

**Yavapai Community Hospital Association and Affiliates
d/b/a Yavapai Regional Medical Center**

Independent Auditor's Report and Combined Financial Statements

December 31, 2018 and 2017

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

December 31, 2018 and 2017

Contents

Independent Auditor's Report.....	1
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Combined Financial Statements

Balance Sheets.....	3
Statements of Operations.....	4
Statements of Changes in Net Assets	5
Statements of Cash Flows	6
Notes to Financial Statements	7

Independent Auditor's Report

Board of Directors
Yavapai Community Hospital Association and Affiliates
d/b/a Yavapai Regional Medical Center
Prescott, Arizona

We have audited the accompanying combined financial statements of Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center (the Organization), which comprise the combined balance sheets as of December 31, 2018 and 2017, and the related combined statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Combined Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the combined 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 combined financial statements.

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

Board of Directors
Yavapai Community Hospital Association and Affiliates
d/b/a Yavapai Regional Medical Center

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center as of December 31, 2018 and 2017, and the results of its operations, changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 2 to the financial statements, in 2018, the Organization adopted ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities* and ASU 2014-19, *Revenue from Contracts with Customers (Topic 606)*. Our opinion is not modified with respect to these matters.

BKD, LLP

Colorado Springs, Colorado
April 15, 2019

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Combined Balance Sheets December 31, 2018 and 2017

Assets

	2018	2017
Current Assets		
Cash and cash equivalents	\$ 44,472,915	\$ 45,821,769
Short-term investments	187,856,083	143,827,818
Patient accounts receivable	43,155,358	41,640,922
Inventories	6,446,150	5,353,751
Contributions receivable, current	232,034	288,352
Prepaid expenses and other current assets	1,649,212	2,887,193
Total current assets	283,811,752	239,819,805
Investments	13,690,424	24,658,833
Assets Limited as to Use - Held by Bond Trustees	1,691,596	1,659,499
Contributions Receivable	21,499	83,326
Property, Plant and Equipment, Net	167,967,288	162,328,168
Other Assets, Net	1,811,040	2,121,318
Total assets	\$ 468,993,599	\$ 430,670,949

Liabilities and Net Assets

Current Liabilities		
Current portion of long-term debt	\$ 3,184,871	\$ 3,164,834
Accounts payable	11,091,712	9,124,716
Accrued expenses and other	23,437,874	21,061,411
Amounts due to third-party payers	2,028,337	1,636,285
Total current liabilities	39,742,794	34,987,246
Long-term Debt	87,063,024	90,556,765
Other Long-term Liabilities	2,565,856	2,629,598
Total liabilities	129,371,674	128,173,609
Net Assets		
Without donor restrictions	337,174,560	301,085,877
With donor restrictions	2,447,365	1,411,463
Total net assets	339,621,925	302,497,340
Total liabilities and net assets	\$ 468,993,599	\$ 430,670,949

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Combined Statements of Operations Years Ended December 31, 2018 and 2017

	2018	2017
Operating Revenues Without Donor Restrictions		
Patient care service revenue	\$ 370,729,978	\$ 347,852,078
Interest, contributions and other income	11,324,272	11,509,728
Net assets released from restriction for operations	367,313	171,800
Total operating revenues without donor restrictions	382,421,563	359,533,606
Operating Expenses		
Salaries and wages	130,006,314	120,362,346
Employee benefits	37,677,561	35,511,191
Professional fees	24,802,858	24,468,383
Supplies, services and other	125,653,296	113,769,063
Depreciation and amortization	15,651,112	15,665,044
Interest	3,834,050	3,766,812
Total operating expenses	337,625,191	313,542,839
Operating Income	44,796,372	45,990,767
Other Income (Expense)		
Gain (loss) in equity investees	(200,904)	52,807
Unrealized gains (losses) on investments	(9,407,920)	2,097,101
Total other income (expense)	(9,608,824)	2,149,908
Excess of Revenues Over Expenses	35,187,548	48,140,675
Contributions for purchase of property and equipment	904,909	22,161
Change in value of split-interest agreements	(3,774)	21,062
Increase in Net Assets Without Donor Restrictions	\$ 36,088,683	\$ 48,183,898

**Yavapai Community Hospital Association and Affiliates
d/b/a Yavapai Regional Medical Center**

Combined Statements of Changes in Net Assets

Years Ended December 31, 2018 and 2017

	2018	2017
Net Assets Without Donor Restrictions		
Excess of revenues over expenses	\$ 35,187,548	\$ 48,140,675
Contributions for purchase of property and equipment	904,909	22,161
Change in value of split-interest agreements	(3,774)	21,062
	<u>36,088,683</u>	<u>48,183,898</u>
Increase in net assets without donor restrictions		
Net Assets With Donor Restrictions		
Contributions received	1,403,215	280,482
Net assets released from restriction for operations	(367,313)	(171,800)
	<u>1,035,902</u>	<u>108,682</u>
Increase in net assets with donor restrictions		
Change in Net Assets	37,124,585	48,292,580
Net Assets, Beginning of Year	<u>302,497,340</u>	<u>254,204,760</u>
Net Assets, End of Year	<u>\$ 339,621,925</u>	<u>\$ 302,497,340</u>

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Combined Statements of Cash Flows Years Ended December 31, 2018 and 2017

	2018	2017
Operating Activities		
Change in net assets	\$ 37,124,585	\$ 48,292,580
Items not requiring (providing) cash		
Depreciation and amortization	15,651,112	15,665,044
Amortization of bond costs and premiums	(265,164)	(329,647)
Gain (loss) in equity investees	200,904	(52,807)
Realized and unrealized losses (gains) on investments	7,602,514	(6,788,989)
Contributions of or for acquisition of property and equipment	(904,909)	(22,161)
Change in allowance for uncollectible contributions	(13,364)	(8,917)
Change in value of split-interest agreements	3,774	(30,950)
Changes in		
Patient accounts receivable	(1,514,436)	(6,658,452)
Estimated amounts due to third-party payers	392,052	1,659,438
Accounts payable and accrued expenses	3,031,420	7,221,967
Other long-term liabilities	(63,742)	707,351
Inventory, prepaids and other assets	427,977	(721,208)
	<u>61,672,723</u>	<u>58,933,249</u>
Net cash provided by operating activities		
Investing Activities		
Purchase of property and equipment	(20,083,479)	(13,486,261)
Distributions from equity investee	60,000	8,700
Purchase of investments and assets limited as to use	(106,548,898)	(121,632,321)
Proceeds from disposition of investments and assets limited as to use	<u>65,854,431</u>	<u>51,511,837</u>
	<u>(60,717,946)</u>	<u>(83,598,045)</u>
Net cash used in investing activities		
Financing Activities		
Principal payments on long-term debt	(3,208,540)	(4,341,392)
Contributions restricted for the purchase of property and equipment	<u>904,909</u>	<u>22,161</u>
	<u>(2,303,631)</u>	<u>(4,319,231)</u>
Net cash used in financing activities		
Decrease in Cash and Cash Equivalents	<u>(1,348,854)</u>	<u>(28,984,027)</u>
Cash and Cash Equivalents, Beginning of Year	<u>45,821,769</u>	<u>74,805,796</u>
Cash and Cash Equivalents, End of Year	<u>\$ 44,472,915</u>	<u>\$ 45,821,769</u>
Supplemental Cash Flows Information		
Interest paid, net of capitalized interest	\$ 3,381,611	\$ 3,434,073
Acquisition of property and equipment accrued for, but unpaid	\$ 1,380,851	\$ 72,586

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

The accompanying combined financial statements include the accounts of Yavapai Community Hospital Association (the Hospital) doing business as Yavapai Regional Medical Center, an Arizona nonprofit corporation; Central Yavapai Hospital District (the District); Yavapai Regional Medical Center Foundation (the Foundation), an Arizona nonprofit corporation; Yavapai Regional Medical Center Physician Care, LLC (the MSO) and North Central Arizona Accountable Care, LLC (the ACO); and Prescott Medical Imaging (PMI) (collectively, the Organization). The Hospital provides health care and related services in Yavapai County, Arizona and is licensed to operate 206 beds. At December 31, 2018, all 206 of these beds were in service. The District was organized primarily to assist in providing medical facilities to serve the population of Central Yavapai County. The MSO was organized in 2008 for the purpose of providing physician services to Central Yavapai County. The ACO was organized in 2014 to promote greater accountability for the quality, effectiveness and efficiency of health care delivered to patients through providers who work together based on the principles of clinical integration to improve the coordination of health care items and services, to encourage investment in infrastructure and redesigned care processes for high quality and efficient service delivery, and to incent higher value care.

Principles of Combination

The combined financial statements include the accounts of the Hospital, the District, the Foundation, the MSO, the ACO and PMI. Intercompany transactions and balances have been eliminated in combination. The District holds certain medical facilities of the Hospital, the Foundation's purpose is to benefit and support the Hospital, and the MSO, ACO and PMI are 100% owned by the Hospital; therefore, the financial statements are combined.

Use of Estimates

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

Cash Equivalents

The Organization considers all liquid investments, other than those limited as to use, with original maturities of three months or less to be cash equivalents. At December 31, 2018 and 2017, cash equivalents consisted primarily of money market accounts with brokers and overnight sweep accounts.

At December 31, 2018, the Organization's cash accounts exceeded federally insured limits by approximately \$48,300,000.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Investments and Investment Return

Investments in debt and equity securities are carried at fair value. The investments in affiliates are reported on the equity method of accounting. Other investments are valued at the lower of cost (or fair value at time of donation, if acquired by contribution) or fair value. Investment return includes dividend, interest and other investment income; realized and unrealized gains and losses on investments carried at fair value; and realized gains and losses on other investments, less external and direct internal investment expense.

Investment return that is initially restricted by donor stipulation and for which the restriction will be satisfied in the same year is included in net assets without donor restrictions. Other investment return is reflected in the consolidated statements of operations and changes in net assets as with or without donor restrictions based upon the existence and nature of any donor or legally imposed restrictions.

Assets Limited as to Use

Assets whose use is limited include assets held by trustees under bond indenture agreements, which can be used only for the purpose designated by such agreements.

Patient Accounts Receivable

Patient accounts receivable reflects the outstanding amount of consideration to which the Hospital expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs) and others. As a service to the patient, the Hospital bills third-party payors directly and bills the patient when the patient's responsibility for co-pays, coinsurance and deductibles is determined. Patient accounts receivable are due in full when billed.

Inventories

The Organization states supply inventories at the lower of cost, determined using the first-in, first-out method, or net realizable value for 2018 and lower of cost or market for 2017.

Property and Equipment

Property and equipment are depreciated on a straight-line basis over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives.

Leasehold improvements	10-20 years
Buildings and service equipment	20-40 years
Equipment	3-20 years

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

The carrying value of property and equipment is reviewed annually to determine potential impairment. If events or circumstances suggest that the carrying value may be permanently impaired and will not be recoverable, the assets will be reduced to their estimated recoverable value.

Donations of property and equipment are reported at fair value as an increase in net assets without donor restrictions unless use of the assets is restricted by the donor. Monetary gifts that must be used to acquire property and equipment are reported as restricted support. The expiration of such restrictions is reported as an increase in net assets without donor restrictions when the donated asset is placed in service.

The Hospital capitalizes interest costs as a component of construction in progress, based on weighted average costs paid for long-term borrowing, net of interest earned on investments acquired with the proceeds of the borrowing, if the borrowing is tax-exempt borrowing.

Deferred Financing and Debt Issuance Costs

Deferred financing and debt issuance costs represent costs incurred in connection with the issuance of long-term debt. These costs are being amortized using the straight-line method over the life of the debt. The Organization records these costs as direct deductions from the related debt and are included in long-term debt in the accompanying combined balance sheets.

Net Assets With Donor Restrictions

Net assets with donor restrictions are those whose use by the Hospital has been limited by donors to a specific time period or purpose.

Patient Care Service Revenue

Patient care service revenue is recognized as the Organization satisfies performance obligations under its contracts with patients. Patient care service revenue is reported at the estimated transaction price or amount that reflects the consideration to which the Organization expects to be entitled in exchange for providing patient care. The Organization determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the Organization's policies and implicit price concessions provided to uninsured patients. The Organization determines its estimates of explicit price concessions which represent adjustments and discounts based on contractual agreements, its discount policies and historical experience by payor groups. The Organization determines its estimate of implicit price concessions based on its historical collection experience by classes of patients. The estimated amounts also include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations by third-party payors.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Contract Assets

Amounts related to health care services provided to patients which have not been billed and that do not meet the conditions of an unconditional right to payment at the end of the reporting period are contract assets. Contract asset balances consist primarily of health care services provided to patients who are still receiving inpatient care in the Hospital at the end of the year. Contract asset balances are included in patient accounts receivable on the balance sheets.

Charity Care

In support of its mission, the Organization voluntarily provides free care to patients who lack financial resources and are deemed to be medically indigent. Because the Organization does not pursue collection of amounts determined to qualify as charity care, they are not reported in patient care service revenue. The cost of charity care is estimated by applying the ratio of cost to gross charges to the gross uncompensated charges. The costs of charity care provided under the Organization's charity care policy for the years ended December 31, 2018 and 2017 were approximately \$2,043,000 and \$2,278,000, respectively. In addition to uncompensated costs, the Organization also commits significant time and resources to endeavors and critical services which meet otherwise unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable.

Contributions

Unconditional promises to give cash and other assets are accrued at estimated fair value at the date each promise is received. Gifts received with donor stipulations are reported as changes in net assets with donor restrictions. When a donor restriction expires, that is, when a time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified and reported as an increase in net assets without donor restrictions.

Professional Liability Claims

The Hospital recognizes an accrual for claim liabilities based on estimated ultimate losses and costs associated with settling claims and a receivable to reflect the estimated insurance recoveries, if any. Professional liability claims are described more fully in Note 9.

Excess of Revenues Over Expenses

The combined statements of operations include excess of revenues over expenses. Changes in net assets without donor restrictions, which are excluded from excess of revenues over expenses, consistent with industry practice, include the change in value of split-interest agreements, permanent transfers to and from affiliates for other than goods and services and contributions of long-lived assets (including assets acquired using contributions which by donor restrictions were to be used for the purpose of acquiring such assets).

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Income Taxes

The Hospital and the Foundation have been recognized as exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code (the IRC) and a similar provision of state law. The District has been recognized as a nonprofit governmental entity and is also exempt from federal income taxes under Section 115 of the IRC and a similar provision of state law. The MSO, ACO and PMI are considered disregarded entities under provisions of the IRC and a similar section of the Arizona income tax law. Therefore, income or loss for the MSO, ACO and PMI are reported to the Hospital for inclusion in its respective tax returns. The Organization is subject to federal income tax on any unrelated business taxable income.

Reclassifications and Revisions

Certain reclassifications have been made to the 2017 notes to the financial statements to conform to the 2018 financial statement presentation. These reclassifications had no effect on the change in net assets.

Certain revisions have been made to the 2017 financial statements regarding the classification of unrealized gains and losses above excess of revenues over expenses. This revision did not have a significant impact on the financial statements.

Subsequent Events

Subsequent events have been evaluated through April 15, 2019, which is the date the combined financial statements were issued.

Note 2: Changes in Accounting Principle

ASU 2016-14, Not-for-Profit Entities (Topic 958)

In 2018, the Organization, adopted ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. A summary of the changes is as follows:

Balance Sheet

The balance sheet distinguishes between two new classes of net assets—those with donor-imposed restrictions and those without. This is a change from the previously required three classes of net assets—unrestricted, temporarily restricted and permanently restricted.

Statement of Operations

Investment income is shown net of external and direct internal investment expenses. Disclosure of the expenses netted against investment income is no longer required.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Notes to the Financial Statements

Enhanced quantitative and qualitative disclosures provide additional information useful in assessing liquidity and cash flows available to meet operating expenses for one-year from the date of the balance sheet.

Expenses are reported by both nature and function in one location.

This change had no impact on previously reported total change in net assets and has been applied retrospectively to all periods presented.

ASU 2014-09, Revenue from Contracts with Customers (Topic 606)

On January 1, 2018, the Organization adopted Accounting Standard Codification Topic 606, *Revenue from Contracts with Customers (Topic 606)*, using a full-retrospective method of adoption to all contracts with customers (patients) at January 1, 2017. The core guidance in Topic 606 is to recognize revenue to depict the transfer of promised goods or services to customers or patients in an amount that reflects the consideration to which the Organization expects to be entitled in exchange for those goods or services. The amount to which the Organization expects to be entitled is calculated as the transaction price and recorded as revenue in exchange for providing patient services to its patients. Adoption of Topic 606 resulted in changes in presentation of the financial statements and related disclosures in the notes to the combined financial statements. Because contracts are generally completed within a year, the Organization used the actual transaction price rather than estimating variable consideration amounts for contracts completed during the year ending December 31, 2017. Prior to the adoption of Topic 606, the majority of the provision for doubtful accounts related to patients without insurance, as well as patient responsibility balances for co-pays, co-insurance and deductibles for patients with insurance. Under Topic 606, the estimated amounts due from patients for which the Organization does not expect to be entitled or collect from the patients are considered implicit price concessions and excluded from the Organization's estimation of the transaction price or revenue recorded.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Combined Statements of Operations	December 31, 2017	
	As Previously Reported	As Adjusted
	Operating revenues	
Patient service revenue (net of contractual discounts and allowances)	\$ 365,530,976	
Provision for uncollectible accounts	<u>(17,678,898)</u>	
Net patient service revenue less provision for uncollectible accounts	<u>\$ 347,852,078</u>	
Patient care service revenue		<u>\$ 347,852,078</u>
Combined Statements of Cash Flows		
Provision for uncollectible accounts	\$ 17,678,898	\$ -
Changes in patient accounts receivable	\$ (24,337,350)	\$ (6,658,452)

The adoption had no impact on operating income, overall change in net assets or net cash provided by (used in) operating activities.

Note 3: Patient Care Service Revenue

Patient care service revenue is reported at the amount that reflects the consideration to which the Organization expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs) and others and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations. Generally, the Organization bills the patients and third-party payors several days after the services are performed or the patient is discharged from the facility and patient accounts receivable are due in full when billed. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by the Organization. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected charges. The Organization believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the Organization receiving inpatient acute care services or patients receiving services in its outpatient centers. The Organization measures the performance obligation from inpatient admission, or the commencement of an outpatient service, to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or completion of the outpatient services. Revenue for performance obligations satisfied at a point in time is generally recognized when goods are provided to its patients and customers in a retail setting (for example, pharmaceuticals and medical equipment) and the Organization does not believe it is required to provide additional goods related to the patient.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Because all of its performance obligations relate to contracts with a duration of less than one year, the Organization has elected to apply the optional exemption provided in FASB ASC 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

The Organization determines the transaction price based on standard charges for goods and services provided, reduced by explicit price concessions which consist of contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the Organization's policy and implicit price concessions provided to uninsured patients. The Organization determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies and historical experience. The Organization determines its estimate of implicit price concessions based on its historical collection experience with this class of patients.

Agreements with third-party payors typically provide for payments at amounts less than established charges. A summary of the payment arrangements with major third-party payors follows:

Medicare. Certain inpatient acute care services are paid at prospectively determined rates per discharge based on clinical, diagnostic and other factors. Certain services are paid based on cost-reimbursement methodologies subject to certain limits. Physician services are paid based upon established fee schedules. Outpatient services are paid using prospectively determined rates. The Organization is a Medicare Designated Sole Community Hospital. Special Medicare payments under this designation approximated \$16.0M and \$10.2M for the years ended December 31, 2018 and 2017, respectively.

Medicaid. Reimbursements for Medicaid services are generally paid at prospectively determined rates per discharge, per occasion of service or per covered member.

Other. Payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations provide for payment using prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various health care organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge the Organization's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon the Organization. In addition, the

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

contracts the Organization has with commercial payors also provide for retroactive audit and review of claims.

Settlements with third-party payors for retroactive adjustments due to cost report or other audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor and the Organization's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known based on newly available information or as years are settled or are no longer subject to such audits, reviews and investigations. Adjustments arising from a change in the transaction price were not significant in 2018 or 2017.

From time to time the Organization will receive overpayments of patient balances from third-party payors or patients resulting in amounts owed back to either the patients or third-party payors. These amounts are excluded from revenues and are recorded as liabilities until they are refunded. As of December 31, 2018 and 2017, the Organization has a liability for refunds to third-party payors and patients recorded in the accounts payable on the combined balance sheets of approximately \$1,072,000 and \$903,000, respectively.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The Organization also provides services to uninsured patients and offers those uninsured patients a discount, either by policy or law, from standard charges. The Organization estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts and implicit price concessions based on historical collection experience. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient care service revenue in the period of the change. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

Consistent with the Organization's mission, care is provided to patients regardless of their ability to pay. Therefore, the Organization has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances, such as copays and deductibles. The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts the Organization expects to collect based on its collection history with those patients.

Patients who meet the Organization's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue.

The Organization has determined that the nature, amount, timing and uncertainty of revenue and cash flows are primarily affected by factors including payers and service lines. Tables providing details of these factors are presented below.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

The composition of patient care service revenue by primary payor for the years ended December 31 is as follows:

	2018	2017
Medicare	\$ 166,240,294	\$ 152,184,504
Medicaid	27,571,090	29,066,655
Commercial	152,346,936	144,208,717
Other third-party payers	14,348,467	13,516,283
Patients	2,340,284	1,624,064
Patients' deductibles, copays, coinsurance	7,882,907	7,251,855
Total	\$ 370,729,978	\$ 347,852,078

The composition of patient care service revenue based on service lines for the years ended December 31 is as follows:

	2018	2017
Hospital inpatient	\$ 139,503,414	\$ 138,235,842
Hospital outpatient	209,096,176	189,565,022
MSO - physician services	22,130,388	20,051,214
	\$ 370,729,978	\$ 347,852,078

Revenue is recognized as health care services are transferred over time. Revenue recognized at a point in time is not significant.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Financing Component

The Organization has elected the practical expedient allowed under FASB ASC 606-10-32-18 and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to the Organization's expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less. However, the Organization does, in certain instances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract.

Contract Costs

The Organization has applied the practical expedient provided by FASB ASC 340-40-25-4 and all incremental customer contract acquisition costs are expensed as they are incurred, as the amortization period of the asset that the Organization otherwise would have recognized is one year or less in duration.

Note 4: Concentration of Credit Risk

The Hospital and the MSO grant credit without collateral to their patients, most of whom are area residents and are insured under third-party payer agreements. The mix of receivables from patients and third-party payers at December 31 were:

	<u>2018</u>	<u>2017</u>
Medicare	31%	31%
Medicaid	5%	6%
Other third-party payers	59%	59%
Patients	<u>5%</u>	<u>4%</u>
	<u>100%</u>	<u>100%</u>

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Note 5: Investments, Assets Limited as to Use and Investment Return

Investments and Assets Limited as to Use

	2018	2017
Investments		
Money markets and cash (assets limited as to use)	\$ 1,691,596	\$ 2,886,808
U.S. equity mutual funds	23,642,194	21,840,144
International equity mutual funds	23,459,506	19,325,552
U.S. fixed income mutual funds	25,696,749	27,468,653
International fixed income mutual funds	1,806,841	1,718,345
Corporate bonds	5,554,068	6,703,654
Government bonds	115,014,924	81,355,912
International bonds	663,680	625,427
Mortgage and asset-backed bonds	5,627,972	8,116,255
Accrued income	80,573	105,400
	\$ 203,238,103	\$ 170,146,150

Investments and assets limited as to use are included in the following combined balance sheets captions:

	2018	2017
Short-term investments	\$ 187,856,083	\$ 143,827,818
Investments	13,690,424	24,658,833
Assets limited as to use - held by bond trustees	1,691,596	1,659,499
	\$ 203,238,103	\$ 170,146,150

Pursuant to the terms of the bond indenture (see Note 11), the Organization is required to maintain amounts on deposit with the bond trustees. The funds held by the bond trustees are invested according to the bond indentures, stated at fair market value and may only be used as permitted by the trust agreements.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Total investment return is composed of the following:

	2018	2017
Interest and dividend income	\$ 4,725,653	\$ 2,854,642
Realized gains	1,805,406	4,691,888
Change in unrealized gains (losses) on investments	(9,407,920)	2,097,101
Total	\$ (2,876,861)	\$ 9,643,631

Total investment return is reflected in the combined statements of operations:

	2018	2017
Net assets without donor restrictions		
Interest, contributions and other income	\$ 6,531,059	\$ 7,546,530
Change in unrealized gains (losses) on investments	(9,407,920)	2,097,101
	\$ (2,876,861)	\$ 9,643,631

Note 6: Property and Equipment

Property and equipment at December 31 consists of the following:

	2018	2017
Land	\$ 15,814,349	\$ 15,814,349
Leasehold and land improvements	12,812,968	12,812,968
Buildings and service equipment	170,773,613	170,591,471
Equipment	181,834,799	166,088,065
Construction-in-progress	7,099,698	1,479,177
Total	388,335,427	366,786,030
Accumulated depreciation	(220,368,139)	(204,457,862)
Total property and equipment	\$ 167,967,288	\$ 162,328,168

In December 2010, the Hospital entered into a commitment contract for \$29,445,000 related to the implementation of an electronic medical records system. In October 2013, the Hospital amended the contract above to include outsourced technology personnel as well as additional costs related to the electronic medical records system. The amended contract results in a total commitment of approximately \$150,000,000 over a 10-year period. The contract was amended again in July of 2018 to extend the initial contract terms through June 10, 2028. Approximately \$86,000,000 and \$69,900,000 of costs associated with the contract have been incurred as of December 31, 2018 and 2017, respectively.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Note 7: Contributions Receivable

Contributions receivable with donor restrictions consisted of the following at December 31:

	2018	2017
Due within one year	\$ 242,750	\$ 304,328
Due in one to five years	25,146	95,077
	267,896	399,405
Less		
Allowance for uncollectible contributions and unamortized discount	14,363	27,727
	\$ 253,533	\$ 371,678

The Organization has established gift annuities where donors may contribute assets to the Organization in exchange for the right to receive a fixed dollar annual return during their lifetimes. The Organization has a liability for these split-interest agreements of \$38,317 and \$42,143 as of December 31, 2018 and 2017, respectively, which is included in accrued expenses. The liability is determined at the time of the contribution using actuarial life expectancy tables and discount rates equal to the applicable federal rates and is updated annually as of December 31.

Note 8: Related-party Transactions

Prescott Outpatient Surgical Center

The Organization has a 20% ownership in a limited partnership that operates a surgery center. The investment in the limited partnership is accounted for on the equity method of accounting. The Organization shares only in the income of the partnership per the partnership agreement. The amount of the investment was \$368,188 and \$629,092 at December 31, 2018 and 2017, respectively, and is recorded in other assets in the combined balance sheets. The Hospital owns the building in which the limited partnership operates, and leases the building to the limited partnership. The Hospital recognized \$304,849 and \$305,695 of rent revenue from Prescott Outpatient Surgical Center for the years ended December 31, 2018 and 2017, respectively.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Note 9: Medical Malpractice Claims

The Organization purchases medical malpractice insurance under a claims-made policy on a fixed premium basis. Under such policy, only claims made and reported to the insurer during the policy term, regardless of when the incident giving rise to the claims occurred, are covered. The Organization has a deductible for the first \$250,000 per occurrence of medical malpractice risks.

The Organization has recorded approximately \$488,000 and \$400,000 of current professional liability reserves, which are included in its combined balance sheets in accrued expenses and other as of December 31, 2018 and 2017, respectively.

Although considerable variability is inherent in professional liability reserve estimates, management believes the reserves for losses and loss expenses are adequate based on information currently known. It is reasonably possible that this estimate could change materially in the near term.

The professional liability risks, in excess of certain per claim and aggregate deductible amounts, are insured through unrelated commercial insurance carriers. The amounts receivable under these insurance contracts totaled \$0 and \$100,000, included in other current assets at December 31, 2018 and 2017, respectively.

The Organization holds standby letters of credit with financial institutions totaling \$2,395,000 as a condition of their insurance policies. There was no amount outstanding at December 31, 2018 or 2017.

Note 10: Self-insured Health Care Plan

The Organization sponsors a health care plan for its employees. This plan is self-insured to the extent of the deductible amounts under the excess risk insurance policy the Organization has obtained. Accruals for unpaid claims amounted to \$2,686,000 and \$2,757,000 at December 31, 2018 and 2017, respectively, and are included in the accompanying combined balance sheets in accrued expenses.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Note 11: Long-term Debt

	2018	2017
Series 2016 (A)	\$ 42,780,000	\$ 43,490,000
Series 2013A (B)	23,910,000	26,085,000
Series 2013B (C)	20,400,000	20,400,000
Notes payable to third parties (D)	2,129,637	2,453,177
Total long-term debt	89,219,637	92,428,177
Less unamortized premium	2,419,272	2,785,948
Less unamortized debt issuance costs	(1,391,014)	(1,492,526)
Less current portion of long-term debt	(3,184,871)	(3,164,834)
Long-term debt, net	\$ 87,063,024	\$ 90,556,765

- (A) Series 2016; principal balances are bifurcated into multiple tranches consisting of serial bonds that are due annually beginning in 2017 through 2037 with each tranche having a separate fixed interest rate ranging from 3.0% to 5.0%; collateralized by the Organization's assets; interest payments are due monthly into an interest fund held by trustee, which is paid out semiannually to bond holders on August 1 and February 1. Unamortized debt issuance costs were \$701,099 and \$738,826 at December 31, 2018 and 2017, respectively.

Upon issuance and delivery of the 2016 Bonds the Hospital defeased its outstanding 2008B, 2002, 1997B bonds, (collectively Bonds) in the total principal amount of \$47,111,750. Proceeds from the 2016 Bonds were used to purchase securities that were deposited in trust under an escrow agreement sufficient in amount to pay future principal, interest and redemption premiums on the defeased Bonds. This advance refunding transaction resulted in an extinguishment of debt since the Hospital was legally released from its obligation on the Bonds at the time of the defeasance.

- (B) Series 2013A; principal balances are bifurcated into multiple tranches consisting of serial bonds that are due annually beginning in 2014 through 2021 with each tranche having a separate fixed interest rate ranging from 3.0% to 5.0%, and term bonds due in 2028 and 2033 with separate fixed interest rates of 5.0% and 5.25%, respectively; collateralized by a security interest in the Organization's gross receipts; interest payments are due monthly into an interest fund held by trustee, which is paid out semiannually to bond holders on August 1 and February 1. Unamortized debt issuance costs were \$547,928 and \$585,500 at December 31, 2018 and 2017, respectively.
- (C) Series 2013B; accrue interest using various modes over the life of the bonds; collateralized by a security interest in the gross receipts of the Organization. The bonds shall initially be in the Flex Private Placement Mode and bear interest at a Variable Rate Flex Private Placement Rate for a Flex Private Placement Rate Period commencing on the closing date to September 1, 2023. Interest payments are due monthly. Principal payments are due annually beginning in 2021 through 2027. Unamortized debt issuance costs were \$141,987 and \$168,200 at December 31, 2018 and 2017, respectively.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

- (D) Notes payable to third parties, fixed interest rates at December 31, 2018 ranging from 5.5% to 6.0%, collateralized by land and building in Prescott Valley owned by the Organization, interest and principal payments due through 2028. Amount includes capital lease obligations of \$42,998 and \$233,060 outstanding at December 31, 2018 and 2017, respectively.

The Organization is required to maintain a ratio of income available for debt service to maximum annual debt service of at least 1.25 to 1. The Organization is also required to maintain a cash balance equal to at least 60 days of cash operating expenses. The Organization is also required to maintain a ratio of debt to net assets without donor restrictions of at least 65%. Management believes they are in compliance with these debt covenants.

Aggregate annual maturities of long-term debt at December 31, 2018 were:

2019	\$	3,184,871
2020		3,340,849
2021		3,480,163
2022		6,393,151
2023		19,996,628
Thereafter		<u>52,823,975</u>
	<u>\$</u>	<u>89,219,637</u>

Note 12: Net Assets With Donor Restrictions

Net Assets With Donor Restrictions

Net assets with donor restrictions are available for the following purposes or periods:

	<u>2018</u>	<u>2017</u>
Subject to expenditure for specified purpose		
Purchase of capital assets	\$ 882,839	\$ 9,754
Other programs	<u>1,310,993</u>	<u>1,030,031</u>
	<u>2,193,832</u>	<u>1,039,785</u>
Subject to the passage of time		
Promises to give that are not restricted by donors but which are unavailable for expenditure until due	<u>253,533</u>	<u>371,678</u>
	<u>\$ 2,447,365</u>	<u>\$ 1,411,463</u>

During 2018 and 2017, net assets released from donor restrictions for the purpose of operations were \$367,313 and \$171,800, respectively.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Note 13: Liquidity and Availability

The Organization's financial assets available within one year of the balance sheets date for general expenditure are:

	2018
Financial assets at year-end	
Cash and cash equivalents	\$ 44,472,915
Investments	201,546,507
Patient accounts receivable	43,155,358
Contributions receivable	253,533
Assets limited as to use - held by bond trustees	1,691,596
Total financial assets	291,119,909
Less amounts not available to be used within one year	
Long-term investments	13,690,424
Donor imposed purpose restrictions	2,425,866
Contributions receivable, net	21,499
Assets limited as to use - held by bond trustees	1,691,596
Financial assets not available to be used within one year	17,829,385
Financial assets available to meet general expenditures within one year	\$ 273,290,524

The Organization has assets limited as to use for debt service. These assets limited as to use, which are more fully described in Notes 1 and 5, are not available for general expenditure within the next year.

As part of the Organization's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities and other obligations come due. In addition, the Organization invests cash in excess of daily requirements in short-term investments.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Note 14: Functional Expenses

The Organization provides health care services primarily to residents within its geographic area. Certain costs attributable to more than one function have been allocated among the health care services, general and administrative and fundraising functional expense classifications based on the estimates of time and effort and other methods. In accordance with the adoption of ASU 2016-14 the following schedule for 2018 presents the natural classification of expenses by function. The 2017 schedule presents only totals for the year and were reclassified with the adoption of the new ASU:

	2018			
	Health Care Services	Support Services		Total
		General and Administrative	Fundraising	
Salaries and wages	\$ 107,226,947	\$ 22,201,916	\$ 577,451	\$ 130,006,314
Benefits	31,075,797	6,434,411	167,353	37,677,561
Professional fees	20,456,966	4,235,725	110,167	24,802,858
Purchased services, supplies and other	103,636,578	21,458,457	558,261	125,653,296
Depreciation and amortization	12,908,687	2,672,749	69,676	15,651,112
Interest	3,162,336	654,843	16,871	3,834,050
	<u>\$ 278,467,311</u>	<u>\$ 57,658,101</u>	<u>\$ 1,499,779</u>	<u>\$ 337,625,191</u>

	2017			
	Health Care Services	Support Services		Total
		General and Administrative	Fundraising	
Total expenses	<u>\$ 258,672,843</u>	<u>\$ 53,615,825</u>	<u>\$ 1,254,171</u>	<u>\$ 313,542,839</u>

Note 15: Operating Leases

The Organization leases certain buildings and equipment under long-term operating leases through 2019. Rental expense totaled approximately \$1,891,000 and \$1,721,000 in 2018 and 2017, respectively.

Future minimum lease payments at December 31, 2018 were:

2019	\$ 1,089,307
2020	<u>788,547</u>
Future minimum lease payments	<u>\$ 1,877,854</u>

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Note 16: Employee Benefit Plan

The Organization sponsors a defined contribution Group Tax Sheltered Annuity Plan (the TSA). Under the TSA, the Organization contributes an amount equal to each participant's contribution, up to a maximum of 5% of each participant's annual compensation. The TSA covers all regular employees who choose to participate; however, the Organization makes contributions only for employees who have worked at least 1,000 hours during the year and completed at least one year of service. Employee contributions are fully vested, whereas Organization contributions vest over a five-year period. The Organization's contributions to the TSA were \$3,349,411 and \$2,993,530 in 2018 and 2017, respectively. The custodian of the TSA is Voya Services Company.

The Organization established the Yavapai Regional Medical Center CEO Supplementary Executive Retirement Plan for the current President and Chief Executive Officer effective October 1, 2013. The plan is a funded deferred compensation plan under Section 457(f) of the Internal Revenue Code.

Note 17: Deferred Revenue

In July 2001, the Organization entered into an agreement with Yavapai County (the County) in connection with the construction of a medical office building. The Organization agreed to pay for the construction of the building and for all repairs and maintenance of the building. The County agreed to pay the Organization \$2,100,000 for the construction of the building and half of any construction costs in excess of \$2,100,000 up to \$600,000. The agreement provides for the County to share the space of the building with the Organization for a period of 40 years. Either party can terminate the contract with notice. In the event of termination of the contract by the County in the first 25 years, the Organization is required to return a prorated amount of the payment received from the County. Should the Organization terminate the contract early, it must return a prorated amount over the 40-year term to the County. The Organization has recorded the amount received from the County as other long-term liabilities and is amortizing the balance to other revenue over the 40-year term of the lease. The balance outstanding was \$1,321,704 and \$1,377,355, which is included in other long-term liabilities, at December 31, 2018 and 2017, respectively.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Note 18: Disclosures About Fair Value of Financial Instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the valuation methodologies used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying combined balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy.

Recurring Measurements

Following is a description of the valuation methodologies and inputs used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying combined balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the year ended December 31, 2018.

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. The Organization does not carry any Level 3 securities.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

The following tables present the fair value measurements of assets and liabilities recognized in the accompanying combined balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31:

	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2018				
Money markets held by brokers included in investments	\$ 1,691,596	\$ 1,691,596	\$ -	\$ -
U.S. large-cap equity mutual funds	23,642,194	23,642,194	-	-
International equity mutual funds	23,459,506	23,459,506	-	-
U.S. fixed income mutual funds	25,696,749	25,696,749	-	-
International fixed income mutual funds	1,806,841	1,806,841	-	-
Corporate bonds	5,554,068	5,554,068	-	-
Government bonds	115,014,924	115,014,924	-	-
International bonds	663,680	-	663,680	-
Mortgage and asset-backed bonds	5,627,972	-	5,627,972	-

	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2017				
Money markets held by brokers included in investments	\$ 1,659,498	\$ 1,659,498	\$ -	\$ -
U.S. large-cap equity mutual funds	21,840,144	21,840,144	-	-
International equity mutual funds	19,325,552	19,325,552	-	-
U.S. fixed income mutual funds	27,468,653	27,468,653	-	-
International fixed income mutual funds	1,718,345	1,718,345	-	-
Corporate bonds	6,703,654	6,703,654	-	-
Government bonds	81,355,912	81,355,912	-	-
International bonds	625,427	-	625,427	-
Mortgage and asset-backed bonds	8,116,255	-	8,116,255	-

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Note 19: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Variable Consideration

Estimates of variable consideration in determining the transaction price for patient care service revenue are described in Notes 1 and 3.

Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in Notes 1 and 9.

Admitting Physicians

The Organization is served by a group of admitting physicians whose patients comprise approximately 56% of the Organization's net patient service revenue for the years ended December 31, 2018 and 2017.

Litigation

The Organization is at times involved in litigation and routine regulatory investigations arising in the normal course of business. Management has consulted with legal counsel and estimates that these matters will be resolved without a material impact on the operations or financial position of the Organization. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Yavapai Community Hospital Association and Affiliates d/b/a Yavapai Regional Medical Center

Notes to Combined Financial Statements

December 31, 2018 and 2017

Note 20: Future Changes in Accounting Principles

Accounting for Leases

The Financial Accounting Standards Board amended its standard related to the accounting for leases. Under the new standard, lessees will now be required to recognize substantially all leases on the balance sheet as both a right-of-use asset and a liability. The standard has two types of leases for income statement recognition purposes: operating leases and finance leases. Operating leases will result in the recognition of a single lease expense on a straight-line basis over the lease term similar to the treatment for operating leases under existing standards. Finance leases will result in an accelerated expense similar to the accounting for capital leases under existing standards. The determination of lease classification as operating or finance will be done in a manner similar to existing standards. The new standard also contains amended guidance regarding the identification of embedded leases in service contracts and the identification of lease and nonlease components in an arrangement. The new standard is effective for annual periods beginning after December 15, 2019 (2018 for not-for-profits that are conduit debt obligors), and any interim periods within annual reporting periods that begin after December 15, 2019 (2018 for not-for-profits that are conduit debt obligors). The Organization is in the process of evaluating the impact the amendment will have on the financial statements.