SALEM HEALTH HOSPITALS AND CLINICS

Consolidated Financial Statements and Supplemental Schedules

June 30, 2019 and 2018

(With Independent Auditors' Report Thereon)

SALEM HEALTH HOSPITALS AND CLINICS

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

Independent Auditors' Report

The Board of Trustees
Salem Health Hospitals and Clinics:

We have audited the accompanying consolidated financial statements of Salem Health Hospitals and Clinics and its subsidiaries, which comprise the consolidated balance sheets as of June 30, 2019 and 2018, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 Salem Health Hospitals and Clinics and its subsidiaries as of June 30, 2019 and 2018, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in note 2 to the consolidated financial statements, in fiscal year 2019, Salem Health Hospitals and Clinics adopted new accounting guidance in Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities* (Topic 958), and ASU No. 2016-01, *Financial Instruments* (Topic 825). Our opinion is not modified with respect to this matter.

Other Matters

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as whole. The lean initiatives information included in note 15 is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

The supplementary consolidating information included in schedules 1 through 4 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

KPMG LLP

Portland, Oregon
October 4, 2019

SALEM HEALTH HOSPITALS AND CLINICS

Consolidated Balance Sheets

June 30, 2019 and 2018

(In thousands)

Assets		**2019**	**2018**
Current assets:			
Cash and cash equivalents	$	15,547	18,816
Patient accounts receivable, less reserves for price concessions		101,503	91,683
Other receivables		17,150	15,579
Supplies inventory		8,174	7,166
Prepaid expenses and other		8,942	6,424
Total current assets		151,316	139,668
Investments		740,651	700,417
Property and equipment, net		481,268	469,229
Rental and other property held for future development, net of accumulated depreciation of $4,023 in 2019 and $3,447 in 2018		32,050	23,374
Investments in health related entities		21,183	545
Other noncurrent assets		5,501	5,571
Total assets	$	1,431,969	1,338,804
Liabilities and Net Assets			
Current liabilities:			
Accounts payable	$	40,837	43,434
Accrued liabilities:			
Payroll, payroll taxes, and withholdings		14,075	7,856
Paid time off		20,727	19,827
Other		12,506	11,710
Estimated third-party payor settlements, net		3,004	1,972
Current portion of long-term debt		6,346	6,055
Current portion of estimated professional liability		1,759	1,663
Total current liabilities		99,254	92,517
Long-term debt, net of current portion		266,044	272,360
Accrued postretirement healthcare benefits		6,978	5,504
Fair value of interest rate swap agreement		11,982	9,159
Other long-term liabilities		133	111
Estimated professional liability, net of current portion		8,212	7,763
Total liabilities		392,603	387,414
Net assets:			
Without donor restrictions		1,033,295	945,351
With donor restrictions		6,071	6,039
Total net assets		1,039,366	951,390
Total liabilities and net assets	$	1,431,969	1,338,804

See accompanying notes to consolidated financial statements.

SALEM HEALTH HOSPITALS AND CLINICS

Consolidated Statements of Operations

Years ended June 30, 2019 and 2018

(In thousands)

		2019	2018
Operating revenue:			
Net patient service revenue	$	802,200	756,455
Other revenue		46,650	42,987
Net assets released from donor restriction used for operations		553	533
Total operating revenues		849,403	799,975
Operating expenses:			
Labor and benefits		464,263	428,643
Medical and other supplies		117,731	111,173
Purchased services and other		131,555	118,134
Depreciation		46,885	44,979
Professional fees		27,244	30,950
Interest and amortization		10,565	10,586
Total operating expenses		798,243	744,465
Excess of revenue over expenses from operations		51,160	55,510
Other income (expense):			
Investment income, net		43,323	54,018
Loss on disposal of property and equipment		(787)	(262)
Other, net		(1,572)	(2,400)
Total other income, net		40,964	51,356
Excess of revenue over expenses		92,124	106,866
Change in fair value of interest rate swap agreement		(2,823)	3,715
Change in net unrealized gain or loss on fixed income investments		473	(6,495)
Change in postretirement benefit obligation		(1,898)	(1,050)
Net assets released from donor restriction used for property and equipment		68	22
Change in net assets without donor restrictions	$	87,944	103,058

See accompanying notes to consolidated financial statements.

SALEM HEALTH HOSPITALS AND CLINICS

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2019 and 2018

(In thousands)

	Without donor restrictions	With donor restrictions	Total
Net assets at June 30, 2017	$ 842,293	5,758	848,051
Excess of revenue over expenses	106,866	—	106,866
Change in net unrealized gain (loss) on other-than-trading securities	(6,495)	—	(6,495)
Change in fair value of interest rate swap agreement	3,715	—	3,715
Change in postretirement benefit obligation	(1,050)	—	(1,050)
Net assets released from restriction used for property		—	
and equipment	22	(22)	—
Contributions with donor restrictions	—	578	578
Donor restricted investment and other income, net	—	258	258
Net assets released from restrictions for operations	—	(533)	(533)
Change in net assets	103,058	281	103,339
Net assets at June 30, 2018	945,351	6,039	951,390
Excess of revenue over expenses	92,124	—	92,124
Change in net unrealized gain (loss) on other-than-trading securities	473	—	473
Change in fair value of interest rate swap agreement	(2,823)	—	(2,823)
Change in postretirement benefit obligation	(1,898)	—	(1,898)
Net assets released from restriction used for property and equipment	68	(68)	—
Contributions with donor restrictions	—	542	542
Donor restricted investment and other income, net	—	111	111
Net assets released from restrictions for operations	—	(553)	(553)
Change in net assets	87,944	32	87,976
Net assets at June 30, 2019	$ 1,033,295	6,071	1,039,366

See accompanying notes to consolidated financial statements.

SALEM HEALTH HOSPITALS AND CLINICS

Consolidated Statements of Cash Flows

Years ended June 30, 2019 and 2018

(In thousands)

		2019	2018
Cash flows from operating activities:			
Change in net assets	$	87,976	103,339
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		46,662	44,616
Change in net unrealized gains on investments and realized gains on sales of investments		(28,588)	(28,761)
Change in fair value of interest rate swap agreement		2,823	(3,715)
Cash collections on contributions for long-term purposes		(68)	(23)
Loss on disposal of property and equipment		787	262
Equity income (loss) on joint venture		(1,269)	—
Equity distributions from joint venture		782	—
Changes in operating assets and liabilities:			
Patient accounts receivable		(9,820)	(1,231)
Other receivables		(1,571)	186
Supplies inventory		(1,008)	(357)
Prepaid expenses		(2,518)	702
Other noncurrent assets		(81)	4,527
Accounts payable		3,204	1,718
Accrued liabilities		7,916	(2,836)
Estimated third-party payor settlements, net		1,032	(524)
Accrued postretirement healthcare benefits		1,474	551
Other long-term liabilities		22	(20)
Estimated professional liability		545	700
Net cash provided by operating activities		108,300	119,134
Cash flows from investing activities:			
Purchases of investments		(49,488)	(100,103)
Investment in joint venture		(20,000)	—
Proceeds from sales of investments		37,842	41,899
Proceeds from sales of property, rental, and other		1,333	147
Purchases of property and equipment and rental and other property		(76,098)	(44,355)
Net cash used in investing activities		(106,411)	(102,412)
Cash flows from financing activities:			
Repayment of long-term debt		(5,227)	(5,103)
Contributions with donor restrictions		68	23
Net cash used in financing activities		(5,159)	(5,080)
Net increase (decrease) in cash and cash equivalents		(3,270)	11,642
Cash and cash equivalents at beginning of year		18,816	7,174
Cash and cash equivalents at end of year	$	15,546	18,816
Supplemental disclosures of cash flow information:			
Cash paid for interest	$	10,588	11,132
Change in construction related payables		(5,803)	3,876

See accompanying notes to consolidated financial statements.

(1) Organization and Principles of Consolidation

Salem Health Hospitals and Clinics and its subsidiaries (collectively, the Corporation) are Oregon nonprofit corporations providing a comprehensive system of healthcare services to the communities of Salem and Dallas, Oregon, and the surrounding Marion and Polk Counties.

The accompanying consolidated financial statements include the accounts and transactions of the Corporation and its subsidiaries, of which Salem Health Hospitals and Clinics is the parent holding company and sole member. The subsidiaries consist of Salem Health (Salem) and Salem Health West Valley (West Valley) (collectively, the Hospitals); Salem Health Foundation (SHF) and West Valley Hospital Foundation (WVHF) (collectively, the Foundations); Willamette Valley Insurance Corporation (WVIC), a captive insurance company domiciled in Hawaii; and Salem Health Professional Services (SHPS), whose principal purpose is to provide professional billing services to the Hospitals. All significant intercompany accounts and transactions have been eliminated in consolidation. The Corporation has formed an obligated group that is responsible for paying hospital revenue bond debt. Currently, Salem is the only member of the obligated group.

The Hospitals provide healthcare and healthcare-related services to patients in their service areas. The Hospitals' mission is to improve the health and well-being of the people and the communities they serve. The Foundations are dedicated to raising, managing, and distributing funds to help the Hospitals achieve their mission.

(2) Summary of Significant Accounting Policies

(a) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles 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 revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates include allowance for implicit and explicit price concessions on patient accounts receivable, valuation of investments, assignment of useful lives to property and equipment, third-party payor cost report settlements, self-insured liabilities, interest rate swap valuation, and postretirement liabilities.

(b) Cash and Cash Equivalents

Cash equivalents include investments in highly liquid instruments with original maturities of three months or less, excluding assets limited as to use. Cash equivalents totaled \$655 and \$997 at June 30, 2019 and 2018, respectively.

The Corporation maintains bank accounts at several financial institutions. The Corporation's bank balances at each financial institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. At June 30, 2019 and 2018, the Corporation's bank balances at certain financial institutions exceeded FDIC coverage.

(In thousands)

(c) *Patient Accounts Receivable and Net Patient Service Revenue*

Patient accounts receivable are recorded at an estimated collectible amount and do not bear interest. Amounts collected on patient accounts receivable are included in net cash provided by operating activities in the consolidated statements of cash flows. Explicit price concessions are established as a result of negotiated reimbursement methodologies with third party payors.

We also record estimated implicit price concessions (based primarily on historical collection experience) related to uninsured accounts to record self-pay revenues at the estimated amounts we expect to collect. The Corporation does not assess credit risk before services are rendered.

The mix of patient accounts receivable from significant third-party payors as of June 30, 2019 and 2018 was as follows:

	12 months ended June 30, 2019	
Medicare	36 %	$ 36,385
Medicaid	8	7,919
Self pay	1	1,362
Commercial and other payors	55	55,837
Total	100 %	$ 101,503

	12 months ended June 30, 2018	
Medicare	38 %	$ 34,774
Medicaid	8	7,334
Self pay	2	1,676
Commercial and other payors	52	47,899
Total	100 %	$ 91,683

The mix of net patient service revenue from significant third-party payors for the years ended June 30, 2019 and 2018 was as follows:

	12 months ended June 30, 2019	
Medicare	35 %	$ 283,189
Medicaid	18	141,814
Self pay	1	5,283
Commercial and other payors	46	371,914
Total	100 %	$ 802,200

(Continued)

(In thousands)

	12 months ended June 30, 2018		
Medicare	35 %	$	267,040
Medicaid	18		132,445
Self pay	1		5,191
Commercial and other payors	46		351,779
Total	100 %	$	756,455

The following tables represent net patient service revenue by line of business in the year ending June 30, 2019 and 2018, respectively:

		Year ended June 30, 2019			
		Inpatient	Outpatient	Clinics	Total
Salem Health Hospitals and Clinics	$	428,344	337,424	36,432	802,200

		Year ended June 30, 2018			
		Inpatient	Outpatient	Clinics	Total
Salem Health Hospitals and Clinics	$	397,174	326,890	32,391	756,455

The adoption of ASU No. 2014-09, *Revenue from Contracts with Customers* (ASU No. 2014-09), as of July 1, 2019, resulted in changes to the presentation of consolidated statements of operations and changes in net assets with the allowance for uncollectible accounts now considered the provision for unpaid services that are recognized as a direct reduction to patient services revenues. Prior to adopting ASU No. 2014-09, the allowance for uncollectible accounts was presented as a deduction to arrive at net patient service revenue.

The adoption of ASU No 2014-09 did not have a significant impact on the recognition of patient services revenues for any periods prior to adoption.

Performance obligations for healthcare services provided to patients generally relate to contracts of one year or less. Performance obligations for inpatient services are generally completed at the time the patients are discharged. Performance obligations for outpatient services are generally satisfied over a period of less than a day.

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

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Services are rendered to patients under contractual arrangements with the Medicare and Medicaid and programs and various other payors, including preferred provider organizations (PPOs) and health maintenance organizations (HMOs), which provide for payment or reimbursement at amounts different from established rates. Contractual adjustments represent the difference between established rates for services and amounts reimbursed by these third-party payors.

The Medicare program reimburses Salem at prospectively determined rates for the majority of inpatient and outpatient services rendered to patients, primarily on the basis of Medicare severity diagnosis–related groups and Ambulatory Payment Classification Groups, respectively. West Valley is a “critical access hospital” (CAH) for Medicare and Medicaid program purposes. As a CAH, West Valley may not operate more than 25 beds and the average length of stay for acute care patients may not exceed 96 hours. The Medicare and Medicaid program reimburses West Valley on the basis of its current allowable costs. When paid under cost reimbursement, the Hospitals are reimbursed at an interim rate with final settlement determined after submission of annual cost reports and audits thereof by the fiscal intermediaries, subjecting the Hospitals to retroactive settlements for prior year cost reports. Actual settlements historically approximated management’s expectations.

Salem’s cost reports have both been audited and final settled by the Medicare fiscal intermediaries through June 30, 2016 and the Medicaid administrators through June 30, 2016. West Valley’s cost reports have both been audited and final settled by the Medicare fiscal intermediaries through June 30, 2017 and the Medicaid administrators through June 30, 2017.

The Hospitals have also entered into payment agreements with certain commercial insurance carriers, HMOs, and PPOs to provide medical services to subscribing participants. The basis for payment to the Hospitals under these agreements includes prospectively determined rates per discharge, actual charges, and fee schedules.

(d) Supplies Inventory

Supplies inventory is stated at the lower of cost (as determined by the first-in, first-out method) or market.

(e) Investments

Investments consist of investments designated by the Corporation’s board of trustees for future capital acquisitions and other purposes, investments held by the Foundations whose use has been restricted by donors, and assets held by a trustee under a bond indenture agreement (notes 5 and 6). Funds held by trustee are set aside in separate trust accounts for future capital projects and debt service reserve funds.

Investments in equity and debt securities are reported at fair value in the accompanying consolidated balance sheets. The fair values are based on quoted market prices at the reporting date for those or similar investments. Investment income or loss (including realized gains and losses on investments, unrealized gains and losses on equity investments, interest, and dividends) is included in the excess of revenue over expenses unless the income or loss is restricted by the donor or law. The Corporation’s debt investments are classified as other-than-trading securities at June 30, 2019 and 2018. Unrealized gains and losses on other-than-trading debt investments are excluded from excess of revenue over expenses unless they are considered other-than-temporarily impaired.

For each of the investment categories accounted for as other than trading, the Corporation continually monitors investment performance and the potential need for recording an impairment on investments. A number of criteria are considered during this process including, but not limited to, whether the Corporation intends to sell the security, the current fair value as compared to cost of the security, the length of time the security's fair value has been below cost, the likelihood that the Corporation will be required to sell the security before recovery of its cost basis, objective information supporting recovery in a reasonable period of time, specific credit issues related to the issuer, and current economic conditions.

For debt securities that the Corporation does not intend to sell and more likely than not would not be required to sell prior to recovery of the cost basis, the Corporation recognizes other-than-temporary losses in accordance with the provisions of the ASC Topic 320 *Investments – Debt and Equity Securities*. The amount of the other-than-temporary loss is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between a security's cost basis and the present value of expected future cash flows discounted at the security's effective interest rate. The amount due to all other factors is recognized in other changes in net assets. For the year ended June 30, 2019 or 2018, the Corporation recognized no other-than-temporary losses.

The Corporation holds investments in corporate bonds, U.S. Treasury and government agency securities, money market funds, and mutual funds. Management believes that the Corporation's credit risk with respect to these investments is minimized due to the diversity of the individual investments and the financial strength of the entities, which have issued the securities or instruments. However, due to changes in economic conditions, interest rates, and common stock prices, the market value of the Corporation's investments can be volatile. Consequently, the fair value of the Corporation's investments could change significantly in the near term as a result of such volatility.

(f) Property and Equipment

Property and equipment (including rental and other property held for future development) are stated at cost. Donated property and equipment are recorded at estimated fair value on the date of donation. Improvements and replacements of property and equipment are capitalized. Routine maintenance and repairs are charged to expense as incurred.

Depreciation is computed using the straight-line method over the shorter of the lease term or estimated useful life of each class of depreciable asset. The estimated useful life of buildings and improvements is 5 to 50 years while the estimated useful life of equipment is 2 to 20 years. Net interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

(g) Long-Lived Assets

Management reviews property and equipment and other long-term assets for possible impairment whenever events or circumstances indicate the carrying amount of such assets may not be recoverable. If there is an indication of impairment, management would prepare an estimate of future cash flows (undiscounted and without interest charges) expected to result from the use of the asset and its eventual disposal. If these cash flows were less than the carrying amount of the asset, an impairment loss would be recognized to write down the asset to its estimated fair value. In addition to consideration of impairment due to the events or changes in circumstances described above, management regularly evaluates the remaining lives of its long-lived assets. If estimates are revised, the carrying value of affected assets is depreciated or amortized over the remaining lives.

(h) Other Assets

Other assets include the Corporations investments in various related entities, which are not consolidated. SHHC consolidates such investees if it (a) owns a majority of the investee’s stock, controls a majority voting interest in the investee’s board of directors and has an economic interest in such investee, or (b) is the sole member of the investee. If these criteria are not met, or if the Corporation owns 50% or less of the voting stock of an investee and can exercise significant influence over the investee’s operating and financial policies (generally presumed when the Corporation owns more than 20% of the voting stock), the Corporation accounts for such investments under the equity method of accounting, whereby SHHC records its proportionate share of the investee’s income or loss in the consolidated statements of operations and records distributions received from the investee as a reduction in the related investment balance.

(i) Net Assets With Donor Restrictions

Net assets with donor restrictions are those whose use has been limited by donors to a specific time period or purpose, or those whose use has been restricted by donors to be maintained in perpetuity.

(j) Consolidated Statements of Operations

Excess of revenue over expenses from operations includes amounts generated from direct patient care, other revenue related to the operation of the Hospitals’ facilities, contributions without donor restrictions received by the Foundations, and gains (losses) on disposals of property and equipment. Other activities that result in income or expenses unrelated to the Hospitals’ and the Foundations’ primary missions are excluded from excess of revenue over expenses from operations. Total other income, net includes net investment income, changes in unrealized gains and losses on equity investment securities, other-than-temporary impairment losses on debt investment securities, rental income and expenses related to non-operating real estate properties, gains and losses on disposals of rental and other property held for future development, gains and losses on extinguishment of debt, and other incidental transactions.

(Continued)

Changes in net assets without donor restrictions that are excluded from the excess of revenue over expenses, consistent with industry practice, include the change in net unrealized gains (losses) on other-than-trading debt securities, change in net benefit obligation related to postretirement benefits, change in fair value of interest rate swap agreement for an effective hedging relationship, and contributions of long-lived assets (including assets acquired using contributions, which, by donor restriction, are to be used for the purpose of acquiring such assets).

(k) Contributions Received

Unconditional promises to give cash and other assets to the Corporation are recorded as other revenue and other receivables at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received or at which point the conditions have been substantially met. Gifts are reported as either contributions with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When the terms of a donor restriction are met, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported in the consolidated statements of operations and consolidated statements of changes in net assets as net assets released from restrictions.

Contributions of long-lived assets, such as property and equipment, are reported as without donor restrictions and are excluded from the excess of revenue over expenses. Contributions of long-lived assets with explicit restrictions that specify how the assets are to be used and contributions of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Corporation reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

SHF is a beneficiary under various wills and trust agreements, the total realizable amounts of which are not presently estimable. SHF's share of such bequests is recorded when the probate court has declared the testamentary instrument valid and the proceeds are measurable.

(l) Income Taxes

The Corporation, Salem, West Valley, SHF, WVHF, SHPS, and WVIC are tax-exempt organizations pursuant to Internal Revenue Code Section 501(c)(3). As such, only unrelated business income is subject to federal or state income taxes. Management has not recorded a provision as unrelated business income, if any, is immaterial to the consolidated financial statements.

Accounting principles generally accepted in the United States of America require the Corporation to evaluate tax positions taken by the Corporation and recognize a tax liability (or an asset) if the Corporation has taken an uncertain position that more likely than not would not be sustained upon examination by the Internal Revenue Service. Management has analyzed tax positions taken by the Corporation and has concluded that as of June 30, 2019, there are no uncertain positions taken or expected to be taken that would require recognition of a liability (or asset) or disclosure in the consolidated financial statements. The Corporation's is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The Corporation management believes it is no longer subject to income tax examinations for years prior to fiscal year 2016.

(m) State of Oregon Provider Tax

Effective July 1, 2004, the state of Oregon instituted a provider tax on certain qualifying hospitals. The Corporation recorded provider taxes of $45,250 and $41,060 for the years ended June 30, 2019 and 2018, respectively, which are included in purchased services and other expense in the accompanying consolidated statements of operations. In addition, the Corporation has entered into an agreement with the Oregon Association of Hospitals and Health Systems (OAHHS), which provides that all payments owed to the Corporation related to beneficiaries of the Oregon Department of Medical Assistance Program are to be remitted directly to OAHHS. OAHHS aggregates these payments, returning a portion to the Corporation. The remaining funds are pooled by OAHHS with like amounts received on behalf of other hospitals subject to the provider tax, and OAHHS redistributes such funds to qualifying hospitals on a quarterly basis. The Corporation received $39,900 and $38,200 for the years ended June 30, 2019 and 2018, respectively, from OAHHS, which are reflected as a component of net patient service revenue in the accompanying consolidated statements of operations.

(n) Recent Accounting Adoptions

In 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606), which requires an entity to recognize the amount of revenue to which is expects to be entitled for the transfer of promised goods or services to customers. The ASU replaced most existing revenue recognition guidance in U.S. generally accepted accounting principles, including industry specific guidance. Topic 606 requires significantly expanded disclosures about revenue recognition. The new standard also requires additional disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts. The new standard was adopted retrospectively on July 1, 2018 and as a result, the year ended June 30, 2018 was adjusted to apply the new standard. As part of adopting the standard, the Corporation has identified revenue streams of like contracts to allow for ease of implementation. The Corporation uses primarily a portfolio approach to apply the new model to classes of customers with similar characteristics. The adoption of the standard did not have a material impact on the consolidated balance sheet or excess of revenue over expenses.

In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets* and *Financial Liabilities.* The ASU requires that changes in the value of equity investments with readily determinable market values be recognized through excess revenue over expenses. The new standard was adopted July 1, 2018. Under the new standard, the Corporation recognized $8,800 in unrealized gains through excess revenue over expenses that previously would have been recognized as changes to net assets without donor restrictions.

In August 2016, the FASB issued ASU No. 2016-14, *Presentation of Financial Statements of Not-for-*Profit *Entities*. 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 not-for-profits to present expenses by their functional and their natural classifications in one location in the financial statements; (C) requires not-for-profits 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 the statement of cash flows using either the direct or indirect method. The new standard became effective for the Corporation on July 1, 2018. The adoption of the new standard had a disclosure impact only.

(Continued)

(In thousands)

(o) New Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which supersedes Topic 840, *Leases*. ASU No. 2016-02 increases the transparency and comparability of organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This guidance requires that lessees recognize a right-of-use asset and a lease liability measured at the present value of the lease payments in the statement of financial position, recognize a single lease cost allocated over the lease term on a generally straight-line basis, and classify all cash payments within operating activities in the statement of cash flows. The amendments in this update are effective for the Corporation beginning July 1, 2019. The Corporation has assessed the impact of adoption and estimates recording a right of use asset and lease liability balance of $5,400 in the fiscal year beginning July 1, 2019. The Corporation's minimum undiscounted commitments under noncancelable operating leases are disclosed in note 14.

(3) Benefits to the Community

The Corporation provides services to the community both for people in need and to enhance the health status of the broader community as part of its charitable mission.

(a) Services for People in Need

The following tables represent the estimated cost of providing certain services to the community, along with a description of selected activities sponsored by the Hospitals during 2019 and 2018:

	Year ended June 30, 2019		
	Estimated costs to provide care	Offsetting revenue	Estimated net cost
Services for people in need:			
Charity care	$ 20,474	—	20,474
Medicaid	186,212	140,463	45,749
Medicare	362,010	300,114	61,896
	$ 568,696	440,577	128,119
Percentage of total operating expenses			16.1 %

(Continued)

(In thousands)

	Year ended June 30, 2018		
	Estimated costs to provide care	Offsetting revenue	Estimated net cost
Services for people in need:			
Charity care	$ 11,735	—	11,735
Medicaid	182,933	136,109	46,824
Medicare	336,052	281,065	54,987
	$ 530,720	417,174	113,546
Percentage of total operating expenses			15.3 %

In support of its mission, the Hospitals voluntarily provide medically necessary patient care services that are discounted or free of charge to persons who have insufficient resources and/or who are uninsured. The criteria for charity care are determined based on eligibility for insurance coverage, household income, qualified assets, catastrophic medical events, or other information supporting a patient's inability to pay for services provided. Specifically, the Hospitals provide an uninsured discount of 35% to all uninsured patients. Further discounts are available for patients, on a sliding scale, whose household income is less than 400% of the federal poverty level, or roughly $97 for a family of four in Salem, Oregon. For patients whose household income is at or below 200% of the federal poverty level, a full subsidy is available. In addition to the household income criteria, the patients' qualified assets (e.g., assets and investments excluding patient's primary residence) and other catastrophic or economic circumstances are considered in determining eligibility for charity care.

In addition to charity care, the Hospitals provide services under various states' Medicaid programs for financially needy patients and to Medicare beneficiaries. The aggregate cost of providing services to Medicaid and Medicare beneficiaries exceeds the aggregate reimbursements from these programs.

The cost of services provided to beneficiaries of the Medicaid and Medicare programs and cost of charity care is estimated based on the relationship of costs (excluding the costs associated with medical education, research, community health services, and other contributions) to billed charges for Medicaid and Medicare patient accounts and for patient charges written off as charity deductions.

The Hospitals employ financial counselors and social workers, who assist patients in obtaining coverage for their healthcare needs. This includes assistance with workers compensation, motor vehicle accident policies, Consolidated Omnibus Budget Reconciliation Act (COBRA), veterans' assistance, and public assistance programs, such as Medicaid.

(b) Benefits to Community

Community health services include classes provided to the community at minimal or no cost, health education for children and parents with young families, resource centers, support groups, health screenings, senior wellness, volunteer programs, caregivers respite, and support for parish nursing programs.

Community benefit activities include activities that develop community health programs and partnerships.

Donations to charitable organizations include direct support provided to community organizations through cash or in-kind donations that support organizations' missions of supporting health and human services, civic and community causes, and business development efforts.

In-kind contributions provided by the Corporation include the following: facility space, staff availability for training and education opportunities, supplies, and professional services in collaboration with charitable, educational, and government organizations throughout the community.

(c) Other Benefits

In furtherance of its mission, the Corporation also commits significant time and resources to endeavors and critical services that meet unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable. Such programs include hospice; mental and behavioral health; primary care clinics in underserved neighborhoods; free patient transportation, lodging, meals, and medications for transient patients when needed; participation in blood drives; and the provision of educational opportunities for students interested in pursuing medical-related careers.

The Corporation also provides additional benefits to the community through the advocacy of community service by employees. Employees of the Corporation serve numerous organizations through board representation, membership in associations, and other related activities.

(Continued)

(In thousands)

(4) Liquidity and Availability

Financial assets available for general expenditure within one year of the consolidated balance sheet date, consist of the following:

		2019	2018
Financial assets at year end			
Cash and cash equivalents	$	15,547	18,816
Patient accounts receivable, less reserves for price concessions		101,503	91,683
Investments		740,651	700,417
Total financial assets		857,701	810,916
Less amounts not available to be used within one year			
Funds held by Trustees	$	42	42
Donor-restricted endowed funds		2,277	2,277
Financial assets not available to be used within one year	$	2,319	2,319
Financial assets available to meet general expenditures within one year	$	855,382	808,597

Donor-restricted funds are available for expenditure upon satisfaction, the expected timing of which is not generally determinable in advance.

As part of the Corporations liquidity management plan, cash reserves no less than 10 days of operating expenses plus known capital expenditures are held in a liquidity pool. As of June 30, 2019 and 2018 the amount of the liquidity pool was $43,900 and $46,300, respectively.

(5) Investments

The composition of investments as of June 30, 2019 and 2018 is set forth in the following table. The following breakout indicates management's methodology for managing its investment portfolio. Investments are carried at fair value.

		2019	2018
Internally designated for operating and capital expenditures:			
Cash and cash equivalents	$	45,558	47,868
Common stocks and equity mutual funds		363,688	340,157
Fixed-income mutual funds		309,908	292,161

(In thousands)

		2019	2018
Corporate bonds	$	4,944	5,598
U.S. government agency securities		2,561	2,563
U.S. Treasury securities		7,073	5,244
Total internally designated for operating and capital expenditures		733,732	693,591
Held by the Foundations:			
Cash and cash equivalents		139	313
Common stocks and equity mutual funds		4,163	3,900
Fixed-income mutual funds		2,575	2,571
Total held by the Foundations		6,877	6,784
Held by trustee:			
Cash and cash equivalents		42	42
Total held by trustee		42	42
Total investments	$	740,651	700,417

Investment income (losses), net consisted of the following for the fiscal years ended June 30, 2019 and 2018:

		12 months ended June 30,	
		2019	2018
Investment income:			
Interest and dividend income	$	15,402	18,984
Realized gains on sales of investments, net		17,488	14,030
Net unrealized gains on equity investments		10,627	21,226
Investment expenses		(194)	(222)
Investment income, net	$	43,323	54,018
Change in net assets:			
Change in net unrealized gains (losses) on investment securities	$	473	(6,495)

(6) Fair Value Measurements

(a) Fair Value of Financial Instruments

The carrying amounts for each class of financial instruments noted below are included in the consolidated balance sheets under the indicated captions.

The fair values of the financial instruments, as discussed below at June 30, 2019 and 2018, represent management's best estimates of the amounts that would be received to sell those assets or that would be paid to transfer those liabilities in an orderly transaction among market participants at the measurement date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the Corporation's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Corporation based on the best information available in the circumstances.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Assets limited as to use: All equity and debt securities are measured using quoted market prices at the reporting date multiplied by the quantity held, when quoted market prices are available. If quoted market prices for those debt securities are not available, the fair value is determined using matrix pricing, which is based on quoted prices for securities with similar coupons, ratings, and maturities, rather than on specific bids and offers for the designated security.

Interest rate swap agreement: The carrying value of the interest rate swap agreement is equal to the estimated fair value of the agreement. The fair value of interest rate swap agreement is determined using pricing models developed based on the LIBOR swap rate and other observable market data. The value was determined after considering the potential impact of collateralization and netting agreements, adjusted to reflect nonperformance risk of both the counterparty and Salem.

(b) Fair Value Hierarchy

FASB ASC Subtopic 820-10, *Fair Value Measurement*, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to measurements involving significant unobservable inputs (Level 3). 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. There was no reclassification of securities between Level 1 and Level 2 during the fiscal year ended June 30, 2019 or 2018. There were no Level 3 securities at June 30, 2019 or 2018.

(In thousands)

The following table presents assets and liabilities that are measured at fair value on a recurring basis at June 30, 2019:

		Fair value measurements at reporting date using	
	June 30, 2019	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)
Assets:			
Cash and cash equivalents	$ 45,738	45,738	—
Common stocks and equity mutual funds	367,852	367,852	—
Corporate bonds	4,944	—	4,944
Fixed-income mutual funds	312,483	312,483	—
U.S. government agency securities	2,561	—	2,561
U.S. Treasury securities	7,073	7,073	—
Total	$ 740,651	733,146	7,505
Liability:			
Interest rate swap	$ 11,982	—	11,982

The following table presents assets and liabilities that are measured at fair value on a recurring basis (including items that are required to be measured at fair value and items for which the fair value option has been elected) at June 30, 2018:

		Fair value measurements at reporting date using	
	June 30, 2018	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)
Assets:			
Cash and cash equivalents	$ 48,223	48,223	—
Common stocks and equity mutual funds	344,057	344,057	—
Corporate bonds	5,598	—	5,598

(Continued)

(In thousands)

		June 30, 2018	Fair value measurements at reporting date using: Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)
Fixed-income mutual funds	$	294,732	294,732	—
U.S. government agency securities		2,563	—	2,563
U.S. Treasury securities		5,244	5,244	—
Total	$	700,417	692,256	8,161
Liability:				
Interest rate swap	$	9,159	—	9,159

(7) Property and Equipment, Net

Property and equipment consisted of the following at June 30, 2019 and 2018:

		2019	2018
Land and improvements	$	43,144	43,128
Buildings and improvements		626,097	609,131
Equipment		312,422	286,329
		981,663	938,588
Less accumulated depreciation		(527,165)	(483,465)
		454,498	455,123
Construction in progress		26,770	14,106
Property and equipment, net	$	481,268	469,229

(In thousands)

(8) Investments in Health Related Activities

The following is a summary of the Corporation's related-party investments which are included in other noncurrent assets in the accompanying consolidated balance sheets at June 30, 2019 and 2018:

Entity	Basis of accounting	Investment balance included in the accompanying consolidated balance sheets as of June 30		The Corporation's share income (losses) included the accompanying consolidated statements of operations the fiscal years ended June 30	
		2019	2018	2019	2018
WVCH	Cost method	545	545	—	—
TSSC	Equity method	51	51	—	—
WSC	Equity method	20,586	—	1,369	—

(a) Willamette Valley Community Health

The Corporation, on behalf of the Hospitals, cofounded Willamette Valley Community Health (WVCH) with nine other providers of healthcare in Marion and Polk Counties. WVCH is an Oregon limited liability company and is certified by the Oregon Health Authority as a coordinated care organization (CCO). Section 26 of house bill 3650 provides that CCOs will be responsible for providing fully integrated physical health services chemical dependency, and mental health services, and beginning dental health services. CCOs provide the foregoing health services to Medicaid beneficiaries. The Corporation's investment in WVCH is accounted for under the cost method.

(b) The Salem Surgery Center, LLC

The Salem Surgery Center, LLC (TSSC) is a limited liability company whose members are the Corporation and various community physician partners (49.0% ownership interest). Equity is allocated 51.0% and 49.0%, respectively. TSSC was formed to own, operate, and manage an outpatient surgery center to be located in Salem, Oregon. As of June 30, 2019 the surgery center is still in the planning phase.

(c) Willamette Surgery Center, LLC

Willamette Surgery Center, LLC (WSC) is a limited liability company, formed in fiscal year 2019, whose members are the Corporation and community physician partners (45.8% ownership interest). Equity is allocated 54.2% and 45.8%, respectively. WSC operates and manages an outpatient orthopedic surgery center located in Salem, Oregon. The Corporation received member distributions of $782 in the year ending June 30, 2019.

(In thousands)

(9) Long-Term Debt

Long-term debt consisted of the following at June 30, 2019 and 2018:

		2019	2018
Hospital Revenue Bonds, Series 2008B; payable in installments from $3,575 to $6,000 beginning in 2020 through 2034; interest at rates resetting every seven days; the rates were 1.89% and 1.50% as of June 30, 2019 and 2018, respectively	$	75,000	75,000
Hospital Revenue Bonds, Series 2016A; payable in installments from $1,915 to $15,490 beginning in 2017 through 2046; interest at rates ranging from 2% to 5%		183,105	188,290
Unamortized cost of issuance		(669)	(698)
Unamortized premium on bonds, net		14,862	15,660
Other		92	163
		272,390	278,415
Less current portion		(6,346)	(6,055)
	$	266,044	272,360

In November 2008, Salem entered into a loan agreement (the November 2008 Agreement) with the Hospital facility authority of Salem (the authority), whereby the authority issued $75,000 of par amount variable-rate, tax-exempt revenue bonds (the 2008B Bonds) with a final maturity of 2034. The 2008B Bonds bear interest at rates that change weekly. The 2008B Bonds are subject to purchase from time to time at the option of the owners thereof and are required to be purchased in certain events. In order to assure the availability of funds for the payment of the purchase price, Salem has provided for the purchase of the 2008B Bonds under a direct-pay, letter-of-credit agreement (the Letter of Credit). The maximum commitment under the Letter of Credit is $76,048 for the 2008B Bonds. The 2008B Bonds are subject to annual mandatory sinking fund redemptions beginning in 2019, ranging from $3,575 to $6,000. The 2008B Bonds are subject to optional and special redemption prior to maturity at the direction of Salem under certain circumstances, as described in the November 2008 Agreement. The Letter of Credit expires in November 2021.

Additionally, in 2008, Salem entered into a cash flow hedge of the 2008B variable rate bonds. The swap agreement maintains the total notional amount of $75,000 and converts the variable interest rate to a fixed rate of approximately 3.541%. See note 11 for further information related to Salem’s interest rate management transactions.

In November 2016, Salem entered into a loan agreement with the authority, whereby the authority issued $197,685 of par amount fixed-rate, tax-exempt revenue refunding bonds (Series 2016A Bonds). The proceeds from Series 2016A were used to refund, redeem and defease various outstanding bond obligations.

(Continued)

(In thousands)

The above-described debt instruments are secured by the gross receivables of the Corporation and carry various financial covenants that the Corporation is required to measure on an annual basis.

Scheduled principal repayments of long-term debt are as follows:

	Revenue bonds	Other	Total
2020	$ 5,490	78	5,568
2021	5,710	14	5,724
2022	5,920	—	5,920
2023	6,165	—	6,165
2024	6,415	—	6,415
Thereafter	228,405	—	228,405
	$ 258,105	92	258,197

(10) Derivative Instruments and Hedging Activities

Salem has an interest rate–related derivative instrument to manage its exposure on its debt instruments. The Corporation does not enter into derivative instruments for any purpose other than cash flow hedging purposes. The Corporation follows FASB ASC Subtopic 815-10, *Derivatives and Hedging*. ASC Subtopic 815-10 provides accounting and reporting standards for derivative instruments and hedging activities and requires that Salem recognize these as either assets or liabilities in the consolidated balance sheets and measure them at fair value.

In 2008, Salem entered into an interest rate swap transaction to effectively convert the 2008B variable rate debt to a fixed rate of 3.541% through August 15, 2034. The interest rate swap has a notional amount of $75,000. Salem evaluated the interest rate swap transaction and determined that it met the criteria to be classified as a cash flow hedge and the changes in fair value have been recorded as a change in unrestricted net assets in the accompanying consolidated financial statements.

The interest rate swap transaction allows Salem to terminate the financial instrument by requiring full settlement of any interest or termination value upon five days' written notice given to Salem's bond insurer and counterparty. The fair value of the interest rate swap agreement is determined by or based on the spread in interest rates with consideration of credit risk to both Salem and its counterparty. The estimated fair value of the interest rate swap at June 30, 2019 and 2018 was a liability of $11,982 and $9,159, respectively. Salem was not required to post collateral against the liability of its interest rate swap during the fiscal years ended June 30, 2019 and 2018 and has not been required to post any collateral to date for the life of the swap.

(In thousands)

(11) Net Assets With Donor Restrictions

Net assets were restricted for the following purposes at June 30, 2019 and 2018:

		2019	2018
Subject to expenditure for specified purpose:			
Acquisition or construction of property and equipment for the hospitals	$	354	300
Specific programs of the hospitals		2,676	2,657
Scholarships		535	523
Other		229	282
		3,794	3,762
Donor-restricted endowed funds:			
Acquisition or construction of property and equipment for the hospitals		1,091	1,091
Specific programs of the hospitals		538	594
Scholarships		357	357
Other		291	235
		2,277	2,277
Total donor restricted net assets	$	6,071	6,039

(12) Retirement and Postretirement Plans

(a) Defined-Contribution Retirement Plan

The Hospitals have a contributory, defined-contribution retirement plan (the Retirement Plan) covering substantially all full-time employees. All eligible employees are allowed to contribute to the Retirement Plan on the first day of the month following their date of hire. The Hospitals contribute 5.5% to 8.5% of participating employees' annual compensation to the Retirement Plan. To receive the benefit of the Hospitals' contributions, employees must have one year or more of service at one of the Hospitals and contribute at least 1.0% of their annual compensation to the Retirement Plan. The Retirement Plan's costs were $19,435 and $17,648 for the fiscal years ended June 30, 2019 and 2018, respectively, and are included in labor and benefits in the accompanying consolidated statements of operations.

(b) Postretirement Healthcare Plan

The Hospitals also sponsor a postretirement healthcare plan (the Postretirement Plan) that provides healthcare benefits to certain retirees and their dependents until the retirees reach the age of Medicare eligibility. Generally, retirees are eligible to participate in the Postretirement Plan if they retire from one of the Hospitals at age 55 years or older with 10 years of service. Retirees can convert 25% of their unused extended illness bank balance to an equivalent dollar amount, which may then be used to purchase medical, dental, or vision coverage for the retiree and/or dependents. Any unused balance will be forfeited when the retiree reaches the age of Medicare eligibility.

(In thousands)

The Corporation accounts for the Postretirement Plan in accordance with FASB ASC Topic 715, *Compensation – Retirement Benefits*, which requires the employer to recognize the overfunded or underfunded status of a plan as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the changes occur through changes in net assets without donor restrictions. Under ASC Topic 715 the measurement of the funded status is the difference between the fair value of the plan assets and the benefit obligation of the plan. ASC Topic 715 also required the Corporation to recognize in net assets without donor restrictions any unrecognized net actuarial gains or losses and any unrecognized prior service costs or credits as they arise and disclose in the notes to the consolidated financial statements additional information about the effect on net periodic benefit cost on the next fiscal year that arises from the delayed recognition of these items.

The accrued liability for postretirement benefits at June 30, 2019 and 2018 was as follows:

		2019	2018
Change in benefit obligation:			
Benefit obligation at beginning of year	$	5,867	5,307
Service cost		84	122
Interest cost		199	141
Participants' contributions		472	338
Actuarial loss (gain)		1,740	652
Benefits paid		(835)	(693)
Benefit obligation at end of year	$	7,527	5,867
Change in plan assets:			
Fair value of plan assets at beginning of year	$	—	—
The Hospitals' contributions		363	355
Participants' contributions		472	338
Benefits paid		(835)	(693)
Fair value of plan assets at end of year	$	—	—

A reconciliation of the Postretirement Plan's funded status at June 30, 2019 and 2018 and to the Hospitals' accrued postretirement healthcare benefits at June 30, 2019 and 2018 was as follows:

		2019	2018
Funded status	$	7,527	5,867
Current portion of accrued postretirement healthcare benefits		(549)	(363)
Long-term portion of accrued postretirement healthcare benefits	$	6,978	5,504

(In thousands)

The current portion of accrued postretirement healthcare benefits is included in accrued liabilities in the accompanying consolidated balance sheets.

The components of the Hospitals' net periodic postretirement benefit cost (benefit) included in labor and benefits in the accompanying consolidated statements of operations for the fiscal years ended June 30, 2019 and 2018 were as follows:

		12 months ended June 30, 2019	
Service cost	$	84	122
Interest cost		199	141
Amortization of net gain		(159)	(398)
Net periodic postretirement benefit cost (benefit)	$	124	(135)

Losses (Gains) accumulated in net assets without donor restrictions in the accompanying consolidated statements of changes in net assets through the fiscal years ended June 30, 2019 and 2018 were $638 and ($1,261), respectively. The components of the Hospitals' other changes in plan assets and benefit obligations recognized in net assets without donor restrictions in the accompanying consolidated statements of changes in net assets for the fiscal years ended June 30, 2019 and 2018 were as follows:

		12 months ended June 30, 2019	
Net gain (loss)	$	1,739	(651)
Amortization of net loss		159	(399)
Total recognized in net assets without donor restrictions	$	1,898	(1,050)

Weighted average assumptions used to determine benefit obligations for June 30, 2019 and 2018 were as follows:

	2019	2018
Discount rate	2.48 %	3.50 %
Rate of compensation increase	3.75	3.75

For actuarial measurement purposes, annual rate increases in the per capita cost of covered healthcare benefits of 6.50% (pre-65) and 7.00% (post-65) were assumed for 2019 through 2020. Thereafter, the rate was assumed to decrease by approximately 0.50% percentage point on an annual basis to 5.18% in 2029 and then decrease gradually to 3.94%. For the fiscal years ended June 30, 2019 and 2018, the Corporation utilized the RP-2014 Mortality Table with the RP-2018 Mortality Improvement Scale for estimating the actuarial values.

(In thousands)

Benefit payments funded by Salem that reflect future service, as appropriate, are expected to be paid as follows for the future fiscal years ending June 30:

2020	$	549
2021		681
2022		807
2023		882
2024		948
2025–2029		4,390

These estimates are based on assumptions about future events. Actual benefit payments may vary significantly from these estimates.

(13) Functional Classification of Expenses

The Corporation allocates expenses by function on a department basis based on their functional role. Departments supporting the entire corporation in a support services function are classified as management and general; departments providing hospital based services and clinics providing ambulatory services are categorized accordingly. Foundation expenses consist of both the hospital foundations and the support services associated with operating those foundations incurred by other Salem entities. Expenses on a functional basis for the fiscal years ended June 30, 2019 and 2018 were as follows:

	2019				
	Hospital	Clinics	Foundation	General and Administrative	Total
Labor and benefits	$ 313,179	69,220	213	81,651	464,263
Medical and other supplies	109,615	2,602	204	5,310	117,731
Purchased services and other	64,354	25,708	2,315	39,178	131,555
Depreciation	28,706	1,842	106	16,231	46,885
Professional fees	14,178	4,059	96	8,911	27,244
Interest and amortization	10,565	—	—	—	10,565
	$ 540,597	103,431	2,934	151,281	798,243

	2018				
	Hospital	Clinics	Foundation	General and Administrative	Total
Labor and benefits	$ 295,427	54,594	218	78,404	428,643
Medical and other supplies	103,537	2,225	169	5,242	111,173
Purchased services and other	59,117	20,818	1,832	36,367	118,134
Depreciation	27,539	1,768	102	15,570	44,979
Professional fees	17,199	4,435	69	9,247	30,950
Interest and amortization	10,586	—	—	—	10,586
	$ 513,405	83,840	2,390	144,830	744,465

(14) Commitments and Contingencies

(a) General and Professional Liability Insurance

On a claims-made basis, WVIC provides excess insurance coverage up to a $1,000 self-insured retention limit per occurrence and $6,000 annual aggregate limit for healthcare professional liability ($1,000/$6,000 limits) for Salem and West Valley for the years ending June 30, 2019 and 2018. In excess of the $1,000/$6,000 limits, the Hospitals annually purchase reinsurance coverage for claims up to $34,000 in aggregate on a claims-made basis. Reinsurance contracts do not relieve the Corporation from its obligations to claimants. Failure of reinsurers to honor their obligations could result in losses to the Corporation. The Corporation evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurer to manage its exposure to significant losses from reinsurer insolvencies.

General and professional liability costs are accrued based upon an actuarial determination with estimated incurred-but-not-reported professional liability losses recorded at the expected, undiscounted level. The Corporation has recorded estimated liabilities for incurred-but-not-reported professional liability claims and for deductibles on reported claims aggregating $7,915 and $7,424 as of June 30, 2019 and 2018, respectively. The estimated liabilities for incurred-but-not-reported medical claims are recorded on the Hospitals' books. WVIC carries the estimated liabilities for deductibles on reported claims. Management believes that these estimated liabilities are adequate; however, the establishment of estimated liabilities for incurred-but-not-reported medical malpractice claims and for deductibles on reported claims is an inherently uncertain process, and there can be no assurance that currently established reserves will prove adequate to cover actual ultimate expenses. Subsequent actual experience could result in reserves being too high or too low, which could positively or negatively impact operations in future periods.

The Corporation records claim liabilities without consideration of insurance recoveries and receivables for insurance recoveries to be reported separately subject to a valuation allowance as appropriate. The Corporation recorded an asset for insurance recoveries receivable and estimated liabilities in the amount of $2,056 and $2,002 as of June 30, 2019 and 2018, respectively. The insurance recovery receivable and insured claims liability are included in other noncurrent assets and estimated medical malpractice claims liability in the accompanying consolidated balance sheets. No valuation allowance was recorded related to reinsurance receivables as of June 30, 2019 or 2018.

(b) Self-Insured Employee Benefits

The Corporation is self-insured for employee's medical and dental claims. Claims are accrued as incurred. The Corporation has recorded an accrual for the estimated claims, including estimates of the ultimate costs for both reported claims and claims incurred but not reported of $3,988 and $3,258 as of June 30, 2019 and 2018, respectively. Management believes that these amounts, which have been included within other accrued liabilities in the accompanying consolidated balance sheets, are adequate to cover estimated employee's medical and dental claims.

(Continued)

(In thousands)

(c) Risk Management

In the ordinary course of business, the Corporation is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and natural disasters. Management believes that adequate commercial insurance coverage has been purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage for the fiscal year ended June 30, 2019 or 2018. The Corporation is self-insured for workers' compensation claims. The Corporation has recorded estimated liabilities for claims in the amount of $2,256 and $3,196 as of June 30, 2019 and 2018, respectively, which have been included in "other accrued liabilities" in the accompanying balance sheet.

(d) Regulation and Litigation

The healthcare industry is governed by various laws and regulations of federal, state, and local governments. These laws and regulations are subject to ongoing government review and interpretation and include matters such as licensure, accreditation, reimbursement for patient services, and referrals for Medicare and Medicaid beneficiaries. Compliance with these laws and regulations is required for participation in government healthcare programs and have become more complicated in recent years due to changes resulting from the health reform law and the introduction of health benefit exchanges and coordinated care organizations into the local marketplace. Certain governmental agencies routinely investigate and pursue allegations concerning possible overpayments resulting from violation of fraud and abuse statutes by healthcare providers. These types of investigations may result in settlements involving fines and penalties, as well as repayment of improper reimbursement. The Corporation has implemented procedures for monitoring and enforcing compliance with laws and regulations and is not aware of significant instances of noncompliance.

(e) Operating Leases

The Corporation has certain noncancelable operating leases for office space and equipment. The Corporation recorded lease expense of $2,883 and $3,370, which is included in purchased services and other, net in the consolidated statements of operations for the fiscal years ended June 30, 2019 and 2018, respectively.

The following is a schedule of future minimum payments required under the Corporation's operating leases at June 30, 2019:

2020	$	1,975
2021		1,906
2022		1,298
2023		603
2024		5
Thereafter		49
	$	5,836

(15) Lean Initiatives (Unaudited)

The lean management system (Lean) was initially introduced to the Corporation in 2010 to improve the quality of care and transform their culture. The purpose of Lean is to create value for the patient through its three main components: continuous improvement, elimination of waste and variation, and respect for people. Using Lean, the Corporation aligns its strategies to their daily work: engaging its providers and employees to become problem solvers and continually ask the question "why," ensuring all employees work together toward the same outcomes, and keeping the Corporation strong and effective.

In fiscal years 2019 and 2018, the Corporation had a strategic goal to engage frontline staff in leading and completing a Lean activity to remove waste from the system, creating improved value for their patients.

	12 months ended June 30, 2019	12 months ended June 30, 2018
	(not in thousands)	
% of front line staff leading and completing a Lean activity	77 %	69 %
Total Lean activities completed	6,346	5,745

The Corporation continues to invest increasing efforts in the Lean to create value for their patients by increasing access to care, improving patient experience, and delivering quality care at a lower cost.

(16) Subsequent Events

The Corporation evaluated subsequent events after the consolidated balance sheet date of June 30, 2019 through October 4, 2019 which was the date the consolidated financial statements were issued.

Schedule 1

SALEM HEALTH HOSPITALS AND CLINICS

Supplemental Schedule – Consolidating Schedule of Balance Sheet Information

June 30, 2019

(In thousands)

	Salem Health	Salem Health Foundation	Salem Health West Valley	West Valley Hospital Foundation	Parent holding company	Willamette Valley Insurance Corporation	Eliminations	Consolidated
Current assets:								
Cash and cash equivalents	$ 13,009	1,151	484	171	129	603	—	15,547
Patient accounts receivable, net	96,728	—	4,775	—	—	—	—	101,503
Intercompany and other receivables	17,087	23	6,234	2	2,962	—	(9,158)	17,150
Supplies inventory	7,525	—	649	—	—	—	—	8,174
Prepaid expense and other	8,791	—	151	—	—	—	—	8,942
Total current assets	143,140	1,174	12,293	173	3,091	603	(9,158)	151,316
Due from Salem Health West Valley, net	—	—	—	—	550	—	(550)	—
Due from parent holding company	545	—	—	—	—	—	(545)	—
Investments	712,717	6,779	—	98	—	21,057	—	740,651
Property and equipment, net	466,104	—	14,247	—	917	—	—	481,268
Rental and other property held for future development, net	31,358	692	—	—	—	—	—	32,050
Investments in health related entities	36,496	—	—	—	546	—	(15,859)	21,183
Other noncurrent assets	8,204	—	375	—	—	—	(3,078)	5,501
Total assets	$ 1,398,564	8,645	26,915	271	5,104	21,660	(29,190)	1,431,969

See accompanying independent auditors' report.

Schedule 1

SALEM HEALTH HOSPITALS AND CLINICS

Supplemental Schedule – Consolidating Schedule of Balance Sheet Information

June 30, 2019

(In thousands)

	Salem Health	Salem Health Foundation	Salem Health West Valley	West Valley Hospital Foundation	Parent holding company	Willamette Valley Insurance Corporation	Eliminations	Consolidated
Current liabilities:								
Accounts and intercompany payable	$ 48,250	202	1,934	17	545	139	(10,250)	40,837
Accrued liabilities:								
Payroll, payroll taxes, and withholdings	13,577	—	498	—	—	—	—	14,075
Paid time off	19,917	—	810	—	—	—	—	20,727
Other	12,228	—	278	—	—	—	—	12,506
Estimated third-party payor settlements, net	2,397	—	607	—	—	—	—	3,004
Current portion of long-term debt	6,346	—	—	—	—	—	—	6,346
Current portion of estimated medical malpractice claims liability	1,724	—	35	—	—	—	—	1,759
Total current liabilities	104,439	202	4,162	17	545	139	(10,250)	99,254
Long-term debt, net of current portion	266,044	—	—	—	—	—	—	266,044
Accrued postretirement healthcare benefits	6,631	—	347	—	—	—	—	6,978
Fair value of interest rate swap agreement	11,982	—	—	—	—	—	—	11,982
Other long-term liabilities	126	—	7	—	—	—	—	133
Estimated medical malpractice claims liability	2,435	—	115	—	—	5,662	—	8,212
Total liabilities	391,657	202	4,631	17	545	5,801	(10,250)	392,603
Net assets:								
Without donor restrictions	1,003,875	2,381	22,236	244	4,559	15,859	(15,859)	1,033,295
With donor restrictions	3,032	6,062	48	10	—	—	(3,081)	6,071
Total net assets	1,006,907	8,443	22,284	254	4,559	15,859	(18,940)	1,039,366
Total liabilities and net assets	$ 1,398,564	8,645	26,915	271	5,104	21,660	(29,190)	1,431,969

See accompanying independent auditors' report.

Schedule 2

SALEM HEALTH HOSPITALS AND CLINICS

Supplemental Schedule – Consolidating Schedule of Operations Information

Fiscal year ended June 30, 2019

(In thousands)

	Salem Health	Salem Health Foundation	Salem Health West Valley	West Valley Hospital Foundation	Parent holding company	Willamette Valley Insurance Corporation	Eliminations	Consolidated
Operating revenue:								
Net patient service revenue	$ 771,840	—	30,360	—	—	—	—	802,200
Other revenue	48,249	455	537	49	—	1,586	(4,226)	46,650
Net assets released from restriction used for operations	—	511	—	42	—	—	—	553
Total operating revenue	820,089	966	30,897	91	—	1,586	(4,226)	849,403
Operating expenses:								
Labor and benefits	447,431	—	16,832	—	—	—	—	464,263
Medical and other supplies	114,796	9	3,026	1	—	—	(101)	117,731
Purchased services and other	126,749	1,457	6,093	157	—	1,292	(4,193)	131,555
Depreciation	45,469	—	1,416	—	—	—	—	46,885
Professional fees	25,608	—	1,566	—	—	70	—	27,244
Interest and amortization	10,565	—	—	—	—	—	—	10,565
Total operating expenses	770,618	1,466	28,933	158	—	1,362	(4,294)	798,243
Operating income	49,471	(500)	1,964	(67)	—	224	68	51,160
Other income:								
Investment income, net	42,478	174	—	6	1	664	—	43,323
Loss on disposal of property and equipment	(783)	—	(4)	—	—	—	—	(787)
Other, net	(313)	—	—	—	102	—	(1,361)	(1,572)
Total other income, net	41,382	174	(4)	6	103	664	(1,361)	40,964
Excess of revenue over expenses	90,853	(326)	1,960	(61)	103	888	(1,293)	92,124
Change in fair value of interest rate swap agreement	(2,823)	—	—	—	—	—	—	(2,823)
Change in net unrealized gain or loss on fixed income	—	—	—	—	—	473	—	473
Change in postretirement benefit obligation	(1,798)	—	(100)	—	—	—	—	(1,898)
Net assets released from restriction used for property and equipment	—	68	—	—	—	—	—	68
Change in without donor restrictions net assets	$ 86,232	(258)	1,860	(61)	103	1,361	(1,293)	87,944

See accompanying independent auditors' report.

Schedule 3

SALEM HEALTH HOSPITALS AND CLINICS

Supplemental Schedule – Consolidating Schedule of Balance Sheet Information

June 30, 2018

(In thousands)

	Salem Health	Salem Health Foundation	Salem Health West Valley	West Valley Hospital Foundation	Parent holding company	Willamette Valley Insurance Corporation	Eliminations	Consolidated
Current assets:								
Cash and cash equivalents	$ 15,108	1,684	947	—	127	950	—	18,816
Patient accounts receivable, net	87,867	—	3,816	—	—	—	—	91,683
Intercompany and other receivables	15,609	18	6,015	1	2,861	—	(8,925)	15,579
Supplies inventory	6,689	—	477	—	—	—	—	7,166
Prepaid expense and other	6,275	—	149	—	—	—	—	6,424
Total current assets	131,548	1,702	11,404	1	2,988	950	(8,925)	139,668
Due from Salem Health West Valley, net	—	—	—	—	550	—	(550)	—
Due from parent holding company	545	—	—	—	—	—	(545)	—
Investments	674,692	6,497	—	286	—	18,942	—	700,417
Property and equipment, net	454,338	—	13,974	—	917	—	—	469,229
Rental and other property held for future development, net	22,682	692	—	—	—	—	—	23,374
Investments in health related entities	14,498	—	—	—	545	—	(14,498)	545
Other noncurrent assets	8,130	—	403	—	—	—	(2,962)	5,571
Total assets	$ 1,306,433	8,891	25,781	287	5,000	19,892	(27,480)	1,338,804

See accompanying independent auditors' report.

Schedule 3

SALEM HEALTH HOSPITALS AND CLINICS

Supplemental Schedule – Consolidating Schedule of Balance Sheet Information

June 30, 2018

(In thousands)

	Salem Health	Salem Health Foundation	Salem Health West Valley	West Valley Hospital Foundation	Parent holding company	Willamette Valley Insurance Corporation	Eliminations	Consolidated
Current liabilities:								
Accounts and intercompany payable	$ 49,337	187	3,172	12	545	202	(10,021)	43,434
Accrued liabilities:								
Payroll, payroll taxes, and withholdings	7,548	—	308	—	—	—	—	7,856
Paid time off	19,024	—	803	—	—	—	—	19,827
Other	11,456	—	254	—	—	—	—	11,710
Estimated third-party payor settlements, net	1,511	—	461	—	—	—	—	1,972
Current portion of long-term debt	6,055	—	—	—	—	—	—	6,055
Current portion of estimated medical malpractice claims liability	1,625	—	38	—	—	—	—	1,663
Total current liabilities	96,556	187	5,036	12	545	202	(10,021)	92,517
Long-term debt, net of current portion	272,360	—	—	—	—	—	—	272,360
Accrued postretirement healthcare benefits	5,243	—	261	—	—	—	—	5,504
Fair value of interest rate swap agreement	9,159	—	—	—	—	—	—	9,159
Other long-term liabilities	105	—	6	—	—	—	—	111
Estimated medical malpractice claims liability	2,451	—	120	—	—	5,192	—	7,763
Total liabilities	385,874	187	5,423	12	545	5,394	(10,021)	387,414
Net assets:								
Without donor restrictions	917,642	2,705	20,312	235	4,455	14,498	(14,496)	945,351
With donor restrictions	2,917	5,999	46	40	—	—	(2,963)	6,039
Total net assets	920,559	8,704	20,358	275	4,455	14,498	(17,459)	951,390
Total liabilities and net assets	$ 1,306,433	8,891	25,781	287	5,000	19,892	(27,480)	1,338,804

See accompanying independent auditors' report.

SALEM HEALTH HOSPITALS AND CLINICS

Supplemental Schedule – Consolidating Schedule of Operations Information

Fiscal year ended June 30, 2018

(In thousands)

		Salem Health	Salem Health Foundation	Salem Health West Valley	West Valley Hospital Foundation	Parent holding company	Willamette Valley Insurance Corporation	Eliminations	Consolidated
Operating revenue:									
Net Patient Service Revenue	$	727,954	—	28,501	—	—	—	—	756,455
Other revenue		45,214	965	540	39	—	2,367	(6,138)	42,987
Net assets released from restriction used for operations		—	492	—	41	—	—	—	533
Total operating revenue		773,168	1,457	29,041	80	—	2,367	(6,138)	799,975
Operating expenses:									
Labor and benefits		413,069	—	15,574	—	—	—	—	428,643
Medical and other supplies		108,682	30	2,513	—	—	—	(52)	111,173
Purchased services and other		116,320	1,345	5,381	57	—	1,545	(6,514)	118,134
Depreciation		43,549	—	1,430	—	—	—	—	44,979
Professional fees		29,549	—	1,332	—	—	69	—	30,950
Interest and amortization		10,586	—	—	—	—	—	—	10,586
Total operating expenses		721,755	1,375	26,230	57	—	1,614	(6,566)	744,465
Operating income		51,413	82	2,811	23	—	753	428	55,510
Other income:									
Investment income, net		53,021	222	—	2	1	772	—	54,018
Loss on disposal of property and equipment		(262)	—	—	—	—	—	—	(262)
Other, net		(1,223)	—	—	—	102	—	(1,279)	(2,400)
Total other income, net		51,536	222	—	2	103	772	(1,279)	51,356
Excess of revenue over expenses		102,949	304	2,811	25	103	1,525	(851)	106,866
Change in fair value of interest rate swap agreement		3,715	—	—	—	—	—	—	3,715
Change in net unrealized gain or loss on fixed income		(6,488)	(11)	—	4	—	—	—	(6,495)
Change in postretirement benefit obligation		(1,000)	—	(50)	—	—	—	—	(1,050)
Net assets released from restriction used for property and equipment		—	22	—	—	—	—	—	22
Change in without donor restrictions net assets	$	99,176	315	2,761	29	103	1,525	(851)	103,058

See accompanying independent auditors' report.