

COMBINED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Presbyterian Healthcare Services and Affiliates
Years Ended December 31, 2019 and 2018
With Reports of Independent Auditors

Ernst & Young LLP



Presbyterian Healthcare Services and Affiliates

Combined Financial Statements
and Supplementary Information

Years Ended December 31, 2019 and 2018

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Ernst & Young LLP
101 E. Washington Street
Suite 910
Phoenix, AZ 85004

Tel: +1 602 322 3000
ey.com

Report of Independent Auditors

The Board of Directors
Presbyterian Healthcare Services

We have audited the accompanying combined financial statements of Presbyterian Healthcare Services and Affiliates, which comprise the combined balance sheets as of December 31, 2019 and 2018, and the related combined statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the combined 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 combined 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 combined financial position of Presbyterian Healthcare Services and Affiliates at December 31, 2019 and 2018, and the combined results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

April 16, 2020

Presbyterian Healthcare Services and Affiliates

Combined Balance Sheets

	December 31	
	2019	2018
	<i>(In Thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 245,160	\$ 284,331
Accounts receivable	146,065	138,523
Other receivables	222,761	180,259
Inventories, prepaid expenses, and other current assets	63,335	56,412
Total current assets	<u>677,321</u>	<u>659,525</u>
Assets limited as to use or restricted:		
Designated for long-term purposes	2,175,445	1,908,842
Designated for self-insurance funds	148,136	137,847
Restricted by donors	50,007	45,265
Held by trustee	247,929	31,250
Restricted for statutory requirements	193,217	114,141
	<u>2,814,734</u>	<u>2,237,345</u>
Property and equipment, net	1,074,041	1,029,299
Goodwill	52,701	52,701
Other assets	224,623	161,636
Total assets	<u>\$ 4,843,420</u>	<u>\$ 4,140,506</u>
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 95,024	\$ 99,155
Due under Medicaid contract	30,276	38,505
Accrued liabilities	245,159	205,878
Medical claims payable	255,804	189,409
Estimated third-party payor settlements	9,131	6,221
Current portion of long-term debt	16,829	16,161
Total current liabilities	<u>652,223</u>	<u>555,329</u>
Long-term debt, net of current portion	1,068,591	830,662
Employee benefit plans	220,291	208,939
Self-insurance plans	207,345	171,809
Other liabilities	131,757	100,062
Total liabilities	<u>2,280,207</u>	<u>1,866,801</u>
Net assets:		
Net assets without donor restrictions	2,510,517	2,226,896
Net assets with donor restrictions	52,696	46,809
Total net assets	<u>2,563,213</u>	<u>2,273,705</u>
Total liabilities and net assets	<u>\$ 4,843,420</u>	<u>\$ 4,140,506</u>

See accompanying notes.

Presbyterian Healthcare Services and Affiliates

Combined Statements of Operations

	Year Ended December 31	
	2019	2018
	<i>(In Thousands)</i>	
Operating revenues:		
Net premiums	\$ 3,189,815	\$ 2,297,979
Net patient service revenue	1,119,138	1,147,405
Other operating revenues	83,991	65,731
Total operating revenues	<u>4,392,944</u>	<u>3,511,115</u>
Expenses:		
Medical claims	2,012,319	1,404,083
Salaries, wages, and employee benefits	1,212,400	1,036,237
Purchased services and other	603,382	520,088
Supplies	354,249	298,349
Professional fees	49,651	50,152
Depreciation and amortization	116,016	97,796
Interest	32,662	30,046
Total expenses	<u>4,380,679</u>	<u>3,436,751</u>
Operating income	12,265	74,364
Other income (loss):		
Investment income	55,691	100,968
Change in net unrealized gains (losses) on investments	271,753	(204,298)
Loss on debt extinguishment	(3,920)	-
Pension settlement loss	-	(19,867)
Change in fair value of interest rate swaps	(5,467)	5,462
Total other income (loss)	<u>318,057</u>	<u>(117,735)</u>
Excess (deficiency) of revenues over expenses before income taxes	330,322	(43,371)
Provision for income taxes	18,272	10,252
Excess (deficiency) of revenues over expenses	<u>\$ 312,050</u>	<u>\$ (53,623)</u>

See accompanying notes.

Presbyterian Healthcare Services and Affiliates

Combined Statements of Changes in Net Assets

	Year Ended December 31	
	2019	2018
	<i>(In Thousands)</i>	
Net assets without donor restrictions		
Excess (deficiency) of revenues over expenses	\$ 312,050	\$ (53,623)
Change in pension obligation	(28,422)	14,578
Other changes in net assets	(7)	(8,594)
Increase (decrease) in net assets without donor restrictions	<u>283,621</u>	<u>(47,639)</u>
Net assets with donor restrictions		
Donor-restricted contributions	4,560	5,336
Investment income (loss) and other	4,953	(1,567)
Net assets released from restrictions	(3,626)	(2,121)
Increase in net assets with donor restrictions	<u>5,887</u>	<u>1,648</u>
Change in net assets	289,508	(45,991)
Net assets, beginning of year	2,273,705	2,319,696
Net assets, end of year	<u>\$ 2,563,213</u>	<u>\$ 2,273,705</u>

See accompanying notes.

Presbyterian Healthcare Services and Affiliates

Combined Statements of Cash Flows

	Year Ended December 31	
	2019	2018
	<i>(In Thousands)</i>	
Operating activities		
Change in net assets	\$ 289,508	\$ (45,991)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Change in net unrealized gains and losses on investments	(271,753)	204,298
Change in fair value of interest rate swaps	5,467	(5,462)
Loss on debt extinguishment	3,920	–
Loss on pension settlement	–	19,867
Depreciation and amortization	116,016	97,796
Changes in operating assets and liabilities:		
Accounts receivable	(7,542)	(5,703)
Other receivables	(42,502)	(69,112)
Inventories, prepaid expenses, and other current assets	(6,923)	(2,613)
Trading securities, net	264,184	(137,732)
Other assets	(67,188)	(51,787)
Accounts payable	(4,131)	23,093
Due under Medicaid contract	(8,229)	(19,221)
Accrued liabilities	39,281	61,746
Medical claims payable	66,395	68,657
Estimated third-party payor settlements	2,910	3,148
Other liabilities	71,961	(10,851)
Net cash provided by operating activities	<u>451,374</u>	<u>130,133</u>
Investing activities		
Sales of assets held by trustee and statutory deposits	42,601	80,321
Purchases of assets held by trustee and statutory deposits	(338,356)	(30,012)
Purchases of property and equipment	(156,263)	(194,974)
Net cash used in investing activities	<u>(452,018)</u>	<u>(144,665)</u>
Financing activities		
Proceeds from issuance of long-term debt	334,932	–
Payments on long-term debt	(99,394)	(16,422)
Net cash provided by (used in) financing activities	<u>235,538</u>	<u>(16,422)</u>
Change in cash, cash equivalents, and restricted cash	234,894	(30,954)
Cash, cash equivalents, and restricted cash, beginning of year	331,829	362,783
Cash, cash equivalents, and restricted cash, end of year	<u>\$ 566,723</u>	<u>\$ 331,829</u>
Supplemental disclosures of cash flow information		
Cash paid for interest, net of amounts capitalized	<u>\$ 33,912</u>	<u>\$ 31,543</u>
Cash paid for income taxes	<u>\$ 15,462</u>	<u>\$ 1,734</u>

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements

(Dollar Amounts in Thousands)

December 31, 2019

1. Organization

Presbyterian Healthcare Services (PHS) is a New Mexico nonprofit corporation exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code (the Code). PHS is a diversified health care organization that owns, leases, controls, operates, or manages a variety of health care-related organizations, including seven hospitals in New Mexico, a for-profit health maintenance organization (HMO), and several other affiliated organizations. PHS provides a broad range of health care services, including inpatient, outpatient, subacute, home health care, and physician services.

PHS consists of the following divisions and affiliates:

Presbyterian Healthcare Services Divisions

Presbyterian Hospital,* including the following, which are designated as remote locations of Presbyterian Hospital:
 Presbyterian Kaseman Hospital*
 Presbyterian Northside*
 Presbyterian Rust Medical Center*
Santa Fe Medical Center *
Plains Regional Medical Center*
Presbyterian Española Hospital*
Socorro General Hospital*
Lincoln County Medical Center (leased facility)
Dr. Dan C. Trigg Memorial Hospital
(leased facility)

Presbyterian Healthcare Services Affiliates

Southwest Health Foundation
Presbyterian Network, Inc.:
 Presbyterian Insurance Company, Inc.
 Presbyterian Health Plan, Inc.
 Fluent Health, LLC
 Albuquerque Imaging Associates
 Southwest Magnetic Imaging Associates
Presbyterian Properties, Inc.
Presbyterian Healthcare Foundation*
Bernalillo County Health Care Corporation
d.b.a. Albuquerque Ambulance Service*

* Denotes Obligated Group members.

PHS accesses the capital markets through an Obligated Group. Obligated Group members include PHS and certain divisions and affiliates as noted above, which are jointly and severally liable for the long-term debt outstanding under a Master Trust Indenture. None of the other PHS affiliates have any obligation related to requirements of the Master Trust Indenture. The Obligated Group's net assets represent approximately 76% of PHS and affiliates' combined net assets at both December 31, 2019 and 2018.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

1. Organization (continued)

Presbyterian Network, Inc. (PNI) is a wholly owned subsidiary of Southwest Health Foundation. PNI is the parent organization of two wholly owned subsidiaries: Presbyterian Health Plan, Inc. (PHP) and Presbyterian Insurance Company, Inc. (PIC). PHP is a state-licensed HMO in New Mexico and is also a federally qualified HMO under Title XIII of the Public Health Service Act. PHP provides comprehensive health care services in New Mexico to individuals primarily through health maintenance contracts with employer groups and individuals. PHP has a five-year contract with the state of New Mexico to provide physical health, behavioral health, and long-term care services to Medicaid eligible individuals under the Centennial Care program. The current five-year contract began January 1, 2019. PHP's previous Centennial Care contract was effective from January 1, 2014 through December 31, 2018. PHP also offers an HMO product to Medicare eligible individuals (Medicare Advantage). The Medicare Advantage product provides managed care services that include all Medicare benefits and, in some cases, additional managed care services. PIC offers preferred provider and indemnity products to individuals through contracts with employer groups, as well as stop-loss coverage to some of PHP's self-funded employer groups.

Fluent Health, LLC (Fluent) is a management services organization owned by PNI, PHP, and PIC. It was formed to facilitate potential health plan joint ventures outside of the state of New Mexico. The business purpose of Fluent is to provide claims processing, administrative, management, and consulting services to health plans. Currently, Fluent provides these services to PHP and PIC.

Basis of Presentation

The accompanying financial statements include the combined accounts of PHS and its affiliates as described in Note 1 (collectively, Presbyterian Healthcare Services), including Presbyterian Healthcare Foundation (the Foundation), which is not a controlled entity. However, the Foundation is organized for the benefit and support of PHS, and its financial position and results of operations are combined herein. All significant intercompany balances and transactions have been eliminated in combination.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued) (Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies

Pending Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2017-04, *Intangibles – Goodwill and Other (Topic 350)*. 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 amount of 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, which will be effective for the year ending December 31, 2021.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*, a new fair value measurement accounting standard. This accounting standard changes the disclosure requirements for fair value measurement. The accounting standard is effective for fiscal years beginning after December 15, 2019, and will be applied using a retrospective approach. Management is currently assessing the impact of this accounting standard, which will be effective January 1, 2020.

Adopted Accounting Pronouncements

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall Recognition and Measurement of Financial Assets and Financial Liabilities*, which amends the accounting and disclosures of financial instruments, including a provision that requires equity investments (except for investments accounted for under the equity method of accounting) to be measured at fair value and recognized in current earnings. Additionally, this ASU removed the disclosure requirement of fair value information for financial instruments measured at amortized cost. This ASU was adopted by PHS on January 1, 2019, using a modified retrospective approach and did not have a material effect on the combined financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires the rights and obligations arising from lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet. This accounting standard also requires additional disclosures about the amount, timing, and uncertainty of cash flows arising from leases.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

PHS adopted the ASU effective January 1, 2019, using a modified retrospective approach. The primary effect of the new standard was to record right-of-use assets of \$6,018 and obligations for leases of \$6,046 as of January 1, 2019.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, which applies to all entities that are required to present a statement of cash flows under Topic 230. ASU 2016-15 addresses the presentation and classification of cash flows related to certain matters pertaining to debt, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, distributions received from equity method investees, and certain other separately identifiable cash flows. The ASU was adopted by PHS for the year ended December 31, 2019, using a modified retrospective approach. This ASU did not have a material impact on the statement of cash flows.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which applies to all entities that have restricted cash and are required to present a statement of cash flows under Topic 230. ASU 2016-18 requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. PHS adopted this ASU for the year ended December 31, 2019, using a modified retrospective approach. The effect of the new standard was to increase the amounts included in cash, cash equivalents, and restricted cash on the statements of cash flows by \$321,563, \$47,498, and \$106,611 as of December 31, 2019, December 31, 2018, and January 1, 2018, respectively.

Cash and Cash Equivalents

Cash and cash equivalents include bank deposits and highly liquid investments with original maturities at the time of purchase of three months or less. The carrying value of cash and cash equivalents approximates fair value.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued) (Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

Cash, cash equivalents, and restricted cash as reported in the combined statements of cash flows are presented separately within the combined balance sheets in the following asset classes:

	Year Ended December 31	
	2019	2018
Cash and cash equivalents	\$ 245,160	\$ 284,331
Assets limited as to use or restricted	321,563	47,498
Total cash, cash equivalents, and restricted cash	<u>\$ 566,723</u>	<u>\$ 331,829</u>

Accounts Receivable

Accounts receivable consist of patient accounts that are recorded at net realizable value based on certain assumptions. In evaluating the collectability of accounts receivable, PHS analyzes its history and identifies trends for the appropriate allowances to reduce accounts receivable to net realizable value of its major payor sources of revenue, as well as self-pay patients.

Management regularly reviews data about these major sources of revenue in evaluating the sufficiency of the allowances on accounts receivable. For receivables associated with services provided to patients who have third-party coverage, PHS analyzes historical collections as a basis for estimating future collections of accounts receivable. PHS has a policy of providing discounts to self-pay patients without insurance. PHS's uninsured discount policies during 2019 and 2018 provided for a discount of 30% from standard rates for most services. These uninsured discounts are recorded with contractual adjustments as a deduction of patient service revenue. The estimated uncollectible amounts due from self-pay patients are generally considered implicit price concessions that are direct reductions of accounts receivable. The implicit price concessions are recognized immediately based on historical results.

Assets Limited as to Use or Restricted

Assets limited as to use or restricted include assets set aside by PHS for future long-term purposes, including capital improvements and self-insurance, over which PHS retains control and may at its discretion subsequently use for other purposes and investments held by PNI that are used to meet specified capital requirements for regulatory purposes. In addition, assets limited as to use or

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

restricted include assets held by trustees under bond indenture agreements, contributions by donors with stipulated restrictions, and amounts on deposit to satisfy statutory requirements of the New Mexico Office of Superintendent of Insurance.

These assets consist primarily of cash, cash equivalents, government securities, other fixed-income securities, equity securities, derivatives, and alternative investments. The carrying amounts of investments in marketable debt and equity securities are reported on the combined balance sheets at fair value. Alternative investments are reported under the equity method of accounting using the NAV as a practical expedient, except for alternative investments held by the Foundation, which are reported at fair value.

PHS also invests in various commingled funds, which are assets from multiple accounts blended into a single fund. Commingled funds do not have a readily determinable fair value; therefore, the net asset value is used as a practical expedient for fair value. As such, they are excluded from the fair value hierarchy.

Income or loss related to the investment portfolio (including realized and unrealized gains and losses on investments, interest, and dividends) is included in the excess (deficiency) of revenues over expenses unless the income or loss is restricted by donor or law. Income or loss restricted by donor or law is classified as a change in net assets with donor restrictions consistent with the applicable restrictions.

As a condition of its Medicaid Centennial Care contract with the New Mexico Human Services Department (HSD), PHP is required to maintain an account with a balance equal to 90% of the average of the past three months' capitation payments made to PHP from HSD. As of December 31, 2019 and 2018, \$192,000 and \$112,926, respectively, were held in bonds and cash in a restricted managed asset account to satisfy this requirement.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued) (Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

Fair Value Measurements

Accounting Standards Codification (ASC) 820, *Fair Value Measurement*, requires the categorization of financial assets and liabilities into a three-level hierarchy based on pricing inputs to the valuation technique. The fair value hierarchy gives the highest priority to the quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable inputs. The various levels of the fair value hierarchy are described as follows:

Level 1 – Pricing is based on observable inputs, such as quoted prices in active markets.

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 noted in ASC 820. 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 (replacement cost).

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

(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).

(d) *Net Asset Value (NAV)* – Represents the difference between the assets and liabilities of an investment fund or partnership expressed on a per share or unit basis on the valuation date. Underlying asset and liability values may utilize techniques (a), (b), or (c).

When observable market data is available, it is required to be used in determining the fair value measurement. When inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level of input that is significant to the fair value measurement.

The majority of PHS's marketable debt and equity securities are measured based on observable market prices. PHS's interest rate swaps are measured using models based upon observable pricing inputs. Note 7 further describes the methods applied to determine the fair value of PHS's financial assets and liabilities.

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

Inventories

Inventories, consisting of drugs and supplies, are stated at the lower of cost (first-in, first-out method) or net realizable value.

Property and Equipment, Net

Property and equipment purchases 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. The following useful lives are being used by PHS:

Land improvements	2–25 years
Buildings and improvements	5–40 years
Equipment and capitalized software	3–20 years

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

Interest cost incurred on borrowed funds, net of interest earned on assets held by trustee during the period of construction of qualified capital projects, is capitalized as a component of the cost of acquiring those assets.

Leases

PHS leases property and equipment, all of which are currently classified as operating leases. Prior to the adoption of ASU 2016-02, operating leases were not recorded on the balance sheet. On January 1, 2019, PHS adopted ASU 2016-02, which requires a right-of-use asset and lease liability to be recorded for operating leases. The related assets and liabilities are initially recorded at the present value of the lease payments over the term of the agreement. Most of the PHS contracts do not provide a readily determinable implicit rate in the contract. Therefore, PHS has elected to discount the payments using a risk-free rate effective as of the commencement of each contract. PHS elected not to record lease assets and liabilities on short-term leases, which are defined as leases with terms of 12 months or less. The related right-of-use assets and liabilities are not considered material to the financial statements.

Goodwill and Other Intangible Assets

PHS follows the provisions of ASC 350, *Intangibles – Goodwill and Other*. Management assesses goodwill impairment using a qualitative evaluation, unless impairment triggers are identified. There was no goodwill impairment in either 2019 or 2018.

On September 1, 2018, PHP acquired approximately 83,000 Medicaid members previously served by another health plan. As a result of the purchase, PHP recorded an intangible asset equal to the cash paid of \$42,011 and, in accordance with ASC 350, determined a useful life of ten years. PHP has recorded \$4,201 and \$1,396 in amortization costs related to this intangible asset for the years ended December 31, 2019 and 2018, respectively.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued) (Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

Impairment of Long-Lived Assets

PHS evaluates whether events and circumstances have occurred that indicate the remaining estimated useful lives of long-lived assets, other than goodwill, may not be recoverable. The assessment of possible impairment is based on the ability to recover the carrying amount of the asset based on undiscounted cash flows. Impairments are calculated as the total by which the carrying amount of the asset exceeds its estimated fair value. For the years ended December 31, 2019 and 2018, management determined that there was no impairment of its long-lived assets.

Net Assets With Donor Restrictions

Unconditional pledges to give cash and other assets are reported at fair value at the date the pledge is received. The gifts 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, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and recognized as a component of other operating revenue. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in other operating revenue.

Premium Revenues, Medical Claims Payable, and Health Care Expenses

Premium revenues are recognized in the month in which members are entitled to health care services. Premiums collected in advance are recorded as unearned premiums and are included in accrued liabilities on the accompanying combined balance sheets. During 2019 and 2018, premium revenue was as follows:

	Year Ended December 31	
	2019	2018
Net premiums:		
Medicaid	\$ 2,419,839	\$ 1,470,272
Medicare	425,268	417,074
Commercial	344,708	410,633
Total	<u>\$ 3,189,815</u>	<u>\$ 2,297,979</u>

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued) (Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

Coordination of benefits and subrogation are recognized in the period such amounts are determined to be recoverable from other insurers.

PHP is contracted with the state of New Mexico to serve the Medicaid population under the New Mexico Centennial Care program. All Medicaid services, including physical health, behavioral health, and long-term care, are provided as part of this program. PHP is one of three HMOs currently contracted by the state to administer the New Mexico Centennial Care program.

Under this contract, PHP receives a fixed premium from the state to provide comprehensive health care services for enrollees, including those enrollees receiving services from PHS. PHS facilities and physicians are paid capitated or discounted fee-for-service rates from each of the HMOs. The medical claims costs of PHP on the combined statements of operations are net of intercompany eliminations for services rendered by PHS facilities, totaling \$761,415 and \$784,960 for the years ended December 31, 2019 and 2018, respectively.

Under the Medicaid Centennial Care contract, PHP is permitted to retain 100% of the underwriting gain generated up to 3% annually. Underwriting gains above 3% are shared 50/50 between PHP and HSD. Additionally, for Hepatitis C drugs, PHP is subject to risk corridor adjustments. PHP and HSD share in excess gains or losses generated under the contract based on a tiered structure. Liabilities for the underwriting gain limitation and risk corridors of \$29,949 and \$20,752 as of December 31, 2019 and 2018, respectively, were recorded on the accompanying combined balance sheets in due under Medicaid contract.

PHP and PIC serve as plan sponsors to offer Medicare Part D prescription drug insurance coverage under a contract with the Centers for Medicare & Medicaid Services (CMS). Premium revenue is recognized ratably over the period in which eligible individuals are entitled to receive prescription drug benefits. Premium revenues are subject to a comprehensive risk reconciliation under which CMS shares in a portion of direct surplus or deficit related to Medicare Part D premiums. In addition to premium revenues, PHP and PIC receive prepayments from CMS related to low income, cost sharing, and catastrophic reinsurance subsidies. PHP and PIC are fully reimbursed by CMS for costs incurred under these contract elements and, accordingly, there is no insurance risk to either company. Amounts received for these subsidies are not reflected as premium revenue, but rather are accounted for as deposits with the related liability recorded on the combined balance sheets. Pharmacy benefit costs not related to low income, cost sharing, or catastrophic reinsurance subsidies and administrative costs under the contract are expensed as incurred.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued) (Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

The estimated cost of all health services rendered to members through December 31, but not yet paid as of that date, is included in medical claims payable. This claims expense estimate is developed using actuarial assumptions based on historical experience with respect to the timing of payments in relation to the dates of service. Subsequent changes to prior period estimates are reflected in the current period. Losses on contracts are recognized in the period when health care costs are expected to exceed premium revenue.

Patient Service Revenue

PHS records net patient service revenue at the transaction price estimated to reflect the total consideration due from patients and third-party payors in exchange for providing goods and services in patient care. These services are considered to be single performance obligations and have durations of less than one year. Revenues are recorded as these goods and services are provided. The transaction price, which involves significant estimates, is determined based on PHS's standard charges for the goods and services provided, with a reduction recorded for price concessions related to third-party contractual arrangements, as well as patient discounts and price concessions. PHS determines the transaction price by grouping contracts with similar characteristics using a portfolio approach as it believes there would not be a material difference using a portfolio of similar contracts than if based on individual contracts.

PHS has agreements with third-party payors that provide for payments at amounts different from established charges. The basis for payment under these agreements includes prospectively determined rates, cost reimbursement, and negotiated discounts from established charges.

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments due to future audits, reviews, and investigations. The differences between the estimated and actual adjustments are recorded as part of patient service revenue in future periods, as the amounts become known, or as years are no longer subject to such audits, reviews, and investigations.

Currently, New Mexico utilizes supplemental reimbursement programs for the purpose of providing reimbursement to providers to offset a portion of the cost of providing care to Medicaid and uninsured patients. Under these programs, PHS recognizes revenue in the period in which amounts are estimable and collection is reasonably assured. Reimbursement under these programs is reflected in net patient service revenue.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

For uninsured patients who do not qualify for charity care, PHS recognizes revenue on the basis of discounted rates, as provided by its policy. On the basis of historical experience, a significant portion of PHS's uninsured patients will be unable or unwilling to pay for the services provided. The estimated uncollectible amounts due from these patients are generally considered implicit price concessions that are a direct reduction to net patient service revenue.

Net patient service revenue, net of contractual allowances, discounts, and implicit price concessions, is recognized from the major payor sources as follows:

	December 31	
	2019	2018
Net patient service revenue:		
Medicare	\$ 342,982	\$ 346,791
Medicaid	151,864	206,730
Managed care and other third-party payors	605,076	562,885
Self pay	19,216	30,999
Total	<u>\$ 1,119,138</u>	<u>\$ 1,147,405</u>

Charity Care

As an integral part of its mission, PHS provides care to all patients, regardless of ability to pay for needed services. A patient is classified as a charity care patient in accordance with standards established across PHS and its affiliates. Charity care represents services rendered for which no, or only partial, payment is expected and, as such, is not included in revenues on the combined statements of operations.

Excess (Deficiency) of Revenues Over Expenses

The combined statements of operations include a measurement for excess (deficiency) of revenues over expenses. Changes in net assets without donor restrictions, which are excluded from excess (deficiency) of revenues over expenses, include contributions of long-lived assets (including assets acquired using contributions that, by donor restrictions, were to be used for the purpose of acquiring such assets) and changes in the pension liability.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued) (Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

Other Income and Loss

Activities that result in gains or losses and are unrelated to the primary mission of PHS are considered to be other income and losses. Accordingly, investment income, changes in unrealized gains and losses on investments, loss on debt extinguishment, loss on the settlement of pension obligations, and unrealized changes in the fair value of interest rate swaps are reported as a component of other income (loss).

Taxes

PHS and all of its affiliates, except for PNI and its subsidiaries, have been determined to be tax-exempt corporations by the Internal Revenue Service and generally are not subject to federal taxes on income.

The taxable affiliates utilize the liability method in accounting for income taxes. Under this method, deferred income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the currently enacted tax rates and laws. Valuation allowances are used to reduce deferred tax assets to their estimated net realizable values when management determines ultimate recovery is not probable.

PHP and PIC are required to pay premium taxes to the state based on a percentage of adjusted premiums received related to the Commercial and Medicaid product lines. As a result of paying premium taxes, PHP and PIC are exempt from paying state income taxes. PHP and PIC recorded net premium tax expense totaling \$86,433 and \$55,589 in 2019 and 2018, respectively. These amounts are included within purchased services and other expenses on the accompanying combined statements of operations.

ASC 740, *Income Taxes*, prescribes criteria for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. As of December 31, 2019 and 2018, there was no significant impact on the combined financial statements related to the tax positions taken. There were no significant tax positions taken by management that required accrual as of December 31, 2019 or 2018.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued) (Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

Derivative and Hedging Instruments

In accordance with ASC 815, *Derivatives and Hedging*, derivatives are recognized as either assets or liabilities at fair value on the combined balance sheets, regardless of the purpose or intent for holding them. For those derivatives not designated as hedges under such standards, the changes in fair value are recognized in the excess (deficiency) of revenues over expenses. PHS has not designated its derivatives related to marketable securities as hedged financial instruments. Accordingly, the change in the fair value of derivatives is recognized as a component of investment income.

One of PHS's investment managers, which utilizes derivative instruments, has executed a master netting arrangement related to marketable securities for each of the derivative instruments held by the same counterparty, which are legally offset as the instrument is settled. PHS's derivative contracts related to marketable securities were reported on a net basis on the accompanying combined balance sheets as of December 31, 2019.

Benefit Plans

PHS is the plan sponsor of a defined benefit pension plan (Plan I) and five other limited postretirement benefit plans. The funded status of Plan I is recognized on the combined balance sheets as the difference between the fair value of the investments and the actuarially determined pension obligation. Other required disclosures of ASC 715, *Compensation – Retirement Benefits*, include the accumulated benefit obligation and fair value of the plan's assets, assumptions used in the benefit obligation calculation, contributions, the asset allocation of the plan, and the expected benefits to be paid, which can be found in Note 11.

In addition to the plans described above, PHS sponsors certain defined contribution plans. Contributions to these plans are expensed as earned by the employees.

Use of Estimates

The preparation of combined financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses in the combined financial statements. Actual results could differ from those estimates.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued) (Dollar Amounts in Thousands)

3. Patient Service Revenue

A summary of payment arrangements with major third-party payors follows:

Medicare – Inpatient acute care and certain outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge or procedure. These rates vary according to patient classification systems based on clinical, diagnostic, and other factors.

Medicaid – The State Medicaid program consists of two primary plans. The larger plan is the New Mexico Centennial Care program. Medicaid services, including physical health, behavioral health, and long-term care, are provided as part of the New Mexico Centennial Care program. The smaller plan is a traditional Medicaid plan. PHS facilities and physicians are paid for inpatient acute care services on prospectively determined rates per discharge. Payments for outpatient services are made on a discounted fee-for-service basis.

Others – PHS has also entered into payment agreements with certain commercial insurance carriers, HMOs, and preferred provider organizations. The basis for payment to PHS under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Amounts received from third-party payors in excess of expected reimbursement are reflected as estimated third-party payor settlements on the accompanying combined financial statements.

4. Other Operating Revenues

Other operating revenues consist of the following:

	Year Ended December 31	
	2019	2018
Health plan administrative fees	\$ 28,672	\$ 25,189
Contributions and other	46,962	32,311
Tax appropriation revenue	8,357	8,231
	<u>\$ 83,991</u>	<u>\$ 65,731</u>

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

5. Community Benefit

In support of its mission and philosophy, PHS voluntarily provides free care to patients who cannot afford health care due to inadequate resources and/or patients who are uninsured. Because PHS does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as patient service revenues. The estimated cost of this voluntary free care less the amount, if any, ultimately received was \$35,773 and \$40,987 in 2019 and 2018, respectively.

In addition, PHS provides services to other patients under certain government-reimbursed public aid programs, which pay providers amounts that are generally less than the cost of rendering the services provided to the patients. The estimated unreimbursed cost of this care was approximately \$237,914 and \$186,487 in 2019 and 2018, respectively. These unreimbursed costs and costs of voluntary free care do not include any governmental funds received for providing access to health care to all residents of the local community.

PHS uses information from its cost accounting system and certain cost-to-charge ratios, where applicable, to estimate the cost of financial assistance and other community benefits reported.

PHS, in furtherance of its mission, also commits significant time and resources to endeavors and critical services that meet otherwise unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable. Such programs include health screenings and assessments; cancer and other support groups; hospice programs; free transportation, lodging, meals, and medications for transient patients when needed; funding for homeless health care programs; significant ongoing and temporary donations of office space and telephone systems for nonprofit health care organizations, including the Meals on Wheels program; free flu vaccine clinics; participation in regular blood drives; and the provision of educational opportunities for students interested in pursuing medical-related or pastoral careers.

6. Assets Limited as to Use or Restricted

PHS has designated the accumulation of certain funds for future replacement of property and equipment, other capital improvements, debt retirement, self-insurance reserves, and other long-term purposes. Under the terms of the Master Trust Indenture for the outstanding bond issues, funds held by the trustee have been established and legally designated for debt service and qualifying capital expenditures.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

6. Assets Limited as to Use or Restricted (continued)

The following is a summary of assets limited as to use or restricted at fair value, except for certain alternative investments, which are recorded at NAV using the equity method:

	December 31	
	2019	2018
Cash and cash equivalents	\$ 321,563	\$ 47,498
Fixed-income securities	593,959	871,168
Equity securities	1,037,347	833,038
Government securities	499,268	138,986
Public master limited partnerships	70,041	64,879
Alternative investments	292,556	281,776
	<u>\$ 2,814,734</u>	<u>\$ 2,237,345</u>

Fixed-Income and Government Securities – These investment classes include investments in various fixed-income instruments that include investment-grade and senior secured below investment-grade domestic and international bonds, mortgage pools, and bonds issued by U.S. government agencies. These investment classes also include investments in commingled, mutual funds, and separately managed accounts that hold investments in fixed-income securities. The fixed-income investments are exposed to various kinds and levels of risk, including interest rate risk, credit risk, foreign exchange risk, and liquidity risk.

Equity Securities – This investment class consists primarily of common equity securities of domestic and international companies. These securities trade through the major public domestic and international exchanges. This investment class also includes investments in commingled and mutual funds that hold investments in equity securities. The equity securities investments are exposed to various risks, including market risk; individual security risk; foreign exchange risk; and, for common equity of companies with a small market capitalization, liquidity risk.

Public Master Limited Partnerships – This investment class consists of master limited partnerships that invest in various domestic infrastructure assets within the energy industry. The master limited partnerships trade through the major public domestic exchanges and are exposed to various risks, including market risk, individual security risk, regulatory risk, interest rate risk, and liquidity risk.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

6. Assets Limited as to Use or Restricted (continued)

Alternative Investments – Funds in this class are invested with external investment managers who invest primarily in various alternative categories, including real estate, long and short equity positions, merger and event arbitrage, natural resources, distressed credit, managed futures, fixed-income arbitrage, and foreign exchange. The managers employ various strategies, including long/short equity, event-driven, relative value, and tactical trading. A long/short equity strategy will take both long and short equity positions in publicly traded stocks to provide maximum capital appreciation, while limiting downside risk. Event-driven strategies deploy funds opportunistically across multiple asset categories seeking positive returns from companies involved in mergers, acquisitions, bankruptcy, litigation, regulatory uncertainty, and other matters with the potential to unlock value. Relative value funds use a variety of different strategies across a broad array of equity and fixed-income securities to take advantage of market inefficiencies between asset pairs, while maintaining a market-neutral risk position. Tactical trading strategies invest primarily in liquid markets, such as fixed-income and mortgage derivative securities, convertible debt, currencies, interest rate swaps, equity indices, and commodities and energy derivatives, while seeking to take advantage of changes in global economies and discrepancies among related sets of securities and derivatives resulting in asymmetrical outcomes. These investments are domestic and international in nature and have varying degrees of illiquidity. The risks associated with these investments are numerous and include liquidity risk, market risk, event risk, interest rate risk, foreign exchange risk, and investment manager risk. In addition, the investment managers are not required to register with the Securities and Exchange Commission and are not subject to regulatory controls. As unregistered investment vehicles, these funds are not required to disclose the holdings in their portfolios to investors. Given the numerous risks involved, these funds have a greater likelihood of losing invested capital.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

6. Assets Limited as to Use or Restricted (continued)

As of December 31, 2019 and 2018, PHS had alternative investments representing various hedge funds and real asset investments that include limited liability companies and limited liability partnerships, as follows:

	December 31	
	2019	2018
Equity long/short	\$ 13,549	\$ 15,039
Event driven	49,741	33,272
Relative value	43,700	44,720
Tactical trading	44,362	34,200
Private equity	6,278	5,089
Real assets	87,203	117,905
Total cost basis	<u>244,833</u>	<u>250,225</u>
Unrealized gain, net	47,723	31,551
	<u>\$ 292,556</u>	<u>\$ 281,776</u>

Approximately 89% of the value of these alternative investments represent investments with original lockup periods ranging from one month to five years. The remaining exposure represents investments with longer lockups and limited redemption rights. At December 31, 2019, PHS had unfunded commitments for alternative investments totaling \$72,162.

Investment (loss) income on assets limited as to use or restricted (excluding restricted by donor) consists of the following:

	Year Ended December 31	
	2019	2018
Interest and dividend income	\$ 52,024	\$ 54,184
Net realized gains on marketable securities	3,667	46,784
Total investment income	<u>55,691</u>	100,968
Net unrealized gains (losses) on marketable securities	255,582	(204,131)
Net unrealized gains (losses) on alternative investments	16,171	(167)
	<u>\$ 327,444</u>	<u>\$ (103,330)</u>

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

7. Fair Value Measurements

The following tables present the fair value hierarchy for PHS's financial assets and liabilities measured at fair value, and financial assets measured at NAV at December 31, 2019:

	Level 1	Level 2	Commingled Investments at NAV	Equity Method Investments at NAV	Total Financial Instruments	Valuation Technique* (a, b, c, d)
Designated for long-term purposes						
Cash and cash equivalents	\$ 7,110	\$ —	\$ —	\$ —	\$ 7,110	a
Government securities	398,169	—	—	—	398,169	a
Fixed-income securities	—	301,380	195,562	—	496,942	b, d
Equity securities	359,460	—	588,531	—	947,991	a, d
Public master limited partnerships	63,428	—	—	—	63,428	a
Alternative investments	—	—	—	261,805	261,805	d
Total designated for long-term purposes	<u>\$ 828,167</u>	<u>\$ 301,380</u>	<u>\$ 784,093</u>	<u>\$ 261,805</u>	<u>\$ 2,175,445</u>	
Designated for self-insurance funds						
Cash and cash equivalents	\$ 843	\$ —	\$ —	\$ —	\$ 843	a
Government securities	21,350	—	—	—	21,350	a
Fixed-income securities	—	13,739	16,875	—	30,614	b, d
Equity securities	18,097	—	51,742	—	69,839	a, d
Public master limited partnerships	5,290	—	—	—	5,290	a
Alternative investments	—	—	—	20,200	20,200	d
Total designated for self-insurance funds	<u>\$ 45,580</u>	<u>\$ 13,739</u>	<u>\$ 68,617</u>	<u>\$ 20,200</u>	<u>\$ 148,136</u>	
Restricted by donors						
Cash and cash equivalents	\$ 320	\$ —	\$ —	\$ —	\$ 320	a
Government securities	7,987	—	—	—	7,987	a
Fixed-income securities	—	6,178	4,131	—	10,309	b, d
Equity securities	7,452	—	12,065	—	19,517	a, d
Public master limited partnerships	1,323	—	—	—	1,323	a
Alternative investments	—	—	—	10,551	10,551	d
Total restricted by donors	<u>\$ 17,082</u>	<u>\$ 6,178</u>	<u>\$ 16,196</u>	<u>\$ 10,551</u>	<u>\$ 50,007</u>	
Held by trustee						
Cash and cash equivalents	<u>\$ 247,929</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 247,929</u>	a
Restricted for statutory requirements						
Cash and cash equivalents	\$ 65,361	\$ —	\$ —	\$ —	\$ 65,361	a
Government securities	40,199	31,563	—	—	71,762	a, b
Fixed-income securities	—	56,094	—	—	56,094	b
	<u>\$ 105,560</u>	<u>\$ 87,657</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 193,217</u>	
Financial liabilities						
Interest rate swaps	<u>\$ —</u>	<u>\$ (20,088)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (20,088)</u>	b

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

7. Fair Value Measurements (continued)

The following tables present the fair value hierarchy for PHS's financial assets and liabilities measured at fair value, and financial assets measured at NAV at December 31, 2018:

	Level 1	Level 2	Commingled Investments at NAV	Equity Method Investments at NAV	Total Financial Instruments	Valuation Technique* (a, b, c, d)
Designated for long-term purposes						
Cash and cash equivalents	\$ 8,839	\$ —	\$ —	\$ —	\$ 8,839	a
Government securities	71,465	—	—	—	71,465	a
Fixed-income securities	353,152	214,616	189,534	—	757,302	a, b, d
Equity securities	270,405	—	490,583	—	760,988	a, d
Public master limited partnerships	58,693	—	—	—	58,693	a
Alternative investments	—	—	—	251,555	251,555	d
Total designated for long-term purposes	<u>\$ 762,554</u>	<u>\$ 214,616</u>	<u>\$ 680,117</u>	<u>\$ 251,555</u>	<u>\$ 1,908,842</u>	
Designated for self-insurance funds						
Cash and cash equivalents	\$ 3,499	\$ —	\$ —	\$ —	\$ 3,499	a
Government securities	2,099	—	—	—	2,099	a
Fixed-income securities	29,036	5,441	16,205	—	50,682	a, b, d
Equity securities	14,534	—	40,910	—	55,444	a, d
Public master limited partnerships	4,887	—	—	—	4,887	a
Alternative investments	—	—	—	21,236	\$21,236	d
Total designated for self-insurance funds	<u>\$ 54,055</u>	<u>\$ 5,441</u>	<u>\$ 57,115</u>	<u>\$ 21,236</u>	<u>\$ 137,847</u>	
Restricted by donors						
Cash and cash equivalents	\$ 218	\$ —	\$ —	\$ —	\$ 218	a
Government securities	1,552	—	—	—	1,552	a
Fixed-income securities	7,829	4,660	4,116	—	16,605	a, b, d
Equity securities	5,953	—	10,653	—	16,606	a, d
Public master limited partnerships	1,299	—	—	—	1,299	a
Alternative investments	—	—	—	8,985	8,985	d
Total restricted by donors	<u>\$ 16,851</u>	<u>\$ 4,660</u>	<u>\$ 14,769</u>	<u>\$ 8,985</u>	<u>\$ 45,265</u>	
Held by trustee						
Cash and cash equivalents	<u>\$ 31,250</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 31,250</u>	a
Restricted for statutory requirements						
Cash and cash equivalents	\$ 3,692	\$ —	\$ —	\$ —	\$ 3,692	a
Government securities	39,149	24,721	—	—	63,870	a, b
Fixed-income securities	—	46,579	—	—	46,579	b
	<u>\$ 42,841</u>	<u>\$ 71,300</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 114,141</u>	
Financial assets (liabilities)						
Interest rate swaps	<u>\$ —</u>	<u>\$ (15,642)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (15,642)</u>	b

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

7. Fair Value Measurements (continued)

Derivative contracts related to marketable securities were reported as a net liability of \$129 as of December 31, 2019, and were included within assets limited as to use. There were no derivative contracts related to marketable securities as of December 31, 2018.

	Level 1	Level 2	Total Financial Instruments	Valuation Technique* (a, b, c, d)
Derivative assets				
Futures contracts	\$ 293,703	\$ —	\$ 293,703	a
Interest rate swap agreements	—	196,089	196,089	b
	<u>\$ 293,703</u>	<u>\$ 196,089</u>	<u>\$ 489,792</u>	
Derivative liabilities				
Futures contracts	\$ (293,703)	\$ —	\$ (293,703)	a
Interest rate swap agreements	—	(195,960)	(195,960)	b
	<u>\$ (293,703)</u>	<u>\$ (195,960)</u>	<u>\$ (489,663)</u>	

*Valuation techniques are described in Note 2.

There were no changes in the fair value level classification, between Level 1 and Level 2, for any investments in 2019 or 2018. PHS has no Level 3 investments. As a result of further analysis of the characteristics of certain private commingled funds, amounts that were previously reported as Level 2 at December 31, 2018, have been removed from the fair value hierarchy and presented as commingled investments at NAV, consistent with the 2019 presentation.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

8. Property and Equipment, Net

Property and equipment, net, consist of the following:

	December 31	
	2019	2018
Land and improvements	\$ 140,195	\$ 126,372
Buildings and improvements	1,232,839	1,184,087
Equipment	669,208	625,245
Software	304,440	250,386
	2,346,682	2,186,090
Less accumulated depreciation and amortization	(1,343,288)	(1,235,767)
	1,003,394	950,323
Construction-in-progress	70,647	78,976
	\$ 1,074,041	\$ 1,029,299

Unamortized software was \$68,265 and \$43,186 as of December 31, 2019 and 2018, respectively. Software amortization expense was \$29,090 and \$24,438 for the years ended December 31, 2019 and 2018, respectively, and is included in depreciation and amortization expense.

At December 31, 2019, PHS has future capital commitments of \$41,298.

9. Medical Claims Expense

For the years ended December 31, 2019 and 2018, medical claims expense increased by \$3,798 and decreased by \$10,669 in 2019 and 2018, respectively, as a result of changes in estimates of prior periods' unpaid claims and claims adjustment expenses. These changes generally are the result of ongoing analyses of recent loss development trends. Original estimates are increased or decreased as additional information becomes known regarding individual claims.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

10. Long-Term Debt and Interest Rate Swaps

Long-term debt consisted of the following as of December 31:

	December 31	
	2019	2018
2019 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates of 3.0% to 5.0% payable semiannually on the established interest payment dates, principal payments beginning in 2025 through 2048	\$ 146,400	\$ —
2019 Series B Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rate of 5.0% payable semiannually on the established interest payment dates, principal payments due in 2025	75,000	—
2019 Series C Taxable Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), variable rate demand bonds with an interest rate of 1.65% at December 31, 2019, payable monthly on the established interest payment date, principal payments beginning in 2033 through 2042	82,845	—
2017 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates of 2.0% to 5.0% payable semiannually on the established interest payment dates, principal payments through 2046	238,335	238,730
2017 Series B Taxable Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates of 4.0% and 5.0% payable semiannually on the established interest payment dates, principal payments beginning in 2037 through 2046	65,665	65,665
2015 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates from 4.125% to 5.0% payable semiannually on the established interest payment dates, principal payments through 2044	212,990	218,195
2012 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates from 4.0% to 5.0% payable semiannually on the established interest payment dates, principal payments beginning in 2033 through 2042	—	75,000
2008 Series B, C, and D Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), variable-rate demand bonds with interest rates of 1.70% to 1.73% at December 31, 2019, and 1.75% to 1.80% at December 31, 2018, payable monthly on the established interest payment date, principal payable in annual installments through 2034	161,075	171,165
2012 note payable to bank, variable rate, interest payable quarterly at one-month LIBOR plus .90% (2.60% at December 31, 2019, and 3.36% at December 31, 2018) due October 2022	50,000	50,000
Other obligations	4,321	4,790
	1,036,631	823,545
Premiums on long-term debt, net	56,769	30,148
Less deferred financing fees	(7,980)	(6,870)
	1,085,420	846,823
Less current portion	(16,829)	(16,161)
	\$ 1,068,591	\$ 830,662

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

10. Long-Term Debt and Interest Rate Swaps (continued)

The 2019 Series A and B Revenue Bonds totaling \$221,400 were issued through the New Mexico Hospital Equipment Loan Council in December 2019. Proceeds of the bonds will be used primarily for the construction of a new patient tower on the Presbyterian main hospital campus in Albuquerque, New Mexico, and the build-out of an ambulatory surgery center on the Kaseman hospital campus. The 2019 Series A Bonds are fixed rate and include serial bonds with annual maturities beginning in August 2025 through 2039 and term bonds with maturities beginning in August 2044 and 2048. The 2019 Series B Bonds are fixed-rate term bonds maturing in 2049 with an initial interest period ending August 1, 2025, at which time they are subject to mandatory tender or rate adjustment for a new interest period.

The 2019 Series C Taxable Revenue Bonds totaling \$82,845 were issued through the New Mexico Hospital Equipment Loan Council in December 2019. Proceeds of the bonds were used to defease the 2012 Series A Revenue Bonds. The 2019 Series C Bonds are variable-rate demand obligations and bear interest on a weekly rate period at amounts set by a remarketing agent. The interest rate mode can be modified under the terms of the legal documents. To secure the tender price of the 2019 Series C Bonds, PHS has entered into a standby bond purchase agreement with JPMorgan Chase Bank, N.A. with an expiration in December 2024. The 2019 Series C Bonds are subject to optional redemption at the discretion of PHS. In addition, the 2019 Series C Bonds have a schedule of mandatory sinking fund deposits in 2033 through 2042.

The 2017 Series A Revenue Bonds totaling \$239,115 were issued through the New Mexico Hospital Equipment Loan Council in May 2017. Proceeds of the bonds were issued to defease the 2009 Series A Revenue Bonds and provide funding for the construction of a new hospital facility in Santa Fe, New Mexico, which opened in October 2018. The 2017 Series A bonds are fixed-rate bonds and have annual maturities that began in August 2018 and continue through 2046.

The 2017 Series B Taxable Revenue Bonds totaling \$65,665 were issued through the New Mexico Hospital Equipment Loan Council in May 2017. Proceeds of the bonds are being used to fund the construction of a physician office building adjacent to the new hospital in Santa Fe, New Mexico, and expand PHS's administrative office in Albuquerque, New Mexico. The 2017 Series B bonds are fixed rate bonds and have annual maturities beginning in August 2037 and continuing through 2046.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued) (Dollar Amounts in Thousands)

10. Long-Term Debt and Interest Rate Swaps (continued)

The 2015 Series A Revenue Bonds were issued through the New Mexico Hospital Equipment Loan Council. Proceeds of the bonds were used to defease the 2008 Series A Bonds and fund various health care facilities throughout the PHS system. The 2015 bonds are fixed-rate serial and term bonds and have scheduled maturities and mandatory sinking fund deposits that began in August 2016, and continue through 2044.

In August 2012, PHS also obtained a \$50,000 taxable bank direct loan (the 2012 Bank Loan), of which \$50,000 was outstanding as of December 31, 2019 and 2018. Proceeds of the 2012 Bank Loan were used for a new system corporate office, which was completed in 2014.

The 2008 Revenue Bonds were issued through the New Mexico Hospital Equipment Loan Council in four series (Series A, Series B, Series C, and Series D) (the Series 2008 Bonds) in November 2008. The Series 2008 Bonds were designed to defease the 2005 Series A and B Revenue Bonds (\$201,895); to pay off a Wells Fargo Credit Agreement, which defeased the 2004 Series A through D Bonds (\$128,655) and the 1993A Bonds (\$17,900) during March and April 2008; to reimburse PHS for prior capital expenditures; and to pay certain costs of issuing the Series 2008 Bonds. The Series 2008 A Bonds were refunded in their entirety in 2015 and have been legally defeased. The Series 2008 B through D Bonds are variable-rate demand obligations and bear interest on a daily (Series C and D) and weekly (Series B) rate period at amounts set by a remarketing agent. The interest rate mode can be modified under the terms of the legal documents. To secure the tender price of the Series 2008 B Bonds, PHS has entered into a standby bond purchase agreement with JPMorgan Chase Bank, N.A with expirations in November 2020. The Series 2008 C and D Bonds are supported by standby bond purchase agreements with Wells Fargo Bank, N.A. with expiration dates in November 2021 and 2022, respectively. The Series 2012 A Bonds were defeased in 2019 and a loss of \$3,920 was recognized.

The Series 2008 B, C, and D Bonds are further subject to optional redemption at the discretion of PHS. In addition, the Series 2008 Bonds have a schedule of mandatory sinking fund deposits through 2034.

All of the outstanding bonds are collateralized by a pledge of unrestricted receivables of the Obligated Group, as defined under the Master Trust Indenture. The Master Trust Indenture of the Obligated Group requires, among other things, that certain funds be established and held by a trustee. The Master Trust Indenture also requires certain limitations on additional indebtedness, liens on property, and disposition or transfers of assets, as well as the maintenance of certain cash balances and other financial ratios. The Obligated Group was in compliance with all such covenants at December 31, 2019.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

10. Long-Term Debt and Interest Rate Swaps (continued)

Scheduled principal payments and sinking fund requirements on long-term debt at December 31 are as follows:

	Long-Term Debt
2020	\$ 16,829
2021	17,548
2022	18,285
2023	19,059
2024	19,862
Thereafter	945,048
	<u>\$ 1,036,631</u>

Interest Rate Swaps

PHS has entered into several interest rate swaps associated with bond issuances, some of which have bonds that are no longer outstanding. The 2005 swaps provide that PHS receives a floating amount based on a percentage of one-month LIBOR (58.30% of LIBOR plus 0.36%) and PHS pays a fixed rate of 3.085% based on a notional amount of \$136,330 and \$146,420 at December 31, 2019 and 2018, respectively.

The 2006 swaps provide that PHS receives a floating amount based on a percentage of one-month LIBOR (68%) and PHS pays a weighted average fixed rate of 3.577% based on a notional amount of \$24,745 at both December 31, 2019 and 2018.

In connection with the issuance of the Series 2019 C Bonds in December 2019, PHS entered into a swap agreement (the 2019 Swap) whereby PHS receives a floating amount based on one-month LIBOR and PHS pays a fixed rate of 1.96% on the notional amount of \$82,845 at December 31, 2019.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

10. Long-Term Debt and Interest Rate Swaps (continued)

All derivatives that are being measured by PHS under ASC 820 are considered Level 2 assets (liabilities) because a quoted price can be obtained from a number of dealer counterparties and other market sources based on observable interest rates and yield curves for the full term of the asset or liability. In order to measure the fair value of municipal derivatives under ASC 820, PHS adjusted its mid-market periodic values of the swaps outstanding to incorporate nonperformance risk by PHS (when the financial instrument is a liability) or the counterparty (when the financial instrument is an asset). In order to determine the risk of nonperformance when the financial instrument is a liability, PHS has determined the change in the credit market for debt issues by entities with the same credit characteristics as PHS. To determine nonperformance risk when the instrument is an asset, PHS determines the change in the credit market for debt issues by the counterparty.

As of December 31, 2019 and 2018, the fair value of the 2005 and 2006 swaps was a net liability of \$20,024 and \$15,642, respectively. As of December 31, 2019, the fair value of the 2019 Swap was a liability of \$64. The combined net swap liability change is included in other liabilities on the accompanying combined balance sheets.

If the liability related to the 2005 and 2006 swaps were to exceed \$40,000, PHS would be required to post a cash deposit for amounts in excess of the threshold as collateral with the counterparty. This collateral threshold would be reduced to \$30,000 if PHS's current AA credit rating were to fall to A+, reduced to \$20,000 at a rating of A, and further reduced to zero at a credit rating below A. If the liability related to the 2019 Swap was to exceed \$75,000, PHS would be required to post a cash deposit for amounts in excess of the threshold as collateral with the counterparty. The collateral threshold would be reduced to \$50,000 if PHS's current AA credit rating were to fall to A+, reduced to \$30,000 at a rating of A, reduced to \$15,000 at a rating of A-, and further reduced to zero at a credit rating below A-.

Interest expense included \$2,492 and \$2,958 in 2019 and 2018, respectively, related to net periodic payments to the counterparty.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

11. Employee Benefit Plans

PHS has a defined benefit pension plan (the original plan) that previously covered substantially all of the employees of its related organizations, except employees of PNI. Effective January 1, 2006, the original plan was closed to new entrants, but it continued to accrue benefits for those employees in the plan as of December 31, 2005, until December 31, 2012, when the original plan was amended to cease future benefit accruals. Any benefits earned by participants under the original plan at December 31, 2012, will be preserved and will be payable based on the original plan's provisions.

In December 2018, certain participants in the original plan were removed from the original plan through lump-sum payments and annuities. Remaining participants in the original plan were transferred to a new ongoing plan (Plan I) and the original plan was terminated. The termination of the original plan resulted in a pension settlement charge of \$19,867, which was recorded in 2018.

PHS contributes such amounts as necessary on an actuarial basis to provide Plan I with assets sufficient to meet the benefits to be paid to Plan I participants. PHS contributed \$29,399 and \$31,739 in 2019 and 2018, respectively, to Plan I.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

A summary of Plan I's benefit obligation, assets, and funded status is as follows:

	Year Ended December 31	
	2019	2018
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 465,825	\$ 553,711
Service cost	2,900	4,300
Interest cost	20,424	21,346
Plan settlements	–	(54,527)
Actuarial loss (gain)	64,044	(33,704)
Benefits paid and plan expenses	<u>(22,310)</u>	<u>(25,301)</u>
Benefit obligation at end of year	<u>\$ 530,883</u>	<u>\$ 465,825</u>
Change in assets:		
Fair value of assets at beginning of year	\$ 306,071	\$ 376,386
Actual return on assets	53,971	(22,226)
Employer contribution	29,399	31,739
Plan settlements	–	(54,527)
Benefits paid and plan expenses	<u>(22,310)</u>	<u>(25,301)</u>
Fair value of plan assets at end of year	<u>\$ 367,131</u>	<u>\$ 306,071</u>
Funded status at year-end	<u>\$ (163,752)</u>	<u>\$ (159,754)</u>
Amounts not yet reflected in net periodic benefit cost and included in net assets:		
Accumulated loss	<u>\$ (203,042)</u>	<u>\$ (176,253)</u>
Cumulative changes in unrestricted net assets	(203,042)	(176,253)
Cumulative employer contributions in excess of net periodic benefit cost	<u>39,290</u>	<u>16,499</u>
Net amount recognized in the combined balance sheets	<u>\$ (163,752)</u>	<u>\$ (159,754)</u>

The actuarial loss recorded in 2019 was primarily due to the change in discount rate from 4.48% to 3.45%. This change increased the benefit obligation by \$67,700 in 2019.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

In 2018, PHS recorded settlement and curtailment charges of \$19,867 for the risk transfer activities that occurred in 2018. These charges are in addition to the regular periodic benefit cost of \$6,936 for 2018.

A summary of the projected benefit obligation, accumulated benefit obligation, and fair value of plan assets is as follows:

	<u>2019</u>	<u>2018</u>
Projected benefit obligation	\$ 530,883	\$ 465,825
Accumulated benefit obligation	530,883	465,825
Fair value of plan assets	367,131	306,071

Assumptions used to determine the benefit obligation as of the measurement date are as follows:

	<u>2019</u>	<u>2018</u>
Discount rate at end of year	3.45%	4.48%
Rate of increase in compensation levels	N/A	N/A

Net periodic pension benefit cost includes the following components:

	<u>2019</u>	<u>2018</u>
Service cost – benefits earned during the year	\$ 2,900	\$ 4,300
Interest cost on projected benefit obligation	20,424	21,346
Expected return on Plan I assets	(21,575)	(24,589)
Amortization of prior service credit	1,535	1,561
Recognized net actuarial loss	3,324	4,318
Net periodic pension benefit cost	<u>\$ 6,608</u>	<u>\$ 6,936</u>

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

Assumptions used to determine net periodic pension benefit cost are as follows:

	2019	2018
Discount rate at beginning of year	4.48%	3.93%
Rate of increase in compensation levels	N/A	N/A
Expected long-term rate of return on assets at beginning of year	6.50%	6.75%

Contributions to be made during 2020 have not been finalized but are expected to be \$28,524.

The expected return on Plan I assets has been developed using both historical and future expected returns for each asset class. Based on the target asset mix, PHS selected a long-term rate of return of 6.5% and 6.0% for 2019 and 2020, respectively. The asset allocation for Plan I, by asset class at the measurement date, was as follows:

	2019	2018
Cash and cash equivalents	3%	4%
Fixed-income securities	44	44
Common stock and equity	39	35
Absolute return, hedge funds, and other	14	17
	100%	100%

Plan I assets have historically been invested in a portfolio designed to preserve principal and obtain competitive investment returns and long-term investment growth, consistent with actuarial assumptions, while minimizing unnecessary investment risk. Diversification is achieved by retaining multiple investment managers with complementary philosophies, styles, and approaches.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

Plan I asset allocation targets at the measurement date were as follows:

	<u>Target</u>	<u>Range</u>
Cash and cash equivalents	1%	0%–6%
Fixed-income securities	44%	39–49%
Domestic equity securities	20%	15–25%
International equity securities	20%	15–25%
Other	15%	7–25%

The following tables present the fair value hierarchy for PHS’s Plan I financial assets and liabilities measured at fair value and financial assets measured at NAV at December 31:

	Level 1	Level 2	Commingled Investments at NAV	Equity Method Investments at NAV	Total	Valuation Techniques*
2019						
Cash and cash equivalents	\$ 10,722	\$ –	\$ –	\$ –	\$ 10,722	a
Fixed-income securities	69,384	4,294	86,887	–	160,565	a, b, d
Equity securities	58,052	–	88,274	–	146,326	a, d
Public master limited partnerships	19,694	–	–	–	19,694	a
Alternative investments	–	–	–	29,824	29,824	d
Total financial assets	<u>\$ 157,852</u>	<u>\$ 4,294</u>	<u>\$ 175,161</u>	<u>\$ 29,824</u>	<u>\$ 367,131</u>	
2018						
Cash and cash equivalents	\$ 11,894	\$ –	\$ –	\$ –	\$ 11,894	a
Fixed-income securities	38,591	6,026	89,072	–	133,689	a, b, d
Equity securities	42,433	–	65,293	–	107,726	a, d
Public master limited partnerships	13,148	–	–	–	13,148	a
Alternative investments	–	–	–	39,614	39,614	d
Total financial assets	<u>\$ 106,066</u>	<u>\$ 6,026</u>	<u>\$ 154,365</u>	<u>\$ 39,614</u>	<u>\$ 306,071</u>	

*Valuation techniques are described in Note 2.

There were no changes in the fair value level classification, between Level 1 and Level 2, for any investments in 2019 or 2018. PHS has no Level 3 investments. As a result of further analysis of the characteristics of certain private commingled funds, amounts that were previously reported as Level 2 at December 31, 2018, have been removed from the fair value hierarchy and presented as commingled investments at NAV, consistent with the 2019 presentation.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

Derivative contracts related to marketable securities were reported as a net liability of \$0 as of December 31, 2019, and were included within PHS's Plan I assets. There were no derivative contracts related to marketable securities as of December 31, 2018.

	Level 1	Level 2	Commingled Investments at NAV	Equity Method Investments at NAV	Total	Valuation Techniques* (a, b, c, d)
December 31, 2019						
Derivative assets						
Future derivative asset contracts	\$ 19,271	\$ -	\$ -	\$ -	\$ 19,271	
Future derivative liability contracts	(19,271)	-	-	-	(19,271)	
Total financial assets	\$ -	\$ -	\$ -	\$ -	\$ -	

* Valuation techniques are described in Note 2.

Plan I's alternative investments are comprised of a hedge fund-of-funds and a private real estate investment trust (REIT). As described in Note 2, management has elected to use the NAV per share, or its equivalent, as a practical expedient for the fair value of Plan I's interest in alternative investments. The underlying funds have restrictions on the timing of withdrawals, which may reduce liquidity from three to six months.

Expected benefits to be paid to the Plan I participants and beneficiaries are as follows:

2020	\$ 21,343
2021	22,837
2022	24,279
2023	25,663
2024–2029	171,910

In addition to Plan I, PHS also has five other limited postretirement benefit plans subject to the funded status recognition provisions of ASC 715. Plan I is funded, and the other postretirement plans are unfunded. As a result of the change in pension obligation, net assets without donor restrictions increased by \$28,422 and decreased by \$14,578 during 2019 and 2018, respectively.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

PHS has a defined contribution plan (Plan II), which consists of a Section 403(b) plan and a Section 401(a) plan under the Code. Plan II requires PHS to pay a basic employer contribution, as well as match participant contributions up to a stated maximum percentage of the participant's salary. Contributions to Plan II are expensed as earned by employees and were \$33,631 and \$29,615 in 2019 and 2018, respectively.

PHP has a 401(k) defined contribution plan (Plan III) for PHP employees. Plan III requires PHP to match participant contributions up to a stated maximum percentage of the participant's salary. Plan III additionally provides an employer contribution for all employees regardless of whether the employee individually contributes to Plan III. PHP contributions to Plan III are expensed as earned by employees and were \$5,158 and \$3,692 in 2019 and 2018, respectively.

12. Net Assets With Donor Restrictions

Net assets with donor restrictions are restricted for the following purposes at December 31:

	<u>2019</u>	<u>2018</u>
Subject to expenditure for specific purpose		
Program services and facility improvements	\$ 36,048	\$ 30,784
Education	4,816	4,230
	<u>\$ 40,864</u>	<u>\$ 35,014</u>
Subject to PHS's spending policy and appropriation		
Investment in perpetuity (including amounts above		
original gift amount) that once appropriated is		
expendable to support:		
Program services and facility improvements	\$ 10,005	\$ 9,959
Education	1,827	1,836
	<u>\$ 11,832</u>	<u>\$ 11,795</u>
Total net assets with donor restrictions	<u>\$ 52,696</u>	<u>\$ 46,809</u>

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

12. Net Assets With Donor Restrictions (continued)

Net assets with donor restrictions are comprised of the following at December 31:

	<u>2019</u>	<u>2018</u>
Marketable securities	\$ 49,351	\$ 44,686
Pledges receivable	2,689	1,544
Other	656	579
	<u>\$ 52,696</u>	<u>\$ 46,809</u>

13. Concentration of Credit Risk

PHS provides health care services through its inpatient and outpatient care facilities throughout New Mexico. PHS grants credit to patients, most of whom are insured under third-party payor agreements, without requiring collateral or other security in extending credit to patients. However, PHS routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, HMOs, and commercial insurance policies). The following table summarizes the percentage of net patient accounts receivable from all payors:

	<u>December 31</u>	
	<u>2019</u>	<u>2018</u>
Managed care and other third-party payors	72%	73%
Government	20	20
Self-pay	8	7
Total	<u>100%</u>	<u>100%</u>

Managed care and other third-party payors consist of receivables from various payors, including contracted third-party payors providing commercial and government programs. Management does not believe there is any significant concentration of credit risk associated with accounts receivable. Furthermore, management continually monitors and adjusts its allowances (contractual and implicit price concessions) associated with these receivables.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

14. Commitments and Contingencies

Litigation and Other Contingent Liabilities

PHS is subject to pending and threatened legal actions arising during the ordinary course of business. Management and legal counsel periodically assess whether losses have been incurred related to pending or threatened litigation, claims, and assessments. Loss estimates are continually monitored and reviewed, and as estimates are adjusted, changes in estimated losses are reflected in current operations. Losses incurred due to the actual results of litigation could differ from estimates recorded. In management's opinion, upon consultation with legal counsel, these matters should not have a material adverse effect on PHS's combined financial condition, results of operations, or cash flows. However, PHS's evaluation of the likely effects of these actions could change in the future, and an unfavorable outcome, depending upon the amount and timing, could have a material effect on PHS's combined financial condition, results of operations, or cash flows of a future period.

On June 6, 2019, PHS discovered anonymous, unauthorized access to Protected Health Information (PHI) was gained through a phishing email sent to some of PHS's workforce in early May 2019. The affected email accounts contained data that included patient and/or health plan member names and, in some cases, dates of birth, Social Security numbers and clinical and/or health plan information. No credit card information was accessed. PHS has notified the appropriate state and federal regulatory agencies of the unauthorized access, and patients and members whose PHI was identified as potentially subject to unauthorized access were mailed breach notification letters. PHS made separate written notification to additional individuals whose Personally Identifiable Information (PII) was subject to unauthorized access in accordance with state law requirements.

Presbyterian implemented additional security safeguards to address issues identified in its ongoing investigation. Further disclosures and notifications are likely to occur, although the extent is unknown at this time.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued) (Dollar Amounts in Thousands)

14. Commitments and Contingencies (continued)

Health Insurer Fee

Section 9010 of the Patient Protection and Affordable Care Act (ACA) imposes a fee on each covered entity engaged in the business of providing health insurance for United States health risks. The annual fee is allocated to health insurers based on the ratio of the amount of an insurer's premium written during the preceding calendar year to the amount of health insurance for all U.S. health risk for those certain lines of business that is written in the preceding calendar year. The expense is recorded in the year that the fees are due. In 2018, the fee was due for both PHP and PIC based on premiums written in 2017. As a result, fees paid and expensed in 2018 were \$34,900. This fee was suspended in 2019, and no amounts were expensed or paid in 2019.

Health Care 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 limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in exclusion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed and paid. Management believes that it has established adequate reserves to investigate, defend, and ultimately resolve any alleged instances of noncompliance. Compliance with such laws and regulations can be subject to future government review, as well as regulatory actions unknown or unasserted at this time.

Self-Insurance Plans

PHS is self-insured for professional and general liability, workers' compensation, and employee health insurance. PHS purchases claims-made insurance to cover professional liability and workers' compensation claims in excess of the self-insured limits. There are known claims and incidents that may result in the assertion of additional claims, as well as claims for unknown incidents that may be asserted arising from services provided to patients. PHS has engaged independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued professional liability, general liability, and workers' compensation losses of \$207,660 and \$167,159 at December 31, 2019 and 2018, respectively, have been discounted at 2.34% and 3.47%, respectively, and, in management's opinion, such amounts provide an adequate reserve for loss contingencies. The increase in the accrued liability can be attributed to adverse claim

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

14. Commitments and Contingencies (continued)

development. The accrued liability relating to professional and general liability and workers' compensation at December 31, 2019 and 2018, is reported on a gross basis and, therefore, has not been reduced by estimated insurance recoveries of \$81,314 and \$41,013, respectively, which are reported in other receivables. The accrued liability for estimated employee health claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported and totaled \$4,885 and \$4,650 at 2019 and 2018, respectively.

At December 31, 2019 and 2018, PHS had an available line of credit to collateralize workers' compensation coverage of \$10,400, of which none was outstanding.

Surety Bond

The Medicaid Centennial Care contract requires PHP to provide a performance bond equal to 90% of the average of the past three months' capitation payments made to PHP from HSD. As of December 31, 2019 and 2018, PHP held a surety bond issued by an unrelated insurance company in the amount of \$191,000 and \$111,100, respectively.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

15. Functional Expenses

PHS provides general health care services to residents within its geographic region. PHS allocates expenses between functional categories through an analysis of each accounting unit within the organization. Accounting units with expenses that are attributable to more than one functional category, such as depreciation, information technology, and insurance, are allocated ratably, based on directly assigned expenses, across all categories. Expenses related to providing these services are as follows:

	Patient Care	Insurance Operations	Other Programs	Supporting Services	Total
Year Ended December 31, 2019					
Medical claims	\$ —	\$ 2,012,319	\$ —	\$ —	\$ 2,012,319
Salaries, wages, and benefits	755,408	164,360	117,299	175,333	1,212,400
Purchased services and other	216,655	251,831	78,539	56,357	603,382
Supplies	334,973	993	18,793	(510)	354,249
Professional fees	34,003	3	6,164	9,481	49,651
Depreciation and amortization	74,388	8,725	13,849	19,054	116,016
Interest	301	549	30,993	819	32,662
	<u>\$ 1,415,728</u>	<u>\$ 2,438,780</u>	<u>\$ 265,637</u>	<u>\$ 260,534</u>	<u>\$ 4,380,679</u>
Year Ended December 31, 2018					
Medical claims	\$ —	\$ 1,404,083	\$ —	\$ —	\$ 1,404,083
Salaries, wages, and benefits	663,081	114,535	102,748	155,873	1,036,237
Purchased services and other	191,143	227,875	64,277	36,793	520,088
Supplies	286,834	671	17,791	(6,947)	298,349
Professional fees	37,125	4	4,706	8,317	50,152
Depreciation and amortization	67,228	2,022	14,185	14,361	97,796
Interest	332	490	29,145	79	30,046
	<u>\$ 1,245,743</u>	<u>\$ 1,749,680</u>	<u>\$ 232,852</u>	<u>\$ 208,476</u>	<u>\$ 3,436,751</u>

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)
(Dollar Amounts in Thousands)

16. Liquidity

PHS's financial assets available within one year of the balance sheet date for general expenditure are as follows for the years ended December 31:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 245,160	\$ 284,331
Patient accounts receivable	146,065	138,523
Other accounts receivable	222,761	139,246
Assets limited as to use	2,145,814	1,891,180
	<u>\$ 2,759,800</u>	<u>\$ 2,453,280</u>

PHS has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, PHS invests cash in excess of daily requirements in short-term investments, which are included in cash and cash equivalents on the combined balance sheets.

17. Income Taxes

The components of the provision for income taxes for the years ended December 31 are as follows:

	<u>2019</u>	<u>2018</u>
Current	\$ 9,927	\$ 14,655
Deferred	8,345	(4,403)
Total provision for income taxes	<u>\$ 18,272</u>	<u>\$ 10,252</u>

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

17. Income Taxes (continued)

The differences between the actual and expected provision for income taxes or benefit computed by applying the federal corporate income tax rate of 21% in 2019 and 2018, plus a state rate of 4.8% for PNI operations only, to income before income taxes for the years ended December 31 are as follows:

	<u>2019</u>	<u>2018</u>
Computed tax expense at combined rate	\$ 17,311	\$ 3,938
Tax reform – tax rate differential	–	(516)
ACA health provider fee	–	7,329
Change in valuation allowance	1,546	1,122
Other permanent differences	200	(172)
Provision to return differences	197	(345)
State taxes and other	(982)	(1,104)
	<u>\$ 18,272</u>	<u>\$ 10,252</u>

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued)

(Dollar Amounts in Thousands)

17. Income Taxes (continued)

Deferred tax assets (liabilities) were included within accrued liabilities on the accompanying combined balance sheets and were comprised of the following at December 31:

	<u>2019</u>	<u>2018</u>
Deferred tax assets:		
Medical liabilities and other reserves	\$ 4,450	\$ 4,490
Medical claims payable (incurred but not reported)	781	473
Deferred compensation	211	61
Investments	1,310	568
Unrealized loss on investments	–	1,774
Net operating loss carryforwards	3,282	1,813
Deferred intercompany loss	10,441	8,590
Other	862	265
Total deferred tax assets	<u>21,337</u>	18,034
Deferred tax liabilities:		
Amortization of intangibles	(14,051)	(14,052)
Prepaid insurance	–	(100)
Partnership – book/tax difference	(4,158)	(740)
Gains on sale of securities	(327)	(1)
Unrealized gains on investments	(4,848)	(240)
Total deferred tax liabilities	<u>(23,384)</u>	(15,133)
Valuation allowance	(13,839)	(10,441)
Deferred tax liabilities, net	<u>\$ (15,886)</u>	<u>\$ (7,540)</u>

At December 31, 2019 and 2018, PNI had no federal net operating loss carryforwards. PNI is subject to state income tax and has state net operating loss carryforwards at December 31, 2019 and 2018, of \$56,259 and \$31,081, respectively, of which a portion is expiring each year.

At December 31, 2019 and 2018, a valuation allowance in the amount of \$13,839 and \$10,441, respectively, was established against the deferred tax asset related to the state net operating loss carryforwards, capital loss carryforwards, and deferred intercompany loss, as management currently believes that the benefit from some or all of these deferred tax assets may not be realized.

Presbyterian Healthcare Services and Affiliates

Notes to Combined Financial Statements (continued) *(Dollar Amounts in Thousands)*

17. Income Taxes (continued)

In the normal course of business, PNI is subject to examination by taxing authorities, and PNI is no longer subject to U.S. federal, state, or local income tax examinations for years before 2015. PNI does not have any current federal tax disputes.

18. Subsequent Events

PHS has evaluated subsequent events occurring between the end of the most recent year-end and April 16, 2020, the date the combined financial statements were issued.

Subsequent to year end, global efforts to contain the spread of COVID-19, often referred to as Coronavirus, have significantly impacted healthcare organizations and the overall economy. This public health emergency is likely to adversely affect certain operating revenues and expenses. However, the extent of the financial impact, including the long-term impact on PHS's investment portfolio, are uncertain at this time.

Supplementary Information



Ernst & Young LLP
101 E. Washington Street
Suite 910
Phoenix, AZ 85004

Tel: +1 602 322 3000
ey.com

Report of Independent Auditors on Supplementary Information

The Board of Directors
Presbyterian Healthcare Services

Our audit was conducted for the purpose of forming an opinion on the combined financial statements as a whole. The combining balance sheet and statement of operations for the year ended December 31, 2019, 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 combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements, or to the 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 combined financial statements as a whole.

Ernst & Young LLP

April 16, 2020

Presbyterian Healthcare Services and Affiliates

Combining Balance Sheet

December 31, 2019

	Obligated Group	Presbyterian Network, Inc.	Other Non- Obligated Group Members	Eliminations	Combined
	<i>(In Thousands)</i>				
Assets					
Current assets:					
Cash and cash equivalents	\$ 143,287	\$ 101,023	\$ 850	\$ –	\$ 245,160
Accounts receivable	174,389	–	5,553	(33,877)	146,065
Other receivables	39,663	182,892	286	(80)	222,761
Inventories, prepaid expenses, and other current assets	51,677	9,863	1,795	–	63,335
Total current assets	409,016	293,778	8,484	(33,957)	677,321
Assets limited as to use or restricted:					
Designated for long-term purposes	1,777,598	397,275	572	–	2,175,445
Designated for self-insurance funds	148,136	–	–	–	148,136
Restricted by donors	50,007	–	–	–	50,007
Held by trustee	247,929	–	–	–	247,929
Restricted for statutory requirements	–	193,217	–	–	193,217
	2,223,670	590,492	572	–	2,814,734
Property and equipment, net	942,020	57,318	74,703	–	1,074,041
Goodwill	200	52,501	–	–	52,701
Other assets	165,607	47,050	126,900	(114,934)	224,623
Intercompany receivables (payables)	22,330	(56,005)	33,675	–	–
Total assets	<u>\$ 3,762,843</u>	<u>\$ 985,134</u>	<u>\$ 244,334</u>	<u>\$ (148,891)</u>	<u>\$ 4,843,420</u>

Presbyterian Healthcare Services and Affiliates

Combining Balance Sheet (continued)

	Obligated Group	Presbyterian Network, Inc.	Other Non- Obligated Group Members	Eliminations	Combined
	<i>(In Thousands)</i>				
Liabilities and net assets					
Current liabilities:					
Accounts payable	\$ 72,404	\$ 18,954	\$ 3,666	\$ –	\$ 95,024
Due under Medicaid contract	–	30,276	–	–	30,276
Accrued liabilities	128,072	113,439	4,121	(473)	245,159
Medical claims payable	–	289,288	–	(33,484)	255,804
Estimated third-party payor settlements	7,645	–	1,486	–	9,131
Current portion of long-term debt	16,829	–	–	–	16,829
Total current liabilities	224,950	451,957	9,273	(33,957)	652,223
Long-term debt, net of current portion	1,068,591	–	–	–	1,068,591
Employee benefit plans	220,291	–	–	–	220,291
Self-insurance plans	207,345	–	–	–	207,345
Other liabilities	97,711	32,753	1,293	–	131,757
Total liabilities	1,818,888	484,710	10,566	(33,957)	2,280,207
Net assets:					
Net asset without donor restrictions	1,891,259	500,424	233,768	(114,934)	2,510,517
Net asset with donor restrictions	52,696	–	–	–	52,696
Total net assets	1,943,955	500,424	233,768	(114,934)	2,563,213
Total liabilities and net assets	\$ 3,762,843	\$ 985,134	\$ 244,334	\$ (148,891)	\$ 4,843,420

Presbyterian Healthcare Services and Affiliates

Combining Statement of Operations

Year Ended December 31, 2019

	Obligated Group	Presbyterian Network, Inc.	Other Non- Obligated Group Members	Eliminations	Combined
<i>(In Thousands)</i>					
Operating revenues:					
Net premiums	\$ —	\$ 3,189,815	\$ —	\$ —	\$ 3,189,815
Net patient service revenue	1,818,548	—	60,608	(760,018)	1,119,138
Other operating revenues	66,447	44,513	9,480	(36,449)	83,991
Total operating revenues	1,884,995	3,234,328	70,088	(796,467)	4,392,944
Expenses:					
Medical claims	—	2,773,734	—	(761,415)	2,012,319
Salaries, wages, and employee benefits	1,020,775	164,360	33,173	(5,908)	1,212,400
Purchased services and other	363,937	251,830	16,759	(29,144)	603,382
Supplies	348,677	993	4,579	—	354,249
Professional fees	46,290	3	3,358	—	49,651
Depreciation and amortization	101,573	8,725	5,718	—	116,016
Interest	31,294	549	819	—	32,662
Total expenses	1,912,546	3,200,194	64,406	(796,467)	4,380,679
Operating (loss) income	(27,551)	34,134	5,682	—	12,265
Other income:					
Investment income	37,447	17,031	1,213	—	55,691
Change in net unrealized gains on investments	240,483	31,270	—	—	271,753
Loss on debt extinguishment	(3,920)	—	—	—	(3,920)
Change in fair value of interest rate swaps	(5,467)	—	—	—	(5,467)
Total other income	268,543	48,301	1,213	—	318,057
Excess of revenues over expenses before income taxes	240,992	82,435	6,895	—	330,322
Provision (benefit) for income taxes	77	18,512	(317)	—	18,272
Excess of revenues over expenses	\$ 240,915	\$ 63,923	\$ 7,212	\$ —	\$ 312,050

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