92,478,000 for the year ended December 31, 2017, and recognized \$13,900,000 in 2018 that was previously deferred.

The policy of the Hospital is to reflect disproportionate share funds, graduate medical education funding, and other AHCCCS supplemental payments 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, 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):

	2018	2017
Charity care	\$ 5,389	\$ 4,186
AHCCCS uncompensated cost of care	122,753	169,688
	128,142	173,874
Supplemental revenue recorded in the current year	(41,807)	(121,752)
Net charity and uncompensated care	\$ 86,335	\$ 52,122

16. Functional Expenses

The Company provides healthcare services and education and performs research. The following table presents operating expenses, as presented on the consolidated statements of operations by the Company's major operating functions and nature of the expense for the year ended December 31, 2018 (in thousands):

	2018					Total
	Healthcare Services	Research	Medical Education	General and Administrative	Fundraising	
Employee compensation and benefits	\$ 330,569	\$ 8,890	\$ 16,917	\$ 119,131	\$ 5,327	\$ 480,834
Supplies, purchased services and professional fees	222,561	810	15,447	15,190	1,449	255,457
Operating and other expenses	15,667	336	1,536	25,351	1,477	44,367
Depreciation and amortization	1,313	-	-	48,125	-	49,438
Interest, net of amounts capitalized	222	-	-	26,535	-	26,757
	\$ 570,332	\$ 10,036	\$ 33,900	\$ 234,332	\$ 8,253	\$ 856,853

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

17. Strategic Affiliation With Dignity Health

In 2011, the Hospital 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 Hospital in return for a 20% membership interest in the Company. Commensurate with the execution of the Contribution Agreement, the Hospital changed from a non-member-based Arizona nonprofit corporation to a member-based Arizona nonprofit corporation. Simultaneously with this change, the Hospital'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 2018 or 2017.

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.

Included in operating and other expenses, the Hospital recorded rent expense under operating leases for the years ended December 31, 2018 and 2017, totaled approximately \$10,112,000 and \$8,844,000, respectively. Rent expense is recorded on a straight-line basis over the respective lease terms.

Future minimum rental commitments under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of December 31, 2018, were as follows (in thousands):

2019	\$	7,462
2020		7,630
2021		7,663
2022		6,732
2023		5,414
Thereafter		79,238
Total minimum lease payments	\$	<u>114,139</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.

Phoenix Children's Hospital and Affiliates

Notes to Consolidated Financial Statements (continued)

18. Commitments and Contingencies (continued)

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.

The self-insured, claims-made professional malpractice and general liability coverage has a limit of \$3,000,000 per claim and a \$12,000,000 annual aggregate. Claims in excess of this self-insured retention are insured through excess liability policies up to an aggregate of \$50,000,000. The Company has accrued the estimated cost of professional liability that is known and that has been incurred but not reported at December 31, 2018 and 2017, based on amounts determined by independent actuarial consultants. Included within current liabilities and other liabilities, the Company has recorded approximately \$30,361,000 and \$27,682,000 as of December 31, 2018 and 2017, respectively, for this estimated professional liability. As of December 31, 2018 and 2017, the Company has recorded a receivable from excess insurance carriers for claims in excess of retained limits of \$2,436,000 and \$2,362,000, respectively. The Company discounted its receivable and liability at December 31, 2018 and 2017, by 2% and 4%, respectively, to reflect the ultimate payment 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 the 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. 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. The Company is not subject to income tax examinations prior to 2015 in major tax jurisdictions.

Supplementary Information



Ernst & Young LLP
Ernst & Young Tower
One Renaissance Square
Suite 2300
2 North Central Avenue
Phoenix, AZ 85004

Tel: +1 602 322 3000
Fax: +1 602 322 3023
ey.com

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, 2018 and 2017, and for the years then ended, taken as a whole. The accompanying 2018 and 2017 consolidating balance sheets and, statements of operations and 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

April 23, 2019

Phoenix Children's Hospital and Affiliates

Consolidating Balance Sheets
(In Thousands)

	December 31, 2018							December 31, 2017						
	PCH	Captive	Foundation	PCCD	PCPD	Eliminations	Total	PCH	Captive	Foundation	PCCD	PCPD	Eliminations	Total
Assets														
Current assets:														
Cash and cash equivalents	\$ 40,332	\$ 1,429	\$ 1,869	\$ 148	\$ 1,550	\$ -	\$ 45,328	\$ 35,416	\$ 1,429	\$ 2,131	\$ 48	\$ 1,224	\$ -	\$ 40,248
Short-term investments	507,458	-	557	-	-	-	508,015	525,194	-	504	-	-	-	525,698
Accounts receivable, net	143,976	-	-	-	-	-	143,976	121,127	-	-	-	-	-	121,127
Contributions receivable, net	-	-	6,583	-	-	-	6,583	-	-	6,382	-	-	-	6,382
Inventory	14,868	-	-	-	-	-	14,868	13,095	-	-	-	-	-	13,095
Other current assets	21,545	3,508	599	30	131	-	25,813	13,318	3,249	541	37	-	-	17,145
Due (to) from affiliate	(101,833)	29,473	60,677	11,822	(139)	-	-	(89,436)	25,431	56,686	7,471	(152)	-	-
Total current assets	626,346	34,410	70,285	12,000	1,542	-	744,583	618,714	30,109	66,244	7,556	1,072	-	723,695
Assets limited as to use:														
Assets held by trustee	40,461	-	-	-	-	-	40,461	39,443	-	-	-	-	-	39,443
Other restricted cash and cash equivalents	43,989	-	26,065	-	-	-	70,054	55,586	-	21,796	-	-	-	77,382
Investments	28,867	-	2,302	-	-	-	31,169	26,887	-	2,103	-	-	-	28,990
Charitable remainder trust investments	-	-	391	-	-	-	391	-	-	458	-	-	-	458
Endowment investments	-	-	12,609	-	-	-	12,609	-	-	10,350	-	-	-	10,350
Total assets limited as to use	113,317	-	41,367	-	-	-	154,684	121,916	-	34,707	-	-	-	156,623
Long-term contributions receivable, net	-	-	3,740	-	-	-	3,740	-	-	3,073	-	-	-	3,073
Property and equipment, net	528,116	-	-	247	10,364	-	538,727	530,686	-	-	399	11,342	-	542,427
Other long-term assets	43,407	-	149	-	-	(3,521)	40,035	43,105	-	149	-	-	(3,521)	39,733
Total assets	\$ 1,311,186	\$ 34,410	\$ 115,541	\$ 12,247	\$ 11,906	\$ (3,521)	\$ 1,481,769	\$ 1,314,421	\$ 30,109	\$ 104,173	\$ 7,955	\$ 12,414	\$ (3,521)	\$ 1,465,551

Phoenix Children's Hospital and Affiliates

Consolidating Balance Sheets (continued)

(In Thousands)

	December 31, 2018							December 31, 2017						
	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	\$ 93,870	\$ 3,075	\$ 693	\$ 891	\$ 13	\$ -	\$ 98,542	\$ 97,769	\$ 4,217	\$ 110	\$ 880	\$ -	\$ -	\$ 102,976
Current portion of long-term debt	11,341	-	-	-	-	-	11,341	10,826	-	-	-	-	-	10,826
Total current liabilities	105,211	3,075	693	891	13	-	109,883	108,595	4,217	110	880	-	-	113,802
Interest rate swap obligations	59,406	-	-	-	-	-	59,406	69,903	-	-	-	-	-	69,903
Long-term debt, less current portion	528,404	-	-	-	11,934	-	540,338	539,726	-	-	-	11,921	-	551,647
Other liabilities	64,167	20,694	125	-	326	-	85,312	71,139	17,945	99	-	538	-	89,721
Total liabilities	757,188	23,769	818	891	12,273	-	794,939	789,363	22,162	209	880	12,459	-	825,073
Net assets (deficit):														
Without donor restrictions:														
Controlling interest	537,398	10,641	64,617	7,150	(367)	(3,521)	615,918	512,581	7,947	60,985	4,474	(45)	(3,521)	582,421
Noncontrolling interest	-	-	-	4,206	-	-	4,206	-	-	-	2,601	-	-	2,601
Total without donor restrictions	537,398	10,641	64,617	11,356	(367)	(3,521)	620,124	512,581	7,947	60,985	7,075	(45)	(3,521)	585,022
With donor restrictions	16,600	-	50,106	-	-	-	66,706	12,477	-	42,979	-	-	-	55,456
Total net assets (deficit)	553,998	10,641	114,723	11,356	(367)	(3,521)	686,830	525,058	7,947	103,964	7,075	(45)	(3,521)	640,478
Total liabilities and net assets	\$ 1,311,186	\$ 34,410	\$ 115,541	\$ 12,247	\$ 11,906	\$ (3,521)	\$ 1,481,769	\$ 1,314,421	\$ 30,109	\$ 104,173	\$ 7,955	\$ 12,414	\$ (3,521)	\$ 1,465,551

Phoenix Children's Hospital and Affiliates

Consolidating Statements of Operations and Change in Net Assets
(In Thousands)

	Year Ended December 31, 2018							Year Ended December 31, 2017						
	PCH	Captive	Foundation	PCCD	PCPD	Eliminations	Total	PCH	Captive	Foundation	PCCD	PCPD	Eliminations	Total
Revenues:														
Patient service revenue	\$ 856,713	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 856,713	\$ 833,194	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 833,194
Provision for bad debts	-	-	-	-	-	-	-	(21,139)	-	-	-	-	-	(21,139)
Net patient service revenue	856,713	-	-	-	-	-	856,713	812,055	-	-	-	-	-	812,055
Other operating revenue	29,190	6,506	-	6,724	1,568	(15,243)	28,745	26,735	6,556	-	5,592	1,568	(14,343)	26,108
Donations, gifts, and contributions	-	-	14,592	-	-	-	14,592	-	-	15,179	-	-	-	15,179
Net assets released from restrictions used for operations	9,346	-	-	-	-	-	9,346	10,553	-	-	-	-	-	10,553
	895,249	6,506	14,592	6,724	1,568	(15,243)	909,396	849,343	6,556	15,179	5,592	1,568	(14,343)	863,895
Expenses:														
Employee compensation and benefits	472,228	-	6,401	2,205	-	-	480,834	428,421	-	5,276	2,002	-	-	435,699
Supplies, purchased services, and professional fees	259,512	92	2,322	72	-	(6,541)	255,457	271,376	85	2,494	11	-	(5,591)	268,375
Operating and other expenses	46,595	3,720	2,063	14	677	(8,702)	44,367	44,033	3,110	2,571	16	678	(8,752)	41,656
Depreciation and amortization	48,295	-	-	152	991	-	49,438	43,488	-	-	157	994	-	44,639
Interest, net of amounts capitalized	26,535	-	-	-	222	-	26,757	25,999	-	-	-	222	-	26,221
	853,165	3,812	10,786	2,443	1,890	(15,243)	856,853	813,317	3,195	10,341	2,186	1,894	(14,343)	816,590
Income (loss) from operations	42,084	2,694	3,806	4,281	(322)	-	52,543	36,026	3,361	4,838	3,406	(326)	-	47,305
Other (loss) income:														
Net investment (loss) income	(30,600)	-	(127)	-	-	-	(30,727)	43,955	-	201	-	-	-	44,156
Change in fair value of interest rate swaps	10,497	-	-	-	-	-	10,497	(2,532)	-	-	-	-	-	(2,532)
Gain on acquisition	-	-	-	-	-	-	-	1,882	-	-	-	-	-	1,882
Total other (loss) income	(20,103)	-	(127)	-	-	-	(20,230)	43,305	-	201	-	-	-	43,506
Excess (deficiency) of revenues over expenses	21,981	2,694	3,679	4,281	(322)	-	32,313	79,331	3,361	5,039	3,406	(326)	-	90,811
Less excess of revenues over expenses attributable to noncontrolling interest	-	-	-	1,605	-	-	1,605	-	-	-	1,278	-	-	1,278
Excess (deficiency) of revenues over expenses attributable to Phoenix Children's Hospital and Affiliates	21,981	2,694	3,679	2,676	(322)	-	30,708	79,331	3,361	5,039	2,128	(326)	-	89,533

Phoenix Children's Hospital and Affiliates

Consolidating Statements of Operations and Change in Net Assets (continued)
(In Thousands)

	Year Ended December 31, 2018							Year Ended December 31, 2017						
	PCH	Captive	Foundation	PCCD	PCPD	Eliminations	Total	PCH	Captive	Foundation	PCCD	PCPD	Eliminations	Total
Net assets without donor restrictions:														
Controlling interest:														
Excess (deficiency) of revenues over expenses	\$ 21,981	\$ 2,694	\$ 3,679	\$ 2,676	\$ (322)	\$ -	\$ 30,708	\$ 79,331	\$ 3,361	\$ 5,039	\$ 2,128	\$ (326)	\$ -	\$ 89,533
Net assets released from restriction for purchase of property and equipment	2,337	-	-	-	-	-	2,337	7,575	-	-	-	-	-	7,575
Other	500	-	-	-	-	-	500	-	-	-	-	-	-	-
Change in controlling interest	24,818	2,694	3,679	2,676	(322)	-	33,545	86,906	3,361	5,039	2,128	(326)	-	97,108
Noncontrolling interest:														
Excess of revenues over expenses attributable to noncontrolling	-	-	-	1,605	-	-	1,605	-	-	-	1,278	-	-	1,278
Capital distribution to noncontrolling partners	-	-	-	-	-	-	-	3,608	-	-	(5,773)	-	-	(2,165)
Change in noncontrolling interest	-	-	-	1,605	-	-	1,605	3,608	-	-	(4,495)	-	-	(887)
Net assets with donor restrictions:														
Donations, gifts, and contributions	5,972	-	16,516	-	-	-	22,488	4,896	-	15,252	-	-	-	20,148
Net assets released from restrictions used for operations and purchase of property and equipment	(1,850)	-	(9,833)	-	-	-	(11,683)	(2,163)	-	(15,965)	-	-	-	(18,128)
Investment income	-	-	397	-	-	-	397	-	-	529	-	-	-	529
Change in net assets with donor restrictions	4,122	-	7,080	-	-	-	11,202	2,733	-	(184)	-	-	-	2,549
Change in net assets	28,940	2,694	10,759	4,281	(322)	-	46,352	93,247	3,361	4,855	(2,367)	(326)	-	98,770
Net assets, beginning 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
Net assets, end of year	\$ 553,998	\$ 10,641	\$ 114,723	\$ 11,356	\$ (367)	\$ (3,521)	\$ 686,830	\$ 525,058	\$ 7,947	\$ 103,964	\$ 7,075	\$ (45)	\$ (3,521)	\$ 640,478

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