

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

Independent Auditor's Report and Combined Financial Statements

December 31, 2019 and 2018

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

December 31, 2019 and 2018

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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, 2019 and 2018, and the related combined statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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, 2019 and 2018, 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 Matters

As described in Note 2 to the combined financial statements, in 2019, the Organization adopted Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)* and ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. Our opinion is not modified with respect to these matters.

BKD, LLP

Colorado Springs, Colorado
April 20, 2020

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

Combined Balance Sheets December 31, 2019 and 2018

Assets

	2019	2018
Current Assets		
Cash and cash equivalents	\$ 55,445,006	\$ 44,472,915
Short-term investments	208,983,761	187,856,083
Patient accounts receivable	42,147,887	43,155,358
Inventories	6,913,172	6,446,150
Contributions receivable, current	183,059	232,034
Prepaid expenses and other current assets	6,187,397	1,649,212
Total current assets	319,860,282	283,811,752
Investments	15,065,067	13,690,424
Assets Limited as to Use - Held by Bond Trustees	41,271,596	1,691,596
Property and Equipment, Net	199,310,823	167,967,288
Other Assets		
Right-of-use assets - operating leases	3,200,555	-
Contributions receivable	5,815	21,499
Other assets, net	2,072,388	1,811,040
Total other assets	5,278,758	1,832,539
Total assets	\$ 580,786,526	\$ 468,993,599

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

Combined Balance Sheets (continued)

December 31, 2019 and 2018

Liabilities and Net Assets

	2019	2018
Current Liabilities		
Current portion of long-term debt	\$ 3,322,638	\$ 3,184,871
Current portion of operating lease liabilities	1,009,101	-
Accounts payable	12,659,646	11,091,712
Accrued expenses and other	26,659,000	23,437,874
Amounts due to third-party payers	2,476,926	2,028,337
Total current liabilities	46,127,311	39,742,794
Other Liabilities		
Long-term debt	133,535,083	87,063,024
Long-term operating lease liabilities	2,240,540	-
Other long-term liabilities	2,720,099	2,565,856
Total other liabilities	138,495,722	89,628,880
Net Assets		
Without donor restrictions	393,356,452	337,174,560
With donor restrictions	2,807,041	2,447,365
Total net assets	396,163,493	339,621,925
Total liabilities and net assets	\$ 580,786,526	\$ 468,993,599

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

Combined Statements of Operations Years Ended December 31, 2019 and 2018

	2019	2018
Operating Revenues Without Donor Restrictions		
Patient care service revenue	\$ 393,514,509	\$ 370,729,978
Interest, contributions and other income	16,204,321	11,324,272
Net assets released from restriction for operations	375,754	367,313
Total operating revenues without donor restrictions	410,094,584	382,421,563
Operating Expenses		
Salaries and wages	136,661,348	130,006,314
Employee benefits	37,787,060	37,677,561
Professional fees	28,132,253	24,802,858
Supplies, services and other	140,127,501	125,653,296
Depreciation and amortization	16,131,455	15,651,112
Interest	3,697,825	3,834,050
Total operating expenses	362,537,442	337,625,191
Operating Income	47,557,142	44,796,372
Other Income (Expense)		
Gain (loss) on investment in equity investees	15,170	(200,904)
Loss on extinguishment of debt	(129,853)	-
Unrealized gains (losses) on investments	9,296,246	(9,407,920)
Total other income (expense)	9,181,563	(9,608,824)
Excess of Revenues Over Expenses	56,738,705	35,187,548
Contributions for purchase of property and equipment	21,909	904,909
Change in value of split-interest agreements	(578,722)	(3,774)
Increase in Net Assets Without Donor Restrictions	\$ 56,181,892	\$ 36,088,683

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

**Combined Statements of Changes in Net Assets
Years Ended December 31, 2019 and 2018**

	2019	2018
Net Assets Without Donor Restrictions		
Excess of revenues over expenses	\$ 56,738,705	\$ 35,187,548
Contributions for purchase of property and equipment	21,909	904,909
Change in value of split-interest agreements	(578,722)	(3,774)
Increase in net assets without donor restrictions	56,181,892	36,088,683
Net Assets With Donor Restrictions		
Contributions received	735,430	1,403,215
Net assets released from restriction for operations	(375,754)	(367,313)
Increase in net assets with donor restrictions	359,676	1,035,902
Change in Net Assets	56,541,568	37,124,585
Net Assets, Beginning of Year	339,621,925	302,497,340
Net Assets, End of Year	\$ 396,163,493	\$ 339,621,925

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

Combined Statements of Cash Flows Years Ended December 31, 2019 and 2018

	2019	2018
Operating Activities		
Change in net assets	\$ 56,541,568	\$ 37,124,585
Items not requiring (providing) cash		
Loss on extinguishment of debt	129,853	-
Depreciation and amortization	16,131,455	15,651,112
Amortization of bond costs and premiums	(323,416)	(265,164)
Non cash operating lease expense	49,086	-
Gain (loss) in equity investees	(15,170)	200,904
Realized and unrealized losses (gains) on investments	(12,843,164)	7,602,514
Contributions of or for acquisition of property and equipment	(21,909)	(904,909)
Change in allowance for uncollectible contributions	(5,879)	(13,364)
Distributions from equity investee	231,950	60,000
Change in value of split-interest agreements	578,722	3,774
Changes in		
Patient accounts receivable	1,007,471	(1,514,436)
Estimated amounts due to third-party payers	448,589	392,052
Accounts payable and accrued expenses	999,221	3,031,420
Other long-term liabilities	154,243	(63,742)
Inventory, prepaids and other assets	(5,315,572)	427,977
Net cash provided by operating activities	<u>57,747,048</u>	<u>61,732,723</u>
Investing Activities		
Purchase of property and equipment	(44,361,098)	(20,083,479)
Purchase of investments	(61,072,016)	(106,516,801)
Proceeds from disposition of investments	51,412,859	65,854,431
Net cash used in investing activities	<u>(54,020,255)</u>	<u>(60,745,849)</u>
Financing Activities		
Principal payments on long-term debt	(23,624,944)	(3,208,540)
Proceeds from issuance of long-term debt	71,434,271	-
Payment of debt issuance costs	(1,005,938)	-
Contributions restricted for the purchase of property and equipment	21,909	904,909
Net cash provided by (used in) financing activities	<u>46,825,298</u>	<u>(2,303,631)</u>
Increase (Decrease) in Cash, Cash Equivalents, Restricted Cash and Restricted Cash Equivalents	<u>50,552,091</u>	<u>(1,316,757)</u>
Cash, Cash Equivalents, Restricted Cash and Restricted Cash Equivalents, Beginning of Year	<u>46,164,511</u>	<u>47,481,268</u>
Cash, Cash Equivalents, Restricted Cash and Restricted Cash Equivalents, End of Year	<u>\$ 96,716,602</u>	<u>\$ 46,164,511</u>

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

Combined Statements of Cash Flows (continued)

Years Ended December 31, 2019 and 2018

	2019	2018
Supplemental Cash Flows Information		
Interest paid, net of capitalized interest	\$ 1,298,229	\$ 3,381,611
Acquisition of property and equipment accrued for, but unpaid	4,591,968	1,380,851
Cash paid for amounts included in the measurement of lease liabilities		
Operating cash flows from operating leases	1,046,793	-
Reconciliation of Cash and Cash Equivalents to Balance Sheet		
Cash and cash equivalents	55,445,006	44,472,915
Cash and cash equivalents in assets limited to use	41,271,596	1,691,596
Total cash and cash equivalents	\$ 96,716,602	\$ 46,164,511

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

Notes to Combined Financial Statements

December 31, 2019 and 2018

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, 2019, 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 and 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, 2019 and 2018, cash equivalents consisted primarily of money market accounts with brokers and overnight sweep accounts.

At December 31, 2019, the Organization's cash accounts exceeded federally insured limits by approximately \$59,300,000.

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

Notes to Combined Financial Statements

December 31, 2019 and 2018

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 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. As a service to the patient, the Organization bills third-party payers 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.

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 combined balance sheets.

Inventories

The Organization states supply inventories at the lower of cost or net realizable value. Costs are determined using the first-in, first-out (FIFO) method.

Debt Investments

Debt securities held by the Organization generally are classified and recorded in the combined financial statements as follows:

Classified as	Description	Recorded at
Trading	Securities that are bought and held principally for the purpose of selling in the near term and, therefore, held for only a short period of time	Fair value, with changes in fair value included in excess (deficiency) revenues over expenses

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

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

Notes to Combined Financial Statements

December 31, 2019 and 2018

Equity Investments

The Organization measures equity securities, other than investments that qualify for the equity method of accounting, at fair value with changes recognized in excess (deficiency) revenues over expenses. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Net Investment Return

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 expenses.

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

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.

Long-lived Asset Impairment

The Organization evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset are less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

No asset impairment was recognized during the years ended December 31, 2019 and 2018.

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

Notes to Combined Financial Statements

December 31, 2019 and 2018

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 various costs are being amortized using both the straight-line method and effective interest 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.

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, 2019 and 2018 were approximately \$2,586,000 and \$2,043,000, 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.

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

Notes to Combined Financial Statements

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Contributions

Contributions are provided to the Organization either with or without restrictions placed on the gift by the donor. Revenues and net assets are separately reported to reflect the nature of those gifts – with or without donor restrictions. The value recorded for each contribution is recognized as follows:

Nature of the Gift	Value Recognized
<i>Conditional gifts, with or without restriction</i>	
Gifts that depend on the Organization overcoming a donor-imposed barrier to be entitled to the funds	Not recognized until the gift becomes unconditional, <i>i.e.</i> , the donor-imposed barrier is met
<i>Unconditional gifts, with or without restriction</i>	
Received at date of gift – cash and other assets	Fair value
Received at date of gift – property, equipment and long-lived assets	Estimated fair value
Expected to be collected within one year	Net realizable value
Collected in future years	Initially reported at fair value determined using the discounted present value of estimated future cash flows technique

In addition to the amount initially recognized, revenue for unconditional gifts to be collected in future years is also recognized each year as the present-value discount is amortized using the level-yield method.

When a donor stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the statements of activities as net assets released from restrictions. Absent explicit donor stipulations for the period of time that long-lived assets must be held, expirations of restrictions for gifts of land, buildings, equipment and other long-lived assets are reported when those assets are placed in service.

Gifts and investment income that are originally restricted by the donor and for which the restriction is met in the same time period the gift is received are recorded as revenue with donor restrictions and then released from restriction.

Conditional contributions having donor stipulations which are satisfied in the period the gift is received are recorded as revenue and net assets without donor restrictions.

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

Notes to Combined Financial Statements

December 31, 2019 and 2018

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 10.

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).

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.

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

Notes to Combined Financial Statements

December 31, 2019 and 2018

Note 2: Changes in Accounting Principle

ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash

In 2019, the Organization changed its method of accounting for restricted cash and restricted cash equivalents by adopting the provisions of Accounting Standards Update No. 2016-18 (ASU 2016-18), *Statement of Cash Flows (Topic 230): Restricted Cash*. The new accounting guidance in ASU 2016-18 requires balances generally described as restricted cash or restricted cash equivalents to be included with cash and cash equivalents when reconciling beginning and end-of-period balances on the statements of cash flows. This change was applied retrospectively to all periods presented, which resulted in the following changes within the 2018 combined statement of cash flows:

	As Originally Reported	As Adjusted	Effect of Change
Purchase of investments	\$ (106,548,898)	\$ (106,516,801)	\$ 32,097
Net cash provided by operating activities	61,672,723	61,732,723	60,000
Net cash used in investing activities	(60,717,946)	(60,745,849)	(27,903)
Increase (decrease) in cash and cash equivalents	(1,348,854)	(1,316,757)	32,097
Cash and cash equivalents, beginning of year	45,821,769	47,481,268	1,659,499
Cash and cash equivalents, end of year	44,472,915	46,164,511	1,691,596

ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments

In 2019, the Organization changed its method of presentation and classification for certain cash flow transactions by adopting the provisions of Accounting Standards Update No. 2016-15 (ASU 2016-05), *Classification of Certain Cash Receipts and Cash Payments*. The new accounting guidance in ASU 2016-15 provides clarification on presentation and classification requirements on certain cash flow transactions where previous accounting guidance is either unclear or does not provide specific guidance. This change was applied retrospectively to all periods presented which resulted in changes within the statement of cash flows related to distributions received from equity investee. This change was applied retrospectively to all periods presented, which resulted in the changes within the 2018 statement of cash flows as shown in the table above.

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ASU No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*

In 2019, the Organization changed its accounting policy on financial assets and liabilities by adopting the provisions of ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The new accounting guidance in ASU 2016-01 (1) requires companies to recognize changes in fair value of equity investments through net income. Due to the classification of the Organizations investment portfolio, this change had no impact on the combined financial statements.

ASU 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*

The Financial Accounting Standards Board (FASB) issued ASU 2018-08, *Not-for-Profit Entities (Topic 958-605)*, that became effective for the Organization on January 1, 2019. It clarifies definitions and application regarding exchange transactions vs. contributions and conditional vs. unconditional contributions. The Organization has adopted the ASU using a modified prospective method and applied it to agreements that either were not completed as of January 1, 2019 or were entered into after that date. Per the FASB requirement, no prior-period results were restated, and no cumulative-effect adjustments to opening net assets were made.

ASU 2016-02, *Leases (Topic 842)*

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This ASU requires lessees to recognize a lease liability and a right-of-use (ROU) asset on a discounted basis, for substantially all leases, as well as additional disclosures regarding leasing arrangements. Disclosures are required to enable users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. In July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842): Targeted Improvements*, which provides an optional transition method of applying the new lease standard. Topic 842 can be applied using either a modified retrospective approach at the beginning of the earliest period presented or, as permitted by ASU 2018-11, at the beginning of the period in which it is adopted, *i.e.*, the comparatives under ASC 840 option.

The Organization adopted Topic 842 on January 1, 2019, using the comparatives under ASC 840 transition method, which applies Topic 842 at the beginning of the period in which it is adopted. Prior period amounts have not been adjusted in connection with the adoption of this standard. The Organization elected the package of practical expedients under the new standard, which permits entities to not reassess lease classification, lease identification or initial direct costs for existing or expired leases prior to the effective date. The Organization has lease agreements with nonlease components that relate to the lease components. The Organization elected the practical expedient to account for nonlease components and the lease components to which they relate as a single lease component for all operating leases. Also, the Organization elected to keep short-term leases with an initial term of 12 months or less off the combined balance sheets. The Organization did elect the hindsight practical expedient in determining the lease term for existing leases as of January 1, 2019.

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

Notes to Combined Financial Statements

December 31, 2019 and 2018

The most significant impact of adoption was the recognition of operating lease ROU assets and operating lease liabilities, disclosed in the table below. The standard did not significantly affect the combined statements of operations or cash flows.

The most significant impact of adoption was the recognition of operating lease ROU assets and operating lease liabilities, disclosed in the table below. As part of adopting the standard, previously recognized liabilities for deferred rent and lease incentives were reclassified as a component of the ROU assets. The standard did not significantly affect our combined statements of operations or cash flows.

The cumulative effect of the changes made to our balance sheets for the adoption of this standard was as follows:

	December 31, 2018 As Originally Reported	Adjustment on January 1, 2019	January 1, 2019 As Adjusted
Assets			
Right-of-use assets-operating leases (A)	\$ -	\$ 4,201,927	\$ 4,201,927
Liabilities			
Current portion of operating lease liabilities (B)	-	952,286	952,286
Long-term operating lease liabilities (B)	-	3,249,641	3,249,641

(A) The adjustment represents the capitalization of right-of-use assets – operating leases

(B) The adjustment represents the recognition of operating lease liabilities

See Note 14 for further disclosures related to ASC 842.

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

Notes to Combined Financial Statements

December 31, 2019 and 2018

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

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.

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.

Transaction Price

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.

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Third-party Payors

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 \$11,900,000 and \$16,000,000 for the years ended December 31, 2019 and 2018, 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 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 2019 or 2018.

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Refund Liabilities

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, 2019 and 2018, 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 \$1,042,000 and \$1,072,000, respectively.

Patient and Uninsured Payors

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.

Revenue Composition

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.

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

	2019	2018
Medicare	\$ 184,925,943	\$ 166,240,294
Medicaid	29,192,819	27,571,090
Commercial	152,915,937	152,346,936
Other third-party payers	17,396,891	14,348,467
Patients	2,774,627	2,340,284
Patients' deductibles, copays, coinsurance	6,308,292	7,882,907
Total	\$ 393,514,509	\$ 370,729,978

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

	2019	2018
Hospital inpatient	\$ 147,504,569	\$ 139,503,414
Hospital outpatient	221,614,732	209,096,176
MSO - physician services	24,395,208	22,130,388
	\$ 393,514,509	\$ 370,729,978

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

Financing Component

The Organization 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 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.

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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:

	2019	2018
Medicare	27%	31%
Medicaid	6%	5%
Other third-party payers	61%	59%
Patients	6%	5%
	100%	100%

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

Investments and Assets Limited as to Use

	2019	2018
Investments		
Money markets and cash (assets limited as to use)	\$ 41,271,596	\$ 1,691,596
U.S. equity mutual funds	34,778,870	23,642,194
International equity mutual funds	34,635,859	23,459,506
U.S. fixed income mutual funds	30,114,984	25,696,749
International fixed income mutual funds	1,156,166	1,806,841
Corporate bonds	3,381,940	5,554,068
Government bonds	114,027,676	115,014,924
International bonds	141,454	663,680
Mortgage and asset-backed bonds	5,768,731	5,627,972
Accrued income	43,148	80,573
	\$ 265,320,424	\$ 203,238,103

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

	2019	2018
Short-term investments	\$ 208,983,761	\$ 187,856,083
Investments	15,065,067	13,690,424
Assets limited as to use - held by bond trustees	41,271,596	1,691,596
	\$ 265,320,424	\$ 203,238,103

Pursuant to the terms of the bond indenture (see Note 12), 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.

Total investment return is composed of the following:

	2019	2018
Interest and dividend income	\$ 6,041,697	\$ 4,725,653
Realized gains	3,546,918	1,805,406
Change in unrealized gains (losses) on investments	9,296,246	(9,407,920)
Total	\$ 18,884,861	\$ (2,876,861)

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

	2019	2018
Net assets without donor restrictions		
Interest, contributions and other income	\$ 9,588,615	\$ 6,531,059
Change in unrealized gains (losses) on investments	9,296,246	(9,407,920)
	\$ 18,884,861	\$ (2,876,861)

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December 31, 2019 and 2018

Note 6: Property and Equipment

Property and equipment at December 31 consists of the following:

	2019	2018
Land	\$ 21,115,776	\$ 15,814,349
Leasehold and land improvements	12,812,968	12,812,968
Buildings and service equipment	189,991,851	170,773,613
Equipment	193,163,477	181,834,799
Construction-in-progress	18,608,979	7,099,698
Total	435,693,051	388,335,427
Accumulated depreciation	(236,382,228)	(220,368,139)
Total property and equipment	<u>\$ 199,310,823</u>	<u>\$ 167,967,288</u>

At December 31, 2019, the Organization has additional construction commitments totaling approximately \$14,000,000.

Note 7: Electronic Health Records Commitment

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 \$103,000,000 and \$86,000,000 of costs associated with the contract have been incurred as of December 31, 2019 and 2018, respectively.

2020	\$ 16,652,520
2021	16,826,760
2022	16,992,656
2023	16,745,614
2024	14,877,956
Thereafter	54,821,410
Future minimum commitments	<u>\$ 136,916,916</u>

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Note 8: Contributions Receivable

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

	2019	2018
Due within one year	\$ 190,953	\$ 242,750
Due in one to five years	6,405	25,146
	197,358	267,896
Less		
Allowance for uncollectible contributions and unamortized discount	8,484	14,363
	<u>\$ 188,874</u>	<u>\$ 253,533</u>

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 \$38,230 and \$38,317 as of December 31, 2019 and 2018, 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 9: 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 \$151,408 and \$368,188 at December 31, 2019 and 2018, 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 \$321,841 and \$304,849 of rent revenue from Prescott Outpatient Surgical Center for the years ended December 31, 2019 and 2018, respectively.

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Note 10: 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 \$4,548,000 and \$488,000 of current professional liability reserves, which are included in its combined balance sheets in accrued expenses and other as of December 31, 2019 and 2018, 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. There was \$3,825,000 and \$0 receivable under these insurance contracts at December 31, 2019 and 2018, respectively.

The Organization holds standby letters of credit with financial institutions totaling \$2,400,000 as a condition of their insurance policies. There was no amount outstanding at December 31, 2019 or 2018.

Note 11: 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 \$1,927,000 and \$2,686,000 at December 31, 2019 and 2018, respectively, and are included in the accompanying combined balance sheets in accrued expenses.

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Note 12: Long-term Debt

	2019	2018
Series 2016 (A)	\$ 42,625,000	\$ 42,780,000
Series 2013A (B)	21,600,000	23,910,000
Series 2013B (C)	-	20,400,000
Series 2019 (D)	65,310,000	-
Notes payable to third parties (E)	1,370,410	2,129,637
Total long-term debt	130,905,410	89,219,637
Add unamortized premium	8,076,074	2,419,272
Less unamortized debt issuance costs	(2,123,763)	(1,391,014)
Less current portion of long-term debt	(3,322,638)	(3,184,871)
Long-term debt, net	\$ 133,535,083	\$ 87,063,024

- (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 \$663,371 and \$701,099 at December 31, 2019 and 2018, 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.

Accordingly, the Bonds, aggregating \$42,775,000 and \$44,050,000 at December 31, 2019 and 2018, respectively, remain outstanding, but are excluded from the Hospital's combined balance sheet.

- (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 \$510,356 and \$547,928 at December 31, 2019 and 2018, 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 were refunded during 2019 with issuance of Series 2019 bonds.

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- (D) Series 2019; principal balances are bifurcated into multiple tranches consisting of serial bonds that are due annually beginning in 2021 through 2043 with each tranche having a separate fixed interest rate ranging from 3.1% 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 \$950,036 at December 31, 2019.

Proceeds from the 2019 Bonds were used to refund the Series 2013B bonds for principal balance of approximately \$20,400,00, and an additional \$50,000,000 was placed in a restricted project fund for future capital expenditures.

- (E) Notes payable to third parties, fixed interest rates at December 31, 2019 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 finance lease obligations of \$3,642 and \$42,998 outstanding at December 31, 2019 and 2018, respectively.

The Organization is required to maintain a ratio of income available for debt service to maximum annual debt service of at least 1.1 to 1. Management believes they are in compliance with this debt covenant.

Aggregate annual maturities of long-term debt at December 31, 2019 were:

2020	\$	3,322,638
2021		3,200,163
2022		6,148,151
2023		19,801,628
2024		3,710,636
Thereafter		94,722,194
		\$ 130,905,410

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Note 13: Operating Leases (ASC 840)

The Organization leases certain buildings under long-term operating leases. Rental expense totaled approximately \$1,891,000 in 2018.

Future minimum lease payments at December 31, 2019 were:

2020	\$ 1,089,307
2021	<u>788,547</u>
Future minimum lease payments	<u>\$ 1,877,854</u>

Note 14: Leases (ASC 842)

Accounting Policies

The Organization determines if an arrangement is a lease or contains a lease at. Leases result in the recognition of ROU assets and lease liabilities on the combined balance sheets. ROU assets represent the right to use an underlying asset for the lease term, and lease liabilities represent the obligation to make lease payments arising from the lease, measured on a discounted basis. The Organization determines lease classification as operating or finance at the lease commencement date.

The Organization combines lease and nonlease components, such as common area and other maintenance costs, in calculating the ROU assets and lease liabilities for its office buildings.

At lease inception, the lease liability is measured at the present value of the lease payments over the lease term. The ROU asset equals the lease liability adjusted for any initial direct costs, prepaid or deferred rent, and lease incentives. The Organization has made a policy election to use a risk-free rate (the rate of a zero-coupon U.S. Treasury instrument) for the initial and subsequent measurement of all lease liabilities. The risk-free rate is determined using a period comparable with the lease term.

The lease term may include options to extend or to terminate the lease that the Organization is reasonably certain to exercise. Lease expense is generally recognized on a straight-line basis over the lease term.

The Organization has elected not to record leases with an initial term of 12 months or less on the combined balance sheets. Lease expense on such leases is recognized on a straight-line basis over the lease term.

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Nature of Leases

Operating Leases

The Organization leases office space for medical offices that expire in various years through 2026. These leases generally contain renewal options and generally require the Organization to pay all executory costs (property taxes, maintenance and insurance). Lease payments have an escalating fee schedule, which range from a 2.0% to 3.0% increase each year. Termination of the leases is generally prohibited unless there is a violation under the lease agreement.

All Leases

The Organization has no material related-party leases other than those disclosed in Note 9 and Note 18. The Organization has a leasing arrangement between the Hospital and the District that is substantially eliminated in combination.

The Organization's lease agreements do not contain any material residual value guarantees or material restrictive covenants.

Quantitative Disclosures

The lease cost and other required information for the year ended December 31, 2019 are:

	2019
Lease cost	
Operating lease cost	\$ 1,087,031
Short-term lease cost	934,891
Total lease cost	\$ 2,021,922
	2019
Other information	
Operating cash flows from operating leases	\$ 1,046,793
Weighted-average remaining lease term	
Operating leases	4.01 years
Weighted-average discount rate	
Operating leases	2.5%

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Future minimum lease payments and reconciliation to the combined balance sheet at December 31, 2019, are as follows:

2020	\$	1,009,101
2021		908,785
2022		653,886
2023		289,066
2024		297,738
Thereafter		<u>260,954</u>
Total lease payments to be paid		3,419,530
Less future interest expense		<u>169,889</u>
Lease liabilities		<u><u>\$ 3,249,641</u></u>

Note 15: Net Assets With Donor Restrictions

Net Assets With Donor Restrictions

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

	<u>2019</u>	<u>2018</u>
Subject to expenditure for specified purpose		
Purchase of capital assets	\$ 884,689	\$ 882,839
Other programs	<u>1,733,478</u>	<u>1,310,993</u>
	<u>2,618,167</u>	<u>2,193,832</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>188,874</u>	<u>253,533</u>
	<u><u>\$ 2,807,041</u></u>	<u><u>\$ 2,447,365</u></u>

During 2019 and 2018, net assets released from donor restrictions for the purpose of operations were \$375,754 and \$367,313, respectively.

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December 31, 2019 and 2018

Note 16: Liquidity and Availability

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

	2019	2018
Financial assets at year-end		
Cash and cash equivalents	\$ 55,445,006	\$ 44,472,915
Investments	224,048,828	201,546,507
Patient accounts receivable	42,147,887	43,155,358
Contributions receivable	188,874	253,533
Assets limited as to use - held by bond trustees	41,271,596	1,691,596
Total financial assets	363,102,191	291,119,909
Less amounts not available to be used within one year		
Long-term investments	15,065,067	13,690,424
Donor imposed purpose restrictions	2,801,226	2,425,866
Contributions receivable, net	5,815	21,499
Assets limited as to use - held by bond trustees	41,271,596	1,691,596
Financial assets not available to be used within one year	59,143,704	17,829,385
Financial assets available to meet general expenditures within one year	\$ 303,958,487	\$ 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.

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Note 17: 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 2019 and 2018 presents the natural classification of expenses by function:

	2019			
	Health Care Services	Support Services		Total
		General and Administrative	Fundraising	
Salaries and wages	\$ 113,918,278	\$ 22,170,925	\$ 572,145	\$ 136,661,348
Benefits	31,498,568	6,130,293	158,199	37,787,060
Professional fees	23,450,506	4,563,969	117,778	28,132,253
Purchased services, supplies and other	116,807,597	22,733,248	586,656	140,127,501
Depreciation and amortization	13,446,871	2,617,048	67,536	16,131,455
Interest	3,082,436	599,908	15,481	3,697,825
	<u>\$ 302,204,256</u>	<u>\$ 58,815,391</u>	<u>\$ 1,517,795</u>	<u>\$ 362,537,442</u>
Total expenses				
	<u>\$ 302,204,256</u>	<u>\$ 58,815,391</u>	<u>\$ 1,517,795</u>	<u>\$ 362,537,442</u>
	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>
Total expenses				
	<u>\$ 278,467,311</u>	<u>\$ 57,658,101</u>	<u>\$ 1,499,779</u>	<u>\$ 337,625,191</u>

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Note 18: 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 \$1,266,053 and \$1,321,704, which is included in other long-term liabilities, at December 31, 2019 and 2018, respectively.

Note 19: 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 \$3,683,736 and \$3,349,411 in 2019 and 2018, 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.

During 2019 the Organization established a cash value life insurance plan for the current President and Chief Executive Officer. The Organization will fund premiums on schedule with the plan. The value of the plan is recorded at the cash surrender value and is not material as of the year-ended December 31, 2019.

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Note 20: 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, 2019.

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.

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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, 2019				
Money markets held by brokers included in investments	\$ 41,271,596	\$ 41,271,596	\$ -	\$ -
U.S. large-cap equity mutual funds	34,778,870	34,778,870	-	-
International equity mutual funds	34,635,859	34,635,859	-	-
U.S. fixed income mutual funds	30,114,984	30,114,984	-	-
International fixed income mutual funds	1,156,166	1,156,166	-	-
Corporate bonds	3,381,940	3,381,940	-	-
Government bonds	114,027,676	114,027,676	-	-
International bonds	141,454	-	141,454	-
Mortgage and asset-backed bonds	5,768,731	-	5,768,731	-

	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	-

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Note 21: 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 10.

Admitting Physicians

The Organization is served by a group of admitting physicians whose patients comprise approximately 58% and 56% of the Organization's net patient service revenue for the years ended December 31, 2019 and 2018.

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.

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Note 22: Subsequent Events

In late 2019, a novel strain of coronavirus (COVID-19) was reported to have surfaced in China. Subsequent to year-end, the spread of COVID-19 began to cause some business disruption through reduced patient revenue, specifically related to elective or non-urgent procedures or testing and physician office visits. Additionally, there has been significant volatility in the investment markets both nationally and globally since December 31, 2019, resulting in an overall market decline in certain market segments which has resulted in a substantial decline in the value of our investment portfolio.

While the disruption is currently expected to be temporary, there is considerable uncertainty around the duration. As with other hospitals and health systems, the Organization expects this matter to negatively impact its financial condition and operating results. However, the related financial impact and duration cannot be reasonably estimated at this time.

Subsequent events have been evaluated through April 20, 2020, which is the date the combined financial statements were issued.