

CONSOLIDATED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Sharp HealthCare
Years Ended September 30, 2018 and 2017
With Report of Independent Auditors

Ernst & Young LLP



Building a better
working world

Sharp HealthCare

Consolidated Financial Statements and Supplementary Information

Years Ended September 30, 2018 and 2017

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Report of Independent Auditors

The Board of Directors
Sharp HealthCare

We have audited the accompanying consolidated financial statements of Sharp HealthCare, which comprise the consolidated balance sheets as of September 30, 2018 and 2017, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sharp HealthCare at September 30, 2018 and 2017, and the consolidated results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating financial statements are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Ernst + Young LLP

December 19, 2018

Sharp HealthCare
Consolidated Balance Sheets

	September 30	
	2018	2017
	<i>(In Thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 448,311	\$ 289,838
Short-term investments	48,166	51,153
Accounts receivable, net of allowance for doubtful accounts of \$75,708,000 and \$64,902,000 in 2018 and 2017, respectively	380,297	338,939
Estimated settlements receivable from government programs, net	393	–
Inventories	49,073	48,099
Prepaid expenses and other	100,255	91,553
Total current assets	<u>1,026,495</u>	<u>819,582</u>
Long-term investments	268,888	245,883
Assets limited as to use:		
Designated for property	2,253,997	2,002,395
Under bond indentures	108,261	49,770
Other restricted investments	64,651	60,451
Under self-insurance programs	10,594	10,892
Total assets limited as to use	<u>2,437,503</u>	<u>2,123,508</u>
Property and equipment, net	1,490,701	1,328,381
Other assets	88,106	106,544
Total assets	<u>\$ 5,311,693</u>	<u>\$ 4,623,898</u>
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 440,588	\$ 291,122
Accrued compensation and benefits	173,902	147,788
Current portion of long-term debt	17,467	18,021
Estimated settlements payable to government programs, net	–	2,745
Accrued interest	3,761	3,731
Total current liabilities	<u>635,718</u>	<u>463,407</u>
Long-term liabilities	81,452	104,809
Reserves for professional and general liabilities <i>(Note 12)</i>	12,729	13,522
Long-term debt	759,075	618,335
Total liabilities	<u>1,488,974</u>	<u>1,200,073</u>
Net assets:		
Unrestricted	3,746,698	3,362,286
Temporarily restricted	67,027	54,841
Permanently restricted	8,994	6,698
Total net assets	<u>3,822,719</u>	<u>3,423,825</u>
Total liabilities and net assets	<u>\$ 5,311,693</u>	<u>\$ 4,623,898</u>

See accompanying notes.

Sharp HealthCare

Consolidated Statements of Operations

	Year Ended September 30	
	2018	2017
	<i>(In Thousands)</i>	
Revenues:		
Patient service	\$ 2,083,422	\$ 1,967,575
Provider tax	248,520	89,736
Provision for doubtful accounts	(25,168)	(31,241)
Net patient service	2,306,774	2,026,070
Premium	1,401,643	1,360,121
Other	97,409	92,274
Total revenues	3,805,826	3,478,465
Expenses:		
Salaries and wages	1,366,015	1,286,152
Employee benefits	327,215	311,387
Medical fees	607,300	574,696
Purchased services	363,621	356,803
Supplies	439,497	412,527
Provider tax	161,066	56,336
Maintenance, utilities, and rentals	132,564	128,527
Depreciation and amortization	118,117	111,926
Business insurance	16,401	14,488
Interest	21,842	23,998
Other	54,129	50,529
Total expenses	3,607,767	3,327,369
Income from operations	198,059	151,096
Other nonoperating gain (loss)	6,210	(3,245)
Investment income	126,982	189,635
Excess of revenues over expenses	331,251	337,486
Net assets transferred from related-party	20,014	12,796
Net assets released from restrictions used for purchase of property, plant, and equipment	6,825	6,653
Pension-related changes other than net periodic pension cost	17,816	12,849
Other changes in net assets	8,506	14,628
Increase in unrestricted net assets	\$ 384,412	\$ 384,412

See accompanying notes.

Sharp HealthCare

Consolidated Statements of Changes in Net Assets

	Year Ended September 30	
	2018	2017
	<i>(In Thousands)</i>	
Unrestricted net assets:		
Excess of revenues over expenses	\$ 331,251	\$ 337,486
Net assets transferred from related party	20,014	12,796
Net assets released from restrictions used for purchase of property and equipment	6,825	6,653
Pension-related changes other than net periodic pension cost	17,816	12,849
Other changes in net assets	8,506	14,628
Increase in unrestricted net assets	384,412	384,412
Temporarily restricted net assets:		
Contributions	25,671	16,075
Investment income	682	856
Change in net unrealized losses on investments	419	803
Net assets released from restrictions	(12,823)	(12,132)
Other changes in net assets	(1,763)	(5,921)
Increase (decrease) in temporarily restricted net assets	12,186	(319)
Permanently restricted net assets:		
Contributions	2,296	45
Increase in permanently restricted net assets	2,296	45
Increase in net assets	398,894	384,138
Net assets, beginning of year	3,423,825	3,039,687
Net assets, end of year	\$ 3,822,719	\$ 3,423,825

See accompanying notes.

Sharp HealthCare

Consolidated Statements of Cash Flows

	Year Ended September 30	
	2018	2017
	<i>(In Thousands)</i>	
Operating activities		
Increase in net assets	\$ 398,894	\$ 384,138
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Net assets transferred from related party	(20,014)	(12,796)
Noncash (gains) losses	(6,297)	1,196
Depreciation of operating and nonoperating facilities	118,117	111,926
Amortization of bond premiums and deferred financing costs	(576)	(105)
Change in fair value of interest and basis rate swaps	(5,338)	(6,343)
Restricted contributions and investment income, net	(28,649)	(16,976)
Pension-related changes other than net periodic pension cost	(17,816)	(12,849)
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(41,358)	36,287
Inventories	(974)	436
Short-term investments	2,987	(6,801)
Assets limited as to use and long-term investments	(337,000)	(242,380)
Prepaid expenses and other	(27,481)	(38,288)
Estimated settlements receivable from/payable to government programs, net	(3,138)	5,356
Increase (decrease) in:		
Accounts payable and accrued liabilities, long-term liabilities, and other liabilities	152,179	(16,432)
Accrued compensation and benefits	26,114	7,504
Net cash provided by operating activities	<u>209,650</u>	<u>193,873</u>
Investing activities		
Acquisition of property and equipment, net of retirements	(270,263)	(177,717)
Increase in other assets	-	(4,613)
Settlement of notes receivable	10,072	-
Proceeds from sale of nonoperating property	12,288	-
Net cash used in investing activities	<u>(247,903)</u>	<u>(182,330)</u>
Financing activities		
Payments on long-term debt	(13,490)	(51,796)
Extinguishment of long-term debt	(118,431)	-
Payments under capital lease obligations	(4,399)	(4,165)
Proceeds from issuance of long-term debt, net	304,397	-
Restricted contributions and investment income, net	28,649	16,976
Net cash provided by (used in) financing activities	<u>196,726</u>	<u>(38,985)</u>

Sharp HealthCare

Consolidated Statements of Cash Flows (continued)

	Year Ended September 30	
	2018	2017
	<i>(In Thousands)</i>	
Net increase (decrease) in cash and cash equivalents	\$ 158,473	\$ (27,442)
Cash and cash equivalents, beginning of year	<u>289,838</u>	<u>317,280</u>
Cash and cash equivalents, end of year	<u><u>\$ 448,311</u></u>	<u><u>\$ 289,838</u></u>
 Supplemental disclosures of cash flow and non-cash information		
Capital lease obligations for building and equipment	\$ (544)	\$ 948
Cash paid for interest	<u>\$ 28,003</u>	<u>\$ 27,509</u>
Net assets transferred from related party	<u>\$ 20,014</u>	<u>\$ 12,796</u>
Extinguishment of New Market Tax Credit Loan	<u>\$ (37,913)</u>	<u>\$ —</u>
Forgiveness of New Market Tax Credit Note Receivable	<u>\$ 29,319</u>	<u>\$ —</u>

See accompanying notes.

Sharp HealthCare

Notes to Consolidated Financial Statements

September 30, 2018

1. Summary of Significant Accounting Policies

Organization

Sharp HealthCare (SHC) is a California nonprofit public benefit corporation with corporate offices in San Diego, California. SHC, together with its affiliated entities (collectively, Sharp), constitutes a regional integrated health care delivery system that does business as Sharp HealthCare, primarily serving the residents of San Diego County. The consolidated financial statements of Sharp include the accounts of the following:

- Sharp Memorial Hospital (SMH), including Stephen Birch Healthcare Center, Sharp Mary Birch Hospital for Women and Newborns, Sharp Outpatient Pavilion, Sharp Mesa Vista Hospital, and Sharp McDonald Center (formerly Sharp Vista Pacifica)
- Sharp Chula Vista Medical Center (SCVMC)
- Sharp Grossmont Hospital (SGH)
- Sharp Coronado Hospital and HealthCare Center (SCHHC)
- Sharp Health Plan (SHP)
- Continuous Quality Insurance SPC (CQI SPC)
- Sharp HealthCare Foundation (SHF)
- Grossmont Hospital Foundation (GHF)

SHC, SMH, SCVMC, and SGH are collectively the Obligated Group under certain bond indentures (see Note 6).

In 2017, Sharp, in concert with its affiliated medical groups, Sharp Community Medical Group (SCMG) and Sharp Rees-Stealy Medical Group (SRSMG), formed Sharp HealthCare ACO-II, a limited liability corporation (Sharp ACO-II). Sharp ACO-II was designed to share risk with CMS for certain Medicare beneficiaries pursuant to the Next Gen ACO model. As part of the Next Gen ACO model, Sharp ACO-II borrowed \$5.2 million from Sharp to fund the required Financial Guarantee against potential shared losses with CMS. On January 15, 2018, Sharp ACO notified CMS that it was terminating its participation in the Next Generation ACO model effective February 28, 2018.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

SHC has certain contractual obligations with its affiliates that govern its operations and the use of certain assets. All significant transactions among Sharp's affiliated entities have been eliminated in the accompanying consolidated financial statements.

Use of Estimates

The preparation of Sharp's consolidated financial statements in conformity with accounting principles generally accepted in the United States (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with original maturities of three months or less. Sharp routinely invests its surplus operating funds in money market mutual funds. These funds generally invest in highly liquid U.S. government and agency obligations.

Inventories

Inventories, consisting principally of supplies, are stated at the lower of cost or market value.

Short-Term Investments

Short-term investments are classified as trading and include corporate and government obligation securities, which are included in professionally managed portfolios, and are measured at fair value on the balance sheet. The maturities of these securities do not exceed one year. Investment income or loss (including unrealized and realized gains and losses) is included in the consolidated excess of revenues over expenses.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Long-Term Investments

Long-term investments are classified as trading, which are included in professionally managed portfolios, and are measured at fair value on the balance sheet. The maturities of these securities are in excess of one year or are investments in equities that are not expected to be liquidated over the next year. Investment income or loss (including unrealized and realized gains and losses) is included in the consolidated excess of revenues over expenses.

Assets Limited as to Use

Assets limited as to use invested in debt and equity securities with readily determined fair values are measured at fair value on the balance sheet and are classified as trading. Investment income or loss (including unrealized and realized gains and losses) is included in the consolidated excess of revenues over expenses unless the income or loss is restricted by donor or law.

Alternative investments represent ownership interests in a private equity limited partnership. The limited partnership has a general manager with full discretionary authority over investment decisions. The private equity limited partnership invests in companies operating in segments within the health care sector. Alternative investments are accounted for using the net asset value (NAV) expedient, which is determined using investment valuations provided by the general partner, and approximates fair value. Alternative investments generally are not marketable and have underlying investments that may not have quoted market values. The estimated value of such investments is subject to uncertainty and could have differed had a ready market existed. The overall risk is the investment and capital call commitments as discussed in Note 2.

Assets limited as to use primarily include assets set aside by Sharp's Board of Directors (the Board) for future capital improvements, over which the Board retains control and may at its discretion subsequently designate for other purposes, and amounts held by trustees under indenture agreements. Assets limited as to use consist of the following:

Designated for property – Cash resources not required for operations have been designated as funded depreciation to be used for future capital improvements. This designation may be changed and such funds used for other purposes – \$25,896,000 and \$26,482,000 at September 30, 2018 and 2017, respectively, of such assets – are pledged as collateral for notes payable and other liabilities.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Under bond indentures – In accordance with the terms of Sharp’s various bond indentures, certain bond proceeds and principal and interest payments have been deposited with a trustee and are limited as to use in accordance with the related indentures.

Other restricted investments – Certain cash and investments are limited as to use for future community benefit and for other purposes.

Under self-insurance programs – Certain cash and investments are restricted under Sharp’s professional liability self-insurance program.

Derivative and Hedging Instruments

Sharp recognizes all derivatives on its consolidated balance sheets at fair value. Derivatives that are not effective hedges are adjusted to fair value through the consolidated statements of operations (see Note 6). At September 30, 2018 and 2017, the outstanding hedging instruments were not considered effective hedges.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset from 3 to 40 years and is computed using the straight-line method. Property and equipment under capital lease obligations are amortized on the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Unamortized Financing Costs

Costs incurred in obtaining long-term financing are amortized over the terms of the related obligations using the effective interest method.

Temporarily and Permanently Restricted Net Assets

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

Impairment or Disposal of Long-Lived Assets

Sharp accounts for the impairment or disposal of long-lived assets using a future cash flow model to determine whether assets have been impaired. Sharp regularly reviews long-lived assets for circumstances that could indicate carrying values may not be recoverable. No impairments were recorded in 2018 or 2017.

Income From Operations

Sharp's primary purpose is to provide diversified health care services to the community served by its affiliates. Only those activities directly associated with the furtherance of this purpose are considered operating activities and classified as operating revenues and expenses. Items excluded from income from operations consist of investment income, gains and losses on disposition of property and equipment, changes in the fair value of interest rate swaps, and net income from SHF and GHF.

Excess of Revenues Over Expenses

The accompanying consolidated statements of operations include excess of revenues over expenses (not-for-profit performance indicator) and other changes in unrestricted net assets. Changes in unrestricted net assets that are excluded from excess of revenues over expenses, consistent with industry practice, include permanent transfers of assets to and from affiliates for other than goods and services, long-lived assets acquired using contributions that by donor restriction were to be used for the purposes of acquiring such assets, and pension-related changes other than net periodic pension cost.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Net Patient Service Revenues

Sharp has agreements with third-party payors that provide for payments to Sharp at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, fee schedule, and per diem payments. 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 under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined. In the opinion of management, adequate provision has been made for such adjustments.

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, Sharp analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, Sharp analyzes contractually due amounts and provides an allowance for doubtful accounts, if necessary. For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and co-payment balances due for which third-party coverage exists for part of the bill), Sharp records a provision for doubtful accounts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

Sharp's allowance for doubtful accounts for self-pay patients was 88% of self-pay accounts receivable at September 30, 2018 and 2017. In addition, Sharp's self-pay write-offs increased to \$32,322,000 for fiscal year 2018 from \$27,111,000 for fiscal year 2017. The increase was the result of increased self-pay revenues due to higher self-pay volumes and increased co-pays and deductibles in fiscal year 2018. Sharp has not changed its charity care or uninsured discount policies during fiscal years 2018 or 2017. Sharp does not maintain a material allowance for doubtful accounts from third-party payors, nor did it incur significant credit losses from third-party payors.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Premium Revenues

Sharp has agreements with various employers and health maintenance organizations to provide medical services to subscribing participants. Under these agreements, Sharp receives monthly capitation payments based on the number of participants who have selected Sharp, regardless of services actually performed by Sharp.

Other Revenues

Other revenues include unrestricted donations, retail pharmacy gross profits, management services, and joint venture income.

Health Care Service Costs

Sharp contracts with certain health care providers for the provision of medical services to eligible members. These services include primary care and specialty physician services, inpatient and outpatient facility services, pharmacy, and other medical services. Providers are paid on capitated, per diem, and structured fee-for-service bases.

Health care service costs (included in medical fees and purchased services on the accompanying consolidated statements of operations) are accrued in the period in which the services are provided to enrollees, based in part on estimates, including estimates of medical services provided but not yet reported to Sharp.

Charity Care

Sharp's policy is to accept all patients regardless of their ability to pay. In assessing a patient's ability to pay, Sharp utilizes financial eligibility requirements or criteria. Sharp provides charity care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because Sharp does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue.

Charity care costs are calculated using a ratio of cost to gross charge methodology by department. Direct revenues and costs of each department were included in the calculation, in addition to an allocation of overhead costs.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

The cost of charity care is summarized as follows:

	Year Ended September 30	
	2018	2017
	<i>(In Thousands)</i>	
Charity care, at cost	\$ 25,005	\$ 22,185

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to Sharp are reported at fair value at the date the promise is received. Conditional promises to give and indications or intentions to give are reported at fair value at the date the gift becomes unconditional. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported on the consolidated statements of operations as other operating revenues. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the consolidated financial statements.

Contributions Received by Related Parties

Sharp recognizes an interest in the net assets of related-party fundraising organizations when Sharp is the sole beneficiary and has the ability to influence or control the financial and operating decisions of such organizations. For the years ended September 30, 2018 and 2017, Sharp held an interest in the net assets of Coronado Hospital Foundation (CHF), a philanthropic organization dedicated to supporting the programs and services of SCHHC. Sharp's interest in the total net assets of CHF totaled \$7,496,000 and \$7,345,000 as of September 30, 2018 and 2017, respectively, and is included in other assets on the accompanying consolidated balance sheets. Changes in Sharp's interest in the unrestricted net assets of CHF are included on the consolidated statements of operations as a component of the total change in unrestricted net assets separate from excess revenues over expenses, and totaled \$1,914,000 and \$8,552,000 for the years ended September 30, 2018 and 2017, respectively. Changes in Sharp's interest in CHF's net assets that are subject to

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

donor restrictions are included on the consolidated statements of changes in net assets as a component of other changes in temporarily or permanently restricted net assets, and totaled \$(1,763,000) and \$(5,921,000) for the years ended September 30, 2018 and 2017, respectively.

Income Taxes

The principal operations of Sharp are exempt from taxation pursuant to Section 501(c)(3) of the Internal Revenue Code and related California provisions.

Sharp recognizes tax benefits from any uncertain tax positions only if it is more likely than not the tax position will be sustained, based solely on its technical merits, with the taxing authority having full knowledge of all relevant information. Sharp records a liability for unrecognized tax benefits from uncertain tax positions as discrete tax adjustments in the first interim period that the more-likely-than-not threshold is not met. Sharp recognizes deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of its assets and liabilities along with net operating loss and tax credit carryovers only for tax positions that meet the more-likely-than-not recognition criteria. At September 30, 2018 and 2017, no such assets or liabilities were recorded.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, which deferred the effective date of ASU 2014-09 by one year. As a result, the adoption of ASU 2014-09 is required for Sharp on October 1, 2018. In March 2016, April 2016, and May 2016, the FASB issued ASU 2016-08, ASU 2016-10, and ASU 2016-12, respectively. These amendments to the Accounting Standards Codification (ASC) 606 did not change the core principle of the guidance but rather clarified the implementation guidance for certain considerations. The adoption of ASU 2014-09 will impact the way Sharp accounts for the Provider Tax Program, requiring earlier recognition of the related revenues and expenses than is permitted by current policy elections. Management intends to apply the guidance using the retrospective method of adoption, and is currently evaluating the quantitative effect of such application on its consolidated financial statements.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which provides revised guidance concerning certain matters involving the recognition, measurement, and disclosure of financial assets and financial liabilities. Among other things, ASU 2016-01 requires equity investments, except those accounted for under the equity method of accounting or those that result in consolidation, to be measured at fair value with changes in fair value recognized in net income; simplifies the impairment assessment of equity investments not having readily determinable fair values by requiring a qualitative assessment to identify impairment so that it is similar to the qualitative assessment applied to long-lived assets, goodwill, and indefinite-lived intangibles; and eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for nonpublic entities. The revised guidance does not alter the basic framework for classifying debt instruments held as financial assets. The adoption of ASU 2016-01 is required for Sharp on October 1, 2018, and is not expected to have a material impact on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which establishes a new lease accounting model for lessees. Under the new guidance, lessees will be required to recognize so-called right-of-use assets and liabilities for most leases having lease terms of 12 months or more. However, lease expense will be recognized on the income statement in a manner similar to existing requirements. In January 2018, the FASB issued ASU 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842*, which establishes a practical expedient for transition to Topic 842 for land easements concurrent with the adoption of FASB ASU 2016-02. Under the new guidance entities have the option, with land easements to which they do not apply current leases guidance, and which exist or will expire before the adoption of FASB ASU 2016-02, not to evaluate such land easements under Topic 842. The adoption of ASU 2018-01 is required for Sharp when FASB ASU 2016-02 becomes effective, on October 1, 2019, and is not expected to have a material impact on the consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. Under the new guidance, the current three classes of net assets (i.e., unrestricted, temporarily restricted, and permanently restricted) have been replaced with two new classes of net assets: net assets with donor restrictions and net assets without donor restrictions. The main provisions of this update are to present on the consolidated balance sheet and on the consolidated statement of operations amounts for two classes of net assets at the end of the period, rather than for the currently required three classes, and continue to present

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

on the consolidated statement of cash flows the net amount for operating cash flows using either the direct or indirect method of reporting but no longer require the presentation or disclosure of the indirect method (reconciliation) if using the direct method. This update also requires the enhanced disclosures about self-imposed limits on the use of resources, composition of net assets with donor restrictions, disclosures about liquidity and availability of resources, amounts of expenses by both their natural classification and their functional classification, methods used to allocate costs among program and support functions, and other disclosures to improve the usefulness of information provided to donors, grantors, creditors, and other users of financial statements. The adoption of ASU 2016-14 is required for Sharp on October 1, 2018, and is not expected to have a material impact on the consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the FASB Emerging Issues Task Force)*. ASU 2016-15, which addresses eight specific classification issues, is intended to reduce diversity in current practice regarding the manner in which certain cash receipts and cash payments are presented and classified on the cash flow statement, as GAAP did not include guidance on the cash flow statement classification of the issues covered prior to the guidance in ASU 2016-15. The adoption of ASU 2016-15 is required for Sharp on October 1, 2018, and is not expected to have a material impact on the consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)*. The amendments in this update require 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. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments in ASU 2016-18 do not provide a definition of restricted cash or restricted cash equivalents. The adoption of ASU 2016-18 is required for Sharp on October 1, 2018, and is not expected to have a material impact on the consolidated financial statements.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

In December 2016, the FASB issued ASU 2016-19, *Technical Corrections and Improvements*, which amends various subsections of the FASB ASC. While the majority of the amendments to the codification are minor, FASB ASC 350-40, *Intangibles – Goodwill and Other – Internal Use Software*, was amended to clarify that internal-use software licensed from a third party should be accounted for as the acquisition of an intangible asset and the incurrence of a liability (i.e., to the extent that all or a portion of the software licensing fees are not paid on or before the acquisition date of the license) by the licensee. Sharp adopted ASU 2016-19 on October 1, 2017, with prospective application, which had the impact of increasing property and equipment, net and accounts payable and accrued liabilities by \$1,231,000 on the accompanying September 30, 2018, balance sheet.

In March 2017, the FASB issued ASU 2017-06, *Plan Accounting: Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), Health and Welfare Benefit Plans (Topic 965): Employee Benefit Plan Master Trust Reporting (a consensus of the FASB Emerging Issues Task Force)*, which enhances the disclosure and financial statement presentation requirements for an employee benefit plan's interest in a master trust and aligns such requirements across all employee benefit plans. The adoption of ASU 2017-06 is required for Sharp on October 1, 2019, and management is currently evaluating the effect of this guidance, if any, on its consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, which amends the FASB ASC to improve the presentation of net periodic pension cost and net periodic postretirement benefit cost in the financial statements. In particular, ASU 2017-07 requires the service cost component to be included in the same line item as other compensation costs arising from services rendered by relevant employees during the period, with the other (i.e., non-service cost) components of net benefit cost presented on the income statement separately from the service cost component. The adoption of ASU 2017-07 is required for Sharp on October 1, 2018, and will have the impact of moving all pension cost components other than the service cost component to nonoperating income (loss) on the consolidated statement of operations.

In April 2017, the FASB issued ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*, which requires that the premium on an individual callable debt security having an explicit, noncontingent call feature that is callable at fixed prices on preset dates be amortized to the earliest call date. After

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

the earliest call date, if the call option is not exercised, the yield should be reset using the payment terms required by the debt security. The adoption of ASU 2017-08 is required for Sharp on October 1, 2019, and management is currently evaluating the effect of this guidance, if any, on its consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, which changed both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedging results. The adoption of ASU 2017-12 is required for Sharp on October 1, 2019, and management is currently evaluating the effect of this guidance, if any, on its consolidated financial statements.

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*, which assists not-for-profit and other entities in (1) evaluating whether transactions should be accounted for as contributions (i.e., nonreciprocal transactions) within the scope of FASB ASC Topic 958, *Not-for-Profit Entities*, or as exchange (i.e., reciprocal) transactions subject to other guidance (e.g., FASB ASC 606, *Revenue from Contracts with Customers*), and (2) distinguishing between conditional and unconditional contributions. The adoption of ASU 2018-08 is required for Sharp on October 1, 2019, for transactions in which Sharp serves as a resource recipient and on October 1, 2020, for transactions in which Sharp serves as a resource provider. Management is currently evaluating the effect of this guidance, if any, on its consolidated group financial statements.

In August 2018, the FASB issued ASU 2018-15, *Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract*, which requires an entity (customer) in a hosting arrangement that is a service contract to capitalize certain costs incurred during the application development stage depending on the nature of the costs. Costs incurred during the preliminary project and post implementation stages are expensed as the activities are performed. Costs capitalized pursuant to this guidance are to be amortized over the term of the hosting arrangement in the same line item in the statement of operations where the non-capital hosting fees are expensed. The capitalized implementation costs are required to be presented in the statement of cash flows in the same manner as fees associated with the hosting element (operating activities), and in the balance sheet in the same line item that a prepayment of fees associated with the hosting element would be presented. This guidance becomes effective for Sharp on October 1, 2020, unless election for early adoption, which is available for any period (including interim periods) starting October 1, 2019, is made. Management is currently evaluating the effect of this guidance on its consolidated financial statements.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

2. Fair Value Measurements

FASB ASC 820, *Fair Value Measurement*, clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, FASB ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1: Pricing is based on observable inputs such as quoted prices for identical assets in active markets. Financial assets in Level 1 include U.S. Treasury securities and listed equities.

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. Financial assets and liabilities in this category generally include corporate bonds, U.S. government agency securities, commercial paper, supranational bonds, negotiable certificates of deposit, fixed-income funds, mortgage-backed securities, interest rate swaps, and commingled plan trust funds.

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. Sharp does not hold any financial assets that would be included in this category.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques noted in FASB ASC 820 as identified below. 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. This technique was utilized for all Level 1 investments.
- b) Cost approach: Amount that would be required to replace the service capacity of an asset (replacement cost). This technique was utilized for all Level 2 investments except for the interest rate swaps.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

2. Fair Value Measurements (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 model). This technique was utilized for the interest rate swaps.

Sharp's investments in partnerships, limited liability companies, and similarly structured entities amounting to approximately \$14,717,000 and \$11,082,000 as of September 30, 2018 and 2017, respectively, are accounted for using the equity method of accounting, which is not a fair value measurement, and are included in other assets on the consolidated balance sheets.

The following table provides the composition of certain investment assets as of September 30, 2018. Only assets and liabilities measured at fair value on a recurring basis are shown in the three-tier fair value hierarchy.

	September 30, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	NAV Practical Expedient
<i>(In Thousands)</i>					
Short-term investments:					
U.S. treasury obligations	\$ 7,071	\$ 7,071	\$ -	\$ -	\$ -
Corporate bonds	24,612	-	24,612	-	-
U.S. government agencies	5,473	-	5,473	-	-
Commercial paper	3,158	-	3,158	-	-
Negotiable certificates of deposit	2,045	-	2,045	-	-
Asset-backed securities	72	-	72	-	-
Supranational	5,498	-	5,498	-	-
Interest receivable	237	-	237	-	-
	<u>\$ 48,166</u>	<u>\$ 7,071</u>	<u>\$ 41,095</u>	<u>\$ -</u>	<u>\$ -</u>
Long-term investments:					
Equities	\$ 30,526	\$ 30,526	\$ -	\$ -	\$ -
U.S. treasury obligations	63,505	63,505	-	-	-
Corporate bonds	94,177	-	94,177	-	-
U.S. government agencies	34,285	-	34,285	-	-
Mortgage-backed securities and collateralized mortgage obligations	7,828	-	7,828	-	-
Asset-backed securities	24,851	-	24,851	-	-
Supranational	12,609	-	12,609	-	-
Interest receivable	1,107	-	1,107	-	-
	<u>\$ 268,888</u>	<u>\$ 94,031</u>	<u>\$ 174,857</u>	<u>\$ -</u>	<u>\$ -</u>

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

2. Fair Value Measurements (continued)

	September 30, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	NAV Practical Expedient
	<i>(In Thousands)</i>				
Assets limited as to use:					
Designated for property:					
Cash and cash equivalents	\$ 15,712	\$ 15,712	\$ -	\$ -	\$ -
Equities	1,244,704	1,244,704	-	-	-
U.S. treasury obligations	408,707	408,707	-	-	-
Corporate bonds	357,583	-	357,583	-	-
U.S. government agencies	74,092	-	74,092	-	-
Mortgage-backed securities and collateralized mortgage obligations	54,621	-	54,621	-	-
Commercial paper	17,262	-	17,262	-	-
Asset-backed securities	49,697	-	49,697	-	-
Supranational	26,588	-	26,588	-	-
Private equity	398	-	-	-	398
Interest receivable	4,633	-	4,633	-	-
	<u>\$ 2,253,997</u>	<u>\$ 1,669,123</u>	<u>\$ 584,476</u>	<u>\$ -</u>	<u>\$ 398</u>
Under bond indentures:					
Cash and cash equivalents	\$ 3,340	\$ 3,340	\$ -	\$ -	\$ -
U.S. treasury obligations	37,949	37,949	-	-	-
Corporate bonds	42,674	-	42,674	-	-
U.S. government agencies	5,284	-	5,284	-	-
Commercial paper	1,492	-	1,492	-	-
Asset-backed securities	10,338	-	10,338	-	-
Supranational	6,790	-	6,790	-	-
Interest receivable	394	-	394	-	-
	<u>\$ 108,261</u>	<u>\$ 41,289</u>	<u>\$ 66,972</u>	<u>\$ -</u>	<u>\$ -</u>

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

2. Fair Value Measurements (continued)

	September 30, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	NAV Practical Expedient
	<i>(In Thousands)</i>				
Assets limited as to use (continued):					
Other restricted investments:					
Cash and cash equivalents	\$ 3,442	\$ 3,442	\$ -	\$ -	\$ -
Equities	33,686	33,686	-	-	-
U.S. treasury obligations	12,093	-	12,093	-	-
Fixed income funds	1,164	1,069	95	-	-
Corporate bonds	8,417	-	8,417	-	-
U.S. government agencies	2,346	-	2,346	-	-
Mortgage-backed securities and collateralized mortgage obligations	1,431	-	1,431	-	-
Commercial paper	357	-	357	-	-
Asset-backed securities	902	-	902	-	-
Supranational	702	-	702	-	-
Interest receivable	111	-	111	-	-
	\$ 64,651	\$ 38,197	\$ 26,454	\$ -	\$ -
Under self-insurance programs:					
Cash and cash equivalents	\$ 44	\$ 44	\$ -	\$ -	\$ -
Equities	2,134	2,134	-	-	-
U.S. treasury obligations	2,962	2,962	-	-	-
Corporate bonds	3,236	-	3,236	-	-
U.S. government agencies	895	-	895	-	-
Mortgage-backed securities and collateralized mortgage obligations	518	-	518	-	-
Commercial paper	159	-	159	-	-
Asset-backed securities	387	-	387	-	-
Supranational	219	-	219	-	-
Interest receivable	40	-	40	-	-
	\$ 10,594	\$ 5,140	\$ 5,454	\$ -	\$ -
Interest rate swap receivables	\$ 7,766	\$ -	\$ 7,766	\$ -	\$ -
	\$ 7,766	\$ -	\$ 7,766	\$ -	\$ -

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

2. Fair Value Measurements (continued)

The following table provides the composition of certain investment assets as of September 30, 2017. Only assets and liabilities measured at fair value on a recurring basis are shown in the three-tier fair value hierarchy.

	September 30, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	NAV Practical Expedient
	<i>(In Thousands)</i>				
Short-term investments:					
U.S. treasury obligations	\$ 7,800	\$ 7,800	\$ –	\$ –	\$ –
Corporate bonds	30,917	–	30,917	–	–
U.S. government agencies	3,408	–	3,408	–	–
Commercial paper	5,556	–	5,556	–	–
Negotiable certificates of deposit	3,285	–	3,285	–	–
Interest receivable	187	–	187	–	–
	\$ 51,153	\$ 7,800	\$ 43,353	\$ –	\$ –

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

2. Fair Value Measurements (continued)

	September 30, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	NAV Practical Expedient
<i>(In Thousands)</i>					
Long-term investments:					
Equities	\$ 29,979	\$ 29,979	\$ –	\$ –	\$ –
U.S. treasury obligations	61,689	61,689	–	–	–
Corporate bonds	78,934	–	78,934	–	–
U.S. government agencies	37,264	–	37,264	–	–
Mortgage-backed securities and collateralized mortgage obligations	2,394	–	2,394	–	–
Asset-backed securities	19,929	–	19,929	–	–
Supranational	14,750	–	14,750	–	–
Interest receivable	944	–	944	–	–
	<u>\$ 245,883</u>	<u>\$ 91,668</u>	<u>\$ 154,215</u>	<u>\$ –</u>	<u>\$ –</u>
Assets limited as to use:					
Designated for property:					
Cash and cash equivalents	\$ 11,848	\$ 11,848	\$ –	\$ –	\$ –
Equities	1,148,275	1,148,275	–	–	–
U.S. treasury obligations	302,727	302,727	–	–	–
Corporate bonds	315,313	–	315,313	–	–
U.S. government agencies	96,416	–	96,416	–	–
Mortgage-backed securities and collateralized mortgage obligations	45,554	–	45,554	–	–
Commercial paper	15,404	–	15,404	–	–
Asset-backed securities	50,560	–	50,560	–	–
Supranational	12,700	–	12,700	–	–
Interest receivable	3,598	–	3,598	–	–
	<u>\$ 2,002,395</u>	<u>\$ 1,462,850</u>	<u>\$ 539,545</u>	<u>\$ –</u>	<u>\$ –</u>
Under bond indentures:					
Cash and cash equivalents	\$ 458	\$ 458	\$ –	\$ –	\$ –
U.S. treasury obligations	8,472	8,472	–	–	–
Corporate bonds	19,697	–	19,697	–	–
U.S. government agencies	9,806	–	9,806	–	–
Commercial paper	3,973	–	3,973	–	–
Asset-backed securities	4,455	–	4,455	–	–
Supranational	2,746	–	2,746	–	–
Interest receivable	163	–	163	–	–
	<u>\$ 49,770</u>	<u>\$ 8,930</u>	<u>\$ 40,840</u>	<u>\$ –</u>	<u>\$ –</u>

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

2. Fair Value Measurements (continued)

	September 30, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	NAV Practical Expedient
	<i>(In Thousands)</i>				
Assets limited as to use (continued):					
Other restricted investments:					
Cash and cash equivalents	\$ 2,831	\$ 2,831	\$ –	\$ –	\$ –
Equities	32,807	32,807	–	–	–
U.S. treasury obligations	10,066	10,066	–	–	–
Fixed-income funds	1,192	1,096	96	–	–
Corporate bonds	7,952	–	7,952	–	–
U.S. government agencies	2,364	–	2,364	–	–
Mortgage-backed securities and collateralized mortgage obligations	1,310	–	1,310	–	–
Commercial paper	373	–	373	–	–
Asset-backed securities	1,179	–	1,179	–	–
Supranational	285	–	285	–	–
Interest receivable	92	–	92	–	–
	<u>\$ 60,451</u>	<u>\$ 46,800</u>	<u>\$ 13,651</u>	<u>\$ –</u>	<u>\$ –</u>
Under self-insurance programs:					
Cash and cash equivalents	\$ 470	\$ 470	\$ –	\$ –	\$ –
Equities	2,251	2,251	–	–	–
U.S. treasury obligations	2,753	2,753	–	–	–
Corporate bonds	3,168	–	3,168	–	–
U.S. government agencies	1,012	–	1,012	–	–
Mortgage-backed securities and collateralized mortgage obligations	448	–	448	–	–
Commercial paper	164	–	164	–	–
Asset-backed securities	475	–	475	–	–
Supranational	115	–	115	–	–
Interest receivable	36	–	36	–	–
	<u>\$ 10,892</u>	<u>\$ 5,474</u>	<u>\$ 5,418</u>	<u>\$ –</u>	<u>\$ –</u>
Interest rate swap receivables	\$ 2,427	\$ –	\$ 2,427	\$ –	\$ –
	<u>\$ 2,427</u>	<u>\$ –</u>	<u>\$ 2,427</u>	<u>\$ –</u>	<u>\$ –</u>

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

2. Fair Value Measurements (continued)

The following table and explanations identify attributes relating to the nature and risk of the investment for which fair value is determined using a calculated NAV as of September 30, 2018. There were no investments in this category as of September 30, 2017.

	September 30, 2018			
NAV practical expedient	Fair Value	Unfunded Commitments	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
	<i>(In Thousands)</i>			
Private equity	\$ 398	\$ 4,602	\$ —	\$ —
	\$ 398	\$ 4,602	\$ —	\$ —

There is no provision for redemption of funds during the term of the fund. Distribution from the fund will be received at the end of the charter term, which is estimated to be over the next 12 years.

3. Net Patient Service Revenue

Patient Service Revenues

Sharp has agreements with third-party payors that provide for payments to Sharp at amounts different from its established rates.

The Medicare program reimburses Sharp at prospectively determined rates for the major portion of inpatient and outpatient services rendered to patients, primarily on the basis of Medicare Severity Diagnosis Related Groups and Ambulatory Payment Classification Groups, respectively. Non-acute inpatient services, defined capital costs, and certain outpatient costs are paid based on a cost reimbursement methodology. When paid under cost reimbursement, Sharp is reimbursed at the interim rate with final settlement determined after submission of annual cost reports and audits by the fiscal intermediaries.

The Medi-Cal program reimburses Sharp primarily on the basis of All Patient Refined Diagnosis Related Groups for inpatient services and prospectively determined rates for outpatient services.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue (continued)

Hospital revenue from the Medicare and Medi-Cal programs combined accounted for approximately 56% of Sharp's gross patient charges for the years ended September 30, 2018 and 2017.

Laws and regulations governing the Medicare and Medi-Cal programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Net patient service revenue includes changes in estimate related to the impact of settlements of prior years' reimbursement from Medicare, Medi-Cal, and Medi-Cal HMO programs, which increased revenue by \$7,882,000 and \$11,308,000 in 2018 and 2017, respectively.

Sharp also has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to Sharp under these agreements includes prospectively determined rates per discharge, discounts from established charges, fee schedule, and prospectively determined daily rates.

Patient service revenues are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered.

The mix of net patient service revenues, net of contractual allowances, and discounts was as follows:

	September 30	
	2018	2017
Government	47%	46%
Contracted	52	53
Self-pay and other	1	1

Provider Tax Revenue

California legislation established a program that imposes a Quality Assurance Fee (QA Fee) on certain general acute care hospitals in order to make supplemental and grant payments (Supplemental Payments) to hospitals up to the aggregate upper payment limit for various periods. There have been four such programs (the Programs) since inception in 2009.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue (continued)

The Programs are designed to make supplemental inpatient and outpatient Medi-Cal payments to private hospitals, including additional payments for certain facilities that provide high acuity care, subacute, and trauma services to the Medi-Cal population. This hospital QA Fee program provides a mechanism for increasing payments to hospitals that serve Medi-Cal patients, with no impact on the state's general fund. Some of these payments will be made directly by the state, while others will be made by the Medi-Cal managed care plans, which will receive increased rates from the state in amounts equal to the Supplemental Payments. Outside of this legislation, the California Hospital Association has created a private program, operated by the California Health Foundation and Trust (CHFT), which was established to alleviate disparities potentially resulting from the implementation of the Programs. Private hospitals that are profitable under the Programs contribute pledge amounts (Pledge Fee) to CHFT. These funds are used to provide grants to hospitals that may not be profitable under the Programs.

The Programs require approval by CMS in order for them to be enacted. If federal approval is not obtained, provisions in the underlying legislation allow for the QA Fee, previously assessed, and Supplemental Payments, previously received, to be returned and recouped, respectively. As such, management elected not to recognize revenue and expense until CMS approval is obtained.

A program covering the period January 1, 2011 through June 30, 2011 (the 6-Month Program) was signed into law by the Governor of California in April 2011. CMS approved the program in December 2011.

A program covering the period of July 1, 2011 through December 31, 2013 (the 30-Month Program) was signed into law by the Governor of California in September 2011. CMS approved the fee-for-service portion of the 30-Month Program in June 2012 and approved the first 24 months of the managed care portion of the 30-Month Program in June 2013. Approval of the final six months of the managed care portion occurred in November 2014.

A program covering the period of January 1, 2014 through December 31, 2016 (the 36-Month Program) was signed into law by the Governor of California in October 2012. CMS approved the fee-for-service portion of the 36-Month Program in December 2014, the first six months of the non-expansion managed care portion of the 36-Month Program in June 2015, and the first six months of the expansion managed care portion of the 36-Month Program in April 2016. In December 2016, CMS approved the non-expansion managed care portion of the 36-Month Program for the period of July 1, 2014 through June 30, 2015, and the expansion managed care portion of the 36-Month Program for the period of July 1, 2014 through December 31, 2014.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue (continued)

A program covering the period of January 1, 2017 through June 30, 2019, (HQAF V) was signed into law by the Governor of California in November 2016. CMS approved the fee-for-service portion of HQAF V in December of 2017.

The QA Fee and Pledge Fee are recorded in provider tax expense in the consolidated financial statements. Supplemental Payments are recorded as provider tax revenue in the consolidated financial statements. Included in the consolidated financial statements are the following amounts related to the Programs:

	September 30, 2018			
	QA Fee	Pledge Fee	Total Provider Tax	Supplemental Revenue
	<i>(In Thousands)</i>			
36-Month Program Fee-For-Service	\$ —	\$ (1,024)	\$ (1,024)	\$ 281
HQAF V Fee-For-Service	(159,216)	(826)	(160,042)	248,239
	\$ (159,216)	\$ (1,850)	\$ (161,066)	\$ 248,520
	September 30, 2017			
	QA Fee	Pledge Fee	Total Provider Tax	Supplemental Revenue
	<i>(In Thousands)</i>			
36-Month Program Fee-For-Service	\$ (27,631)	\$ (335)	\$ (27,966)	\$ 42,693
36-Month Program Managed Care	(27,946)	(424)	(28,370)	47,043
	\$ (55,577)	\$ (759)	\$ (56,336)	\$ 89,736

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

4. Investment Income

Investment income for cash equivalents, short-term investments, long-term investments, and assets limited as to use is composed of the following:

	Year Ended September 30	
	2018	2017
	<i>(In Thousands)</i>	
Interest income	\$ 60,975	\$ 50,860
Unrealized gains (losses), net	47,049	(48,110)
Realized gains, net	18,958	186,885
	\$ 126,982	\$ 189,635

5. Property and Equipment

Property and equipment consist of the following:

	September 30	
	2018	2017
	<i>(In Thousands)</i>	
Land and improvements	\$ 112,167	\$ 98,458
Buildings and improvements	1,682,923	1,595,671
Equipment and furniture	506,216	447,418
Software cost	143,418	138,594
Construction-in-progress	278,890	166,610
	2,723,614	2,446,751
Less accumulated depreciation and amortization	(1,232,913)	(1,118,370)
	\$ 1,490,701	\$ 1,328,381

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

5. Property and Equipment (continued)

Accumulated amortization related to software costs amounted to \$136,833,000 and \$130,066,000 at September 30, 2018 and 2017, respectively.

	September 30	
	2018	2017
	<i>(In Thousands)</i>	
Software cost	\$ 143,418	\$ 138,594
Current year amortization	6,282	6,040
Accumulated amortization	136,833	130,066

Depreciation and amortization expense for the years ended September 30, 2018 and 2017, amounted to approximately \$118,117,000 and \$111,926,000, respectively. Included in these amounts is amortization for buildings and equipment under capital lease obligations. Sharp has approximately \$80,720,000 and \$80,736,000 at September 30, 2018 and 2017, respectively, of buildings and equipment under capital lease, at cost. Sharp has outstanding commitments to complete construction-in-progress totaling approximately \$112,413,000 at September 30, 2018.

On May 29, 1991, Sharp leased the Grossmont Hospital (the Hospital) existing campus land, buildings, and equipment from the Grossmont Healthcare District (the District). The lease provided for an original 30-year term ending May 29, 2021, at \$1 per year. In 2014, the lease was extended for an additional 30-year term ending on May 29, 2051. The buildings, improvements, and equipment acquired by the Hospital since the inception of the lease will revert to the District at the end of the lease term.

The Hospital and the District initiated, in 2006, a project for the construction of three shelled floors in the Emergency and Critical Care Center, central plant upgrades, infrastructure improvements, and facility renovations (the Project). The Project is being funded using the proceeds of general obligation (GO) bonds. In July 2007 and February 2011, \$85,500,000 and \$136,860,000, respectively, in GO bonds were issued by the District. In May 2015, \$24,500,000 in GO bonds were issued by the District, which was the third and final series of GO bonds. Sharp considers the District to be a related party based upon these relationships between Sharp and the District.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

5. Property and Equipment (continued)

The Hospital is not required to make any payments to the District with respect to the contribution to the Project of assets constructed using the GO bond proceeds. Therefore, the GO bonds have not been included in the consolidated financial statements as a liability of Sharp. The portion of the Project funded with the GO bonds is being recognized as a transfer of net assets from the District as the Project is completed. In fiscal 2018 and 2017, the Hospital recorded \$20,014,000 and \$12,796,000, respectively, of construction-in-progress and a related transfer of net assets for the portion of the Project completed during the year with proceeds of the GO bonds.

6. Long-Term Debt

Long-term debt consists of the following:

	September 30	
	2018	2017
	<i>(In Thousands)</i>	
<p>Series 2017B and Series C Variable Rate Revenue Bonds (Series 2017B and C Bonds), collateralized by a three-year direct-pay letter of credit reimbursement agreement between the Obligated Group and a bank. Principal is due in annual amounts ranging from \$1,455,000 in 2022 to \$10,380,000 in 2052. The letter of credit is renewable in December 2021. Interest is payable monthly at a variable rate (1.27% at September 30, 2018).</p>	\$ 148,045	\$ —
<p>Series 2017A Revenue Bonds (Series 2017A Bonds) collateralized by revenues of the Obligated Group. Principal due in annual amounts ranging from \$1,640,000 in 2031 to \$34,030,000 in 2047. Interest payable semiannually at rates ranging from 3.00% to 5.00%. The borrowing amount is net of the unamortized original issue premium of \$15,593,000 and unamortized debt issuance costs of \$1,365,000 at September 30, 2018. The bonds include issuer call features totaling \$141,840,000 in 2028.</p>	156,068	—

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt (continued)

	September 30	
	2018	2017
	<i>(In Thousands)</i>	
<p>Series 2014A Revenue Bonds (Series 2014A Bonds) collateralized by revenues of the Obligated Group. Principal due in annual amounts ranging from \$2,395,000 in 2019 to \$32,300,000 in 2043. Interest payable semiannually at rates ranging from 4.50% to 5.00%. The borrowing amount is net of the unamortized original issue premium of \$5,410,000 and unamortized debt issuance costs of \$1,483,000 at September 30, 2018. The bonds include issuer call features totaling \$140,120,000 in 2023.</p>	\$ 158,112	\$ 159,657
<p>Series 2009B Revenue Bonds (Series 2009B Bonds) collateralized by revenues of the Obligated Group. Interest paid semiannually at rates ranging from 6.00% to 6.25%. These bonds were partially defeased in November 2017, with the remaining bonds advance refunded in December 2017.</p>	–	107,254
<p>Series 2009C and Series D Variable Rate Revenue Bonds (Series 2009C and D Bonds), collateralized by a three-year direct-pay letter of credit reimbursement agreement between the Obligated Group and a bank. Principal is due in annual amounts ranging from \$145,000 in 2022 to \$11,805,000 in 2035. The letter of credit is renewable in December 2020. Interest is payable monthly at a variable rate (1.30% at September 30, 2018).</p>	99,880	99,880
<p>Series 2011A Revenue Bonds (Series 2011A Bonds) collateralized by revenues of the Obligated Group. Principal due in annual amounts ranging from \$160,000 in 2019 to \$8,180,000 in 2030. Interest payable semiannually at rates ranging from 4.38% to 6.00%. The borrowing amount is net of the unamortized original issue premium of \$203,000 and unamortized debt issuance costs of \$556,000 at September 30, 2018. The bonds include issuer call features totaling \$54,490,000 in 2021.</p>	54,542	59,844

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt (continued)

	September 30	
	2018	2017
	<i>(In Thousands)</i>	
<p>Series 2012A Revenue Bonds (Series 2012A Bonds) collateralized by revenues of the Obligated Group. Principal due in annual amounts ranging from \$5,080,000 in 2019 to \$5,055,000 in 2028. Interest payable semiannually at rates ranging from 4.00% to 5.00%. The borrowing amount is net of the unamortized original issue premium of \$2,384,000 and unamortized debt issuance costs of \$363,000 at September 30, 2018. The bonds include issuer call features totaling \$30,735,000 in 2023.</p>	\$ 44,956	\$ 45,315
<p>Series 2009A Variable Rate Revenue Bonds (Series 2009A Bonds) collateralized by a direct-pay letter of credit reimbursement agreement between the Obligated Group and a bank. Principal due in annual amounts ranging from \$4,095,000 in 2019 to \$5,360,000 in 2024. The borrowing amount is net of the unamortized debt issuance costs of \$219,000 at September 30, 2018. The letter of credit is renewable in April 2020. Interest is payable monthly at a variable rate (1.30% at September 30, 2018).</p>	25,501	29,382
<p>Series 2010A Variable Rate Revenue Bonds (Series 2010A Bonds) collateralized by revenues of the Obligated Group. Principal due in quarterly amounts ranging from \$240,000 to \$450,000 through 2035. The borrowing amount is net of the unamortized debt issuance costs of \$196,000 at September 30, 2018. Interest payable quarterly at a variable rate (1.83% at September 30, 2018).</p>	22,974	23,898

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt (continued)

	September 30	
	2018	2017
	<i>(In Thousands)</i>	
Reverse Repurchase Agreement collateralized by U.S. Treasury securities. Principal due in April 2021. Interest payable quarterly at a variable rate (2.41% at September 30, 2018).	\$ 15,500	\$ 15,500
Series 1988A Insured Hospital Revenue Bonds collateralized by revenues of the Obligated Group. Interest paid every 35 days at a variable rate (average of 1.78% through July 15, 2018).	–	1,896
Construction loan agreement. Interest ranging from 0.90% to 1.26% paid quarterly, through June 26, 2018.	–	37,832
Capital lease obligations at imputed rates of interest ranging from 2.09% to 7.27%, collateralized by leased building or equipment.	50,964	55,898
Total	776,542	636,356
Less current portion	(17,467)	(18,021)
	\$ 759,075	\$ 618,335

On November 28, 2017, Sharp deposited \$12.1 million into an escrow fund to legally defease \$11.0 million of outstanding fixed rate Series 2009B bonds (2009B bonds). The escrow funds have been irrevocably designated for retirement of the 2009B bonds on August 1, 2019, which is the earliest date covered by the existing 2009B redemption option. As a result of the defeasance, a \$1.3 million loss on extinguishment of debt was recorded and is included in other nonoperating gain in the accompanying statement of operations, which represents advance interest payments through July 2019 and the write-off of the unamortized cost of issuance and bond discount of the defeased portion of the 2009B bonds.

In December 2017, Sharp issued Series 2017A bonds in the amount of \$141.8 million, Series 2017B bonds in the amount of \$74.5 million, and Series 2017C bonds in the amount of \$74.5 million. Costs of issuance associated with the 2017A, 2017B, and 2017C bonds totaling \$2.5 million were paid for with Sharp's operating cash and will be amortized over the life of the bonds. The 2017A bonds provided bond proceeds of \$157.8 million as the bonds sold at a net

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt (continued)

premium. Sharp used 2017A bond proceeds to advance refund \$99.0 million in outstanding 2009B bonds and fund capital projects. The 2017B and 2017C bonds will fund capital projects. As a result of the advance refunding, \$10.9 million of debt service reserve fund for the 2009B bonds was released and a \$9.3 million loss on extinguishment of debt was recorded and is included in other nonoperating gain in the accompanying statement of operations, which represents advance interest payments through July 2019 and the write-off of the unamortized cost of issuance and bond discount of the 2009B bonds.

In June 2018, Sharp completed the unwinding of a New Markets Tax Credit (NMTC) financing arrangement that was established in June 2011 to finance the acquisition and construction of certain facilities and equipment. The NMTC program is administered by the federal government and provides tax incentives for the benefit of low-income communities. Upon inception of the arrangement in June 2011, Sharp loaned \$29.3 million to a special purpose entity that was owned and controlled by an unaffiliated banking partner. These loan proceeds, together with invested capital from the bank, were used to capitalize three community development entities (CDEs). Pursuant to terms of the federally managed NMTC program, these CDEs financed an SRS construction project and provided certain tax benefits to the bank for a period of seven years. In June 2018, the seven-year compliance period ended, and an exit agreement was executed between all parties, pursuant to which the bank exercised an option to “put” its interest to Sharp for \$519,000. Upon exercise, Sharp cancelled \$39.3 million in loans previously payable to the CDEs, wrote off the \$1.4 million unamortized cost of issuance, and terminated the \$29.3 million receivable from the special purpose entity. As a result, Sharp recognized an \$8.0 million gain on extinguishment of debt, which is net of \$569,000 in transaction costs and is included in other nonoperating gain in the accompanying consolidated statement of operations.

On January 1, 2015, Sharp entered into a build-to-suit lease agreement. Under the build-to-suit lease agreement, a three-story medical office building was constructed and Sharp’s lease payments were calculated based on 7% of the landlord’s total development costs (not to exceed \$38,260,000, subject to tenant delays, tenant design changes, and tenant’s election to take the tenant improvement allowance). The term of the lease was 240 months and included three options to extend in five-year increments. In this build-to-suit lease transaction, various forms of Sharp’s involvement during construction have deemed Sharp, in substance, the accounting owner of the asset during the construction period. As such, during the construction period Sharp recorded all construction-related costs as construction-in-progress and construction payable (long-term debt). Sharp recorded \$485,000 of construction improvements to construction-in-progress and construction payable as of September 30, 2017. The build-to-suit lease included a lessee purchase

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt (continued)

option that precluded de-recognition of the construction asset upon completion of the construction period. Construction was completed in February 2017 and was accounted for as a secured financing. Immediately upon completion of the construction period, Sharp exercised its option to purchase the building and extinguished \$34,340,000 in long-term debt. Sharp continues to lease the related land from the seller/lessor, pursuant to a separate 60-year ground lease that was not subject to the aforementioned purchase option.

In 2012, SGH entered into a Co-Generation and Energy Equipment Purchase Agreement (Co-Generation Agreement) with the District. Under the Co-Generation Agreement, the District financed an \$18,000,000 loan through a separate lease agreement with a bank for the purchase and installation of a co-generation unit and replacement energy equipment at SGH. The loan was repayable in monthly installments of principal and interest over nine years. The interest rate was 2.09% and the monthly installments were \$182,977 through August 2016. In September 2016, unused project funds of \$3,285,000 were paid by the District as a partial reduction of the \$18,000,000 financing, which resulted in a new monthly installment of \$123,381. In October 2017, unused project funds of \$544,000 were paid by the District as a partial reduction of the \$18,000,000 financing, which resulted in a new monthly installment of \$110,491.

The Co-Generation Agreement requires SGH to pay the bank directly an amount equal to the principal and interest amount the District is obligated to pay on the loan. Upon payment of all amounts due, the co-generation and energy equipment will be transferred to SGH as part of leasehold improvements pursuant to the May 29, 1991, lease (see Note 5).

As of September 30, 2017, the co-generation project was complete. Prior to completion, all lease payments were recorded as prepaid rent, with the financed portion as notes payable. Upon completion of the project, \$7,300,000 of prepaid rent was offset against the notes payable balance and the project was treated as a capital lease, and is included in the balance of long-term debt in the balance sheets as of September 30, 2018 and 2017. As of September 30, 2018, there are \$10,000 of unamortized issuance costs related to this project.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt (continued)

Scheduled principal payments on long-term debt and payments on capital lease obligations for years ending September 30 are as follows:

	Long-Term Debt	Capital Lease Obligations
	<i>(In Thousands)</i>	
2019	\$ 12,710	\$ 4,757
2020	13,075	5,080
2021	29,610	5,030
2022	14,910	4,397
2023	16,015	9,018
Thereafter	620,880	13,677

Scheduled interest payments Sharp is obligated to make on capital lease obligations referenced in the table noted above total approximately \$13,082,000 at September 30, 2018.

A summary of interest cost on borrowed funds follows:

	Year Ended September 30	
	2018	2017
	<i>(In Thousands)</i>	
Interest cost:		
Capitalized	\$ 5,263	\$ 2,690
Charged to operations	21,842	23,998
	\$ 27,105	\$ 26,688

Interest Rate Swaps

During 2003, Sharp entered into a floating-to-fixed interest rate swap on the Series 2003A and B Bonds that were refunded in 2009. The swap agreement hedges an initial notional amount of \$109,650,000 at a fixed payor rate of 3.01% for the entire swap term, which expires on August 1, 2024, and receives 59% of the one-month London Interbank Offered Rate (LIBOR) plus 0.14%. Settlements are made weekly. Cash paid on the interest rate swap was \$0 and \$293,000 in 2018 and 2017, respectively, which increased Sharp's overall cost of borrowing and was included in

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt (continued)

interest expense. The change in fair value of the swap increased nonoperating income by \$0 and \$5,019,000 in 2018 and 2017, respectively. The 2003 floating-to-fixed interest rate swap was terminated during 2017 and a new floating-to-fixed interest rate swap was entered into during 2017.

During 2006, Sharp entered into a fixed-spread yield curve swap with a bank. The swap arrangement hedges an initial notional amount of \$80,000,000 and entails Sharp paying 67% of one-month LIBOR and receiving 67% of ten-year International Swaps and Derivative Association less 0.423%. Under the terms of the agreement, Sharp may terminate the swap at any time. Cash received on the interest rate swap was \$169,000 and \$347,000 in 2018 and 2017, respectively, which reduced Sharp's overall cost of borrowing and was offset against interest expense. The change in fair value of the swap decreased nonoperating income by \$349,000 and \$489,000 in 2018 and 2017, respectively. The fair value of the swap liability at September 30, 2018 and 2017, is \$0 and \$349,000, respectively, and is included in other assets in the consolidated balance sheets. The 2006 fixed-spread yield curve swap was terminated during 2018 and a new fixed-spread yield curve swap was entered into during 2018.

During 2014, Sharp entered into a fixed-spread basis swap with a bank. The swap arrangement hedges an initial notional amount of \$80,000,000 at a fixed payor rate of the Securities Industry and Financial Markets Association Municipal Swap Index for the entire swap term, which expires on February 2, 2034, and receives 67% of one-month LIBOR plus 0.733%. Settlements are made quarterly. Cash received on the interest rate swap was \$536,000 and \$447,000 in 2018 and 2017, respectively, which reduced Sharp's overall cost of borrowing and was offset against interest expense. The change in fair value of the swap decreased nonoperating income by \$32,000 and \$1,394,000 in 2018 and 2017, respectively. The fair value of the swap asset at September 30, 2018 and 2017, is \$3,320,000 and \$3,351,000, respectively, and is included in other assets in the consolidated balance sheets.

During 2016, Sharp entered into a forward-starting floating-to-fixed interest rate swap to coincide with the planned refunding of the Series 2009B Bonds. The forward swap replaced fixed rates for the 2009B Bonds ranging from 6.00% to 6.25% with synthetic fixed rate debt. The swap agreement hedges an initial notional amount of \$99,075,000 at a fixed payor rate of 1.51% for the entire swap term, which expires on August 1, 2039, and receives 67% of one-month LIBOR. Settlements are to be made monthly, starting in September 2019. The change in fair value of the swap increased nonoperating income by \$4,944,000 and \$6,252,000 in 2018 and 2017, respectively. The fair value of the swap asset at September 30, 2018 and 2017, is \$6,716,000 and \$1,772,000, respectively, and is included in other assets in the consolidated balance sheets.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt (continued)

During 2017, Sharp entered into a floating-to-fixed interest rate swap on the Series 2003A and B Bonds that were refunded in 2009. The swap agreement hedges an initial notional amount of \$50,175,000 at a fixed payor rate of 3.01% for the entire swap term, which expires on August 1, 2024, and receives 59% of the one-month LIBOR plus 0.14%. Settlements are made weekly. Cash paid on the interest rate swap was \$797,000 and \$852,000 in 2018 and 2017, respectively, which increased Sharp's overall cost of borrowing and was offset against interest expense. The change in fair value of the swap increased nonoperating income by \$1,568,000 in 2018 and decreased nonoperating income by \$3,045,000 in 2017. The fair value of the swap liability at September 30, 2018 and 2017, is \$1,477,000 and \$3,045,000, respectively, and is included in other assets in the consolidated balance sheets.

During 2018, Sharp entered into a fixed-spread yield curve swap with a bank. The swap arrangement hedges an initial notional amount of \$80,000,000 and entails Sharp paying 67% of one-month LIBOR and receiving 67% of ten-year International Swaps and Derivative Association less 0.375% for the entire swap term, which expires on February 2, 2034. Under the terms of the agreement, Sharp may terminate the swap at any time. Cash received on the interest rate swap was \$30,000 in 2018, which reduced Sharp's overall cost of borrowing and was offset against interest expense. The change in fair value of the swap decreased nonoperating income by \$793,000 in 2018. The fair value of the swap liability at September 30, 2018, is \$793,000, and is included in other assets in the September 30, 2018, consolidated balance sheet.

7. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes:

	September 30	
	2018	2017
	<i>(In Thousands)</i>	
Hospital programs	\$ 22,657	\$ 12,185
Hospital department	20,765	14,225
Research	8,389	4,505
Purchase of equipment	8,107	18,502
Health education	6,273	5,045
Indigent care	836	379
Total	\$ 67,027	\$ 54,841

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

7. Temporarily and Permanently Restricted Net Assets (continued)

Permanently restricted net assets of \$8,994,000 and \$6,698,000 at September 30, 2018 and 2017, respectively, represent investments to be held in perpetuity, the income from which is expendable to support health care services.

8. Endowments

Sharp's endowments consist of 55 separate endowment funds included in assets limited as to use established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Directors of Sharp's affiliated foundations to function as endowments. As required by U.S. GAAP, net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

On September 30, 2008, California Senate Bill No. 1329 was signed into law, which enacted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) for California. California also adopted one of the optional provisions of the act, creating a rebuttable presumption of imprudence for spending more than 7% of the value of an endowment fund in one year (based on a three-year rolling average). The Board has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Sharp classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by Sharp in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, Sharp considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund, (2) the purposes of Sharp and the donor-restricted endowment fund, (3) general economic conditions, (4) the possible effect of inflation and deflation, (5) the expected total return from income and the appreciation of investments, (6) other resources of Sharp, and (7) the investment policies of Sharp.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

8. Endowments (continued)

The endowment net asset composition as of September 30, 2018, by fund type was as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
	<i>(In Thousands)</i>			
Board-designated endowment funds	\$ 4,572	\$ 3,699	\$ –	\$ 8,271
Donor-restricted endowment funds	–	6,625	8,994	15,619
Total funds	\$ 4,572	\$ 10,324	\$ 8,994	\$ 23,890

The endowment net asset composition as of September 30, 2017, by fund type was as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
	<i>(In Thousands)</i>			
Board-designated endowment funds	\$ 4,111	\$ 2,940	\$ –	\$ 7,051
Donor-restricted endowment funds	–	6,026	6,698	12,724
Total funds	\$ 4,111	\$ 8,966	\$ 6,698	\$ 19,775

Sharp has adopted investment and spending policies for endowment assets that attempt to provide a stream of funding to programs supported by its endowment while balancing the risk of investment loss with long-term preservation of purchasing power. Endowment assets include those assets of donor-restricted funds that Sharp must hold in perpetuity or for a donor-specified period as well as board-designated funds.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

8. Endowments (continued)

Sharp targets a diversified asset allocation that places greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints. Sharp's spending policy is to annually appropriate for distribution no more than 4% per year of each endowment fund's average fair value (based on a two-year rolling average).

	Temporarily Permanently			Total
	Unrestricted	Restricted	Restricted	
	<i>(In Thousands)</i>			
Endowment net assets, September 30, 2016	\$ 3,710	\$ 8,209	\$ 6,653	\$ 18,572
Investment return:				
Investment income	670	524	–	1,194
Net appreciation (realized and unrealized)	243	387	–	630
Total investment return	913	911	–	1,824
Contributions	117	100	45	262
Appropriation of endowment assets for expenditure	(629)	(254)	–	(883)
Endowment net assets, September 30, 2017	4,111	8,966	6,698	19,775
Investment return:				
Investment income	290	414	–	704
Net appreciation (realized and unrealized)	247	300	–	547
Total investment return	537	714	–	1,251
Contributions	(39)	747	2,296	3,004
Appropriation of endowment assets for expenditure	(37)	(103)	–	(140)
Endowment net assets, September 30, 2018	\$ 4,572	\$ 10,324	\$ 8,994	\$ 23,890

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

9. Functional Expenses

Sharp provides general health care services to residents within its geographic locations. Expenses related to providing these services are as follows:

	Year Ended September 30	
	2018	2017
	<i>(In Thousands)</i>	
Hospital patient services	\$ 2,503,813	\$ 2,274,907
Clinic patient services	581,060	552,053
General and administrative	331,215	310,476
Purchased services under capitated agreements	191,678	189,933
	<u>\$ 3,607,766</u>	<u>\$ 3,327,369</u>

10. Pension Plans

Sharp sponsors a voluntary retirement plan (the Plan), which consists of defined benefit cash balance plans and a defined contribution plan. Under the defined benefit cash balance plans, Sharp made contributions of \$21,984,000 and \$31,502,000 in 2018 and 2017, respectively. Under the defined contribution plan, Sharp made contributions of \$22,945,000 and \$21,489,000 in 2018 and 2017, respectively.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

10. Pension Plans (continued)

The following sets forth the funded status of Sharp's defined benefit pension plans at September 30:

	2018	2017
	<i>(In Thousands)</i>	
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 496,168	\$ 461,606
Service cost	23,794	22,360
Interest cost	15,632	13,172
Actuarial (gain) loss	(26,267)	10,291
Plan participant contributions	9,171	8,600
Benefits paid	(27,060)	(19,861)
Benefit obligation at end of year	491,438	496,168
Change in plan assets:		
Fair value of plan assets at beginning of year:	471,818	412,021
Actual gain on plan assets	11,870	39,556
Plan participants' contributions	9,171	8,600
Employer contributions	21,984	31,502
Benefits paid	(27,060)	(19,861)
Fair value of plan assets at end of year	487,783	471,818
Funded status	\$ (3,655)	\$ (24,350)

The net liability at September 30, 2018, consisted of an unfunded balance of \$4,646,000 related to Sharp's primary defined benefit pension plan and is included on the balance sheet in long-term liabilities, partially offset by an overfunded balance of \$991,000 related specifically to the separate defined benefit plan for employees of SGH, which is included on the balance sheet in other assets. At September 30, 2017, the entire net liability of \$24,350,000 was included in the balance sheet in long-term liabilities.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

10. Pension Plans (continued)

Included in unrestricted net assets at September 30 are the following amounts that have not yet been recognized in net periodic pension cost:

	2018	2017
	<i>(In Thousands)</i>	
Net actuarial loss	\$ 117,004	\$ 133,747
	\$ 117,004	\$ 133,747

Additional information for the Plan is as follows:

	September 30 2018	2017
	<i>(In Thousands)</i>	
Projected benefit obligation	\$ 491,438	\$ 496,168
Accumulated benefit obligation	467,517	470,361
Fair value of plan assets	487,783	471,818

Net periodic pension cost includes the following components for the years ended September 30:

	2018	2017
	<i>(In Thousands)</i>	
Service cost	\$ 23,794	\$ 22,360
Interest cost	15,632	13,172
Expected return on plan assets	(29,468)	(25,882)
Recognized net actuarial loss	8,074	9,458
Net periodic pension cost	\$ 18,032	\$ 19,108

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

10. Pension Plans (continued)

Weighted average assumptions used to determine benefit obligations were as follows:

	September 30	
	2018	2017
Discount rate	4.33%	3.85%
Rate of compensation increase	3.00	3.00

Weighted average assumptions used to determine net periodic pension cost were as follows:

	September 30	
	2018	2017
Discount rate	3.85%	3.70%
Expected return on plan assets, net of expenses	6.25	6.25
Rate of compensation increase	3.00	3.00

The expected rate of return on plan assets is updated annually, taking into consideration the Plan's asset allocation, historical returns on the types of assets held in the pension trust, and the current economic environment.

The estimated net actuarial loss for the defined benefit pension plans that will be amortized from net assets into net periodic pension cost during the 2019 fiscal year is \$6,110,000.

Plan Assets

The Plan's assets are invested in an institutional trust company commingled employee benefit plan trust (Commingled Plan Trust). The Plan's asset allocation utilizes a long-range asset allocation strategy. The target asset allocation gradually shifts as the funded ratio increases from an initial mix of 65% equity securities and 35% fixed income when the Plan's funded ratio is less than 80%

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

10. Pension Plans (continued)

to an ultimate target of 40% equity securities and 60% fixed income when the Plan's funded ratio reaches 100%. As of September 30, based on the Plan's funded ratio, the Plan's allocation of investments in the Commingled Plan Trust was as follows:

	<u>2018</u>	<u>2017</u>
Asset category:		
Equity securities	53%	53%
Fixed income	47	47
Total	<u>100%</u>	<u>100%</u>

Plan assets are managed according to an investment policy adopted by Sharp's Retirement Committee. Professional investment managers are retained to manage plan assets. The primary objective of the Plan is to generate a consistent total investment return sufficient to pay present and future Plan benefits to retirees. The investment policy includes an asset allocation that includes equities and fixed-income instruments. The target mix represents a long-term asset allocation strategy for the Plan. Although the Retirement Committee will seek to maintain the target mix over the long term, short-term deviations may occur due to market impact and cash flow. The timing and degree of rebalancing of the actual portfolio will be determined by the Retirement Committee.

Financial assets measured at fair value are grouped in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to estimate fair value. These levels and associated valuation methodologies are described in Note 2. All of the Plan's investments in the Commingled Plan Trust are measured using net asset value in accordance with the practical expedient offered by ASU 2015-07 as of September 30, 2018 and 2017.

Contributions

Sharp expects to contribute \$11,880,000 to the Plan in 2019.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

10. Pension Plans (continued)

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid (in thousands):

2019	\$	26,103
2020		27,681
2021		29,225
2022		32,135
2023		34,222
2024–2028		166,519

11. Long-Term Liabilities

Long-term liabilities consist of the following:

	September 30	
	2018	2017
	<i>(In Thousands)</i>	
Defined benefit pension plan unfunded liability	\$ 4,646	\$ 24,350
Workers' compensation	42,266	44,517
Deferred income	26,256	28,209
Other	8,284	7,733
	<u>\$ 81,452</u>	<u>\$ 104,809</u>

12. Commitments and Contingencies

Leases

Sharp leases various equipment and facilities under operating leases expiring at various dates through 2037. Total rental expense in 2018 and 2017 for all operating leases was \$33,067,000 and \$32,976,000, respectively.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

12. Commitments and Contingencies (continued)

The following is a schedule by year of future minimum lease payments (in thousands) under operating leases as of September 30, 2018, that have initial or remaining lease terms in excess of one year:

2019	\$	24,806
2020		23,445
2021		17,994
2022		16,517
2023		15,299
Thereafter		147,212
	\$	<u>245,273</u>

Legal Matters

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations are subject to ongoing government review and interpretations, and include matters such as licensure, accreditation, and reimbursement for patient services. Compliance with these laws and regulations is required for participation in government health care programs. Government activity continues to increase with respect to investigations and allegations concerning possible violations of regulations by health care providers, which could result in the imposition of significant fines and penalties as well as significant repayment of previously billed and collected revenues for patient services. Sharp believes it is in compliance with current laws and regulations.

In the normal course of business, Sharp is involved in legal proceedings. Sharp accrues a liability for such matters when it is probable that a liability has been incurred and the amount can be reasonably estimated. The accrual for a litigation loss contingency might include, for example, estimates of potential damages, outside legal fees, interest penalties, and other directly related costs expected to be incurred.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

12. Commitments and Contingencies (continued)

Labor Matters

Not-for-profit health care providers and their employees are under the jurisdiction of the National Labor Relations Board. As of September 30, 2018, approximately 27% of Sharp employees are represented by unions. Such unionized employees are represented by the Sharp Professional Nurses Network/United Nurses Association of California. The collective bargaining agreement with the union expires in 2019.

Professional Liability

CQI SPC is a wholly owned captive insurance company that insures a portion of the medical malpractice (professional liability) claims of certain affiliates of Sharp. Malpractice losses are accrued based on estimates of the ultimate costs for both reported claims and claims incurred but not reported. Sharp's liability is limited to \$3,000,000 per individual claim. As of September 30, 2018 and 2017, Sharp's liability was limited in the aggregate each year to \$16,000,000. Sharp has obtained excess loss insurance covering claims above these amounts up to \$40,000,000.

Professional and general liability costs have been accrued based upon an actuarial determination. Accrued malpractice losses have been discounted at 3.0% at September 30, 2018 and 2017. The current portion of professional liability costs is included in accounts payable and accrued liabilities on the consolidated balance sheets.

Included on the consolidated balance sheets at September 30 are the following amounts related to professional and general liability:

	<u>2018</u>	<u>2017</u>
	<i>(In Thousands)</i>	
Reserves for professional and general liabilities	\$ 12,729	\$ 13,522
Accounts payable and accrued liabilities	10,827	9,172
	<u>\$ 23,556</u>	<u>\$ 22,694</u>

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

12. Commitments and Contingencies (continued)

Claims, including alleged malpractice, have been asserted against Sharp and are currently in various stages of litigation. Additional claims may be asserted against Sharp arising from services provided to patients through September 30, 2018. In management's opinion, however, the estimated liability accrued at September 30, 2018, is adequate to provide for potential losses resulting from pending or threatened litigation. It is management's opinion that the ultimate disposition of such litigation will not have a material adverse effect on the consolidated financial position, results of operations, or cash flows of Sharp.

Sharp Health Plan

SHP is required to meet certain financial responsibility regulations of the California Department of Managed Healthcare (DMHC). Pursuant to these regulations, SHP maintains a reserve totaling \$500,000 on deposit with various financial institutions. In addition, SHP is required to maintain two times the normal requirement of tangible net equity, as defined in regulations of the DMHC. At September 30, 2018 and 2017, SHP was required to maintain tangible net equity totaling \$17,863,000 and \$20,730,000, respectively. SHP's tangible net equity was \$87,334,000 and \$82,698,000 at September 30, 2018 and 2017, respectively. Management believes it is in compliance with these requirements at September 30, 2018 and 2017.

Unemployment Claims and Workers' Compensation

Sharp has elected to self-insure for unemployment claims through various group plans. Prior to January 1, 1996, Sharp was also self-insured for workers' compensation claims. Since 1996, Sharp has purchased high-deductible insurance policies and has been responsible for workers' compensation claims up to amounts covered by these insurance policies (Sharp was responsible for individual claims up to \$1,000,000 in 2018 and 2017). For workers' compensation, Sharp accrues for the unpaid portion of claims that have been reported and estimates of claims that have been incurred but not reported, based on an actuarial study. Accrued workers' compensation losses have been discounted at 2.90% and 1.80% at September 30, 2018 and 2017, respectively. Workers' compensation liabilities of \$54,911,000 and \$56,596,000 at September 30, 2018 and 2017, respectively, are included in other current liabilities and long-term liabilities on the consolidated balance sheets.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

12. Commitments and Contingencies (continued)

Seismic Standards (Unaudited)

All of Sharp's major hospital buildings are in compliance with the earthquake retrofit requirements under a state of California law through 2030. Due to regulatory changes in the definition of buildings over the past year, one small corridor at SMH is now subject to the requirements. The corridor is expected to be completely removed as part of renovations prior to the compliance requirement date.

Credit Facilities

Sharp has a \$50,000,000 line of credit with a bank, which expires on September 1, 2019, of which \$20,504,000 and \$20,108,000 was available at September 30, 2018 and 2017, respectively. As part of the workers' compensation insurance agreement, letters of credit have been provided as collateral. The total letters of credit used as collateral totaled \$29,496,000 and \$29,892,000 as of September 30, 2018 and 2017, respectively. These letters of credit are each considered a decrease in the available \$50,000,000 line of credit with the bank. There are no amounts outstanding as of September 30, 2018 or 2017.

Sharp has a bank liquidity facility to provide credit enhancement and liquidity support for the \$60,000,000 of Series 2009A Bonds. The bank liquidity facility was executed in February 2009 by a bank letter of credit that expires in April 2020. The letter of credit used as collateral totaled \$26,016,000 at September 30, 2018.

Sharp has a bank liquidity facility to provide credit enhancement and liquidity support for the \$99,880,000 of Series 2009C and D Bonds. The bank liquidity facility was executed in September 2009 by a bank letter of credit that expires in December 2020. The letters of credit used as collateral totaled \$101,391,000 at September 30, 2018.

Sharp has a bank liquidity facility to provide credit enhancement and liquidity support for the \$149,075,000 of Series 2017B and C Bonds. The bank liquidity facility was executed in December 2017 by a bank letter of credit that expires in December 2021. The letters of credit used as collateral totaled \$151,967,000 at September 30, 2018.

SHP has a bank credit facility that provides for the issuance of up to an aggregate of \$2,400,000 at September 30, 2018 and 2017, under letters of credit. Such letters of credit are under irrevocable standby letters of credit. At September 30, 2018 and 2017, none of these letters have been drawn upon.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

13. Fair Value of Financial Instruments

The following methods and assumptions were used by Sharp in estimating fair value of its financial instruments:

Cash and cash equivalents: The carrying amount reported on the balance sheet for cash and cash equivalents approximates fair value.

Short-term, long-term investments and assets limited as to use: Fair values, which are the amounts reported on the balance sheet, are based on quoted market prices.

Estimated settlements receivable from (payable to) government programs, net: The carrying amount reported on the balance sheet for estimated third-party payor settlements approximates its fair value.

Prepaid expenses and other: The carrying amount reported on the balance sheet for prepaid expenses and other approximates its fair value.

Interest rate swap receivables and liabilities: Fair values are computed using an estimated third-party analysis using an income approach for the individual swaps. The fair value is considered Level 2 in the fair value hierarchy at September 30, 2018 and 2017.

Accounts payable and accrued expenses: The carrying amount reported on the balance sheet for accounts payable and accrued expenses approximates its fair value.

Accrued compensation and benefits: The carrying amount reported on the balance sheet for accrued compensation and benefits approximates its fair value.

Long-term debt: Fair values are computed using an estimated third-party pricing analysis based on the individual bond terms. The fair value is considered Level 2 in the fair value hierarchy at September 30, 2018 and 2017.

Sharp HealthCare

Notes to Consolidated Financial Statements (continued)

13. Fair Value of Financial Instruments (continued)

The carrying amounts and fair values of Sharp's financial instruments are as follows (in thousands):

	September 30, 2018		September 30, 2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and cash equivalents	\$ 448,311	\$ 448,311	\$ 289,838	\$ 289,838
Short-term investments	48,166	48,166	51,153	51,153
Estimated settlements receivable from government programs, net	393	393	–	–
Prepaid expenses and other	100,255	100,255	91,553	91,553
Long-term investments	268,888	268,888	245,883	245,883
Assets limited as to use	2,437,503	2,437,503	2,123,508	2,123,508
Interest rate swap receivables included in other assets	7,766	7,766	2,427	2,427
Accounts payable and accrued liabilities	440,588	440,588	291,122	291,122
Accrued compensation and benefits	173,902	173,902	147,788	147,788
Estimated settlements payable to government programs, net	–	–	2,745	2,745
Current and long-term debt	776,542	789,461	636,356	679,035

14. Subsequent Events

In preparing these consolidated financial statements, management has evaluated and disclosed all material subsequent events up to December 19, 2018, which is the date that the accompanying consolidated financial statements were issued.

Supplementary Information

Sharp Healthcare
Consolidating Balance Sheet

September 30, 2018

	Sharp HealthCare	Sharp Memorial Hospital	Sharp Chula Vista Medical Center	Sharp Grossmont Hospital	Sharp Coronado Hospital and HealthCare Center	Sharp Health Plan	Continuous Quality Insurance	Sharp HealthCare Foundation	Grossmont Hospital Foundation	Combined Totals	Consolidating Eliminations	Totals
	<i>(In Thousands)</i>											
Assets												
Current assets:												
Cash and cash equivalents	\$ 313,736	\$ 1,545	\$ 554	\$ 58,426	\$ 94	\$ 63,898	\$ 4,416	\$ 971	\$ 4,671	\$ 448,311	\$ -	\$ 448,311
Short-term investments	33,675	-	-	13,180	-	1,311	-	-	-	48,166	-	48,166
Accounts receivable, net	34,059	169,402	53,999	94,960	13,028	34,858	-	4,809	1,350	406,465	(26,168)	380,297
Intercompany receivables	-	2,273,315	152,724	-	41,110	-	-	-	23	2,467,172	(2,467,172)	-
Estimated settlements receivable from government programs, net	-	1,899	(338)	(1,091)	(77)	-	-	-	-	393	-	393
Inventories	7,931	18,989	7,590	12,109	2,454	-	-	-	-	49,073	-	49,073
Prepaid expenses and other	42,691	20,720	11,598	20,077	1,472	2,903	5	24	765	100,255	-	100,255
Total current assets	432,092	2,485,870	226,127	197,661	58,081	102,970	4,421	5,804	6,809	3,519,835	(2,493,340)	1,026,495
Long-term investments	204,774	-	-	10,799	-	53,315	-	-	-	268,888	-	268,888
Assets limited as to use:												
Designated for property	1,832,636	-	-	421,361	-	-	-	-	-	2,253,997	-	2,253,997
Under bond indentures	28	848	92,765	14,620	-	-	-	-	-	108,261	-	108,261
Other restricted investments	-	-	-	-	-	552	-	49,019	15,080	64,651	-	64,651
Under self-insurance programs	-	-	-	-	-	-	10,594	-	-	10,594	-	10,594
Total assets limited as to use	1,832,664	848	92,765	435,981	-	552	10,594	49,019	15,080	2,437,503	-	2,437,503
Property and equipment, net	384,315	393,667	253,152	425,808	32,963	615	-	181	-	1,490,701	-	1,490,701
Other assets	58,628	9	2,717	2,647	7,496	237	28,528	41,847	8,871	150,980	(62,874)	88,106
Beneficial interest in foundations	74,649	-	-	29,979	-	-	-	-	-	104,628	(104,628)	-
Total assets	\$ 2,987,122	\$ 2,880,394	\$ 574,761	\$ 1,102,875	\$ 98,540	\$ 157,689	\$ 43,543	\$ 96,851	\$ 30,760	\$ 7,972,535	\$ (2,660,842)	\$ 5,311,693

Sharp Healthcare

Consolidating Balance Sheet (continued)

	Sharp HealthCare	Sharp Memorial Hospital	Sharp Chula Vista Medical Center	Sharp Grossmont Hospital	Sharp Coronado Hospital and HealthCare Center	Sharp Health Plan	Continuous Quality Insurance	Sharp HealthCare Foundation	Grossmont Hospital Foundation	Combined Totals	Consolidating Eliminations	Totals
	<i>(In Thousands)</i>											
Liabilities and net assets												
Current liabilities:												
Accounts payable and accrued liabilities	\$ 200,736	\$ 65,968	\$ 49,781	\$ 65,567	\$ 5,269	\$ 66,437	\$ 12,951	\$ 191	\$ 6	\$ 466,906	\$ (26,318)	\$ 440,588
Intercompany payable	2,449,114	–	–	17,128	–	342	113	392	–	2,467,089	(2,467,089)	–
Accrued compensation and benefits	57,217	51,480	20,112	35,239	5,768	3,388	–	521	91	173,816	86	173,902
Current portion of long-term debt	3,628	7,088	2,911	3,840	–	–	–	–	–	17,467	–	17,467
Accrued interest	283	1,921	1,052	505	–	–	–	–	–	3,761	–	3,761
Total current liabilities	2,710,978	126,457	73,856	122,279	11,037	70,167	13,064	1,104	97	3,129,039	(2,493,321)	635,718
Long-term liabilities	89,887	2,411	652	7,792	212	201	18,787	21,099	685	141,726	(60,274)	81,452
Reserves for professional and general liabilities	3,700	–	–	–	–	–	9,029	–	–	12,729	–	12,729
Long-term debt	75,270	328,917	274,445	80,443	–	–	–	–	–	759,075	–	759,075
Total liabilities	2,879,835	457,785	348,953	210,514	11,249	70,368	40,880	22,203	782	4,042,569	(2,553,595)	1,488,974
Net assets:												
Unrestricted	44,394	2,422,609	225,808	871,403	95,120	87,321	2,663	11,756	9,020	3,770,094	(23,396)	3,746,698
Temporarily restricted	55,018	–	–	19,839	(7,829)	–	–	55,017	19,839	141,884	(74,857)	67,027
Permanently restricted	7,875	–	–	1,119	–	–	–	7,875	1,119	17,988	(8,994)	8,994
Total net assets	107,287	2,422,609	225,808	892,361	87,291	87,321	2,663	74,648	29,978	3,929,966	(107,247)	3,822,719
Total liabilities and net assets	\$ 2,987,122	\$ 2,880,394	\$ 574,761	\$ 1,102,875	\$ 98,540	\$ 157,689	\$ 43,543	\$ 96,851	\$ 30,760	\$ 7,972,535	\$ (2,660,842)	\$ 5,311,693

Sharp Healthcare
Consolidating Statement of Operations

Year Ended September 30, 2018

	Sharp HealthCare	Sharp Memorial Hospital	Sharp Chula Vista Medical Center	Sharp Grossmont Hospital	Sharp Coronado Hospital and HealthCare Center	Sharp Health Plan	Continuous Quality Insurance	Sharp HealthCare Foundation	Grossmont Hospital Foundation	Combined Totals	Consolidating Eliminations	Totals
<i>(In Thousands)</i>												
Revenues:												
Patient service revenue	\$ 187,792	\$ 1,203,844	\$ 360,110	\$ 666,585	\$ 92,111	\$ –	\$ –	\$ –	\$ –	\$ 2,510,442	\$ (427,020)	\$ 2,083,422
Provider tax revenue	–	111,129	45,854	73,854	17,683	–	–	–	–	248,520	–	248,520
Provision for doubtful accounts	(7,033)	(8,317)	(4,857)	(3,750)	(1,211)	–	–	–	–	(25,168)	–	(25,168)
Net patient service	180,759	1,306,656	401,107	736,689	108,583	–	–	–	–	2,733,794	(427,020)	2,306,774
Premium	1,027,578	–	–	–	–	725,275	–	–	–	1,752,853	(351,210)	1,401,643
Other	308,581	10,080	6,242	9,474	2,934	50	16,587	–	–	353,948	(256,539)	97,409
Total revenues	1,516,918	1,316,736	407,349	746,163	111,517	725,325	16,587	–	–	4,840,595	(1,034,769)	3,805,826
Expenses:												
Salaries and wages	386,621	441,123	167,213	304,715	46,052	20,291	–	–	–	1,366,015	–	1,366,015
Employee benefits	101,974	102,933	39,492	68,447	10,324	4,045	–	–	–	327,215	–	327,215
Medical fees	311,905	17,247	10,034	13,617	1,632	640,059	–	–	–	994,494	(387,194)	607,300
Purchased services	193,289	69,496	31,995	46,833	9,214	29,327	213	–	–	380,367	(16,746)	363,621
Supplies	69,077	189,321	62,698	102,754	15,266	384	–	–	–	439,500	(3)	439,497
Provider tax	–	64,040	32,988	60,647	3,391	–	–	–	–	161,066	–	161,066
Maintenance, utilities and rentals	74,635	29,741	9,266	19,534	4,270	1,191	–	–	–	138,637	(6,073)	132,564
Depreciation and amortization	36,098	46,802	13,865	33,273	3,904	667	6	–	–	134,615	(16,498)	118,117
Business Insurance	6,352	4,602	1,820	2,985	434	208	16,103	–	–	32,504	(16,103)	16,401
Interest	3,156	12,996	2,973	3,121	–	5	–	–	–	22,251	(409)	21,842
Purchased services from affiliate	395,136	125,814	45,893	80,688	10,736	5,951	107	–	–	664,325	(664,325)	–
Other	15,013	9,085	2,327	4,350	886	22,454	14	–	–	54,129	–	54,129
Total expenses	1,593,256	1,113,200	420,564	740,964	106,109	724,582	16,443	–	–	4,715,118	(1,107,351)	3,607,767
Income (loss) from operations	(76,338)	203,536	(13,215)	5,199	5,408	743	144	–	–	125,477	72,582	198,059
Other non-operating income (loss)	18,163	(9,439)	(1,251)	(1,692)	148	82	–	(1,521)	1,592	6,082	128	6,210
Investment income	93,301	53,746	19,290	23,296	3,979	3,649	152	1,498	781	199,692	(72,710)	126,982
Excess of revenues over expenses	35,126	247,843	4,824	26,803	9,535	4,474	296	(23)	2,373	331,251	–	331,251
Net assets transferred from related-party	–	–	–	20,014	–	–	–	–	–	20,014	–	20,014
Net assets released from restrictions used for purchase of property, plan and equipment	146	3,677	1,268	1,734	–	–	–	–	–	6,825	–	6,825
Pension related changes other than net periodic pension cost	5,645	5,722	1,943	3,944	412	150	–	–	–	17,816	–	17,816
Other changes in net assets	(23)	–	–	2,997	7,882	–	–	–	–	10,856	(2,350)	8,506
Increase (decrease) in unrestricted net assets	\$ 40,894	\$ 257,242	\$ 8,035	\$ 55,492	\$ 17,829	\$ 4,624	\$ 296	\$ (23)	\$ 2,373	\$ 386,762	\$ (2,350)	\$ 384,412

Sharp Healthcare

Consolidating Statement of Changes in Net Assets

Year Ended September 30, 2018

	Sharp HealthCare	Sharp Memorial Hospital	Sharp Chula Vista Medical Center	Sharp Grossmont Hospital	Sharp Coronado Hospital and HealthCare Center	Sharp Health Plan	Continuous Quality Insurance	Sharp HealthCare Foundation	Grossmont Hospital Foundation	Combined Totals	Consolidating Eliminations	Totals
	<i>(In Thousands)</i>											
Unrestricted net assets:												
Excess of revenues over expenses	\$ 35,126	\$ 247,843	\$ 4,824	\$ 26,803	\$ 9,535	\$ 4,474	\$ 296	\$ (23)	\$ 2,373	\$ 331,251	\$ -	\$ 331,251
Net assets transferred from related-party	-	-	-	20,014	-	-	-	-	-	20,014	-	20,014
Net assets released from restrictions used for purchase of property, plan and equipment	146	3,677	1,268	1,734	-	-	-	-	-	6,825	-	6,825
Pension related changes other than net periodic pension cost	5,645	5,722	1,943	3,944	412	150	-	-	-	17,816	-	17,816
Other changes in net assets	(23)	-	-	2,997	7,882	-	-	-	-	10,856	(2,350)	8,506
Increase (decrease) in unrestricted net assets	40,894	257,242	8,035	55,492	17,829	4,624	296	(23)	2,373	386,762	(2,350)	384,412
Temporarily restricted net assets:												
Contributions	-	-	-	-	-	-	-	18,973	6,698	25,671	-	25,671
Investment income	-	-	-	-	-	-	-	608	74	682	-	682
Change in net unrealized gains (losses) on other than trading securities	-	-	-	-	-	-	-	339	80	419	-	419
Net assets released from restrictions	-	-	-	-	-	-	-	(9,373)	(3,450)	(12,823)	-	(12,823)
Other	10,548	-	-	3,401	(1,763)	-	-	-	-	12,186	(13,949)	(1,763)
Increase (decrease) in temporarily restricted net assets	10,548	-	-	3,401	(1,763)	-	-	10,547	3,402	26,135	(13,949)	12,186
Permanently restricted net assets:												
Contributions	-	-	-	-	-	-	-	2,295	1	2,296	-	2,296
Other	2,295	-	-	1	-	-	-	-	-	2,296	(2,296)	-
Increase (decrease) in permanently restricted net assets	2,295	-	-	1	-	-	-	2,295	1	4,592	(2,296)	2,296
Increase (decrease) in net assets	53,737	257,242	8,035	58,894	16,066	4,624	296	12,819	5,776	417,489	(18,595)	398,894
Net assets, beginning of the year	53,550	2,165,367	217,773	833,467	71,225	82,697	2,367	61,829	24,202	3,512,477	(88,652)	3,423,825
Net assets, end of the year	\$ 107,287	\$ 2,422,609	\$ 225,808	\$ 892,361	\$ 87,291	\$ 87,321	\$ 2,663	\$ 74,648	\$ 29,978	\$ 3,929,966	\$ (107,247)	\$ 3,822,719

Sharp Healthcare

Consolidating Balance Sheet – Obligated Group

September 30, 2018

	Sharp HealthCare	Sharp Memorial Hospital	Sharp Chula Vista Medical Center	Sharp Grossmont Hospital	Combined Totals	Consolidating Eliminations	Totals
	<i>(In Thousands)</i>						
Assets							
Current assets:							
Cash and cash equivalents	\$ 313,736	\$ 1,545	\$ 554	\$ 58,426	\$ 374,261	\$ –	\$ 374,261
Short-term investments	33,675	–	–	13,180	46,855	–	46,855
Accounts receivable, net	34,059	169,402	53,999	94,960	352,420	(1,857)	350,563
Intercompany receivables	–	2,273,315	152,724	–	2,426,039	(2,425,319)	720
Estimated settlements receivable from government programs, net	–	1,899	(338)	(1,091)	470	–	470
Inventories	7,931	18,989	7,590	12,109	46,619	–	46,619
Prepaid expenses and other	42,691	20,720	11,598	20,077	95,086	–	95,086
Total current assets	432,092	2,485,870	226,127	197,661	3,341,750	(2,427,176)	914,574
Long-term investments	204,774	–	–	10,799	215,573	–	215,573
Assets limited as to use:							
Designated for property	1,832,636	–	–	421,361	2,253,997	–	2,253,997
Under bond indentures	28	848	92,765	14,620	108,261	–	108,261
Other restricted investments	–	–	–	–	–	–	–
Under self-insurance programs	–	–	–	–	–	–	–
Total assets limited as to use	1,832,664	848	92,765	435,981	2,362,258	–	2,362,258
Property and equipment, net	384,315	393,667	253,152	425,808	1,456,942	–	1,456,942
Other assets	58,628	9	2,717	2,647	64,001	(117)	63,884
Beneficial interest in foundations	74,649	–	–	29,979	104,628	–	104,628
Total assets	\$ 2,987,122	\$ 2,880,394	\$ 574,761	\$ 1,102,875	\$ 7,545,152	\$ (2,427,293)	\$ 5,117,859

Sharp Healthcare

Consolidating Balance Sheet – Obligated Group (continued)

	Sharp HealthCare	Sharp Memorial Hospital	Sharp Chula Vista Medical Center	Sharp Grossmont Hospital	Combined Totals	Consolidating Eliminations	Totals
	<i>(In Thousands)</i>						
Liabilities and net assets							
Current liabilities:							
Accounts payable and accrued liabilities	\$ 201,813	\$ 65,968	\$ 49,781	\$ 65,567	\$ 383,129	\$ (1,857)	\$ 381,272
Intercompany payable	2,448,037	–	–	17,128	2,465,165	(2,425,319)	39,846
Accrued compensation and benefits	57,217	51,480	20,112	35,239	164,048	–	164,048
Current portion of long-term debt	3,628	7,088	2,911	3,840	17,467	–	17,467
Accrued interest	283	1,921	1,052	505	3,761	–	3,761
Total current liabilities	2,710,978	126,457	73,856	122,279	3,033,570	(2,427,176)	606,394
Long-term liabilities	89,887	2,411	652	7,792	100,742	(117)	100,625
Reserves for professional and general liabilities	3,700	–	–	–	3,700	–	3,700
Long-term debt	75,270	328,917	274,445	80,443	759,075	–	759,075
Total liabilities	2,879,835	457,785	348,953	210,514	3,897,087	(2,427,293)	1,469,794
Net assets:							
Unrestricted	44,394	2,422,609	225,808	871,403	3,564,214	–	3,564,214
Temporarily restricted	55,018	–	–	19,839	74,857	–	74,857
Permanently restricted	7,875	–	–	1,119	8,994	–	8,994
Total net assets	107,287	2,422,609	225,808	892,361	3,648,065	–	3,648,065
Total liabilities and net assets	\$ 2,987,122	\$ 2,880,394	\$ 574,761	\$ 1,102,875	\$ 7,545,152	\$ (2,427,293)	\$ 5,117,859

Sharp Healthcare

Consolidating Statement of Operations – Obligated Group

Year Ended September 30, 2018

	Sharp HealthCare	Sharp Memorial Hospital	Sharp Chula Vista Medical Center	Sharp Grossmont Hospital	Combined Totals	Consolidating Eliminations	Totals
	<i>(In Thousands)</i>						
Revenues:							
Patient service revenue	\$ 187,792	\$ 1,203,844	\$ 360,110	\$ 666,585	\$ 2,418,331	\$ (397,986)	\$ 2,020,345
Provider tax revenue	–	111,129	45,854	73,854	230,837	–	230,837
Provision for doubtful accounts	(7,033)	(8,317)	(4,857)	(3,750)	(23,957)	–	(23,957)
Net patient service	180,759	1,306,656	401,107	736,689	2,625,211	(397,986)	2,227,225
Premium	1,027,578	–	–	–	1,027,578	–	1,027,578
Other	308,581	10,080	6,242	9,474	334,377	(223,280)	111,097
Total revenues	1,516,918	1,316,736	407,349	746,163	3,987,166	(621,266)	3,365,900
Expenses:							
Salaries and wages	386,621	441,123	167,213	304,715	1,299,672	–	1,299,672
Employee benefits	101,974	102,933	39,492	68,447	312,846	–	312,846
Medical fees	311,905	17,247	10,034	13,617	352,803	(20,829)	331,974
Purchased services	193,289	69,496	31,995	46,833	341,613	(13,294)	328,319
Supplies	69,077	189,321	62,698	102,754	423,850	(3)	423,847
Provider tax	–	64,040	32,988	60,647	157,675	–	157,675
Maintenance, utilities and rentals	74,635	29,741	9,266	19,534	133,176	(5,163)	128,013
Depreciation and amortization	36,098	46,802	13,865	33,273	130,038	(15,293)	114,745
Business Insurance	6,352	4,602	1,820	2,985	15,759	–	15,759
Interest	3,156	12,996	2,973	3,121	22,246	(382)	21,864
Purchased services from affiliate	395,136	125,814	45,893	80,688	647,531	(635,032)	12,499
Other	15,013	9,085	2,327	4,350	30,775	–	30,775
Total expenses	1,593,256	1,113,200	420,564	740,964	3,867,984	(689,996)	3,177,988
Income (loss) from operations	(76,338)	203,536	(13,215)	5,199	119,182	68,730	187,912
Other non-operating income (loss)	18,163	(9,439)	(1,251)	(1,692)	5,781	–	5,781
Investment income	93,301	53,746	19,290	23,296	189,633	(68,730)	120,903
Excess of revenues over expenses	35,126	247,843	4,824	26,803	314,596	–	314,596
Net assets transferred from related-party	–	–	–	20,014	20,014	–	20,014
Net assets released from restrictions used for purchase of property, plant and equipment	146	3,677	1,268	1,734	6,825	–	6,825
Pension-related changes other than net periodic pension cost	5,645	5,722	1,943	3,944	17,254	–	17,254
Other changes in net assets	(23)	–	–	2,997	2,974	–	2,974
Increase in unrestricted net assets	\$ 40,894	\$ 257,242	\$ 8,035	\$ 55,492	\$ 361,663	\$ –	\$ 361,663

Sharp Healthcare

Consolidating Statement of Changes in Net Assets – Obligated Group

Year Ended September 30, 2018

	Sharp HealthCare	Sharp Memorial Hospital	Sharp Chula Vista Medical Center	Sharp Grossmont Hospital	Combined Totals	Consolidating Eliminations	Totals
	<i>(In Thousands)</i>						
Unrestricted net assets:							
Excess of revenues over expenses	\$ 35,126	\$ 247,843	\$ 4,824	\$ 26,803	\$ 314,596	\$ –	\$ 314,596
Net assets transferred from related-party	–	–	–	20,014	20,014	–	20,014
Net assets released from restrictions used for purchase of property, plant and equipment	146	3,677	1,268	1,734	6,825	–	6,825
Pension-related changes other than net periodic pension cost	5,645	5,722	1,943	3,944	17,254	–	17,254
Other changes in net assets	(23)	–	–	2,997	2,974	–	2,974
Increase in unrestricted net assets	40,894	257,242	8,035	55,492	361,663	–	361,663
Temporarily restricted net assets:							
Contributions	–	–	–	–	–	–	–
Investment income	–	–	–	–	–	–	–
Other changes in net assets	10,548	–	–	3,401	13,949	–	13,949
Increase in temporarily restricted net assets	10,548	–	–	3,401	13,949	–	13,949
Permanently restricted net assets:							
Contributions	–	–	–	–	–	–	–
Other changes in net assets	2,295	–	–	1	2,296	–	2,296
Increase in permanently restricted net assets	2,295	–	–	1	2,296	–	2,296
Increase in net assets	53,737	257,242	8,035	58,894	377,908	–	377,908
Net assets (deficit), beginning of the year	53,550	2,165,367	217,773	833,467	3,270,157	–	3,270,157
Net assets (deficit), end of the year	\$ 107,287	\$ 2,422,609	\$ 225,808	\$ 892,361	\$ 3,648,065	\$ –	\$ 3,648,065

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