PEACEHEALTH NETWORKS

Consolidated Financial Statements

June 30, 2015 and 2014

(With Independent Auditors' Report Thereon)

PEACEHEALTH NETWORKS

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KPMG LLP
Suite 3800
1300 South West Fifth Avenue
Portland, OR 97201

Independent Auditors' Report

The Board of Directors
PeaceHealth Networks:

We have audited the accompanying consolidated financial statements of PeaceHealth Networks (a Washington not-for-profit corporation), which comprise the consolidated balance sheets as of June 30, 2015 and 2014, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PeaceHealth Networks as of June 30, 2015 and 2014, and the results of its operations, changes in net assets, and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Portland, Oregon
September 25, 2015

PEACEHEALTH NETWORKS

Consolidated Balance Sheets

June 30, 2015 and 2014

(In thousands)

Assets		2015	2014
Current assets:			
Cash and cash equivalents	$	264,467	145,426
Short-term investments		351,437	424,222
Accounts receivable, net of allowance for doubtful accounts of $65,337 and $78,193		354,881	302,356
Other receivables		45,685	53,696
Inventory of supplies		42,398	40,353
Prepaid expenses and other		21,191	17,362
Assets whose use is limited that are required for current liabilities		40,015	31,988
Total current assets		1,120,074	1,015,403
Assets whose use is limited:			
Cash and investments		1,098,781	1,073,757
Investments in joint ventures and other		29,120	30,996
Total assets whose use is limited		1,127,901	1,104,753
Less current portion		(40,015)	(31,988)
Net assets whose use is limited		1,087,886	1,072,765
Property, plant, and equipment:			
Land and improvements		138,454	128,078
Buildings, fixed equipment, and other		1,706,188	1,650,533
Moveable equipment		715,169	672,675
Construction in progress		119,449	55,531
Total property, plant, and equipment		2,679,260	2,506,817
Less accumulated depreciation		(1,299,635)	(1,180,286)
Net property, plant, and equipment		1,379,625	1,326,531
Interest in net assets of related foundations		52,105	47,963
Other assets		44,513	45,298
Total assets	$	3,684,203	3,507,960

(Continued)

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Consolidated Balance Sheets

June 30, 2015 and 2014

(In thousands)

Liabilities and Net Assets		**2015**	**2014**
Current liabilities:			
Accounts payable	$	132,331	126,988
Accrued payroll, payroll taxes, and employee benefits		175,216	157,489
Accrued interest payable		4,776	5,314
Other current liabilities		57,897	37,347
Reimbursement settlements payable		2,480	6,792
Current portion of long-term debt		36,774	33,250
Total current liabilities		409,474	367,180
Other long-term liabilities		318,112	301,504
Long-term debt, net current portion		1,037,785	1,060,353
Net assets:			
Unrestricted, controlling		1,846,087	1,707,475
Unrestricted, noncontrolling interest		3,989	4,382
Temporarily restricted		44,338	49,693
Permanently restricted		24,418	17,373
Total net assets		1,918,832	1,778,923
Total liabilities and net assets	$	3,684,203	3,507,960

See accompanying notes to consolidated financial statements.

PEACEHEALTH NETWORKS

Consolidated Statements of Operations

Years ended June 30, 2015 and 2014

(In thousands)

		2015	2014
Revenues:			
Net patient service revenue before provision for bad debts	$	2,399,483	2,156,154
Provision for bad debts		(68,059)	(105,027)
Net patient service revenue		2,331,424	2,051,127
Premium revenue		138,879	113,008
Other operating revenue		89,546	81,731
Total revenues		2,559,849	2,245,866
Expenses:			
Salaries and wages		1,118,044	1,018,724
Payroll taxes and benefits		239,996	226,756
Supplies		343,137	308,840
Purchased services		229,241	233,571
Medical claims expense		110,096	108,025
Other		196,290	145,111
Depreciation and amortization of other assets		133,951	134,254
Interest and amortization of deferred financing costs		30,686	31,984
Total expenses		2,401,441	2,207,265
Income from operations		158,408	38,601
Other income (loss):			
Investment income, net		22,126	130,652
Loss on bond refinancing		—	(2,680)
Net change in interest rate swaps		(26,658)	(18,860)
Contribution from the United General Hospital affiliation		—	11,450
Other		—	3,183
Excess of revenues over expenses		153,876	162,346
Net assets released from restrictions for property, plant, and equipment		2,990	5,249
Change in interest in net assets of related foundations		12	2,089
Change in pension liability		(21,850)	(6,227)
Other changes in unrestricted net assets		3,191	(4,580)
Increase in unrestricted net assets	$	138,219	158,877

See accompanying notes to consolidated financial statements.

PEACEHEALTH NETWORKS

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2015 and 2014

(In thousands)

	Unrestricted controlling	Unrestricted noncontrolling interest	Temporarily restricted	Permanently restricted	Total
Net assets at June 30, 2013	$ 1,550,375	2,605	37,798	26,050	1,616,828
Excess of revenues over expenses	160,569	1,777	—	—	162,346
Other restricted contributions	—	—	12,132	—	12,132
Net assets released from restrictions	5,249	—	(5,249)	—	—
Change in interest in net assets of related foundations	2,089	—	5,012	(3,577)	3,524
Change in pension liability	(6,227)	—	—	—	(6,227)
Other changes in net assets	(4,580)	—	—	(5,100)	(9,680)
Change in net assets	157,100	1,777	11,895	(8,677)	162,095
Net assets at June 30, 2014	1,707,475	4,382	49,693	17,373	1,778,923
Excess of revenues over expenses	153,846	30	—	—	153,876
Other restricted contributions	—	—	2,990	—	2,990
Net assets released from restrictions	2,990	—	(3,970)	—	(980)
Change in interest in net assets of related foundations	12	—	289	3,841	4,142
Change in pension liability	(21,850)	—	—	—	(21,850)
Other changes in net assets	3,614	(423)	(4,664)	3,204	1,731
Change in net assets	138,612	(393)	(5,355)	7,045	139,909
Net assets at June 30, 2015	$ 1,846,087	3,989	44,338	24,418	1,918,832

See accompanying notes to consolidated financial statements.

PEACEHEALTH NETWORKS

Consolidated Statements of Cash Flows

Years ended June 30, 2015 and 2014

(In thousands)

		2015	2014
Cash flows from operating activities:			
Change in net assets	$	139,909	162,095
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		134,326	134,630
Contribution from affiliation with United General Hospital		—	(11,450)
Loss (gain) on sale of land held for sale and property, plant, and equipment		799	(1,430)
Provision for bad debts		68,059	105,027
Change in pension liability		21,850	6,227
Restricted contributions		(2,990)	(5,249)
Net change in unrealized losses (gains) on investments		3,881	(32,072)
Realized gains on investments		(653)	(49,231)
Valuation adjustments on swap arrangements		11,855	3,844
Loss on refinancing		—	2,680
Vesting of Premier Class B units		(7,364)	(3,196)
Equity investment loss		—	43
Increase in interest in net assets of related foundations		(4,142)	(3,524)
Distributions of earnings from joint ventures		8,948	8,373
Changes in operating assets and liabilities:			
Increase in:			
Accounts receivable, net		(120,584)	(141,871)
Other assets		1,154	(22,969)
Increase in:			
Accounts payable		5,344	47,570
Accrued payroll, payroll taxes, and employee benefits		17,727	6,795
Other liabilities		(1,397)	29,674
Net cash provided by operating activities		276,722	235,966
Cash flows from investing activities:			
Purchase of property, plant, and equipment		(186,473)	(121,688)
Proceeds from sale of land held for sale and property, plant, and equipment		21	535
Capital contributions to joint ventures		—	(4,834)
Purchase of investments		(372,046)	(410,562)
Sales and maturities of investments		416,871	182,858
Net cash used in investing activities		(141,627)	(353,691)
Cash flows from financing activities:			
Proceeds from long-term borrowings		27,347	416,400
Principal payments on long-term debt		(46,391)	(249,338)
Proceeds from restricted contributions		2,990	5,249
Deferred financing costs expended		—	(1,849)
Net cash (used in) provided by financing activities		(16,054)	170,462
Net increase in cash and cash equivalents		119,041	52,737
Cash and cash equivalents at beginning of year		145,426	92,689
Cash and cash equivalents at end of year	$	264,467	145,426

See accompanying notes to consolidated financial statements.

(1) Organization

(a) Corporate Structure

PeaceHealth Networks is a Washington not-for-profit corporation, recognized as tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code, which is the sole corporate member of PeaceHealth, which is also a Washington not-for-profit corporation, recognized as tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code, with its corporate office located in Vancouver, Washington. PeaceHealth Networks is not affiliated with the Roman Catholic Church, currently has no operations, and currently holds no financial assets in its own name (other than shares of stock in Columbia United Providers), however, it is the member corporation of PeaceHealth, which is a Private Pontifical Juridic Person according to the canon law of the Roman Catholic Church, does have extensive healthcare operations and holds substantial financial assets. Effective January 1, 2014, PeaceHealth Networks and PeaceHealth were reorganized so that the corporate membership relationship between them was reversed from what it had been for the three previous calendar years, as described hereafter. When PeaceHealth affiliated with Southwest Washington Health System in January 2011, PeaceHealth became the sole member of Southwest Washington Health System. In 2014, Southwest Washington Health System became the sole member of PeaceHealth and changed its name to PeaceHealth Networks. PeaceHealth Networks and its associated entities are collectively referred to herein as “the Corporation.” PeaceHealth Networks and PeaceHealth are the only members of the Corporation’s Obligated Group. At June 30, 2015, the following regional healthcare delivery systems and operating divisions were components of PeaceHealth:

Northwest Network:
- PeaceHealth Ketchikan Medical Center
- PeaceHealth St. Joseph Medical Center
- Peace Island Medical Center
- PeaceHealth United General Medical Center

Columbia Network:
- PeaceHealth St. John Medical Center
- PeaceHealth Southwest Medical Center

Oregon West Network:
- PeaceHealth Sacred Heart Medical Center at University District
- PeaceHealth Sacred Heart Medical Center at RiverBend
- PeaceHealth Cottage Grove Community Medical Center
- PeaceHealth Peace Harbor Hospital

Systemwide Organizations:
- PeaceHealth Medical Group
- PeaceHealth Laboratories
- PeaceHealth Self-insured Trusts

These regional healthcare delivery systems and operating divisions, provide inpatient, outpatient, primary and specialty care and home care services in Alaska, Washington and Oregon. These divisions primarily operate in Ketchikan, Alaska; Bellingham, Friday Harbor, Sedro Woolley, Longview, and Vancouver, Washington; Springfield, Eugene, Florence, and Cottage Grove, Oregon.

(Continued)

PeaceHealth Networks included the following controlled affiliates at June 30, 2015:
PeaceHealth
Health Ventures
Pooled Income Funds (including Charitable Life Income Funds)
PeaceHealth Southwest Medical Center Foundation
Columbia United Providers (CUP) – owned 89.5%

The consolidated financial statements include the accounts of the Corporation. All significant intercompany transactions and balances have been eliminated.

(b) Affiliations

During 2013, the Corporation entered into an affiliation agreement with United General Hospital, a critical access hospital in Sedro Woolley, Washington. As part of the agreement, the Corporation leases the building and equipment from the hospital district, and operates the hospital. As part of the transaction, the Corporation recognized an intangible asset in other assets of $11,450 for the estimated fair value of the lease agreement, which is being amortized over the 30-year lease term. In addition, the Corporation acquired certain assets and assumed specific liabilities. No consideration was transferred, and the Corporation recorded a contribution from United General Hospital of $11,450 in other income on the statement of operations in fiscal year 2014 upon completion of the affiliation. United General Hospital has approximately $40,000 in net operating revenue annually.

(2) Summary of Significant Accounting Policies

(a) Estimates

The preparation of consolidated 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates. The significant estimates in the Corporation's consolidated financial statements include accounts receivable allowances, reimbursement settlements payable, valuation of alternative investments, interest rate swaps, pension obligations, incurred but not reported amounts related to accrued healthcare costs, and liabilities related to self-insurance programs.

(b) Cash and Cash Equivalents

Cash and cash equivalents consist of petty cash, cash in demand bank accounts, and all highly liquid debt instruments purchased with an original maturity of three months or less other than those amounts included in assets whose use is limited by the board of directors. The Corporation held cash equivalents of approximately $191,028 and $53,899 as of June 30, 2015 and 2014, respectively.

The Corporation maintains cash and cash equivalents on deposit at various institutions, which, at times, exceed the insured limits of the Federal Deposit Insurance Corporation. This exposes the Corporation to potential risk of loss in the event the institution becomes insolvent.

(c) Short-Term Investments

Short-term investments consist primarily of certificates of deposit, U.S. government, and other investment-grade securities, which are carried at fair value. Investment income or loss (including realized and unrealized gains and losses and interest and dividends) is included in the excess of revenues over expenses.

(d) Inventory of Supplies

Inventory is valued on weighted average cost.

(e) Other Receivables

Other receivables primarily consist of amounts receivable from the federal government related to grants for electronic health record implementation, amounts receivable from the state of Oregon, amounts receivable from excess insurance carriers and other miscellaneous amounts due.

(f) Assets Whose Use is Limited

Certain assets have been set aside by management of the Corporation for future capital improvements, self-insured liabilities and other purposes, over which management retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of the Corporation have been reclassified as current in the consolidated balance sheets at June 30, 2015 and 2014. These items consist primarily of investments in marketable equity and fixed income securities, mutual funds, and investments in joint ventures. Money market funds and all marketable securities have readily determinable market values and are, therefore, carried at fair value. The investments in joint ventures and other are accounted for using the equity or cost method.

(g) Property, Plant, and Equipment

Property, plant, and equipment are stated at cost at the date of acquisition or fair value at the date of donation. Improvements and replacements of plant and equipment are capitalized. Maintenance and repairs are expensed as they are incurred. When property, plant, and equipment is sold or retired, the cost and the related accumulated depreciation are removed from the accounts, and the resulting gain or loss is recorded. The Corporation assesses potential impairment of its long-lived assets when there is evidence that events or changes in circumstances have made recovery of the asset's carrying value unlikely. An impairment loss is indicated when the sum of expected undiscounted future net cash flows is less than the carrying amount. The loss recognized is the difference between the fair value and the carrying amount. No impairment losses related to property, plant, and equipment were recognized during the years ended June 30, 2015 and 2014.

In addition to consideration of impairment due to the events or changes in circumstances described above, management regularly evaluates the remaining lives of long-lived assets. If estimates are revised, the carrying value of affected assets is depreciated or amortized over remaining lives. During fiscal year 2014, the Corporation re-evaluated the remaining useful lives of certain buildings. As a result, the remaining useful life was increased, decreasing depreciation expense by approximately $11,052 as compared to fiscal year 2013. No additional adjustments were made in fiscal year 2015.

(Continued)

(In thousands of dollars)

The Corporation capitalized salary and wages along with related benefit costs in the amount of $11,174 and $3,946 during 2015 and 2014, respectively, related to the development of software for internal use.

(h) Depreciation

Depreciation on property, plant, and equipment is computed using the straight-line method over the following estimated useful lives:

Land improvements	5–25 years
Buildings and improvements	5–80 years
Fixed equipment	10–75 years
Leasehold improvements	Shorter of remaining length of the lease or useful life
Moveable equipment	3–30 years

(i) Other Assets

Other assets include intangible assets, primarily deferred financing costs, trade names and, goodwill. The deferred financing costs are amortized over the lives of the related debt issuances using the effective interest method. Intangible assets with indefinite lives are evaluated annually for impairment. There were no impairment losses recognized during the years ended June 30, 2015 and 2014.

(j) Other Long-Term Liabilities

Other long-term liabilities consists primarily of the estimated fair value associated with the Corporation's interest rate swaps of $107,316 and $95,461 at June 30, 2015 and 2014, respectively; the liability for the PeaceHealth SWHS Frozen DB Pension Plan of $62,492 and $58,473 at June 30, 2015 and 2014, respectively; and the long-term portion of the liability for the self-insurance programs of $73,152 and $72,619 at June 30, 2015 and 2014, respectively. The remaining balance of other long-term liabilities includes gift annuities, environmental liability, and deferred compensation plan liability.

(k) Contributions and Grants

Contributions and grants are recognized as revenue upon receipt of the donor's pledge to contribute. Contributions and grants are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts pledged that are restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support. Unconditional promises to give that are silent as to the due date are presumed to be time restricted by the donor until received and are reported as temporarily restricted net assets.

A donor restriction expires when an unconditional promise with an implied time restriction is collected or when the purpose for the restriction is accomplished. Upon expiration, temporarily restricted net assets are reclassified to unrestricted net assets and are reported in the consolidated statements of operations as net assets released from restrictions. Restricted contributions received in the same year in which the restrictions are met are recorded as an increase in restricted support at the time of receipt and as net assets released from restrictions at the time restrictions are met.

(In thousands of dollars)

Permanently restricted net assets include the principal amount of contributions with the stipulation from the donor that the principal be maintained in perpetuity and only the income is available to be expended for purposes specified by the donor, if any.

(l) Interest in Net Assets of Related Foundations

The Corporation accounts for activities with its unconsolidated related foundations in accordance with applicable accounting guidance. That guidance requires the Corporation to recognize its interests in the net assets of these foundations on the consolidated balance sheets as the asset caption interest in net assets of related foundations, and the annual changes as shown in the consolidated statements of changes in net assets.

(m) Separation Benefits

The Corporation actively seeks operational efficiency improvements. These plans may result in employees becoming eligible for separation benefits upon termination. The Corporation recognizes these benefits upon its communication to employees. In 2015 and 2014, $7,635 and $7,730, respectively, were expensed as salaries, wages, and benefits.

(n) Pooled Income Funds

The Corporation has created several pooled income funds. These funds are structured such that the Corporation sold and leased back certain properties. Donors make a contribution and receive annuity payments based on the associated rental income. Upon the annuity termination, the remaining interest is transferred to the Corporation. At June 30, 2015 and 2014, the Corporation has recorded the present value of the annuity payments of $14,828 and $14,864, respectively, as part of other long-term liabilities. The discount rate was 6.0% and 4.4% at June 30, 2015 and 2014, respectively.

(o) Net Patient Service Revenue

The Corporation has agreements with third-party payors that provide for payments of amounts different from established charges. The Corporation's net patient service revenue came from the following sources:

	2015	**2014**
Medicare	33%	34%
Medicaid	15	12
Commercial and other	51	53
Private pay	1	1
	100%	100%

(In thousands of dollars)

There is a corresponding significant concentration of credit risk in net accounts receivable balances at June 30, 2015 and 2014:

	2015	2014
Medicare	30%	33%
Medicaid	13	14
Commercial and other	56	51
Private pay	1	2
	100%	100%

Reimbursement for inpatient and outpatient services rendered to Medicare recipients has been made principally under a prospective pricing system. Services to Medicaid patients are also reimbursed based on a combination of prospectively determined rates and cost reimbursement methodology. Continuation of these reimbursement programs at the present level, and on the present basis, is dependent upon future policies of federal and state governmental agencies. The Corporation operates five critical access hospitals that are reimbursed based on costs for inpatient and outpatient services rendered to Medicare and Medicaid program beneficiaries. Interim reimbursement to critical access hospitals is based upon tentative rates and retroactive adjustment is made to actual cost during final settlement by either the Medicare fiscal intermediary or the applicable state's Medicaid agency.

The Corporation has estimated payments for services rendered to Medicare and Medicaid patients during the year by applying the payment principles of the applicable governmental agencies and believes that an adequate provision has been made in the accompanying consolidated financial statements for final settlement. Estimates of final settlements due to and due from Medicare, Medicaid, and other third-party payors have been reflected net as reimbursement settlement payable in the accompanying consolidated balance sheets. Differences between the net amounts accrued and subsequent settlements are recorded in operations at the time of settlement. The net amount of adjustments from finalization and adjustment of prior years' cost reports and other third-party settlements resulted in an increase in net patient service revenue of approximately $5,000 in 2015 and a decrease in net patient service revenue of $6,000 in 2014.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretations. As a result, there is at least a reasonable possibility that recorded estimates associated with these programs will change by a material amount in the near term.

The Corporation has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Corporation under these agreements includes prospectively determined rates per unit of service and discounts from established charges, as well as, risk sharing arrangements. Most arrangements provide for payment or reimbursement to the Corporation at amounts different than established rates. Contractual discounts represent the difference between established rates for services and amounts paid or reimbursed by these third-party payors. Risk sharing arrangements include incentive payments for specific quality outcomes, effective management of costs, and other measures and in some cases may result in a penalty.

The Corporation provides for an allowance against patient accounts receivable for amounts that could become uncollectible. The Corporation estimates this allowance based on the aging of accounts receivable, historical collection experience by payor, and other relevant factors. There are various factors that can impact the collection trends, such as changes in the economy, which in turn have an impact on unemployment rates and the number of uninsured and underinsured patients, the increased burden of copayments to be made by patients with insurance coverage and business practices related to collection efforts. These factors continuously change and can have an impact on collection trends and the estimation process used by the Corporation. Net bad debt write-offs during 2015 and 2014 were $80,915 and $122,030, respectively.

(p) Premium Revenue and Accrued Healthcare Costs

PeaceHealth Networks' majority-owned subsidiary, CUP, receives premium revenue that consists of premiums paid by the state of Washington for healthcare services.

On December 31, 2013, CUP entered into an agreement with another health plan that had been awarded the contract from the state for the period January 1, 2014 through December 31, 2014. Under this contract, in return for receiving a defined premium amount from the other health plan, CUP was responsible for providing medical, hospital, pharmaceutical, and related medical services to Apple Health members assigned to CUP from the other plan. After the contract expired on December 31, 2014, CUP entered into a contract directly with the Health Care Authority (HCA) for the period January 1, 2015 through December 31, 2015. Under this contract, in return for receiving a defined premium amount from the HCA, CUP will be responsible for providing medical, hospital, pharmaceutical, and related medical services to Apple Health members.

Under these contracts, PeaceHealth Networks recognized premium revenue of $138,879 and $113,008 for the years ended June 30, 2015 and 2014, respectively, which is included as premium revenue in the accompanying consolidated statements of operations. The related medical expense recognized by CUP was $92,060 and $77,898 for the years ended June 30, 2015 and 2014, respectively, and is included in medical claims expenses in the consolidated statements of operations. CUP is not part of the obligated group.

CUP has stop-loss reinsurance indemnifying it against the cost of providing services to individual enrolled participants at 90% in excess of $125 for hospital charges up to a maximum of $1,000 per year for each enrolled member.

In December 2014, Community Health Plan of Washington (CHPW) refused to make premium payments to CUP as required by the terms of the contract between the two companies and as demanded by CUP. CUP continued to honor the claims from providers despite not having received premiums from CHPW and, in order to mitigate its damages from CHPW's nonpayment, CUP withheld certain pharmaceutical payments that were contractually due from it to CHPW. CHPW's alleged basis for nonpayment to CUP is a predicted refund due from CHPW to the State of Washington Healthcare

Authority, which would be passed through CUP as a negative premium, but there is uncertainty as to the 2014 determination of the expansion risk mitigation retrospective premium settlement between the State of Washington Healthcare Authority and CHPW. There is also a significant difference of opinion between CHPW and CUP as to how that settlement will impact the premium calculation between CHPW and CUP. For purposes of preparing the CUP financial statement, CUP evaluated a range of potential outcomes and accrued the low end of this range. The collectibility of the remaining net receivable from CHPW is questionable due to the continued failure of CHPW to pay premiums in accordance with the contract.

(q) Other Operating Revenue

Other operating revenue includes revenue from nonpatient care services, clinical space rental revenue, and contributions both unrestricted in nature and those released from restriction to support operating activities, grants from the federal government to help fund electronic health record implementation (discussed below in Meaningful Use) and other miscellaneous revenue.

(r) Meaningful Use

The Health Information Technology for Economic and Clinical Health Act, part of the American Recovery and Reinvestment Act of 2009, created an incentive program, beginning in 2011, to promote the “meaningful use” of Electronic Health Records (EHR). To qualify, providers must attest that they are using certified EHR in a “meaningful” way by meeting objectives at established thresholds, as defined by the Centers for Medicare and Medicaid Services. Meaningful use revenue is recognized as grant revenue. Grant revenue is recognized when there is reasonable assurance that the grant will be received and that the organization will comply with the conditions attached to the grant. Meaningful use revenue of $4,215 and $8,326 was recognized for the years ended June 30, 2015 and 2014, respectively, and is included in other operating revenue in the accompanying consolidated statements of operations. The amount recognized is based on management’s best estimate and is subject to audit and potential retrospective adjustments.

The recognition of the incentive for critical access hospitals is over the remaining useful life of the asset. At June 30, 2015, $4,824 was included in deferred revenue related to this incentive and will be recognized in future periods.

(s) Hospital Transformation Performance Plan (HTPP)

In fiscal year 2015, the Corporation received $15,400 related to the Hospital Transformation Performance Plan (HTPP), a program through the Oregon Health Authority that uses quality metrics to show how well hospitals are advancing health system transformation, reducing costs, and improving patient safety. This payment was primarily related to reporting; year two of the program is based on performance and was classified in other operating revenue in the consolidated statement of operations.

(t) Income from Operations

Income from operations excludes certain items that the Corporation deems outside the scope of its primary business such as investment income, change in valuation of interest rate swaps, changes in defined benefit plan expense, and other items.

(u) Excess of Revenues over Expenses

Excess of revenues over expenses includes results from the Corporation's operating and nonoperating investing activities. Investment income includes interest income, dividends, realized and unrealized investment gains and losses, and equity in earnings from joint ventures. Changes in unrestricted net assets not included in excess of revenues over expenses include net assets released from restriction for the purchase of property, changes in the Corporation's interest in the net assets of noncontrolled foundations, and certain changes in funded status of postretirement benefit plans.

(v) Federal and State Income Taxes

PeaceHealth and PeaceHealth Networks have received determination letters from the Internal Revenue Service stating that it is exempt from federal and state income tax under Section 501(c)(3) of the Internal Revenue Code except for tax on unrelated business income. It is management's belief that none of its activities have produced material unrelated business income.

The Corporation recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that exceeds a 50% probability of being realized. Changes in recognition or measurement are reflected in the period in which the change in estimate occurs.

Certain affiliated entities included in the consolidated financial statements may be subject to taxation. The tax expense and related provision for these entities are not material to the consolidated financial statements.

(w) Oregon State Provider Tax and Washington State Safety Net Assessment

Effective July 1, 2004, the state of Oregon instituted a provider tax on certain patient service revenue at qualifying hospitals. The state of Washington enacted the safety net program in 2009 involving Washington State hospitals to increase funding from other sources and obtain additional federal funds to support increased payments to providers for Medicaid services.

In 2014, the state of Washington re-enacted legislation that provided for increased Medicaid payments to certain hospitals funded by assessments paid by these hospitals as well as matching federal funds (the safety net program). The safety net program covers the period from July 1, 2013 to June 30, 2017. Providers are assessed and reimbursed on a quarterly basis. During 2015, the state of Washington received approval from CMS related to the managed care portion of the program. Therefore, as of June 30, 2015, the fee-for-service and managed care portions of the program are both approved. In 2014, the Corporation had a liability of $25,414 reflective of the net cash paid and received related to the managed care portion of the program. In 2015, the Corporation recognized supplemental payments of $28,183 and assessments of $22,366 related to 2014 dates of service.

In 2015 and 2014, with the States of Washington and Oregon programs, supplemental payments of $103,257 and $43,148, respectively, and assessments of $84,727 and $41,010, respectively, were recorded in net patient service revenue and expenses, in the accompanying consolidated statements of operations and changes in net assets.

(x) Ownership in Group Purchasing Organization

The Corporation was an owner of several of the entities associated within a group purchasing organization (GPO), Premier. In October 2013, Premier restructured its business, including its initial public offering.

As part of the transaction, the Corporation received $6,053 in cash, and approximately 1,253,000 shares of Class B units in Premier in fiscal year 2014. These shares vest over the next seven years, as long as the Corporation remains a member of Premier. Upon each vesting date, the Corporation has the option to convert these shares into the publically traded securities of Premier or have them repurchased by Premier. The Corporation is recognizing the value of the shares over the vesting period, as a reduction of supplies expense. Upon the annual vesting date, October 31, the vested shares will be accounted for under the fair value option, whereby future changes in share price will be treated as nonoperating investment activity. In fiscal year 2015, 179,055 shares of Class B stock vested. In addition, the Corporation receives quarterly distributions associated with its purchasing volumes and tax benefits associated with the restructuring. These distributions are recognized as a reduction of supplies expense.

In 2015 and 2014, the Corporation recognized approximately $10,367 and $13,765, respectively, as a reduction of supplies expense associated with these transactions. The 2015 reduction comprised $7,364 related to Class B units and $3,003 in quarterly distributions. The 2014 reduction comprised $6,053 in initial IPO proceeds, $3,196 related to Class B units, and $4,516 in quarterly distributions.

(y) Environmental Liability

Financial Accounting Standards Board (FASB) Accounting Standard Codification (ASC) Subtopic 410-30, *Environmental Obligations*, requires the fair value of a liability for a legal obligation associated with an asset retirement be recorded in the period in which the obligation is incurred. When the liability is initially recorded, the cost of the asset retirement is capitalized. The Corporation had $18,051 and $17,353 recorded as other long-term liabilities as of June 30, 2015 and 2014, respectively. The Corporation recognized $794 and $771 in 2015 and 2014, respectively, related to amortization. Amortization is recognized over the life of the related asset.

(z) Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the current year presentation to more consistently present financial information between years.

(aa) Recent Accounting Pronouncements

On May 28, 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. generally accepted accounting principles when it becomes effective. The new standard is effective for the Corporation on January 1, 2017. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The new standard also requires additional disclosures regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts. The Corporation has neither selected a transition method nor determined the effect of the standard on its ongoing financial reporting.

(3) Fair Value of Financial Instruments

ASC Topic 820, *Fair Value Measurement*, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The Corporation uses a practical expedient for the estimation of the fair value of investments in funds for which the investment does not have a readily determinable fair value. The practical expedient used by the Corporation is the net asset value (NAV) per share, or its equivalent. In some instances, the NAV may not equal the fair value that would be calculated under fair value accounting standards. Valuations provided by fund administrators consider variables such as the financial performance of underlying investments, recent sales prices of underlying investments, and other pertinent information. In addition, actual market exchanges at year-end provide additional observable market inputs of the exit price. Management reviews the valuations and assumptions provided by fund administrators for reasonableness and believes that the carrying amounts of these financial instruments are reasonable estimates of fair value. Because the net asset value reported for these funds is used as a practical expedient to estimate the fair value of the Corporation's interest therein, its classification in Level 2 is based on the Corporation's ability to redeem its interest at or near the balance sheet date. The initial valuation is adjusted when changes to inputs and assumptions are corroborated by evidence, such as transactions of similar securities, completed or pending third-party transactions in the underlying security or comparable entities, offerings in the capital markets, and changes in financial results, data, or cash flows. For positions that are not traded in active markets or are subject to notice provisions, valuations are adjusted to reflect such provisions, and such adjustments are generally based on available market evidence.

The fair value of long-term debt is based on Level 2 inputs, such as the discounted value of the future cash flows using current rates for debt with the same remaining maturities, considering the existing call premium and protection. When available, quoted market prices are also used. The carrying value and fair value of bond debt, was approximately $1,043,844 and $1,060,037, respectively, as of June 30, 2015, and approximately $1,062,667 and $1,082,825, respectively, as of June 30, 2014. Remaining other debt of $30,715 and $30,936 as of June 30, 2015 and 2014, respectively, approximates carrying value.

Other financial instruments of the Corporation include cash and cash equivalents and other receivables. The carrying amount of these instruments approximates fair value because these items mature in less than one year. The carrying amount of other long-term investments approximates fair value.

(In thousands of dollars)

(4) Investments

The composition of cash and investments carried at fair value on a recurring basis at June 30, 2015 is set forth in the following table:

	June 30, 2015	Fair value measurements at reporting date using: Level 1	Level 2	Level 3
Assets:				
Short-term investments:				
Cash and money market funds	$ 2,667	2,667	—	—
Fixed income:				
Government obligations	107,769	—	107,769	—
Corporate obligations	86,430	—	86,430	—
Mortgage-backed securities:				
Commercial	27,215	—	27,215	—
Residential	72,834	—	72,834	—
Municipal, foreign, and other fixed income	14,931	—	14,931	—
Mutual funds:				
Domestic debt securities	29,497	29,497	—	—
International debt securities	9,293	9,293	—	—
Other short-term investments	801	—	801	—
Total	351,437	41,457	309,980	—
Designated for capital acquisition:				
Cash and money market funds	58,929	58,929	—	—
Fixed income:				
Government obligations	46,772	—	46,772	—
Corporate obligations	67,554	—	67,554	—
Mortgage-backed securities:				
Commercial	13,072	—	13,072	—
Residential	39,938	—	39,938	—
Municipal, foreign, and other fixed income	25,345	—	25,345	—
Mutual funds:				
Fixed income	96,376	96,376	—	—
Domestic equities:				
Large capitalization	224,233	224,233	—	—
Medium-small capitalization	103,057	103,057	—	—

(Continued)

(In thousands of dollars)

		Fair value measurements at reporting date using		
	June 30, 2015	**Level 1**	**Level 2**	**Level 3**
International equities:				
Foreign stock	$ 116,105	116,105	—	—
Emerging markets	35,669	35,669	—	—
Real estate trusts	24,958	24,958	—	—
Commodities	14	—	14	—
Other long-term equity invest	11,477	—	11,477	—
Total	863,499	659,327	204,172	—
Funds designated for 457 plans:				
Cash and short term	1,357	1,357	—	—
Mutual funds:				
Equity	13,561	13,561	—	—
Fixed income	6,603	6,603	—	—
Target/blended/other	17,650	17,650	—	—
Total	39,171	39,171	—	—
Trustee-held funds:				
Cash and money market funds	3,706	3,706	—	—
Fixed income:				
Government obligations and other	5,277	—	5,277	—
Mortgage-backed securities:				
Residential	4,587	—	4,587	—
Mutual funds:				
Domestic equities:				
Large capitalization	36,864	36,864	—	—
Medium-small capitalization	18,235	18,235	—	—
International equities:				
Foreign stock and emerging markets	29,846	29,846	—	—
Domestic debt securities	76,753	76,753	—	—
International debt securities	293	293	—	—
Real estate	7,823	7,823	—	—
Total	183,384	173,520	9,864	—
Total assets	$ 1,437,491	913,475	524,016	—

(In thousands of dollars)

		June 30, 2015	Fair value measurements at reporting date using Level 1	Level 2	Level 3
Liabilities:					
Interest rate swaps	$	107,316	—	107,316	—
Total liabilities	$	107,316	—	107,316	—

The composition of cash and investments carried at fair value on a recurring basis at June 30, 2014 is set forth in the following table:

		June 30, 2014	Fair value measurements at reporting date using Level 1	Level 2	Level 3
Assets:					
Short-term investments:					
Cash and money market funds	$	2,853	2,853	—	—
Fixed income:					
Government obligations		109,752	—	109,752	—
Corporate obligations		79,463	—	79,463	—
Mortgage-backed securities:					
Commercial		26,918	—	26,918	—
Residential		58,473	—	58,473	—
Municipal, foreign, and other fixed income		13,980	—	13,980	—
Mutual funds:					
Domestic debt securities		122,829	122,829	—	—
International debt securities		9,153	9,153	—	—
Other short-term investments		801	—	801	—
Total		424,222	134,835	289,387	—
Designated for capital acquisition:					
Cash and money market funds		9,291	9,291	—	—
Fixed income:					
Government obligations		48,124	—	48,124	—
Corporate obligations		76,562	—	76,562	—
Mortgage-backed securities:					
Commercial		9,322	—	9,322	—
Residential		45,152	—	45,152	—
Municipal, foreign, and other fixed income		21,648	—	21,648	—

(In thousands of dollars)

		Fair value measurements at reporting date using		
	June 30, 2014	**Level 1**	**Level 2**	**Level 3**
Mutual funds:				
Fixed income	$ 92,212	92,212	—	—
Domestic equities:				
Large capitalization	216,560	216,560	—	—
Medium-small capitalization	96,170	96,170	—	—
International equities:				
Foreign stock	119,095	119,095	—	—
Emerging markets	38,773	38,773	—	—
Real estate trusts	24,031	24,031	—	—
Commodities	34,554	16,901	17,653	
Other long-term Equity invest	3,196		3,196	
Total	834,690	613,033	221,657	—
Funds designated for 457 plans:				
Cash and short term	640	640	—	—
Mutual funds:				
Equity	13,657	13,657	—	—
Fixed income	7,007	7,007	—	—
Target/blended/other	18,407	18,407	—	—
Total	39,711	39,711	—	—
Trustee-held funds:				
Cash and money market funds	50,860	50,860	—	—
Fixed income:				
Government obligations and other	4,652	—	4,652	—
Mortgage-backed securities:				
Residential	4,903	—	4,903	—
Mutual funds:				
Domestic equities:				
Large capitalization	37,143	37,143	—	—
Medium-small capitalization	16,146	16,146	—	—

(In thousands of dollars)

	June 30, 2014	Fair value measurements at reporting date using Level 1	Level 2	Level 3
International equities:				
Foreign stock and emerging markets	$ 26,088	26,088	—	—
Domestic debt securities	35,003	35,003	—	—
International debt securities	4,381	4,381	—	—
Real estate	4,807	4,807	—	—
Total	183,983	174,428	9,555	—
Total assets	$ 1,482,606	962,007	520,599	—
Liabilities:				
Interest rate swaps	$ 95,461	—	95,461	—
Total liabilities	$ 95,461	—	95,461	—

The Corporation held alternative investments in one limited partnership of $17,245 at June 30, 2014, which was not publicly traded. No alternative investments were held with limited partnerships at June 30, 2015. These amounts are included as a part of commodities in the tables above. The underlying assets in the limited partnership are based on fair market values, and the redemption period related to these investments is between 3 to 30 days.

At June 30, 2015 and 2014, the Corporation had $12,412 and $15,373, respectively, in alternative investments, referred to as Private Equity and Distressed Debt, accounted for using the equity method, which are not publicly traded. These amounts are not included in the tables above. These investment instruments contain elements of both credit and market risk. Such risks may include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, emphasis on speculative investments (nonmarketable investments), and nondisclosure of portfolio composition. Because these investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a readily available market for such investments existed. These investments represented 0.7% and 1.0% of total investments and 0.6% and 0.9% of total net assets of the Corporation at June 30, 2015 and 2014, respectively.

Investment income is comprises the following for the years ended June 30, 2015 and 2014:

	2015	2014
Interest and dividend income	$ 25,354	49,349
Net realized gains on sales of investments	653	49,231
Net change in unrealized gains on investments	(3,881)	32,072
Investment income, net	$ 22,126	130,652

In addition, the Corporation recognized a reduction in benefit expense of $1,893 and $5,147 in 2015 and 2014, respectively, related to investment income on certain 457 retirement plans.

Other Investments

Health Ventures is a not-for-profit corporation that has entered into joint ventures to provide radiology, oncology, and surgery services. PeaceHealth is the sole member of Health Ventures. Health Ventures is included in the consolidated financial statements but is not part of the obligated group. The majority of these joint ventures are accounted for under the equity method. As of June 30, 2015 and 2014, the carrying value of the joint ventures was approximately $13,360 and $14,095, respectively, and is recorded in investments in joint ventures and other on the consolidated balance sheets. Investment income from the joint ventures of $7,970 and $7,603 for the years ended June 30, 2015 and 2014, respectively, is included in other operating revenue. The assets, liabilities, and equity of these joint ventures accounted for under the equity method were $31,525, $5,706, and $25,819, respectively, at June 30, 2015 and $34,906, $6,861, and $28,045, respectively, at June 30, 2014.

In 2014, Health Ventures increased its ownership in Riverbend Ambulatory Surgery Center to a majority interest of 54.05%. The fair value of this transaction was $4,400 and there was an $870 gain on the step-up in share value of the previously held shares. Riverbend Ambulatory Surgery Center is consolidated within Health Ventures.

(5) Charity Care

The Corporation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

The Corporation maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies under its charity care policy. Estimated costs (based on the proportion of overall costs to charges foregone for charity care) for services and supplies furnished under the charity care policy for the years ended June 30, 2015 and 2014 were approximately $20,283 and $51,295, respectively.

(In thousands of dollars)

(6) Long-Term Debt

Long-term debt at June 30 consisted of the following:

		2015	2014
Series 1995 Oregon Bonds, variable interest rate (0.01% at June 30, 2015) payable each December 1, due in annual installments through December 2015	$	1,295	2,515
Series 2008 Washington Bonds, Series A, fixed interest rate of 5% payable on each May 1 and November 1 through November 2018.		80,650	80,650
Series 2008 Oregon Bonds, Series A-B, variable interest rate (0.05% at June 30, 2015), principal payable each August, due in annual installments from 2030 to 2034 for Series A and B		145,975	145,975
Series 2009 Oregon Bonds, Series A, fixed interest rates of 3.25% to 5.00% payable each May and November, due in installments from 2013 to 2039		91,505	96,375
Series 2009 Washington Bonds, Series A, fixed interest rates of 4.5% to 5.0% payable each in May and November, due in installments through 2028		75,160	79,220
Series 2011 Oregon Bonds, Series A-B, variable interest rates (0.80% at June 30, 2015) principal payable each May, due in installments from 2036 to 2047		150,000	150,000
2011 Direct Note Obligation to Union Bank 2.46% payable monthly based on a ten-year amortization with remaining amount due November 2016		6,417	7,417
2012 Direct Note Obligation to Bank of America, fixed interest rate of 2.3%, due on December 1, 2022		43,181	48,353
2013 Washington Bonds, Series A, variable interest rate (0.83% at June 30, 2015), principal payable each September, in annual installments from 2013 to 2034		51,265	52,365
2013 Direct Note Obligation to Bank of America, fixed interest rate of 3.23%, due on October 2, 2023		42,753	47,145
2013 Direct Note Obligation to Bank of America, fixed interest rate of 3.92%, due on October 2, 2023		172,714	177,127

(In thousands of dollars)

		2015	2014
2013 Direct Note Obligation to US Bank, fixed interest rate of 3.43%, due on October 8, 2020	$	50,000	50,000
Series 2014 Washington Bonds, Series A, fixed interest rates of 4.0% to 5.0% payable each May and November, due in installments through 2028		38,610	40,140
Series 2014 Oregon Bonds, Series A, fixed interest rates of 4.1% to 5.0% payable each May and November, due in installments from 2016 through 2032		66,060	66,060
2015 Direct Note Obligation to US Bank, variable interest rate (0.94% at June 30, 2015), due on June 30, 2020		10,100	—
Long-term debt at par value		1,025,685	1,043,342
Premium and other on long-term debt		18,159	19,325
Other long-term debt		30,715	30,936
Total long-term debt		1,074,559	1,093,603
Less amounts due within one year		(36,774)	(33,250)
Total long-term debt due after one year	$	1,037,785	1,060,353

PeaceHealth Networks and PeaceHealth are the only members of the Corporation’s Obligated Group. The assets of the Obligated Group are available for the satisfaction of debts of PeaceHealth and PeaceHealth Networks under the terms of its Master Trust Indenture.

The Series 1995 Oregon Variable Rate Demand Bonds, the Series 2008 Oregon Series A-B Variable Rate Demand Bonds, the Series 2011 Oregon Series A-B Direct Placement Bonds, and the Washington 2013(A) Direct Placement Bonds have variable interest rates that may bear interest at a daily, weekly, 28-day, monthly, semiannual, or annual rates. The rate determination mode may be changed upon request of PeaceHealth and PeaceHealth Networks. The bonds are subject to optional redemption by PeaceHealth and PeaceHealth Networks, in whole or in part at 100% of the principal amount plus accrued interest. The Variable Rate Demand Bonds are backed by letters of credit in the amount of approximately $147,600 for the 2008 Oregon bonds and $1,316 for the 1995 Oregon bonds. The letter of credit for Series A-B of the 2008 Oregon bonds will expire in June 2019. The letter of credit for the 1995 Oregon bonds will expire in December 2015. The 2011 Oregon bonds are held directly by two financial institutions subject to continuing covenant agreements, which contain substantially the same credit terms as the letters of credit, but which are not subject to the same remarketing and put risk as the 1995 and 2008 bonds. The 2011 Oregon bonds and Washington 2013(A) bonds can be converted to publicly held variable rate demand bonds if PeaceHealth and PeaceHealth Networks chooses. The continuing covenant agreements for the Oregon 2011 Direct Placement Bonds expire in February 2018 for Series (A) and August 2019 for Series (B). The continuing covenant agreement for the Washington 2013(A) bonds expires February 2017. The letters of credit and the continuing covenant agreements are extendable annually at the option of the bank upon request from PeaceHealth and PeaceHealth Networks for an additional year. The 2008, 2011, and 2013(A) bonds are matched to fixed payor swaps ranging between 3.60% and 4.10% for approximately their par value, the notional amounts of swaps amortizing proportionately to the bonds.

(In thousands of dollars)

The Series 1995 Oregon and Series 2008 Oregon variable rate demand bonds, which have long-term amortization periods, may be put back to the letter of credit bank on any interest rate reset date if the bonds fail to be remarketed. In the event of a failed remarketing, the letter of credit bank is obligated under the terms of the letter of credit agreement to buy the bonds. If the bonds continue to fail to be remarketed, and become a term loan from the letter of credit bank to PeaceHealth and PeaceHealth Networks, the payments commence not less than 367 days after the purchase of the bonds by the letter of credit bank, and are payable in equal quarterly installments thereafter for a period of three years.

Other long-term debt primarily includes $30,715 in capital leases and other debt.

Scheduled principal payments of long-term debt, excluding the premium on bonds, as due according to their original long-term amortization schedule and other debt according to its original maturity schedule for the next five years and thereafter are as follows:

	Long-term debt	Capitalized leases and other	Total
Year ending June 30:			
2016	$ 29,851	7,972	37,823
2017	34,364	7,622	41,986
2018	30,621	3,877	34,498
2019	103,570	3,504	107,074
2020	30,791	2,392	33,183
Thereafter	796,488	8,888	805,376
Total	$ 1,025,685	34,255	1,059,940
Less amounts representing interest		(3,540)	(3,540)
Present value of net minimum capital lease payments		30,715	
Less current installments of obligations under capital leases		(6,886)	
Obligations under capital leases, excluding current installments		$ 23,829	
Total long-term debt			$ 1,056,400

The PeaceHealth Master Trust Indenture, the loan agreements and other contractual documents under which bonds were issued include covenants which, among others, obligate PeaceHealth and PeaceHealth Networks to: maintain net patient service revenue at levels sufficient to achieve specified debt service coverage ratios; meet certain financial tests before additional debt can be incurred; and meet certain financial tests before there can be any significant disposition of property.

(Continued)

Cash paid for interest totaled approximately $32,914 and $32,262 for the years ended June 30, 2015 and 2014, respectively. Interest totaling approximately $2,035 and $830 was capitalized in connection with construction projects during the years ended June 30, 2015 and 2014, respectively.

(7) Accounting for Derivative Instruments and Hedging Activities

In accordance with the policy adopted by the board of directors, the Corporation may use interest rate swap contracts to manage its net exposure to interest rate changes in attempting to reduce its overall cost of borrowing over time. Interest rate swap contracts generally involve the exchange of fixed and floating interest rate payments without the exchange of underlying principal (the swap of fixed or floating rates are on a notional amount). The Corporation accounts for its interest rate hedging transactions in accordance with FASB ASC 815, *Derivatives and Hedging*. That standard requires that every derivative instrument be recorded on the balance sheet as either an asset or a liability measured at its estimated fair value. The interest rate swaps do not meet the criteria for hedge accounting and all changes in the valuation of the interest rate swaps are recognized in the consolidated statements of operations.

The Corporation had the following interest rate swap contracts outstanding as of June 30, 2015 and 2014, respectively, with a total current notional amount of approximately $427,600 and $430,950: a $40,000 basis swap where the Corporation receives 81.9% of 30 day LIBOR and pays a 30 day tax-exempt index rate, and approximately $387,600 and $390,950 (fixed payer swaps) which the Corporation uses to convert a portion of the outstanding variable rate bonds to fixed rates ranging from 3.5% to 4.1%. The fixed payer interest rate swaps are associated with the variable rate bonds, but have not been integrated to any of the underlying debt for the purpose of hedge accounting.

Change in valuation of interest rate swaps consists of the noncash change in the liability and the cash payments and receipts associated with the swaps, and the amortization of the accumulated hedge effectiveness included in net assets. The noncash change in the fair value of the interest rate swaps, was an increase of $11,855 and $3,844 in the liability for the years ended June 30, 2015 and 2014, respectively. Net cash settlement cost for the interest rate swaps was $14,724 and $14,937, for the years ended June 30, 2015 and 2014, respectively. The amortization of the accumulated hedge effectiveness included in net assets was $79 for both years ended June 30, 2015 and 2014.

Derivative instruments are recorded at fair value taking into consideration the Corporation's nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. The impact of taking into account the nonperformance risk on the estimated fair value of the interest rate swaps was a benefit of approximately $15,264 and $13,267, as of June 30, 2015 and 2014, respectively. Recording the interest rate swaps at fair value results in a total liability of $107,316 and $95,461 as of June 30, 2015 and 2014, respectively, in other long-term liabilities in the accompanying consolidated balance sheets rather than the $122,580 and $108,728 that would be paid if all of the swaps were terminated as of June 30, 2015 and 2014, respectively. The inputs used to determine the impact of the counterparty nonperformance risk are Level 2 inputs; as such derivative liabilities have been recorded as Level 2 in the Corporation's disclosure of fair value instruments, see note 4.

(In thousands of dollars)

The Corporation currently has five swap counterparties which minimize counterparty risk and collateral posting requirements. These swap agreements contain various credit thresholds that if breached by the Corporation would constitute an additional termination event whereby the swap counterparties could terminate the swap by either making a payment to, or receiving a payment from the Corporation, depending upon the termination value of the swaps as of the date of termination. The Corporation retains the right to terminate the swaps at any point, which would also require either making or receiving a payment depending on the termination value of the swap as of the termination date.

(8) Benefit Plans

Defined Benefit Pension Plan

The Corporation sponsors a noncontributory defined benefit pension plan, the Southwest Washington Health System Retirement Plan, now known as PeaceHealth SWHS Frozen DB Pension Plan (the Plan) effective January 30, 2015, covering all employees at PeaceHealth Southwest Medical Center who meet requirements as specified in the Plan. The assets of the Plan are available to pay the benefits of all eligible employees of the Plan. The Plan has two benefit structures that include a cash balance and a final average pay structure. Effective December 31, 2010, the Plan was frozen. No new participants are admitted to the Plan after this date. This event did not terminate the Plan. Benefits earned before the plan was frozen will continue to be paid as participants qualify to receive benefits.

The following table sets forth disclosures related to the Plan in accordance with FASB ASC 715-20-65, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, as of June 30, 2015 and 2014:

		Years ended June 30	
		2015	**2014**
Change in projected benefit obligation:			
Projected benefit obligation (PBO) at beginning of period	$	221,721	201,692
Service cost		1,094	942
Interest cost		9,040	9,226
Actuarial loss on PBO		14,005	16,261
Benefits and administrative expenses paid		(7,437)	(6,400)
Projected benefit obligation at June 30	$	238,423	221,721

(In thousands of dollars)

		Years ended June 30	
		2015	**2014**
Change in fair value of plan assets:			
Fair value of assets at beginning of period	$	163,247	144,072
Actual return on plan assets		2,941	20,201
Employer contribution		17,180	5,374
Benefits and administrative expenses paid		(7,437)	(6,400)
Fair value of assets at June 30	$	175,931	163,247
Reconciliation of funded status:			
Funded status	$	(62,492)	(58,473)
Net amount recognized	$	(62,492)	(58,473)
Amounts recognized in the consolidated balance sheets consist of:			
Accrued pension liability	$	62,492	58,473
Accumulated change in net assets		(36,813)	(31,814)

The accumulated benefit obligation for the Plan was $238,424 and $221,721 at June 30, 2015 and 2014, respectively.

Net periodic benefit cost for the years ended June 30, 2015 and 2014 included the following components and is included in payroll taxes and benefits in the accompanying consolidated statements of operations and changes in net assets:

		2015	**2014**
Service cost	$	1,094	942
Interest cost		9,040	9,226
Expected return on plan assets		(11,976)	(10,820)
Amortization of loss		3,885	2,708
Net periodic pension cost	$	2,043	2,056

(a) Assumptions

The Corporation used the following actuarial assumptions to determine its benefit obligations at June 30, 2015 and 2014, with measurement dates of June 30, 2015 and 2014:

	2015	**2014**
Discount rate	4.30%	4.15%

(In thousands of dollars)

The Corporation used the following actuarial assumptions to determine its net periodic benefit cost for the years ended June 30, 2015 and 2014:

	2015	**2014**
Discount rate	4.15%	4.65%
Expected long-term rate of return on plan assets	7.25	7.25

This discount rate is based on a proprietary yield curve tool used by the Plan's actuary, which uses a composite of high-yield, investment-grade corporate bonds, and the projected payouts from the Plan to develop an equivalent yield rate to use in determining plan liabilities.

The expected long-term rate of return on plan assets was based on the asset allocation mix and the long-term historical return for each asset class, taking into account current and expected market conditions. The actual return on pension plan assets was approximately 1.8% and 14.1% during the years ended June 30, 2015 and 2014, respectively. In the calculation of pension plan expense, the expected long-term rate of return on plan assets is applied to a calculated value of plan assets that recognizes changes in fair value over a four-year period. This practice is intended to reduce year-to-year volatility in pension expense, but it can have the effect of delaying the recognition of differences between actual returns and expected returns based on the long-term rate of return assumptions.

(b) Pension Plan Assets

The asset allocation of the Corporation's pension plan at June 30, 2015 and 2014 is as follows:

	2015	**2014**
Equity securities	$ 99,726	98,417
Debt securities	65,912	58,980
Other	10,293	5,850
Total	$ 175,931	163,247

Pension plan assets are managed according to an investment policy adopted by the Plan's trustees. Professional investment managers are retained to manage specific asset classes and professional consulting is utilized for investment performance reporting. The primary objective of the Plan's trustees is to achieve the highest possible total return commensurate with safety and preservation of capital in real, inflation-adjusted terms. The objective includes having funds invested in the long term, which protect the principal and produce returns sufficient to meet future benefit obligations. The investment policy includes an asset allocation that includes equity securities, debt securities, and cash/other investments. The target allocations are 35% bonds and 65% stocks. Assets are rebalanced quarterly when balances fall outside of the approved range for each asset class.

In accordance with FASB ASC 820, financial assets and financial liabilities measured at fair value are grouped in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to estimate fair value. These levels and the adoption of FASB ASC 820 are further discussed in note 4.

Following is a description of the valuation methodologies used for plan assets measured at fair value.

- Mutual Funds: Valued at the NAV of shares held by the Plan at year-end.
- Common and Collective Trusts: Valued at fair value of the underlying assets on close of the valuation date and expressed in units. The unit value is determined at the valuation date by dividing the value of the entire common and collective trust by the number of units.
- Real Estate Investment Fund and Hedge Fund: Valued based on the fair value of the underlying assets as supported by audited financial statements.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

(In thousands of dollars)

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of June 30, 2015:

Assets	Total fair value	Level 1	Level 2	Level 3
Equity securities:				
Mutual funds:				
Large cap	$ 38,360	38,360	—	—
Mid cap	9,973	9,973	—	—
Small cap	6,660	6,660	—	—
Foreign stock and emerging markets	42,737	42,737	—	
Private equity	1,997	—	—	1,997
Total equity securities	99,727	97,730	—	1,997
Debt securities:				
Mutual funds:				
Fixed income	43,579	43,579	—	—
Global fixed income	10,014	10,014	—	—
Hedge capital appreciation fund	12,318	—	—	12,318
Total debt securities	65,911	53,593	—	12,318
Other:				
Cash and money markets	10,293	10,293	—	—
Total other	10,293	10,293	—	—
Total plan assets at fair value	$ 175,931	161,616	—	14,315

(Continued)

(In thousands of dollars)

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of June 30, 2014:

Assets	Total fair value	Level 1	Level 2	Level 3
Equity securities:				
Mutual funds:				
Large cap	$ 38,369	36,443	—	1,926
Mid cap	9,729	9,729	—	—
Small cap	6,590	6,590	—	—
Foreign stock and emerging markets	39,372	33,386	—	5,986
Long-short hedge	2,218	—	—	2,218
Private equity	2,139	—	—	2,139
Total equity securities	98,417	86,148	—	12,269
Debt securities:				
Mutual funds:				
Fixed income	15,598	15,598	—	—
Global fixed income	23,720	23,720	—	—
Hedge capital appreciation fund	19,662	964	—	18,698
Total debt securities	58,980	40,282	—	18,698
Other:				
Cash and money markets	5,850	5,850	—	—
Total other	5,850	5,850	—	—
Total plan assets at fair value	$ 163,247	132,280	—	30,967

(In thousands of dollars)

The following table presents a reconciliation of the beginning and ending balances of those Level 3 assets:

		Fair value measurements Level 3
Fair value, June 30, 2013	$	58,793
Realized and unrealized gains, net		5,484
Purchases, issuances, and settlements, net		(33,310)
Fair value, June 30, 2014		30,967
Realized and unrealized gains, net		(129)
Purchases, issuances, and settlements, net		(16,523)
Fair value, June 30, 2015	$	14,315

At June 30, 2015 and 2014, the Plan held $14,315 and $30,967, respectively, in alternative investments, reflected as Level 3 assets in the above table, which are not publicly traded. These investment instruments contain elements of both credit and market risk. Such risks may include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, emphasis on speculative investments (nonmarketable investments), and nondisclosure of portfolio composition. Because these investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a readily available market for such investments existed. These investments currently include redemption periods ranging from quarterly to redemption upon liquidity of the fund. These investments represented 8% and 19% of Plan assets at June 30, 2015 and 2014, respectively.

(c) Cash Flows

The Corporation's policy with respect to funding the Plan is to fund at least the minimum required by the Employee Retirement Income Security Act of 1974, as amended, plus such additional amounts deemed appropriate. In fiscal year 2015, the Corporation contributed $7,189 to the Plan for fiscal year 2016 and $9,990 to the Plan for fiscal year 2015.

(In thousands of dollars)

Benefit payments are expected to be paid as follows for the fiscal years ended June 30:

	Pension benefits
2016	$ 8,586
2017	9,328
2018	10,130
2019	10,968
2020	11,588
2021–2025	65,165

Expected benefit payments presented above are based on actuarial estimates. Actual benefit payments may vary significantly from these estimates.

Management is not aware of any settlements or curtailments that would require additional recognition during 2015.

(9) Defined Contribution Retirement Plans

PeaceHealth sponsors two defined contribution retirement plans, the Southwest Washington Health System Retirement Plan and the PeaceHealth Plan. These plans cover substantially all employees of PeaceHealth meeting certain age and length of service requirements. Total defined contribution retirement plan costs charged to operations were approximately $70,111 and $73,977 for the years ended June 30, 2015 and 2014, respectively, which are included in payroll taxes and benefits in the accompanying consolidated statements of operations.

PeaceHealth Deferred Compensation Plans

The estimated fair value associated with the plan assets of PeaceHealth's 457(b) and 457(f) postretirement savings plans, in the amount of approximately $39,171 and $39,710 at June 30, 2015 and 2014, respectively, is included in assets whose use is limited, cash and investments, with a corresponding amount included in other long-term liabilities. Contributions associated with these funds in 2015 and 2014 were $7,276 and $5,993, respectively, and included in payroll taxes and benefits in the accompanying consolidated statements of operations.

(10) Restricted Net Assets

Restricted net assets are those whose use by the Corporation has been limited by donor-imposed restrictions to a specific time period and/or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity.

(In thousands of dollars)

Temporarily restricted net assets are available for the following purposes at June 30:

		2015	2014
Purchase of property, plant, and equipment	$	15,021	17,407
Hospice and indigent care		2,544	4,164
Patient care		14,740	17,832
Other		12,033	10,290
	$	44,338	49,693

Permanently restricted net assets are available for the following purposes at June 30:

		2015	2014
Purchase of property, plant, and equipment	$	1,442	1,590
Hospice and indigent care		5,536	2,700
Patient care operating activities		16,343	13,026
Other		1,097	57
	$	24,418	17,373

During 2014, primarily due to updated information received from an unconsolidated foundation and a donor restriction change, $7,525 of previously restricted assets were released from permanently restricted net assets. This change is included in other changes in net assets on the consolidated statements of changes in net assets.

Charitable Gift Annuities

PeaceHealth has been granted a license by the state of Washington, Office of Insurance Commissioner, to issue Charitable Gift Annuities in support of its charitable activities. The Corporation has delegated all its charitable fund raising activities to several fund-raising foundations whose net assets, held for the beneficial interest of PeaceHealth, are shown on the consolidated balance sheets of the Corporation. The liability for annuity contracts issued under the PeaceHealth license and the separately maintained reserve accounts are recorded on the books of PeaceHealth. As of June 30, 2015 and 2014, the following liabilities for annuity contracts issued under the PeaceHealth license and reserve account investments were recorded:

		2015	2014
State of Washington gift annuity liabilities (other long-term liabilities)	$	792	837
Gift annuity reserve accounts (other assets whose use is limited, cash and investments)		1,052	1,147

(Continued)

(In thousands of dollars)

(11) Commitments and Contingent Liabilities

(a) Litigation

Various laws and regulations of federal, state, and local governments govern the healthcare industry. These laws and regulations are subject to ongoing government review and interpretation, as well as regulatory actions unknown or unasserted at this time. The Corporation is also involved in litigation and regulatory investigations arising in the normal course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Corporation's future financial position or results of operations.

(b) Operating Leases

The Corporation leases, for a nominal amount, the buildings and certain equipment for Ketchikan General Hospital from the City of Ketchikan, Alaska under a 10-year lease that expires in 2023.

The Corporation leases, from Skagit County Public Hospital District No. 304, the buildings and certain equipment for United General Medical Center in Sedro Woolley, Washington under a 30-year lease that expires in 2044.

Rent and lease expense future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) as of June 30, 2015 are as follows:

		Operating leases
Year ending June 30:		
2016	$	13,365
2017		5,691
2018		1,460
2019		963
2020		642
Later years, 2021 through 2025		12,513
Total minimum lease payments	$	34,634

Rent expense related to all operating leases was $25,497 and $32,270 during the years ended June 30, 2015 and 2014, respectively, and was included in supplies and other expenses in the consolidated statements of operations.

(c) Collective Bargaining Agreements

Approximately 34% and 33% of the Corporation's employees are covered under collective bargaining agreements, including nurses, professional employees, and service employees as of June 30, 2015 and 2014, respectively. The Corporation's various collective bargaining agreements expire between September 2015 and January 2018.

(d) Construction Commitments

As of June 30, 2015, the Corporation entered into construction commitments for approximately $13,043 related to open projects at year-end.

(12) Insurance Coverages

The Corporation has a self-insurance program for hospital and physician professional and general liability claims under which the Corporation contributes actuarially determined amounts to a trust to fund estimated ultimate losses. In connection with the self-insurance program, the Corporation has accrued estimates for asserted and incurred but not reported claims, including both the expected liability under each claim and the cost to administer the claim. Self-insured professional and general liability retention in 2015 and 2014 was $5,000 and $7,000, respectively, per occurrence and $15,000 and $20,000, respectively, in aggregate. Individual general and professional liability claims in excess of the above self-insured retention levels are insured through claims-made excess insurance policy.

The Corporation also self-insures all or a portion of liabilities for medical and dental benefit plans, unemployment, and workers' compensation claims. Funding levels and liabilities are determined based on actuarial studies.

Based on actuarial studies, the Corporation has recorded a liability for all of the self-insurance programs of approximately $111,862 and $101,334 at June 30, 2015 and 2014, respectively. The liabilities are classified within other current liabilities and other long-term liabilities based on the historical amounts paid within one year. Total current amounts included in other current liabilities were approximately $38,710 and $30,115 at June 30, 2015 and 2014, respectively. Management has recorded amounts receivable from excess insurance carriers totaling approximately $8,000 as of June 30, 2015 and 2014, respectively, which is included in other receivables in the accompanying consolidated balance sheets.

The Corporation is a minority investor in American Excess Insurance Exchange (AEIX). AEIX is a risk retention group owned by a group of healthcare providers and provides them with excess professional liability insurance coverage. The Corporation accounts for its interest in AEIX on the equity method of accounting less mandatory withdrawal penalties and an estimated discount to present value. As of June 30, 2015 and 2014, the carrying value of AEIX was approximately $5,590 and $6,131, respectively, and is recorded in investments in joint ventures and other on the consolidated balance sheets. Investment income from AEIX is recorded as an adjustment to supplies and other operating expenses in the accompanying consolidated statements of operations.

(In thousands of dollars)

(13) Functional Expenses

The Corporation provides general healthcare services to residents within its geographic location. Expenses related to providing these services are as follows:

		2015	2014
Healthcare services	$	2,101,371	1,909,128
General and administrative		300,070	298,137
	$	2,401,441	2,207,265

(14) Subsequent Events

In connection with the preparation of the consolidated financial statements in accordance with FASB ASC Topic 855, *Subsequent Events*, the Corporation has evaluated subsequent events through September 25, 2015, which is the date the consolidated financial statements were issued.