



PEACEHEALTH NETWORKS

Consolidated Financial Statements

June 30, 2019 and 2018

(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, 2019 and 2018, and the related consolidated statements of operations and changes in net assets without donor restrictions, 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, 2019 and 2018, 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.



Emphasis of Matters

As discussed in notes 2(u) and 3 to the consolidated financial statements, in 2019, PeaceHealth Networks adopted new accounting guidance in Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (Topic 606) and ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities* (Topic 958). Our opinion is not modified with respect to these matters.

KPMG LLP

Portland, Oregon
September 27, 2019

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Consolidated Balance Sheets

June 30, 2019 and 2018

(In thousands)

| Assets | 2019 | 2018 |
|--|--------------|-------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 46,885 | 53,467 |
| Short-term investments | 862,785 | 932,732 |
| Accounts receivable, net of allowance for doubtful accounts of \$1,059 and \$86,994 | 360,294 | 336,762 |
| Other receivables | 43,699 | 46,651 |
| Inventory of supplies | 44,545 | 43,403 |
| Prepaid expenses and other | 30,520 | 27,053 |
| Assets whose use is limited that are required for current liabilities | 6,907 | 8,358 |
| Total current assets | 1,395,635 | 1,448,426 |
| Assets whose use is limited: | | |
| Cash and investments | 1,336,434 | 1,221,259 |
| Investments in joint ventures and other | 26,881 | 26,143 |
| Total assets whose use is limited | 1,363,315 | 1,247,402 |
| Less current portion | (6,907) | (8,358) |
| Net assets whose use is limited | 1,356,408 | 1,239,044 |
| Property, plant, and equipment: | | |
| Land and improvements | 142,351 | 141,984 |
| Buildings, fixed equipment, and other | 1,779,651 | 1,756,173 |
| Moveable equipment | 930,732 | 822,297 |
| Construction in progress | 151,440 | 60,034 |
| Total property, plant, and equipment | 3,004,174 | 2,780,488 |
| Less accumulated depreciation | (1,739,782) | (1,559,368) |
| Net property, plant, and equipment | 1,264,392 | 1,221,120 |
| Interest in net assets of related foundations | 69,338 | 72,375 |
| Other assets | 103,471 | 36,967 |
| Total assets | \$ 4,189,244 | 4,017,932 |

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Consolidated Balance Sheets

June 30, 2019 and 2018

(In thousands)

| Liabilities and Net Assets | 2019 | 2018 |
|---|---------------------|------------------|
| Current liabilities: | | |
| Accounts payable | \$ 137,944 | 112,642 |
| Accrued payroll, payroll taxes, and employee benefits | 150,420 | 150,326 |
| Accrued interest payable | 4,193 | 4,328 |
| Other current liabilities | 40,612 | 34,051 |
| Pending trades payable | 17,348 | 77,021 |
| Current portion of long-term debt | 24,933 | 106,282 |
| Total current liabilities | <u>375,450</u> | <u>484,650</u> |
| Other long-term liabilities | 340,913 | 284,924 |
| Long-term debt, net of current portion | 978,886 | 847,397 |
| Net assets: | | |
| Without donor restrictions, controlling interest | 2,399,852 | 2,301,885 |
| Without donor restrictions, noncontrolling interest | 5,229 | 4,569 |
| With donor restrictions | 88,914 | 94,507 |
| Total net assets | <u>2,493,995</u> | <u>2,400,961</u> |
| Total liabilities and net assets | <u>\$ 4,189,244</u> | <u>4,017,932</u> |

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Operations and Changes in Net Assets Without Donor Restrictions

Years ended June 30, 2019 and 2018

(In thousands)

| | <u>2019</u> | <u>2018</u> |
|--|------------------|-------------------|
| Revenues: | | |
| Net patient service revenue | \$ 2,715,953 | 2,618,321 |
| Provision for bad debts | — | (71,837) |
| Net patient service revenue | <u>2,715,953</u> | <u>2,546,484</u> |
| Other operating revenue | <u>67,995</u> | <u>79,792</u> |
| Total revenues | <u>2,783,948</u> | <u>2,626,276</u> |
| Expenses: | | |
| Salaries and wages | 1,348,644 | 1,260,688 |
| Payroll taxes and benefits | 278,294 | 256,526 |
| Supplies | 422,953 | 398,375 |
| Purchased services | 264,397 | 221,679 |
| Other | 246,452 | 227,645 |
| Depreciation and amortization | 138,672 | 139,069 |
| Interest and amortization of deferred financing costs | <u>35,196</u> | <u>31,898</u> |
| Total expenses | <u>2,734,608</u> | <u>2,535,880</u> |
| Income from operations | <u>49,340</u> | <u>90,396</u> |
| Other income (expense): | | |
| Investment return, net | 103,534 | 93,030 |
| Net change in interest rate swaps | (40,346) | 10,219 |
| Other | <u>(3,924)</u> | <u>(1,501)</u> |
| Total other income | <u>59,264</u> | <u>101,748</u> |
| Excess of revenues over expenses from continued operations | <u>108,604</u> | <u>192,144</u> |
| Discontinued operations (note 14): | | |
| Gain from operations (including gain on disposal of \$0 and \$899, in 2019 and 2018, respectively) | <u>—</u> | <u>4,949</u> |
| Total gain on discontinued operations | <u>—</u> | <u>4,949</u> |
| Excess of revenues over expenses | 108,604 | 197,093 |
| Net assets released from restrictions for property, plant, and equipment | 7,188 | 3,095 |
| Change in pension liability | (15,337) | 15,216 |
| Other changes in net assets without donor restrictions | <u>(1,828)</u> | <u>(1,742)</u> |
| Increase in net assets without donor restrictions | \$ <u>98,627</u> | \$ <u>213,662</u> |

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Changes in Net Assets

Years ended June 30, 2019 and 2018

(In thousands)

| | <u>Without donor restrictions</u> | | <u>With donor restrictions</u> | <u>Total</u> |
|--|-----------------------------------|--------------------------------|--------------------------------|--------------|
| | <u>Controlling interest</u> | <u>Noncontrolling interest</u> | | |
| Net assets at June 30, 2017 | \$ 2,089,235 | 3,557 | 81,871 | 2,174,663 |
| Excess of revenues over expenses from continued operations | 191,456 | 688 | — | 192,144 |
| Other restricted contributions | — | — | 3,274 | 3,274 |
| Net assets released from restrictions | 3,095 | — | (4,283) | (1,188) |
| Change in interest in net assets of related foundations | — | — | 9,028 | 9,028 |
| Change in pension liability | 15,216 | — | — | 15,216 |
| Other changes in net assets | (1,742) | — | 4,617 | 2,875 |
| Change in net assets before discontinued operations | 208,025 | 688 | 12,636 | 221,349 |
| Discontinued operations (note 14) | 4,625 | 324 | — | 4,949 |
| Change in net assets | 212,650 | 1,012 | 12,636 | 226,298 |
| Net assets at June 30, 2018 | 2,301,885 | 4,569 | 94,507 | 2,400,961 |
| Excess of revenues over expenses from continued operations | 107,944 | 660 | — | 108,604 |
| Other restricted contributions | — | — | 7,188 | 7,188 |
| Net assets released from restrictions | 7,188 | — | (8,118) | (930) |
| Change in interest in net assets of related foundations | — | — | (3,037) | (3,037) |
| Change in pension liability | (15,337) | — | — | (15,337) |
| Other changes in net assets | (1,828) | — | (1,626) | (3,454) |
| Change in net assets | 97,967 | 660 | (5,593) | 93,034 |
| Net assets at June 30, 2019 | \$ 2,399,852 | 5,229 | 88,914 | 2,493,995 |

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows

Years ended June 30, 2019 and 2018

(In thousands)

| | <u>2019</u> | <u>2018</u> |
|---|------------------|------------------|
| Cash flows from operating activities: | | |
| Change in net assets | \$ 93,034 | 226,298 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | 138,672 | 139,069 |
| (Gain) loss on sale of land held for sale and property, plant, and equipment | (1,698) | 260 |
| Provision for bad debts | — | 71,837 |
| Change in pension liability | 15,337 | (15,216) |
| Restricted contributions | (7,188) | (3,274) |
| Net change in unrealized losses on investments | (36,282) | (1,616) |
| Realized gains on investments | (24,881) | (55,508) |
| Valuation adjustments on swap arrangements | 31,585 | (21,174) |
| Vesting of Premier Class B units | (8,383) | (5,892) |
| Change in interest in net assets of related foundations | 3,037 | (9,028) |
| Equity earnings on investments, net | (537) | 1,404 |
| Loss on sale of discontinued operations | — | 899 |
| Gain on refinancing | (732) | — |
| Changes in operating assets and liabilities: | | |
| Increase (decrease) in: | | |
| Accounts receivable, net | (23,532) | (95,269) |
| Other assets | (69,069) | (18,756) |
| Increase (decrease) in: | | |
| Accounts payable | 25,302 | 16,155 |
| Accrued payroll, payroll taxes, and employee benefits | 94 | (6,454) |
| Other liabilities | (44,180) | (16,367) |
| Net cash provided by operating activities | <u>90,579</u> | <u>207,368</u> |
| Cash flows from investing activities: | | |
| Purchase of property, plant, and equipment | (181,357) | (110,995) |
| Proceeds from sale of land held for sale and property, plant, and equipment | 2,019 | 96 |
| Purchase of alternative investments | (83,569) | (204,293) |
| Purchases/Sales of investments, net | 108,418 | 86,722 |
| Net cash used in investing activities | <u>(154,489)</u> | <u>(228,470)</u> |
| Cash flows from financing activities: | | |
| Principal payments on long-term debt | (525,979) | (34,462) |
| Proceeds from new financing | 576,119 | — |
| Proceeds from restricted contributions | 7,188 | 3,274 |
| Net cash provided by (used in) financing activities | <u>57,328</u> | <u>(31,188)</u> |
| Net decrease in cash and cash equivalents | (6,582) | (52,290) |
| Cash and cash equivalents at beginning of year | <u>53,467</u> | <u>105,757</u> |
| Cash and cash equivalents at end of year | <u>\$ 46,885</u> | <u>53,467</u> |

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(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; 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. 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, 2019, the following regional healthcare delivery systems and operating divisions are 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 Medical Center

Systemwide Organizations:

- PeaceHealth Medical Group

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Notes to Consolidated Financial Statements

June 30, 2019 and 2018

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.

PeaceHealth Networks included the following controlled affiliates at
June 30, 2019:

- PeaceHealth
- Health Ventures
- Pooled Income Funds (including Charitable Life Income Funds)
- PeaceHealth Southwest Medical Center Foundation
- PeaceHealth Networks On Demand (established January 1, 2019)
- Columbia United Providers (CUP) – owned 91.7% (Discontinued Operations as of December 2015)

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

(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.

(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.

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. The maturities of these related securities can exceed one year. Management anticipates the securities will be liquidated within one year. Investment income or loss (including realized and unrealized gains and losses and interest and dividends) is included in the excess of revenues over expenses.

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(d) Inventory of Supplies

Inventory is valued on weighted average cost.

(e) Other Receivables

Other receivables primarily consist of amounts receivable from the Oregon Hospital Assessment Program and the Washington State Safety Net Assessment Program, 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, 2019 and 2018. These items consist primarily of investments in marketable equity and fixed-income securities. Investment income or loss (including realized and unrealized gains and losses and interest and dividends) is included in the excess of revenues over expenses.

PeaceHealth accounts for its investments on a trade-date basis. Investment sales and purchases initiated prior to the consolidated balance sheet date and settled subsequent to the consolidated balance sheet date result in amounts due from and to brokers. Changes in these assets and liabilities represent noncash investing activities excluded from the consolidated statement of cash flows. As of June 30, 2019 and 2018, PeaceHealth recorded payables of \$17,348 and \$77,021, respectively, for investments purchased but not settled as pending trades payable in the accompanying consolidated balance sheets.

(g) Liquidity

Cash and cash equivalents, accounts receivable, and short-term investments are the primary liquid resources used by the Corporation to meet expected expenditure needs within the next year. The Corporation has credit facility programs, as described in note 6, available to meet unanticipated liquidity needs. Although intended to satisfy long-term obligations, management estimates that approximately 88% of assets whose use is limited, as stated at June 30, 2019, could be liquidated within the next year if needed.

(h) 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 are sold or retired, the cost and the related accumulated depreciation are removed from the accounts, and the resulting gain or loss is recorded.

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June 30, 2019 and 2018

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 year ended June 30, 2019 or 2018.

(i) **Depreciation**

Depreciation on property, plant, and equipment are 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 |

(j) **Other Assets**

Other assets include intangible assets, primarily trade names, and goodwill. Intangible assets with indefinite lives are evaluated annually for impairment. Impairment reviews are performed of the purchased intangible assets whenever events or changes in circumstances indicate carrying amount of an asset may not be recoverable. There were no impairment losses recognized during the year ended June 30, 2019 or 2018.

(k) **Other Long-Term Liabilities**

Other long-term liabilities consist primarily of the estimated fair value associated with the Corporation's interest rate swaps of \$123,500 and \$91,915 at June 30, 2019 and 2018, respectively; the liability for the PeaceHealth SWHS Frozen DB Pension Plan of \$52,768 and \$42,634 at June 30, 2019 and 2018, respectively; and the long-term portion of the liability for the self-insurance programs of \$73,596 and \$64,055 at June 30, 2019 and 2018, respectively. The remaining balance of other long-term liabilities includes environmental liability, gift annuities, and deferred compensation plan 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 \$20,198 and \$19,898 recorded as other long-term liabilities as of June 30, 2019 and 2018, respectively. The Corporation recognized \$569 and \$564 in 2019 and 2018, respectively, related to amortization. Amortization is recognized over the life of the related asset.

The Corporation has created several pooled income funds. 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, 2019 and 2018, the Corporation has recorded the

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Notes to Consolidated Financial Statements

June 30, 2019 and 2018

present value of the annuity payments of \$9,769 and \$10,057, respectively, as part of other long-term liabilities. The discount rate ranged from 6.3% to 7.0% at June 30, 2019 and 6.2% to 6.8% at June 30, 2018.

(l) Net Assets

Net assets without donor restrictions are those that are not subject to donor-imposed stipulations. Net assets with donor restrictions are those whose use by the Corporation have been limited by donor-imposed restrictions to a specific time period, in perpetuity, and/or purpose.

Net assets with donor restrictions represent resources subject to donor-imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that are restricted by the donor for a particular purpose and that will be met by the passage of time or other events specified by the donor. Other donor restrictions are perpetual in nature, whereby the donor has stipulated the funds be maintained in perpetuity. When specific donor restrictions are satisfied, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the consolidated statements of operations and the consolidated statements of changes in net assets as net assets released from restrictions.

(m) 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 net assets with donor restrictions. 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 net assets with donor restrictions.

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, net assets with donor restrictions are reclassified to net assets without donor restrictions 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.

(n) Interest in Net Assets of Related Foundations

The Corporation recognizes its interest in its unconsolidated related foundations representing certain net assets that will ultimately benefit the Corporation. The Corporation records an asset on the consolidated balance sheets for its beneficial interest in net assets of related foundations. The Corporation recognizes changes in this beneficial interest in the consolidated statements of changes in net assets.

(o) 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, and other miscellaneous revenue.

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Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(p) *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, and other items.

(q) *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, and realized and unrealized investment gains and losses. Changes in net assets without donor restrictions 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 the pension plan.

(r) *Federal and State Income Taxes*

PeaceHealth and PeaceHealth Networks have received determination letters from the Internal Revenue Service stating that they are 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.

(s) *Oregon Hospital Assessment Program and Washington State Safety Net Assessment Program*

In the states of Oregon and Washington, PeaceHealth is subject to a provider tax program on certain patient service revenues at qualifying hospitals to increase funding from other sources and obtain additional federal funds to support increased payments to providers for Medicaid services. These programs resulted in assessments paid to the states and enhanced supplemental payments paid to PeaceHealth in the way of lump-sum payment and per claim increases. In 2019 and 2018, these programs resulted in supplemental payments of \$96,119 and \$90,781, respectively, recorded in net patient service revenue, and assessments of \$83,867 and \$81,873, respectively, recorded in other expenses in the accompanying consolidated statements of operations and changes in net assets without donor restrictions.

(t) *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.

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Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(u) Recently Adopted or Newly Issued Accounting Standards

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, to clarify the principles for recognizing revenue and to improve financial reporting by creating common revenue recognition guidance for U.S. generally accepted accounting principles and International Financial Reporting Standards. The ASU was adopted on July 1, 2018 using the cumulative effect method for those contracts that were not substantially completed as of July 1, 2018. Results for reporting periods after July 1, 2018 are presented under ASC Topic 606, while prior period amounts continue to be presented in accordance with the Corporation's historical accounting under *Revenue Recognition (Topic 605)*. The adoption of the ASU primarily changes the Corporation's presentation of revenues and the provision and allowance for bad debts. The ASU requires that the Corporation recognize revenue based on an estimate of the transaction price expected to be collected as a result of satisfying the performance obligation. Accordingly, for performance obligations satisfied after July 1, 2018, the Corporation no longer separately presents a provision for bad debts on the consolidated statements of operations and changes in net assets without donor restrictions or the related allowance for bad debts on the consolidated balance sheets. The adoption of ASC Topic 606 did not have any impact on the Corporation's recognition of net patient service revenue for any period prior to adoption.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which requires lessees to recognize a lease liability and a right-of-use asset for all lease obligations with exception to short-term leases. The lease liability will represent the lessee's obligation to make lease payments arising from the lease measured on a discounted basis and the right-of-use asset will represent the lessee's right to use or control the use of a specified asset for a lease term. The lease guidance also simplifies accounting for sale-leaseback transactions. ASC Topic 842 is effective for the Corporation beginning on July 1, 2019. In 2018, the FASB updated its guidance allowing entities to adopt the provisions of the standard prospectively without adjusting comparative periods. The Corporation is planning to adopt this option. Management expects to record right-of-use assets and lease liabilities of approximately \$97,636 on its consolidated balance sheet in 2020. The adoption of ASC Topic 842 is not expected to have a significant impact on the results of operations or cash flows. The Corporation will include new disclosures in 2020 in accordance with ASC Topic 842.

In August 2016, the FASB issued ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities (Topic 958)*, to reduce diversity in reporting practice, reduce complexity, and enhance understandability of not-for-profit (NFP) financial statements. This ASU contains the following key aspects: (A) reduces the number of net asset classes presented from three to two: with donor restrictions and without donor restrictions; (B) requires all NFPs to present expenses by their functional and their natural classifications in one location in the financial statements; (C) requires NFPs to provide quantitative and qualitative information about management of liquid resources and availability of financial assets to meet cash needs within one year of the balance sheet date; and (D) retains the option to present operating cash flows in the statement of cash flows using either the direct or indirect method. The Corporation implemented ASU No. 2016-14 as of July 1, 2018, which was adopted retrospectively for the years ended June 30, 2019 and 2018.

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Notes to Consolidated Financial Statements

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The impact of adoption resulted in enhanced disclosures about the classification of expense and management of liquid resources. As a result of adoption, temporarily restricted and permanently restricted net assets in the amounts of \$71,779 and \$22,728, respectively, were combined to create net assets with donor restrictions as stated on the consolidated balance sheet as of June 30, 2018.

In March 2017, the FASB issued ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, which requires a company to present service cost separately from the other components of net benefit cost. This ASU is effective for the Corporation's year beginning July 1, 2019, with early adoption permitted. The Corporation is currently evaluating the extent of the anticipated impact of the adoption of ASU No. 2017-07. Upon adoption of the ASU, the Corporation will modify its financial statements and disclosures, including a retrospective reclassification of prior year balances.

In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which requires that a statement of cash flows explain the change during the reporting period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments in this update are effective for the Corporation's fiscal year beginning July 1, 2019. Early adoption is permitted.

(3) Revenue Recognition

(a) Net Patient Service Revenues

Net patient service revenue relates to contracts with patients involving third-party payors where the Corporation has an obligation to perform healthcare services. This revenue is recorded at the amount due from patients, third-party payors, and others when the performance obligations are satisfied. The adoption of ASU No. 2014-09, *Revenue from Contracts with Customers (ASC Topic 606)* resulted in changes to the presentation of the consolidated statements of operations and changes in net assets without donor restrictions with the provision of bad debts now being considered implicit price concessions that are recognized as a direct deduction to net patient service revenue rather than the presentation of the provision for bad debts, prior to adoption, as a deduction to arrive at net patient service revenue. For the year ended June 30, 2019, \$70,770 of implicit price concessions was recorded as a direct deduction to net patient service revenue. The Corporation bases the implicit price concessions on historical collectibility data by payor using a portfolio approach to recognize the deductions netted against revenue when it is recognized.

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.

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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, 2019 and 2018 were approximately \$63,108 and \$35,213, respectively.

(b) Disaggregation of Revenue

The Corporation earns the majority of its revenues from contracts with customers. Revenues and adjustments not related to contracts with customers are included in other revenue.

Total revenues from contracts with customers by payor are as follows for the years ended June 30:

| | 2019 | 2018 |
|-----------------------------|--------------|-------------|
| Medicare | \$ 1,089,872 | 973,630 |
| Medicaid | 348,378 | 350,856 |
| Commercial and other | 1,234,312 | 1,120,139 |
| Private pay | 43,391 | 101,859 |
| Net patient service revenue | 2,715,953 | 2,546,484 |
| Other revenue | 67,995 | 79,792 |
| Total revenue | \$ 2,783,948 | 2,626,276 |

(c) Variable Consideration

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.

Net patient service revenue is recognized at the time services are provided to patients. Revenue is recorded in the amount which the Corporation expects to collect, which may include variable components. Variable consideration is included in the transaction price to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with variable consideration is subsequently resolved. 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

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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 a decrease in net patient service revenue of approximately \$10,941 and increase of \$3,309 in 2019 and 2018, respectively.

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.

(d) Concentration of Credit Risk

There is a corresponding significant concentration of credit risk in net accounts receivable balances at June 30, 2019 and 2018:

| | 2019 | 2018 |
|----------------------|-------|-------|
| Medicare | 32 % | 30 % |
| Medicaid | 10 | 10 |
| Commercial and other | 47 | 50 |
| Private pay | 11 | 10 |
| | 100 % | 100 % |

(4) Fair Value of Financial Instruments

ASC Topic 820, *Fair Value Measurement*, requires 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 value measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety. In accordance with ASU No. 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, investments valued utilizing net asset value (NAV) as a practical expedient are excluded from the hierarchy.

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The fair value of cash and investments, other than those measured using NAV as a practical expedient for fair value, is estimated using quoted market prices multiplied by shares held or other observable inputs when quoted market prices are unavailable.

Registered mutual funds and money market funds are classified in Level 1 of the fair value hierarchy as defined above because their fair values are based on quoted prices for identical securities.

The common/collective trusts have been determined to trade daily on an active private exchange at NAV as the trading price and are classified in Level 1 of the fair value hierarchy, as defined above, because their fair values are based on quoted prices for identical securities.

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 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. Investments in hedge funds, real estate funds, and private equity investments are carried at estimated fair value using NAV as a practical expedient as determined by the external investment manager. 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. 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.

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, excluding joint ventures, which are accounted for under the equity method of accounting.

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(5) Investments

The composition of cash and investments carried at fair value on a recurring basis at June 30, 2019 is set forth in the following table:

| | June 30, 2019 | Fair value measurements at reporting date using | | |
|--|------------------|--|---------|---------|
| | | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Short-term investments: | | | | |
| Cash and cash equivalents | \$ 117,240 | 117,240 | — | — |
| Fixed income: | | | | |
| Government, municipal, foreign, and other | 224,707 | 161,674 | 63,033 | — |
| Mortgage and asset-backed securities | 108,596 | — | 108,596 | — |
| Corporate obligations | 149,742 | — | 149,742 | — |
| Mutual funds | 139,108 | 139,108 | — | — |
| Other short-term investments | 56,475 | 17,422 | 39,053 | — |
| Common/collective trusts | 15,356 | — | 15,356 | — |
| Total | 811,224 | 435,444 | 375,780 | — |
| Designated for capital acquisition: | | | | |
| Cash and cash equivalents | 28,567 | 28,567 | — | — |
| Fixed income: | | | | |
| Government, municipal, foreign, and other | 92,017 | 66 | 91,951 | — |
| Corporate obligations | 289 | 289 | — | — |
| Mutual funds: | | | | |
| Fixed income | 103,977 | 103,977 | — | — |
| Domestic equities | 399,707 | 399,707 | — | — |
| International equities | 349,240 | 349,240 | — | — |
| Other long-term equity investments | 46,117 | 45,962 | 155 | — |
| Common/collective trusts | 12,848 | — | 12,848 | — |
| Hedge funds and other | 58,547 | — | 58,547 | — |
| Total | 1,091,309 | 927,808 | 163,501 | — |
| Funds designated for 457 plans: | | | | |
| Cash and short-term investments | 57,093 | 57,093 | — | — |
| Mutual funds | 1,531 | 1,531 | — | — |
| Total | 58,624 | 58,624 | — | — |

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| | June 30, 2019 | Fair value measurements at reporting date using | | |
|----------------------------------|---------------------|--|----------------|----------|
| | | Level 1 | Level 2 | Level 3 |
| Trustee-held funds: | | | | |
| Cash and cash equivalents | \$ 71 | 71 | — | — |
| Total | 71 | 71 | — | — |
| Total assets at fair value | <u>1,961,228</u> | <u>\$ 1,421,947</u> | <u>539,281</u> | <u>—</u> |
| Investments measured at NAV: | | | | |
| Hedge funds | 169,169 | | | |
| Private equity | 23,910 | | | |
| Real estate limited partnerships | <u>44,912</u> | | | |
| Total assets | <u>\$ 2,199,219</u> | | | |
| Liabilities: | | | | |
| Interest rate swaps | \$ 123,500 | — | 123,500 | — |
| Total liabilities | <u>\$ 123,500</u> | <u>—</u> | <u>123,500</u> | <u>—</u> |

The composition of cash and investments carried at fair value on a recurring basis at June 30, 2018 is set forth in the following table:

| | June 30, 2018 | Fair value measurements at reporting date using | | |
|--|------------------|--|----------------|----------|
| | | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Short-term investments: | | | | |
| Cash and cash equivalents | \$ 70,697 | 70,697 | — | — |
| Fixed income: | | | | |
| Government, municipal, foreign, and other | 412,852 | — | 412,852 | — |
| Mortgage and asset-backed securities | 53,286 | — | 53,286 | — |
| Corporate obligations | 175,948 | — | 175,948 | — |
| Mutual funds: | | | | |
| Equity | 141,814 | 141,814 | — | — |
| Common/collective trusts | 25,711 | — | 25,711 | — |
| Other short-term investments | <u>724</u> | <u>—</u> | <u>724</u> | <u>—</u> |
| Total | <u>881,032</u> | <u>212,511</u> | <u>668,521</u> | <u>—</u> |

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| | June 30, 2018 | Fair value measurements at reporting date using | | |
|--|---------------------|--|----------------|----------|
| | | Level 1 | Level 2 | Level 3 |
| Designated for capital acquisition: | | | | |
| Cash and cash equivalents | 7,322 | 7,322 | — | — |
| Fixed income: | | | | |
| Government, municipal, foreign, and other | 87,556 | — | 87,556 | — |
| Mortgage and asset-backed securities | 28,247 | — | 28,247 | — |
| Corporate obligations | 54,679 | — | 54,679 | — |
| Mutual funds: | | | | |
| Fixed income | 25,037 | 25,037 | — | — |
| Domestic equities | 450,402 | 450,402 | — | — |
| International equities | 343,414 | 343,414 | — | — |
| Other long-term equity investments | 11,011 | 10,857 | 154 | — |
| Hedge funds and other | 55,389 | — | 55,389 | — |
| Total | <u>1,063,057</u> | <u>837,032</u> | <u>226,025</u> | <u>—</u> |
| Funds designated for 457 plans: | | | | |
| Cash and short-term investments | 1,397 | 1,397 | — | — |
| Mutual funds | 51,565 | 51,565 | — | — |
| Total | <u>52,962</u> | <u>52,962</u> | <u>—</u> | <u>—</u> |
| Trustee-held funds: | | | | |
| Cash and cash equivalents | 1,545 | 1,545 | — | — |
| Total | <u>1,545</u> | <u>1,545</u> | <u>—</u> | <u>—</u> |
| Total assets at fair value | 1,998,596 | \$ <u>1,104,050</u> | <u>894,546</u> | <u>—</u> |
| Investments measured at NAV: | | | | |
| Hedge funds | 148,908 | | | |
| Private equity | 6,487 | | | |
| Total assets | \$ <u>2,153,991</u> | | | |
| Liabilities: | | | | |
| Interest rate swaps | \$ 91,915 | — | 91,915 | — |
| Total liabilities | \$ <u>91,915</u> | <u>—</u> | <u>91,915</u> | <u>—</u> |

The Corporation holds investments in private equity and distressed debt limited partnerships where NAV is used as a practical expedient to measure fair value at June 30, 2019 and 2018. These partnerships do not

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allow for periodic redemptions but rather liquidate upon the termination date as stated in the partnership agreement. Therefore, the private equity investments are considered illiquid investments. At June 30, 2019 and 2018, the Corporation held \$23,910 and \$6,487, respectively, of private equity and distressed debt limited partnerships that had termination dates that ranged from 2019 to 2024.

| | <u>2019</u> | <u>2018</u> | <u>Unfunded commitments</u> |
|-----------------|------------------|--------------|---------------------------------|
| Distressed debt | \$ 1,067 | 1,384 | 1,899 |
| Private equity | 22,843 | 5,103 | 11,626 |
| Total | \$ <u>23,910</u> | <u>6,487</u> | <u>13,525</u> |

The following table summarizes investments measured at fair value based on NAV per share as of June 30, 2019 and their redemption restrictions:

| | <u>Fair value at June 30, 2019</u> | <u>Fair value at June 30, 2018</u> | <u>Lockup terms or redemption restrictions</u> | <u>Redemption frequency</u> | <u>Redemption notice period</u> |
|-------------|--|--|--|---------------------------------|-------------------------------------|
| Hedge funds | \$ 32,265 | 33,993 | None | Monthly | 10 Days |
| Hedge funds | 15,842 | 15,763 | None | Monthly | 30 Days |
| Hedge funds | 17,305 | 15,573 | Gate at 20% of total fund net assets | Monthly | 60 Days |
| Hedge funds | 2,769 | 7,229 | None | Monthly | 75 Days |
| Hedge funds | 28,987 | 34,285 | None | Semimonthly | 30 Days |
| Hedge funds | 16,268 | 15,624 | Gate at 50% of total fund net assets | Quarterly | 60 Days |
| Hedge funds | 16,075 | 15,429 | Gate at 10% | Quarterly | 65 Days |
| Hedge funds | 11,358 | 11,012 | Withdrawal limits across four successive withdrawal dates | Quarterly | 90 Days |
| Hedge funds | 12,374 | — | None | Monthly | 30 Days |
| Hedge funds | 6,957 | — | None | Quarterly | 90 Days |
| Hedge funds | 8,969 | — | None | Quarterly | 60 Days |
| Real estate | 22,778 | — | First business day of the calendar quarter with 45 days notice. | Quarterly | 45 Days |
| Real estate | 22,134 | — | Two-year lock up period | N/A | N/A |
| | \$ <u>214,081</u> | <u>148,908</u> | | | |

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Investment return is included in other income (expense) as part of nonoperating income in the consolidated statements of operations and changes in net assets without donor restrictions. Investment return comprises the following for the years ended June 30, 2019 and 2018:

| | <u>2019</u> | <u>2018</u> |
|---|-------------------|---------------|
| Interest and dividend income | \$ 42,371 | 35,906 |
| Net realized gains on sales of investments | 24,881 | 55,508 |
| Net change in unrealized gains on investments | <u>36,282</u> | <u>1,616</u> |
| Investment return, net | <u>\$ 103,534</u> | <u>93,030</u> |

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. Health Venture's ownership interest in the joint ventures ranged from approximately 24.2% and 50.0% at both June 30, 2019 and 2018, respectively. As of June 30, 2019 and 2018, the carrying value of the joint ventures was approximately \$15,273 and \$14,518, respectively, and is recorded in investments in joint ventures and other on the consolidated balance sheets. Equity earnings from the joint ventures of \$9,842 and \$9,744 for the years ended June 30, 2019 and 2018, respectively, are included in other operating revenue. The unaudited assets, liabilities, and equity of these joint ventures accounted for under the equity method were \$42,384, \$10,382, and \$32,002, respectively, at June 30, 2019 and \$43,811, \$14,479, and \$29,332, respectively, at June 30, 2018.

At June 30, 2019, Health Ventures had a controlling ownership of 51.02% in Riverbend Ambulatory Surgery Center, which is consolidated within Health Ventures.

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(6) Long-Term Debt

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

| | Maturing through | Coupon rates | | Unpaid principal | |
|---|---------------------|--------------|--------------|------------------|---------|
| | | 2019 | 2018 | 2019 | 2018 |
| (In thousands of dollars) | | | | | |
| Master trust debt: | | | | | |
| Fixed rate: | | | | | |
| Series 2008 Washington Bonds, Series A | | — % | 5.00 % | \$ — | 80,650 |
| Series 2009 Oregon Bonds, Series A | | — % | 3.25–5.00% | — | 75,060 |
| Series 2009 Washington Bonds, Series A | | — % | 3.00–5.00% | — | 67,165 |
| 2012 Direct Note Obligation to Bank of America | 2022 | 2.32 % | 2.32 % | 21,235 | 26,917 |
| 2013 Direct Note Obligation to Bank of America | 2023 | 3.23 % | 3.23 % | 23,679 | 28,685 |
| 2013 Direct Note Obligation to Bank of America | 2023 | 3.92 % | 3.92 % | 153,221 | 158,392 |
| 2013 Direct Note Obligation to US Bank | 2020 | 3.43 % | 3.43 % | — | 50,000 |
| Series 2014 Washington Bonds, Series A | 2028 | 2.00–5.00% | 2.00–5.00% | 30,105 | 32,385 |
| Series 2014 Oregon Bonds, Series A | 2032 | 4.125%–5.00% | 4.125%–5.00% | 62,555 | 64,015 |
| Series 2018 Taxable Bonds | 2048 | 4.79% | — % | 355,144 | — |
| Total fixed rate | | | | \$ 645,939 | 583,269 |
| Variable: | | | | | |
| Series 2008 Oregon Bonds, Series A-B, variable interest rate (A: SIFMA +35 bps and B: SIFMA + 42 bps) | | — % | 0.02 % | \$ — | 145,975 |
| Series 2011 Oregon Bonds, Series A-B, variable interest rate (A: 80%*1ml +62 bps and B: 68%*1ml +57.5 bps), | 2047 | 2.21 % | 2.16 % | 75,000 | 150,000 |
| Series 2013 Washington Bonds, Series A, variable interest rate (68%*1ml+ 70 bps), | 2034 | 2.36 % | 2.05 % | 46,265 | 47,565 |
| 2015 Direct Note Obligation to US Bank, variable interest rate (1ml+ 75 bps), | 2020 | 2.97 % | 2.73 % | 2,188 | 4,208 |
| Series 2018 Oregon Bonds, Series A variable interest rate (prevailing market rates), | 2034 | 1.92 % | — % | 45,975 | — |
| Series 2018 Oregon Bonds, Series B variable interest rate (prevailing market rates), | 2034 | 1.92 % | — % | 100,000 | — |
| Series 2018 Oregon Bonds, Series C variable interest rate (80%1ml+ 62 bps), | 2047 | 2.57 % | — % | 75,000 | — |
| Total variable rate | | | | \$ 344,428 | 347,748 |

* ML as used in the table above is defined as monthly LIBOR.

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| | Maturing through | Coupon rates | | Unpaid principal | |
|---|---------------------|--------------|------|---------------------------|-----------|
| | | 2019 | 2018 | 2019 | 2018 |
| | | | | (In thousands of dollars) | |
| Unpaid principal, master trust debt | | | | \$ 990,367 | 931,018 |
| Premium and other on long-term debt | | | | 2,571 | 10,603 |
| Master trust debt, including premiums and discounts, net | | | | 992,938 | 941,621 |
| Other long-term debt | | | | 10,881 | 12,058 |
| Total long-term debt | | | | 1,003,819 | 953,679 |
| Less amounts due within one year | | | | (24,933) | (106,282) |
| Total long-term debt due after one year | | | | \$ 978,886 | 847,397 |

PeaceHealth Networks and PeaceHealth are the sole members of the PeaceHealth 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.

PeaceHealth issued debt in fiscal year 2019 to diversify its debt profile and raise funds for future capital needs. Series 2018 taxable fixed rate bonds with a par amount of \$355,144 were issued to refinance the 2008 Washington Bonds Series A and 2013 direct note obligation with US Bank, defease the 2009 Oregon Bonds Series A and 2009 Washington Bonds Series A and provide \$70,000 of funds for future capital needs. PeaceHealth issued 2018 tax-exempt Oregon variable rate demand bonds Series A-B to refinance the outstanding 2008 Oregon Bonds Series A-B. Additionally, PeaceHealth issued 2018 tax-exempt Oregon Bonds Series C to refinance the 2011 Oregon Bonds Series A.

The Series 2011 Oregon Series A-B Direct Placement Bonds, the Washington 2013(A) Direct Placement Bonds, and the 2018 Oregon Series A-B Variable Rate Demand 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 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 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 2020 for Series (A) and August 2021 for Series (B). The continuing covenant agreement for the Washington 2013(A) bonds requires a minimum two-year notice period prior to any anniversary of the date of issue occurring on or after February 27, 2016 to be given from the bank to PeaceHealth if the bank chooses to no longer hold the debt, provided that PeaceHealth is in compliance with financial covenants. With the exception of the Washington 2013(A) bonds, where the bank must give a two-year notice if it wishes to terminate its holding of PeaceHealth's debt, 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 2011 and

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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.

Other long-term debt includes \$10,399 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:

| | <u>Long-term debt</u> | <u>Capitalized leases and other</u> | <u>Total</u> |
|--|---------------------------|---|---------------------|
| Year ending June 30: | | | |
| 2020 | \$ 24,780 | 882 | 25,662 |
| 2021 | 23,443 | 1,921 | 25,364 |
| 2022 | 24,304 | 475 | 24,779 |
| 2023 | 22,144 | 476 | 22,620 |
| 2024 | 139,914 | 476 | 140,390 |
| Thereafter | <u>755,782</u> | <u>9,033</u> | <u>764,815</u> |
| Total | \$ <u>990,367</u> | 13,263 | 1,003,630 |
| Less amounts representing interest | | <u>(2,382)</u> | (2,382) |
| Present value of net minimum capital lease payments | | \$ <u>10,881</u> | |
| Total long-term debt | | | \$ <u>1,001,248</u> |

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.

Cash paid for interest totaled approximately \$35,048 and \$31,898 for the years ended June 30, 2019 and 2018, respectively.

Deferred financing costs are amortized over the lives of the related debt issuances using the effective-interest method.

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(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 Topic 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 and changes in net assets without donor restrictions.

The Corporation has interest rate swap contracts outstanding as of June 30, 2019 and 2018, respectively, with a total current notional amount of approximately \$372,675 and \$376,625. The Corporation uses the fixed payor swaps to convert a portion of the outstanding variable rate bonds to fixed rates ranging from 3.50% to 4.10%. The fixed payor 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 primarily due to changes in market bond yields, as well as 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 \$31,585 and a decrease of \$21,174 in the liability for the years ended June 30, 2019 and 2018, respectively. Net cash settlement cost for the interest rate swaps was \$8,762 and \$10,955, for the years ended June 30, 2019 and 2018, respectively. The amortization of the accumulated hedge effectiveness included in net assets was \$78 for both years ended June 30, 2019 and 2018.

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 \$8,310 and \$8,407, as of June 30, 2019 and 2018, respectively. Recording the interest rate swaps at fair value results in a total liability of \$123,500 and \$91,915 as of June 30, 2019 and 2018, respectively, in other long-term liabilities in the accompanying consolidated balance sheets rather than the \$131,810 and \$100,322 that would be paid if all of the swaps were terminated as of June 30, 2019 and 2018, 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 (note 5).

The Corporation currently has four 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.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

The following is a summary of the derivative instruments in place as of June 30, 2019 and 2018:

| <u>Maturity date</u> | <u>Current notional amounts at June 30, 2019</u> | <u>Current notional amounts at June 30, 2018</u> | <u>Counterparty</u> | <u>Credit value adjustment at June 30, 2019</u> | <u>Liability fair value at June 30, 2019</u> | <u>Credit value adjustment at June 30, 2018</u> | <u>Liability fair value at June 30, 2018</u> |
|----------------------|--|--|-------------------------------------|---|--|---|--|
| August 01, 2034 | \$ 45,000 | 45,000 | Union Bank, N.A. | \$ 504 | (13,026) | 484 | (9,749) |
| May 24, 2047 | 75,000 | 75,000 | Deutsche Bank AG | 3,152 | (33,959) | 3,251 | (24,946) |
| May 22, 2047 | 75,000 | 75,000 | Deutsche Bank AG | 3,152 | (33,959) | 3,250 | (24,946) |
| August 01, 2034 | 50,000 | 50,000 | U.S. Bank N.A. | 586 | (15,103) | 570 | (11,454) |
| August 01, 2034 | 50,000 | 50,000 | U.S. Bank N.A. | 585 | (15,092) | 569 | (11,443) |
| September 01, 2034 | 44,925 | 46,225 | Morgan Stanley Capital Services LLC | 279 | (8,634) | 247 | (6,325) |
| September 01, 2034 | 32,750 | 35,400 | Morgan Stanley Capital Services LLC | 52 | (3,727) | 36 | (3,052) |
| | <u>\$ 372,675</u> | <u>376,625</u> | | <u>\$ 8,310</u> | <u>(123,500)</u> | <u>8,407</u> | <u>(91,915)</u> |

(8) Benefit Plans

(a) 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.

A plan amendment was made effective December 31, 2016 to spin off a group of participants into PeaceHealth SWHS Frozen DB Pension Plan II. As of that date, the Plan was renamed PeaceHealth SWHS Frozen DB Pension Plan I. The PeaceHealth SWHS Plan I and Plan II are collectively referred as "the Plans." Plan provisions are identical between the Plans. The plan split was effective January 1, 2017.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

The following table sets forth disclosures related to the Plans in accordance with FASB ASC Paragraph 715-20-65, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, as of June 30, 2019 and 2018, measured as of January 1, 2019 and January 1, 2018, respectively:

| | Years ended June 30 | |
|---|----------------------------|-----------------|
| | 2019 | 2018 |
| Change in projected benefit obligation: | | |
| Projected benefit obligation (PBO) at beginning of period | \$ 230,593 | 250,060 |
| Service cost | 1,370 | 1,680 |
| Interest cost | 8,376 | 7,728 |
| Actuarial gain on PBO | 24,021 | (10,848) |
| Benefits and administrative expenses paid | <u>(11,085)</u> | <u>(18,027)</u> |
| Projected benefit obligation at June 30 | <u>\$ 253,275</u> | <u>230,593</u> |
| Change in fair value of plan assets: | | |
| Fair value of assets at beginning of period | \$ 187,958 | 181,009 |
| Actual return on plan assets | 18,430 | 13,776 |
| Employer contribution | 5,203 | 11,200 |
| Benefits paid | (9,576) | (16,200) |
| Administrative expenses | <u>(1,509)</u> | <u>(1,827)</u> |
| Fair value of assets at June 30 | <u>\$ 200,506</u> | <u>187,958</u> |
| Reconciliation of funded status: | | |
| Funded status | <u>\$ (52,768)</u> | <u>(42,634)</u> |
| Net amount recognized | <u>\$ (52,768)</u> | <u>(42,634)</u> |
| Amounts recognized in the consolidated balance sheets consist of: | | |
| Accrued pension liability | \$ 52,768 | 42,634 |
| Accumulated change in net assets | (26,109) | (15,975) |

Net periodic benefit cost for the years ended June 30, 2019 and 2018 included the following components and is included in changes in net assets without donor restrictions:

| | 2019 | 2018 |
|--------------------------------|-----------------|--------------|
| Service cost | \$ 1,370 | 1,680 |
| Interest cost | 8,376 | 7,728 |
| Expected return on plan assets | (12,721) | (12,432) |
| Amortization of loss | <u>5,017</u> | <u>6,565</u> |
| Net periodic pension cost | <u>\$ 2,042</u> | <u>3,541</u> |

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(b) Assumptions

The Corporation used the following actuarial assumptions to determine its benefit obligations at June 30, 2019 and 2018 with measurement dates of June 30, 2019 and 2018:

| | <u>2019</u> | <u>2018</u> |
|---------------|-----------------------------------|-----------------------------------|
| Discount rate | Plan I 3.30% and Plan II 3.26% | Plan I 4.03% and Plan II 3.99% |

The Corporation used the following actuarial assumptions to determine its net periodic benefit cost for the years ended June 30, 2019 and 2018:

| | <u>2019</u> | <u>2018</u> |
|--|-------------|-------------|
| Discount rate | 4.03 % | 3.70 % |
| Expected long-term rate of return on plan assets | 6.80 | 7.00 |

This discount rate is based on a proprietary yield curve tool used by the Plans' actuary, which uses a composite of high-yield, investment-grade corporate bonds, and the projected payouts from the Plans 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 a gain of approximately 9.41% and 11.30% for Plan I and Plan II, respectively, during the year ended June 30, 2019. The actual return on pension plan assets was a gain of approximately 7.30% for both Plan I and Plan II during the year ended June 30, 2018. 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.

(c) Pension Plan Assets

The asset allocation of the Corporation's pension plan at June 30, 2019 and 2018 is as follows:

| | <u>2019</u> | <u>2018</u> |
|-------------------|-------------------|----------------|
| Equity securities | \$ 80,712 | 110,807 |
| Debt securities | 119,046 | 76,057 |
| Other | 748 | 1,094 |
| Total | \$ <u>200,506</u> | <u>187,958</u> |

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

Pension plan assets are managed according to an investment policy adopted by the Plans' 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 Plans' 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 40% bonds and 60% equity. Assets are rebalanced quarterly when balances fall outside of the approved range for each asset class.

In accordance with FASB ASC Topic 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 Topic 820 are further discussed in note 3.

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

- The fair value of cash, money market funds, and mutual funds is estimated using quoted market prices or other observable inputs when quoted market prices are unavailable.
- Private equity fund: Valued at the NAV as a practical expedient 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.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

The following table sets forth by level, within the fair value hierarchy, the Plans' assets at fair value as of June 30, 2019:

| <u>Assets</u> | <u>Total fair value</u> | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> |
|---------------------------------|-------------------------|----------------|----------------|----------------|
| Mutual funds: | | | | |
| Equity securities | \$ 48,235 | 48,235 | — | — |
| Debt securities | 32,477 | 32,477 | — | — |
| Total mutual fund securities | 80,712 | 80,712 | — | — |
| Other securities: | | | | |
| Cash and money markets | 119,046 | 119,046 | — | — |
| Total other securities | 119,046 | 119,046 | — | — |
| Total plan assets at fair value | 199,758 | \$ 199,758 | — | — |
| Investments at NAV | 748 | | | |
| Total plan assets | \$ 200,506 | | | |

The following table sets forth by level, within the fair value hierarchy, the Plans' assets at fair value as of June 30, 2018:

| <u>Assets</u> | <u>Total fair value</u> | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> |
|---------------------------------|-------------------------|----------------|----------------|----------------|
| Mutual funds: | | | | |
| Equity securities | \$ 110,807 | 110,807 | — | — |
| Debt securities | 76,057 | 76,057 | — | — |
| Total mutual fund securities | 186,864 | 186,864 | — | — |
| Other securities: | | | | |
| Cash and money markets | 50 | 50 | — | — |
| Total other securities | 50 | 50 | — | — |
| Total plan assets at fair value | 186,914 | \$ 186,914 | — | — |
| Investments at NAV | 1,044 | | | |
| Total plan assets | \$ 187,958 | | | |

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

The following table provides information regarding redemption of investments where NAV has been used as a practical expedient at June 30, 2019 and June 30, 2018:

| | <u>2019</u> | <u>2018</u> |
|----------------|---------------|--------------|
| Private equity | \$ 748 | 1,044 |
| Total | \$ <u>748</u> | <u>1,044</u> |

At June 30, 2019 and 2018, the Plans held \$748 and \$1,044, respectively, in alternative investments that are not actively marketed on an open exchange. These investments consist of shares or units in investment funds as opposed to direct interests in the funds' underlying holdings, which may be marketable. Due to the nature of these funds, the NAV is used as a practical expedient to measure fair value at June 30, 2019 and 2018. These private equity partnerships do not allow for periodic redemptions but rather liquidate upon the termination date as stated in the partnership agreement. Therefore, the private equity investment is considered an illiquid investment. At June 30, 2019, the Corporation held \$748 of private equity limited partnerships that had a termination date of June 2020, but may be extended by up to three additional one-year periods.

(d) 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 the start of fiscal year 2020, the Corporation contributed \$8,800 to the Plan for the plan year ended December 31, 2018. In the start of fiscal year 2019, the Corporation contributed \$5,203 to the Plan for the plan year ended December 31, 2017.

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

| | <u>Pension benefits</u> |
|-----------|-----------------------------|
| 2020 | \$ 13,168 |
| 2021 | 12,469 |
| 2022 | 12,878 |
| 2023 | 13,228 |
| 2024 | 13,514 |
| 2025–2029 | 69,716 |

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

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

(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 \$77,116 and \$73,327 for the years ended June 30, 2019 and 2018, respectively, which are included in payroll taxes and benefits in the accompanying consolidated statements of operations and changes in net assets without donor restrictions.

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 \$58,624 and \$52,962 at June 30, 2019 and 2018, 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 2019 and 2018 were \$9,235 and \$7,972, respectively, and are included in payroll taxes and benefits in the accompanying consolidated statements of operations and changes in net assets without donor restrictions.

(10) Net Assets with Donor Restrictions

Net assets with donor restrictions are available for the following purposes at June 30:

| | <u>2019</u> | <u>2018</u> |
|--|------------------|---------------|
| Purchase of property, plant, and equipment | \$ 8,009 | 13,788 |
| Hospice and indigent care | 14,643 | 15,445 |
| Patient care | 24,461 | 25,244 |
| Childrens services | 2,246 | 3,100 |
| Training and education | 1,796 | 3,572 |
| Other | 37,759 | 33,358 |
| | <u>\$ 88,914</u> | <u>94,507</u> |

Approximately \$7,188 and \$3,095 was released from restriction for capital expenditures made during 2019 and 2018, respectively.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

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 fundraising activities to several fundraising 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, 2019 and 2018, the following liabilities for annuity contracts issued under the PeaceHealth license and reserve account investments were recorded:

| | <u>2019</u> | <u>2018</u> |
|--|-------------|-------------|
| State of Washington gift annuity liabilities (other long-term liabilities) | \$ 512 | 495 |
| Gift annuity reserve accounts (other assets whose use is limited, cash, and investments) | 587 | 619 |

(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.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

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, 2019 are as follows:

| | Operating leases |
|---------------------------------|-----------------------------|
| Year ending June 30: | |
| 2020 | \$ 17,896 |
| 2021 | 18,045 |
| 2022 | 17,292 |
| 2023 | 13,449 |
| 2024 | 10,852 |
| Later years, 2025 through 2029 | <u>25,632</u> |
| Total minimum lease payments | <u>\$ 103,166</u> |

Rent expense related to all operating leases was \$27,280 and \$23,503 during the years ended June 30, 2019 and 2018, respectively, and was included in purchased services in the consolidated statements of operations and changes in net assets without donor restrictions.

(c) Collective Bargaining Agreements

Approximately 56% and 53% of the Corporation's employees are covered under collective bargaining agreements, including nurses, professional employees, and service employees as of June 30, 2019 and 2018, respectively. The Corporation is currently negotiating certain expired collective bargaining agreements. The Corporation's various collective bargaining agreements expire between March 2019 and September 2021.

(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. During the year ended June 30, 2019, the Corporation dissolved the trust. 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 2019 and 2018 was \$5,000 per occurrence and \$17,000 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.

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

Based on actuarial studies, the Corporation has recorded an undiscounted liability for all of the self-insurance programs of approximately \$92,762 and \$91,682 at June 30, 2019 and 2018, 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 \$19,166 and \$27,627 at June 30, 2019 and 2018, respectively. Management has recorded amounts receivable from excess insurance carriers totaling approximately \$7,302 and \$7,451 as of June 30, 2019 and 2018, 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, 2019 and 2018, the carrying value of AEIX was approximately \$4,744 and \$3,587, 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 and change in net assets without donor restrictions.

(13) Functional Expenses

The Corporation provides general healthcare services to residents within its geographic location. Operating expenses related to providing these services classified by their natural classification on the consolidated statements of operations and changes in unrestricted net assets are presented by their functional classifications as follows for the year ended June 30:

| | 2019 | | |
|---|-------------------------|---------------------------------------|---------------------------|
| | Patient care | General and administrative | Total expenses |
| Salaries and wages | \$ 1,287,207 | 61,437 | 1,348,644 |
| Payroll taxes and benefits | 137,459 | 140,835 | 278,294 |
| Supplies | 422,468 | 485 | 422,953 |
| Purchased services | 223,358 | 41,039 | 264,397 |
| Other | 226,376 | 20,076 | 246,452 |
| Depreciation and amortization | 96,486 | 42,186 | 138,672 |
| Interest and amortization of deferred financing costs | 540 | 34,656 | 35,196 |
| Total | <u>\$ 2,393,894</u> | <u>340,714</u> | <u>2,734,608</u> |

PEACEHEALTH NETWORKS

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

| | 2018 | | |
|---|-------------------------|---------------------------------------|---------------------------|
| | Patient care | General and administrative | Total expenses |
| Salaries and wages | \$ 1,205,374 | 55,314 | 1,260,688 |
| Payroll taxes and benefits | 128,341 | 128,185 | 256,526 |
| Supplies | 397,637 | 738 | 398,375 |
| Purchased services | 190,380 | 31,299 | 221,679 |
| Other | 221,470 | 6,175 | 227,645 |
| Depreciation and amortization | 95,715 | 43,354 | 139,069 |
| Interest and amortization of deferred financing costs | 583 | 31,315 | 31,898 |
| Total | \$ <u>2,239,500</u> | <u>296,380</u> | <u>2,535,880</u> |

(14) Discontinued Operations – Columbia United Providers

PeaceHealth Networks' majority-owned subsidiary, Columbia United Providers (CUP), entered into an asset purchase agreement to sell certain Medicaid assets to Molina Health Care of Washington, Inc. (Molina) on December 31, 2015. Molina purchased the right to assume CUP's Medicaid membership in the state of Washington, as well as certain other rights and assets, including the assumption of CUP's assignable provider contracts, related to the operation of the Medicaid business. As of December 31, 2015, CUP discontinued all of its Medicaid and Individual healthcare plan coverages, and subsequently discontinued all administrative services only (ASO) services provided to local companies. CUP withdrew its certificate of authority with the Washington State Office of the Insurance Commissioner effective April 30, 2017 and is in the final stages of the dissolution process.

The results of CUP from discontinued operations are disclosed under discontinued operations for the years ended June 30, 2019 and 2018. Total from operations of CUP were a gain of \$0 and a gain of \$4,045 for the years ended June 30, 2019 and 2018, respectively. CUP is in the final stages of discontinuation and closed as of June 30, 2019.

(15) 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 27, 2019, which is the date the consolidated financial statements were issued.