



LEGACY HEALTH

Consolidated Financial Statements and Other Financial Information

March 31, 2019 and 2018

(With Independent Auditors' Report Thereon)

LEGACY HEALTH

Table of Contents

	Page
Independent Auditors' Report	1
Consolidated Financial Statements:	
Consolidated Balance Sheets	3
Consolidated Statements of Operations	4
Consolidated Statements of Changes in Net Assets	5
Consolidated Statements of Cash Flows	6
Notes to Consolidated Financial Statements	7
Other Financial Information	
Consolidating Financial Information:	
Consolidating Schedule of Balance Sheet Information	33
Consolidating Schedule of Operations Information	34
Consolidated Financial and Statistical Highlights (Unaudited)	35



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

Independent Auditors' Report

The Board of Directors
Legacy Health

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Legacy Health, which comprise the consolidated balance sheets as of March 31, 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 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 consolidated financial position of Legacy Health as of March 31, 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 1 to the consolidated financial statements, in 2019, Legacy Health adopted new accounting guidance in accordance with 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.

Other Matters

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplemental information included in the consolidating schedule of balance sheet information and consolidating schedule of operations information on pages 33 through 34 is presented for the 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 as a whole.

The consolidated financial and statistical highlights on page 35 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

KPMG LLP

Portland, Oregon
June 20, 2019

LEGACY HEALTH

Consolidated Balance Sheets

March 31, 2019 and 2018

(Dollars in thousands)

Assets	2019	2018
Current assets:		
Cash and cash equivalents	\$ 89,257	67,256
Short-term investments	10	31,158
Accounts receivable from patients, net	279,663	254,574
Settlements receivable from third-party payors, net	26,423	12,438
Other receivables	70,623	52,770
Inventories	23,710	23,390
Prepaid expenses	14,843	14,064
Total current assets	504,529	455,650
Assets limited as to use	140,854	157,328
Property, plant, and equipment, net	810,959	840,329
Noncurrent investments	938,425	867,443
Investments in unconsolidated affiliates	211,255	172,188
Other assets	35,863	36,250
Total assets	\$ 2,641,885	2,529,188
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ 54,845	53,745
Accrued wages, salaries, and benefits	151,092	131,319
Accrued interest	6,060	6,244
Other current liabilities	67,253	61,688
Current portion of long-term debt	22,390	11,532
Total current liabilities	301,640	264,528
Long-term debt, less current portion	553,531	577,067
General and professional claims liability	43,245	41,482
Pension liability	113,876	103,660
Other liabilities	47,771	43,486
Total liabilities	1,060,063	1,030,223
Net assets:		
Without donor restrictions, controlling	1,498,395	1,414,039
Without donor restrictions, noncontrolling	20,614	20,918
With donor restrictions	62,813	64,008
Total net assets	1,581,822	1,498,965
Total liabilities and net assets	\$ 2,641,885	2,529,188

See accompanying notes to consolidated financial statements.

LEGACY HEALTH

Consolidated Statements of Operations

Years ended March 31, 2019 and 2018

(Dollars in thousands)

	2019	2018
Operating revenues:		
Net patient service revenue	\$ 2,066,673	1,979,603
Capitation revenue	47,638	39,435
Other revenue	105,057	98,832
	2,219,368	2,117,870
Operating expenses:		
Wages, salaries, and benefits	1,315,479	1,248,477
Supplies	334,103	328,045
Professional fees	52,940	54,482
Purchased services	129,186	131,102
Purchased medical services	43,183	27,406
Utilities, insurance, and other expenses	169,625	161,957
Depreciation	98,945	102,867
Interest and amortization	16,535	18,536
	2,159,996	2,072,872
Total operating expenses		
Income from operations	59,372	44,998
Nonoperating income (loss):		
Investment income, net	54,381	67,996
Other, net	(10,248)	(12,817)
	44,133	55,179
Total nonoperating income		
Excess of revenues over expenses	103,505	100,177
Change in pension liability	(19,365)	4,579
Net assets released from restriction	2,832	8,598
Distributions to joint venture partners	(2,920)	(2,528)
Other	—	(19)
	84,052	110,807
Change in net assets without donor restrictions	\$ 84,052	110,807

See accompanying notes to consolidated financial statements.

LEGACY HEALTH

Consolidated Statements of Changes in Net Assets

Years ended March 31, 2019 and 2018

(Dollars in thousands)

	Without donor restrictions, controlling	Without donor restrictions, noncontrolling	With donor restrictions	Total net assets
Balance, March 31, 2017	\$ 1,305,306	18,844	64,934	1,389,084
Excess of revenues over expenses	97,374	2,803	—	100,177
Change in pension liability	4,579	—	—	4,579
Restricted contributions and grants	—	—	9,981	9,981
Net assets released from restriction	8,598	—	(15,380)	(6,782)
Investment gain, net	—	—	4,454	4,454
Distributions to joint venture partners	(1,799)	(729)	—	(2,528)
Other	(19)	—	19	—
	<hr/>	<hr/>	<hr/>	<hr/>
Change in net assets	108,733	2,074	(926)	109,881
	<hr/>	<hr/>	<hr/>	<hr/>
Balance, March 31, 2018	1,414,039	20,918	64,008	1,498,965
Excess of revenues over expenses	101,135	2,370	—	103,505
Change in pension liability	(19,365)	—	—	(19,365)
Restricted contributions and grants	—	—	7,348	7,348
Net assets released from restriction	2,832	—	(7,369)	(4,537)
Investment gain, net	—	—	(1,174)	(1,174)
Distributions to joint venture partners	(246)	(2,674)	—	(2,920)
Other	—	—	—	—
	<hr/>	<hr/>	<hr/>	<hr/>
Change in net assets	84,356	(304)	(1,195)	82,857
	<hr/>	<hr/>	<hr/>	<hr/>
Balance, March 31, 2019	\$ <u>1,498,395</u>	<u>20,614</u>	<u>62,813</u>	<u>1,581,822</u>

See accompanying notes to consolidated financial statements.

LEGACY HEALTH

Consolidated Statements of Cash Flows

Years ended March 31, 2019 and 2018

(Dollars in thousands)

	2019	2018
Cash flows from operating activities:		
Change in net assets	\$ 82,857	109,881
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Net distributions to noncontrolling partners	2,674	729
Depreciation and amortization	106,043	109,075
Loss on disposal of assets	186	215
Change in net realized and unrealized gains on investments	(46,372)	(61,862)
Restricted contributions	8	(1,115)
Equity earnings from joint ventures and investment companies, net	(14,251)	(16,404)
Pension and other post retirement adjustments	19,365	(4,579)
Change in certain current assets and current liabilities	(33,086)	1,791
Change in certain long-term operating assets and liabilities	(2,817)	4,181
Net cash from operating activities	114,607	141,912
Cash flows from investing activities:		
Purchase of property, plant, and equipment	(77,115)	(91,147)
Proceeds from sale of assets	38	45
Change in funds held by trustee	15,211	18,853
Change in other long-term assets	1,366	(806)
Investment in joint ventures	(32,400)	(30,650)
Distributions from joint ventures and investment companies	6,925	3,479
Purchases of investments	(966,733)	(45,037)
Sales of investments	973,931	46,094
Net cash from investing activities	(78,777)	(99,169)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	297	544
Refund of deferred financing costs	—	9
Repayment of long-term debt	(11,444)	(19,944)
Distributions to noncontrolling partners	(2,674)	(729)
Proceeds from restricted contributions	(8)	1,115
Net cash from financing activities	(13,829)	(19,005)
Increase in cash and cash equivalents	22,001	23,738
Cash and cash equivalents, beginning of year	67,256	43,518
Cash and cash equivalents, end of year	\$ 89,257	67,256
Supplemental disclosures of cash flow information:		
Cash paid for interest (net of amount capitalized)	\$ 18,294	20,958
Change in amounts accrued for property, plant, and equipment, net	(1,313)	88

See accompanying notes to consolidated financial statements.

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

(1) Organization and Summary of Significant Accounting Policies

(a) Organization and Basis of Consolidation

Legacy Health (Legacy), an Oregon nonprofit corporation, is an integrated healthcare delivery system providing various healthcare-related services. The consolidated financial statements include Legacy and its direct affiliates, which are organized primarily as nonprofit corporations under the laws of the State of Oregon or Washington, and include the following:

- Legacy Emanuel Hospital & Health Center
- Legacy Good Samaritan Hospital and Medical Center
- Legacy Meridian Park Hospital
- Legacy Mount Hood Medical Center
- Silverton Health
- Legacy Salmon Creek Hospital
- Legacy Visiting Nurse Association and Affiliates
- Managed HealthCare Northwest, Inc. (MHN)
- Legacy Health System Insurance Company (LHSIC)
- Legacy USP Surgery Centers, LLC (LUSC)

The consolidated financial statements also include the accounts of affiliated foundations (Emanuel Medical Center Foundation and Randall Children's Hospital Foundation, Good Samaritan Foundation, Meridian Park Medical Foundation, Mt. Hood Medical Center Foundation, Silverton Health Foundation, and Salmon Creek Hospital Foundation). All significant inter-affiliate accounts and transactions have been eliminated.

On June 1, 2016, Legacy became the sole corporate member of Silverton Health (SH) and affiliates, assuming their operations and assets, in exchange for the assumption of their liabilities and outstanding debt obligations. Among the requirements of the affiliation agreement are for Legacy to operate SH's hospital and additional health facilities for 10 years, invest \$57,600 within 8 years to grow and improve patient care services at SH (of which \$16,734 has been invested as of March 31, 2019) and provide the Silverton Health Foundation with a contribution of \$3,000.

(b) 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 estimates include implicit and explicit price concessions on patient accounts receivable, self-insured liabilities, and pension obligations.

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

(c) Income Taxes

Legacy has been recognized as exempt from federal income taxes, except on unrelated business income, under Section 501(a) of the Internal Revenue Code (IRC) as an organization described in Section 501(c)(3) and further described as a public charitable organization under Section 509(a)(3). Substantially all of Legacy's direct affiliates have been granted exemptions from federal income tax under Section 501(a) of the IRC as charitable organizations described in Section 501(c)(3), except MHN, LHSIC, and LUSC. During 2019 and 2018, Legacy did not record any liability for uncertain tax benefits.

(d) Income from Operations

Income from operations excludes certain items that Legacy deems to be outside the scope of its primary business. These nonoperating activities include investment income, rental activities, and research activities.

(e) Excess of Revenues Over Expenses

The performance indicator is excess of revenues over expenses. Changes in net assets without donor restrictions that are excluded include certain changes in funded status of pension plans and net assets released from restriction for the purchase of property, plant, and equipment.

(f) Fair Value Measurements

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

- Level 1 inputs include quoted prices (unadjusted) in active markets for identical assets and liabilities.
- Level 2 inputs include 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. Investments valued utilizing net asset value (NAV) as a practical expedient are excluded from the hierarchy.

(g) Net Patient Service Revenue

Net patient service revenue is reported at the amount that reflects the consideration to which Legacy expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, Legacy bills patients and third-party payors several days after the services

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

are performed and/or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

Revenue for performance obligations satisfied over time is recognized based on actual goods or services provided. Generally, performance obligations satisfied over time relate to patients in Legacy's hospitals receiving inpatient acute care services. Revenue for performance obligations satisfied at a point in time is recognized when goods or services are provided and Legacy does not believe it is required to provide additional goods or services to the patient. The timing of revenue and recognition of substantially all services is at the time services are rendered.

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

Agreements with third-party payors typically provide for payments at amounts less than established charges. Payment arrangements with major third-party payors may be based on prospectively determined rates, reimbursed cost, discounted charges, per diem payments, and other methods.

Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor, and Legacy's historical settlement activity and are adjusted in future periods as adjustments become known or as years are settled or are no longer subject to such audits, reviews, and investigations. In 2019 and 2018, Legacy recorded an increase (decrease) to net patient service revenue of approximately \$20,659 and \$(292), respectively, relating to settlement of prior years' reimbursement from Medicare and Medicaid programs.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance. Legacy also provides services to uninsured patients and offers those uninsured patients a discount from standard charges. Legacy estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense. Bad debt expense for the years ended December 31, 2019 and 2018 was not significant.

Consistent with Legacy's mission, Legacy provides care without charge or at amounts less than its established rates to patients who meet certain criteria under its financial assistance policy. Therefore, Legacy has determined it has provided price concessions to uninsured patients and patients with uninsured balances. The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts Legacy expects to collect

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

based on its collection history with those patients who have been determined to qualify for financial assistance.

(h) Capitation Revenue

Capitation revenue is received on a prepaid basis and is recognized as revenue during the month for which the enrolled member is entitled to healthcare services. Capitation revenue received for future months is recorded as unearned revenue.

(i) Cash and Cash Equivalents

Cash equivalents include investments in highly liquid investments with original maturities of three months or less.

(j) Inventories

Inventories are stated at the lower of average cost, as determined by the first-in, first-out method or market.

(k) Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Donated items are reported at fair market value on the date of donation. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of acquiring those assets.

Impairment of property, plant, and equipment is assessed when there is evidence that events or changes in circumstances have made recovery of the net carrying value of assets unlikely.

Depreciation is determined by the straight-line method, which allocates cost equally over the estimated useful life. Average useful lives are as follows: buildings and improvements, 27 years; equipment and software, 7 years; and land improvements, 14 years. Leased assets that have been capitalized are amortized over the term of the lease or the useful life of the asset, whichever is shorter. Leased asset amortization is reported as part of depreciation expense.

(l) Assets Limited as to Use, Investments, and Investment Income

Short-term investments include corporate and government obligation securities, which are included in managed, low duration portfolios. The maturities of these related securities can exceed one year. Management anticipates the securities will be liquidated within the next year. These investments are considered trading securities.

Assets limited as to use include assets held by trustees under indenture agreements of \$128,924 and \$144,135 as of March 31, 2019 and 2018, respectively, as well as designated assets set aside by the board of directors to provide funding for certain community health projects and assets restricted for capital acquisition.

Noncurrent investments, which are accounted for as a trading portfolio, include investments in equity securities with readily determinable fair values, funds accounted for at NAV as a practical expedient, and investments in debt securities and are recorded at fair value in the consolidated balance sheets.

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

Investments in unconsolidated affiliates include investments in joint ventures over which Legacy does not exercise control and are accounted for using the equity method of accounting.

Investment income or loss is included in revenues in excess of expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are included in investment income.

(m) Net Assets with Donor Restrictions and Donor-Restricted Gifts

Net assets with donor restrictions include those whose use has been limited by donors to a specific time period or purpose or has been restricted by donors to be maintained in perpetuity. Income from net assets with donor restrictions is accounted for in accordance with donor instructions.

Unconditional promises to give cash and other assets to Legacy are reported 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 condition is satisfied or the gift is received. Gifts or grants are reported as restricted contributions if they are received with donor or grantor stipulations that limit the use of the donated assets. When the terms of a donor or grantor restriction are met, net assets with donor restrictions may be reclassified as net assets without donor restrictions and reported in the consolidated statements of operations or consolidated statements of changes in net assets as net assets released from restriction. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions.

(n) Charitable Gift Annuities

Legacy has certificates of authority from the State of Oregon and the State of Washington to receive transfers of money or property upon agreement to pay an annuity. A charitable gift annuity is an arrangement between a donor and Legacy in which the donor contributes assets to Legacy in exchange for Legacy's agreement to pay a fixed amount for a specified period of time to the donor or other individuals and organizations as designated by the donor (annuitant). Upon execution of such an arrangement, Legacy recognizes the assets received at fair value and an annuity payment liability at the present value of future cash flows expected to be paid. Contribution revenue is recognized based upon the difference between these two amounts based on donor intent for the proceeds. In subsequent periods, payments to the annuitant reduce the annuity liability. Adjustments to the annuity liability to reflect amortization of the discount, changes in life expectancy, and death of the annuitant are recognized as other operating expenses. The annuity liability included in other current liabilities in the consolidated balance sheets as of March 31, 2019 and 2018 was \$80 and \$47, respectively. The annuities are not issued by an insurance company and are not subject to regulation by the State of Oregon or protected by an insurance guaranty association.

Although Legacy is exempt under Oregon Revised Statute 731.039 from the requirement to maintain a separate and distinct trust fund adequate to meet the actuarially determined future payments of the charitable gift annuities, Legacy does maintain trust accounts with a bank for all gift annuities. The amounts under trust were \$169 and \$103 as of March 31, 2019 and 2018, respectively. These marketable securities are comprised of cash, cash equivalents, and other fixed income instruments.

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

(o) New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*, 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. Effective April 1, 2018, Legacy adopted ASU No. 2014-09 using the full retrospective method of transition. This ASU converged and replaced existing revenue recognition. As a result of implementing ASU No. 2014-09, certain patient activity for which collection is uncertain no longer meets the criteria for revenue recognition. Accordingly, the provision for uncollectible accounts after the adoption date is significantly reduced with a corresponding reduction to net patient service revenue as this activity was previously reported through March 31, 2018 as the provision for uncollectible accounts in Legacy's consolidated statements of operations. Such patient activity is now classified as an implicit price concession. Other aspects of Legacy's implementation of ASU No. 2014-09 impacting net patient service revenue include judgments regarding collection analyses and estimates of variable consideration and the addition of certain qualitative and quantitative disclosures, and these are reflected in note 1(g). The adoption of ASU No. 2014-09 in relation to other applicable revenue activity had no material impact on the consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which requires lessees to recognize a lease liability and a right of use asset for all lease obligations with exception for 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 new standard is effective for Legacy on April 1, 2019. Management estimates that the additional lease liabilities and right of use assets to be approximately \$47,000.

In August 2016, the FASB issued ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, with the intent 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 the statement of cash flows using either the direct or indirect method. Legacy adopted ASU No. 2016-14 for the period beginning April 1, 2018.

In June 2018, the FASB issued ASU No. 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The ASU is intended to clarify and improve current guidance about whether a transfer of assets (or the reduction, settlement, or cancellation of liabilities) is a contribution or an exchange transaction. Legacy adopted ASU No. 2018-08 for the period beginning April 1, 2018 and there was no material change to Legacy's financial statements upon adoption.

In August 2018, the FASB issued ASU No. 2018-15, *Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract*. The ASU provides guidance for

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

determining when fees paid in a cloud computing arrangement (hosting arrangement) includes a software license such that an intangible asset is recognized for the license and amortized. The new standard is effective for Legacy on April 1, 2021. Legacy is currently evaluating the extent of the impact of the adoption of ASU No. 2018-15.

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 Pension Cost*. Legacy adopted the ASU for the period beginning April 1, 2018 and recorded nonoperating income of \$2,535 for reductions in net periodic benefit costs of the Legacy Employee Retirement Plan. This amount is included in “Other, net” in the nonoperating section of the statements of operations for the year ended March 31, 2019.

(p) Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

(2) Net Patient Service Revenue

The composition of accounts receivable from patients and net patient service revenue as of and for the years ended March 31 were as follows:

	Accounts receivable from patients, net		Net patient service revenue	
	2019	2018	2019	2018
Medicare	27.5 %	24.3 %	29.7 %	28.7 %
Medicaid	13.7	13.8	20.3	20.5
Blue Cross	17.3	15.7	16.8	15.6
Private pay	4.3	4.8	0.3	0.3
Other	37.2	41.4	32.9	34.9
	100.0 %	100.0 %	100.0 %	100.0 %

The composition of net patient revenue based on service lines for the years ended as of March 31 was as follows:

	2019	2018
Hospital	88.1 %	88.1 %
Physician services	8.8	8.4
Hospice	0.7	0.9
Referral lab	1.7	1.8
Other	0.7	0.8
	100.0 %	100.0 %

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

(3) Benefits to the Community

The board of directors allocates funds for health initiatives and programs capable of impacting the health of the community either by prevention or health improvement. Contributions made to community-sponsored initiatives were \$620 and \$567 in 2019 and 2018, respectively.

In addition to funding selected community health initiatives, Legacy 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. The following tables represent the estimated cost of providing certain services to the community, along with a description of selected activities sponsored by Legacy:

	March 31, 2019			
	In-kind costs	Costs of service	Offsetting revenue	Net cost
Services for people in need:				
Charity care	\$ —	48,189	—	48,189
Medicaid	—	529,325	319,621	209,704
Medicare	—	783,113	605,238	177,875
Other government programs	—	22,011	17,176	4,835
	—	1,382,638	942,035	440,603
Benefits to the community:				
Medical education and research	—	25,739	7,649	18,090
Community health services	—	4,099	342	3,757
Community benefit activities	234	60	—	294
Donations to charitable organizations	396	2,325	—	2,721
Community health fund contributions	—	620	—	620
	630	32,843	7,991	25,482
	\$ 630	1,415,481	950,026	466,085
Percentage of total operating expenses				21.6 %

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

	March 31, 2018			
	In-kind costs	Costs of service	Offsetting revenue	Net cost
Services for people in need:				
Charity care	\$ —	49,236	—	49,236
Medicaid	—	550,892	327,580	223,312
Medicare	—	739,213	596,284	142,929
Other government programs	—	21,644	18,719	2,925
	—	1,360,985	942,583	418,402
Benefits to the community:				
Medical education and research	—	24,574	7,795	16,779
Community health services	—	4,072	296	3,776
Community benefit activities	361	65	—	426
Donations to charitable organizations	290	2,945	—	3,235
Community health fund contributions	—	567	—	567
	651	32,223	8,091	24,783
	\$ 651	1,393,208	950,674	443,185
Percentage of total operating expenses				21.4 %

(a) Services for People in Need

In support of its mission, Legacy provides 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 is 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, Legacy provides an uninsured discount of 35% to patients. Additional discounts, on a sliding scale, are available to patients whose household income is less than 400% of the federal poverty level. For patients whose household income is at or below 300% of the federal poverty level, a full subsidy is available. In addition to the household income criteria, the patients' qualified assets (e.g., 25% of household assets) and other catastrophic or economic circumstances are considered in determining eligibility for charity care. During 2019 and 2018, Legacy provided charity care benefiting patients associated with 65,210 and 73,556 patient accounts, respectively.

In addition to charity care, Legacy provides services under various states' Medicaid programs for low-income patients, to Medicare beneficiaries, and to beneficiaries under other government programs (such as TRICARE). The cost of providing services to these beneficiaries exceeds the reimbursement from these programs. The cost of services is determined based on the relationship of costs (excluding the provision for uncollectible accounts and costs associated with medical education, research, community health services, and other contributions) to billed charges.

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

Legacy also employs 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, COBRA, veterans' assistance, and public assistance programs, such as Medicaid. This program assists many patients in obtaining coverage through a third party, reducing the patients' financial responsibility. The costs associated with this program were \$1,202 and \$1,407 in 2019 and 2018, respectively.

(b) Benefits to the Community

Medical education and research includes, among other initiatives, the unreimbursed cost of nursing education, graduate medical education, and research.

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, caregiver 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 to enhance those organizations' missions of supporting health and human services, civic and community causes, and business development efforts.

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

(c) Other Benefits

In furtherance of its mission, Legacy 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 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.

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

Legacy pays taxes associated with various states' local business and occupation taxes and property taxes that local and state governments use to fund healthcare, civil, and education services to the community. Legacy paid \$7,676 and \$7,446 in local and state taxes in 2019 and 2018, respectively.

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

(4) Liquidity and Availability

As of March 31, 2019, Legacy had a working capital of \$202,889 and average days (based on normal expenditures) cash on hand of 180.6. As part of Legacy's liquidity management plan, cash in excess of daily requirements are invested in cash equivalents and short-term investments. Noncurrent investments are classified as such as management does not intend to use them in the next year; however, they are sufficiently liquid that they would be available if needed. Financial assets available for general expenditures within one year of the balance sheet date consist of the following:

	2019
Cash and cash equivalents	\$ 89,257
Short-term investments	10
Accounts receivable from patients, net	279,663
Other receivables	70,623
Noncurrent investments	938,425
	\$ 1,377,978

(5) Investments

Legacy invests in different classes of securities for a variety of financial assets, including short-term investments, assets limited as to use, and noncurrent investments. The composition of these investments is as follows:

	March 31, 2019			Total fair value
	Level 1	Level 2	Level 3	
Cash and cash equivalents	\$ 53,478	—	—	53,478
Mutual funds – equity	269,002	—	—	269,002
Equity securities:				
Domestic	174,261	—	—	174,261
Foreign	22,688	—	—	22,688
Mutual funds – fixed income	29,981	—	—	29,981
Domestic debt securities:				
State and federal governments	—	41,078	—	41,078
Corporate and securitized	—	340,215	—	340,215
Foreign debt securities	—	29,849	—	29,849
Commingled funds	—	60,208	—	60,208
Interest rate swaps	—	9,850	—	9,850
Derivatives, net	—	(80)	—	(80)
	\$ 549,410	481,120	—	1,030,530
Investments measured using NAV as a practical expedient				48,759
Total investments				\$ 1,079,289

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

March 31, 2018					
		Level 1	Level 2	Level 3	Total fair value
Cash and cash equivalents	\$	59,852	—	—	59,852
Mutual funds – equity		231,493	—	—	231,493
Equity securities:					
Domestic		91,737	—	—	91,737
Foreign		11,104	—	—	11,104
Mutual funds – fixed income		192,432	—	—	192,432
Domestic debt securities:					
State and federal governments		—	4,113	—	4,113
Corporate and securitized		—	101,662	—	101,662
Other		—	1,446	—	1,446
Commingled funds		118,809	—	—	118,809
Absolute return funds		67,423	—	—	67,423
Interest rate swaps		—	8,008	—	8,008
	\$	772,850	115,229	—	888,079
Investment in Oregon Community Foundation					130
Investments measured using NAV as a practical expedient					167,720
Total investments					\$ 1,055,929

Legacy's primary fixed income manager uses derivatives for both investment and hedging purposes and may take long and/or short positions. The derivative investments may include, but are not restricted to, futures and swaps.

Legacy participates in various funds 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 per share or its equivalent reported by each fund manager is used as a practical expedient to estimate the fair value of Legacy's interest therein. Legacy believes that the carrying amounts provided by the fund managers are reasonable estimates of fair value. The following table presents information for investments where the NAV was used as a practical expedient to measure fair value at March 31:

		Fair value		Redemption frequency	Redemption notice period
		2019	2018		
Hedge funds	\$	5,473	56,368	Quarterly	60–95 days
Private real estate		43,026	110,652	Quarterly	60–95 days
Private equity		260	700	N/A	N/A
Total	\$	48,759	167,720		

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

Hedge fund investments utilize strategies designed to generate consistent long-term capital appreciation with low volatility and little correlation with equity and bond markets. Legacy invests in a fund of hedge funds, which is an investment vehicle whose portfolio consists of shares in a number of hedge funds and engages in a variety of investment strategies, including convertible bond arbitrage, equity long/short, and statistical arbitrage.

Private real estate investments include the acquisition, financing, and ownership of property via a pooled, commingled fund. Legacy's private real estate funds are classified as core funds, which aim to generate a target return mainly from rental returns by income producing properties.

As of March 31, 2019, Legacy had a capital commitment of \$24,654 to private equity funds in the form of limited partnership/trust investments. These commitments are due on demand from the general partners/advisers. These private equity funds invest in emerging companies, venture capital funds, and other alternative investments. The termination of these partnerships/trusts is based upon specific provisions in the agreements. In most cases, the life of the trusts is a minimum of 10 years. Legacy can only transfer its interest in the investments with the consent of the general partner/adviser. The fair values of these investments are determined either by the underlying security value on the open market or by the general partner/adviser utilizing fair value principles.

As of March 31, 2019, approximately 4% of noncurrent investments require advance written notice of 90 days or longer to redeem the securities. For certain of these investments, it may take up to 90 days to receive the funds after the requested redemption date, and certain redemptions may be subject to other restrictions in accordance with subscription agreements.

Legacy has executed the following basis swaps with investment-banking firms:

<u>Notional amount</u>	<u>Cash flow settlement</u>	<u>Legacy pays</u>	<u>Legacy receives</u>	<u>Termination date</u>
\$ 82,000	Semiannually	SIFMA index	62% of LIBOR, plus 1.011%	December 2033
50,000	Quarterly	SIFMA index	67% of LIBOR, plus 0.6% for three years; 94.1% of LIBOR thereafter	April 2029
50,000	Quarterly	SIFMA index	67% of LIBOR, plus 0.6% for three years; 84.45% of LIBOR thereafter	September 2030
50,000	Quarterly	SIFMA index	67% of LIBOR, plus 0.6% for three years; 84% of LIBOR thereafter	September 2030

The objective of these transactions is to assume the tax-basis risk for a portion of the fixed-rate exposure on outstanding long-term indebtedness in exchange for positive cash flows. These transactions do not meet the criteria for hedge accounting; therefore, any changes in fair value under these agreements are recorded as part of investment income in the consolidated statements of operations. The fair value of these swaps is determined by the spread in interest rates.

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

(6) Investments in Unconsolidated Affiliates

Investments in unconsolidated affiliates as of March 31 are as follows:

	<u>2019</u>	<u>2018</u>
PacificSource	\$ 168,064	133,489
Lifelight Network	32,812	26,655
Other	10,379	12,044
Total investments in unconsolidated affiliates	<u>\$ 211,255</u>	<u>172,188</u>

In September 2016, Legacy completed a transaction to acquire up to a 50% ownership interest in PacificSource (PS). PS is the sole corporate member of PacificSource Health Plans, a not-for-profit community health plan offering commercial medical and dental plans in Oregon, Idaho, Montana, and Washington. PS is also the sole corporate member of PacificSource Community Health Plans, a health insurance company licensed in the states of Oregon, Idaho, and Montana, which offers Medicare Advantage and, through a subsidiary, Medicaid plans. PS owns 60% of the outstanding shares of Idaho Physicians Network, Inc., a physician contracting network.

An initial investment of \$100,000 was funded with unrestricted cash and investments in September 2016 to acquire a 28.8% interest in PS. Legacy's agreement with PS includes plans for additional investments over five years to attain 50% ownership before September 2021. Legacy's equity interest was 39.1% and 34.4% as of March 31, 2019 and 2018, respectively. The following table represents assets, liabilities, and net assets of PS per audited financial statements as of December 31 and the related operating results for the year ended December 31:

	<u>2018</u>	<u>2017</u>
Assets	\$ 564,936	541,311
Liabilities	249,853	277,642
Net assets:		
Unrestricted	324,089	264,114
Accumulated other comprehensive loss	(9,673)	(1,094)
Noncontrolling interests	667	649
Total net assets without donor restrictions	<u>315,083</u>	<u>263,669</u>
Total liabilities and net assets	<u>\$ 564,936</u>	<u>541,311</u>

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

	<u>2018</u>	<u>2017</u>
Underwriting income	\$ 36,821	36,559
Other income	8,142	4,370
Income tax expense	<u>(14,438)</u>	<u>(12,407)</u>
Net income	<u>\$ 30,525</u>	<u>28,522</u>

Legacy recorded net income on the investment in PS of \$8,351 and \$8,588 in 2019 and 2018, respectively. Legacy recorded \$3,276 and \$4,383 of amortization expense in 2019 and 2018, respectively, related to intangible assets acquired as part of the PS investment. Both net income and amortization expense related to PS are included in nonoperating income (loss), other in the consolidated statements of operations.

Legacy paid PS \$3,578 and \$3,284 in 2019 and 2018, respectively, for third-party health claims administration services for Legacy's self-insured health benefit plan, which are included in wages, salaries, and benefits in the consolidated statements of operations.

(7) Property, Plant, and Equipment

Property, plant, and equipment balances as of March 31 are as follows:

	<u>2019</u>	<u>2018</u>
Land	\$ 53,122	51,421
Land improvements	22,929	19,880
Buildings and improvements	1,219,654	1,193,350
Equipment and software	934,758	914,276
Construction in progress	<u>40,171</u>	<u>29,588</u>
	2,270,634	2,208,515
Accumulated depreciation	<u>(1,459,675)</u>	<u>(1,368,186)</u>
	<u>\$ 810,959</u>	<u>840,329</u>

There were capital expenditure purchase commitments outstanding as of March 31, 2019 for various construction and equipment projects. The estimated cost to complete such projects at March 31, 2019 was \$268,420, of which \$14,390 was contractually committed.

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

(8) Long-Term Debt

A summary of long-term debt at March 31 is as follows:

	2019	2018
Hospital Revenue Bonds, Series 2008, payable in installments through 2038, subject to a seven-day put provision; variable interest rate	\$ 100,000	100,000
Hospital Revenue Bonds, Series 2010A, payable in installments from \$2,125 to \$2,735 through 2030, at rates ranging from 4.375% to 5.0%, callable on or after March 2020	26,425	28,465
Hospital Revenue Bonds, Series 2011A, payable in installments from \$19,980 to \$22,060 through 2021, at rates ranging from 4.125% to 5.25%	63,010	72,170
Hospital Revenue Bonds, Series 2014A, payable in installments from \$2,985 to \$10,540 through 2040, at fixed rate of 2.425% subject to a mandatory tender on June 30, 2021, at which time Legacy can remarket the bonds, convert the bonds to a different mode, or pay off the bonds	71,720	71,720
Hospital Revenue Bonds, Series 2016A, payable in installments from \$1,950 to \$28,330 through 2047, at rates ranging from 3.0% to 5.0%, callable on or after June 2027	288,635	288,635
Other debt	985	932
	550,775	561,922
Deferred financing costs	25,146	26,677
Less current portion	(22,390)	(11,532)
	\$ 553,531	577,067

Interest cost incurred related to funds borrowed was \$16,473 and \$18,495 in 2019 and 2018, respectively. These amounts were reduced by \$883 and \$526 in 2019 and 2018, respectively, in the consolidated statements of operations for amounts capitalized for construction and other capital projects.

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

Scheduled principal repayments of long-term debt, including mandatory tenders of bonds eligible for refinancing, according to long-term amortization schedules are as follows:

2020	\$	22,390
2021		23,380
2022		24,531
2023		12,909
2024		13,310
Thereafter		<u>454,255</u>
	\$	<u>550,775</u>

The master trust indenture and other loan agreements covering these obligations contain, among other things, provisions placing restrictions on additional borrowings and leases and require the maintenance of debt service coverage and other ratios.

In November 2008, Legacy issued \$150,000 of Revenue Bonds Series 2008 (2008 Bonds), which are unsecured, variable-rate debt in an initial short-term interest rate mode, through the Hospital Facility Authority of Clackamas County, Oregon. The proceeds from the 2008 Bonds were restricted for capital expenditures and to pay the expenses incurred with the issuance. The 2008 Bonds, while subject to a long-term amortization period, may be put to Legacy at the option of the bondholders at certain remarketing dates. Series C (\$50,000) of the 2008 Bonds were refinanced in November 2016. In conjunction with the issuance, Legacy has entered into four year letter of credit and reimbursement agreements with a national bank, whereby the bank will purchase any bonds that are put by bondholders and not successfully remarketed. In the event of a draw under this agreement, there are no principal payments due within a year. If the bonds have not been remarketed or redeemed and amounts remain outstanding after a year, such amounts are converted to a term loan due in eight quarterly payments. As a result, the 2008 Bonds are classified as long-term.

In January 2010, Legacy issued \$123,745 of Revenue Bonds Series 2010A (2010 Bonds) through the Oregon Facilities Authority. The proceeds from the 2010 Bonds were used to refund previously issued debt and pay expenses for the issuance.

In May 2011, Legacy issued \$111,470 of Refunding Revenue Bonds Series 2011A (2011 Bonds) through the Oregon Facilities Authority. The proceeds from the 2011 Bonds were used to refund previously issued debt and pay expenses for the issuance.

In June 2014, Legacy issued \$71,700 of Hospital Revenue Bonds Series 2014A (2014 Bonds) under a Bond Purchase Agreement with the Oregon Facilities Authority and a commercial bank. The proceeds from the 2014 Bonds were used to refinance previously issued debt.

In November 2016, Legacy issued \$288,635 of Revenue Bonds Series 2016A (2016 Bonds) through the Oregon Facilities Authority. The proceeds from the 2016 Bonds will be used for capital expenditures, debt service during the construction period, and expenses incurred for the issuance. A portion of the proceeds was used to refinance Series C of the 2008 Bonds and previously issued debt.

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

(9) Net Assets with Donor Restrictions

Net assets with donor restrictions are available for the following purposes as of March 31:

	Restricted to a specific time period or purpose		Principal restricted in perpetuity	
	2019	2018	2019	2018
Education	\$ 8,053	7,916	3,035	2,831
Patient care	21,016	21,801	11,319	10,897
Research	5,363	6,674	1,950	1,949
Capital acquisition	5,440	7,074	—	—
Other	6,254	4,483	383	383
	<u>\$ 46,126</u>	<u>47,948</u>	<u>16,687</u>	<u>16,060</u>

(10) Functional Expenses

Legacy provides hospital services, physician services, and referral lab and other services. Support services include costs that are not controllable by operational leadership. Legacy leadership drives these costs, which benefit the entire organization. Costs that are controllable by operational leadership are allocated to the respective program activities.

Expenses related to providing services were as follows for the years ended March 31:

	2019				
	Hospital services	Physician services	Lab and other health services	Support services	Total
Wages, salaries, and benefits	\$ 792,925	270,151	49,408	202,995	1,315,479
Supplies	273,531	14,702	22,785	23,085	334,103
Professional fees	45,564	1,451	44	5,881	52,940
Purchased services	30,540	4,930	9,387	84,329	129,186
Purchased lab services	56,217	—	(56,217)	—	—
Purchased medical services	43,183	—	—	—	43,183
Utilities, insurance, and other expenses	24,658	18,235	57	126,675	169,625
Depreciation	62,600	3,158	2,433	30,754	98,945
Interest and amortization	12,605	52	—	3,878	16,535
	<u>\$ 1,341,823</u>	<u>312,679</u>	<u>27,897</u>	<u>477,597</u>	<u>2,159,996</u>

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

	2018				Total
	Hospital services	Physician services	Lab and other health services	Support services	
Wages, salaries, and benefits	\$ 765,136	246,674	49,804	186,863	1,248,477
Supplies	270,283	13,888	22,870	21,004	328,045
Professional fees	44,988	1,294	23	8,177	54,482
Purchased services	30,581	4,998	10,290	85,233	131,102
Purchased lab services	55,499	—	(55,499)	—	—
Purchased medical services	27,406	—	—	—	27,406
Utilities, insurance, and other expenses	27,905	20,363	5	113,685	161,958
Depreciation	63,084	2,722	2,417	34,643	102,866
Interest and amortization	14,338	16	—	4,182	18,536
	<u>\$ 1,299,220</u>	<u>289,955</u>	<u>29,910</u>	<u>453,787</u>	<u>2,072,872</u>

(11) Retirement Plans

(a) *Defined Contribution Plans*

Legacy sponsors defined contribution retirement plans that cover substantially all employees. The plans provide for employer matching contributions in an amount equal to a percentage of employee pretax contributions, up to a maximum. Expense related to these plans was \$59,620 and \$55,353 for 2019 and 2018, respectively.

(b) *Pension Benefit Plans*

Legacy sponsors a pension plan, the Legacy Employees' Retirement Plan (the Plan). The retirement benefits of all participants in the Plan were frozen effective December 31, 2016 (the Freeze Date). No benefit service after the Freeze Date will be taken into account in determining a participant's retirement benefits. After the Freeze Date, future retirement benefits are provided by the defined contribution plans. Legacy uses a measurement date of March 31 for the Plan.

Legacy maintains other retirement plans for certain management employees, which include a pension restoration plan, deferred compensation plans, and supplemental executive retirement plans.

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

A summary of changes in benefit obligations, fair values of plan assets, and the pension liability at March 31 and for the years then ended is as follows:

	2019	2018
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	\$ 914,952	897,087
Interest cost	36,408	37,338
Actuarial loss	11,879	24,528
Benefits paid	(47,770)	(44,001)
Projected benefit obligation at end of year	915,469	914,952
Change in plan assets:		
Fair value of assets at beginning of year	811,292	780,508
Actual return on plan assets	37,987	74,785
Employer contribution	84	—
Benefits paid	(47,770)	(44,001)
Fair value of assets at end of year	801,593	811,292
Funded status	\$ (113,876)	(103,660)
Unrecognized net actuarial loss	\$ 278,362	258,996
Accumulated benefit obligation	915,469	914,952

The prior service credit and actuarial losses included in unrestricted net assets without donor restrictions and expected to be recognized in net periodic pension cost during the year ending March 31, 2020 are \$0 and \$5,444, respectively.

Net periodic pension benefit for the years ended March 31 included the following components:

	2019	2018
Interest cost	\$ 36,408	37,338
Expected return on plan assets	(50,395)	(49,972)
Special recognition curtailments and settlements	12	—
Recognized net actuarial loss	4,910	4,294
Net periodic pension benefit	\$ (9,065)	(8,340)

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

(i) *Assumptions*

Legacy used the following actuarial assumptions to determine its benefit obligations at March 31 and its net periodic benefit cost for the years ended March 31:

	2019	2018
Benefit obligation (measured as of March 31):		
Discount rate	4.00 %	4.09 %
	2018	2017
Net periodic benefit cost (measured as of March 31):		
Discount rate	4.09 %	4.29 %
Long-term rate of return	6.50	6.50

The source data for the discount rate used to determine the benefit obligation was a universe of AA or higher rated U.S. dollar denominated bonds with similar maturities to the projected benefit payments. The expected long-term rate of return on plan assets was based on Legacy's asset allocation mix and the long-term historical return for each asset class, taking into account current and expected market conditions. The source data for the mortality table utilized was the RP-2014 Blue Collar Blended Employee and Annuitant for all annuitants as of December 31, 2014. All mortality tables were projected forward to 2027 using improvements rates determined on Legacy's specific population of participants.

(ii) *Pension Plan Assets*

The asset allocation of Legacy's pension plans at March 31 and the target allocation are as follows:

	2019 Target allocation	2019	2018 Target allocation	2018
Equity securities	42%–75%	54 %	22%–40%	33 %
Fixed income	40%–100%	42	35%–48%	42
Real estate	— %	3	0%–15%	8
Absolute return funds	— %	—	0%–18%	15
Alternative investments	— %	1	0%–5%	2

Pension plan assets are managed according to an investment policy adopted by the Legacy Health Employees Retirement Plan Trustees. Professional investment managers are retained to manage specific asset classes and professional consulting is utilized for investment performance reporting. The primary objectives are to preserve and grow the assets to provide for long-term benefit payments. Diversification is intended to reduce the risk of large losses and enhance opportunities for appropriate appreciation along with current income. It is also an objective to invest a significant portion of the assets in fixed-income assets that have a similar interest rate sensitivity as the projected liabilities for the Plan. Assets are rebalanced quarterly when balances fall outside of the approved range for each asset class.

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

The following tables set forth by level, within the fair value hierarchy, the Plan's assets at fair value:

March 31, 2019				
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total fair value</u>
Cash and cash equivalents	\$ 17,585	—	—	17,585
Mutual funds – equity	171,785	—	—	171,785
Equity securities:				
Domestic	146,711	—	—	146,711
Foreign	19,386	—	—	19,386
Mutual funds – fixed income	68,623	—	—	68,623
Domestic debt securities:				
State and federal government	—	115,195	—	115,195
Corporate and securitized	—	138,489	—	138,489
Foreign debt securities	—	42,390	—	42,390
Commingled funds	—	75,401	—	75,401
Derivative assets, net	—	543	—	543
	<u>\$ 424,090</u>	<u>372,018</u>	<u>—</u>	796,108
Investments measured using NAV as a practical expedient				37,702
Unsettled trades				<u>(32,217)</u>
Total assets at fair value				<u>\$ 801,593</u>

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

March 31, 2018				
	Level 1	Level 2	Level 3	Total fair value
Cash and cash equivalents	\$ 17,526	—	—	17,526
Mutual funds – equity	191,747	—	—	191,747
Equity securities:				
Domestic	63,278	—	—	63,278
Foreign	7,433	—	—	7,433
Mutual funds – fixed income	113,927	—	—	113,927
Domestic debt securities:				
State and federal government	—	35,126	—	35,126
Corporate and securitized	—	17,319	—	17,319
Foreign debt securities	—	3,674	—	3,674
Commingled funds	164,090	—	—	164,090
Absolute return funds	78,579	—	—	78,579
Derivative assets, net	—	1,228	—	1,228
	\$ 636,580	57,347	—	693,927
Investments measured using NAV as a practical expedient				123,771
Unsettled trades				(6,406)
Total assets at fair value				\$ 811,292

The following table presents information for plan assets where the NAV was used as a practical expedient to measure fair value at March 31:

	2019	2018	Redemption frequency	Redemption notice period
Hedge funds	\$ 1,867	38,485	Quarterly	60–95 days
Private real estate	24,970	71,256	Quarterly	60–95 days
Private equity	10,865	14,030	N/A	N/A
Total	\$ 37,702	123,771		

The Plan allows certain fixed-income investment managers to use derivative financial instruments to manage interest rate risk, which may include, but are not limited to, futures, options, swaps, and forward currency contracts.

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

The following table presents gross investment derivative assets and liabilities reported on a net basis in plan investments:

	2019	2018
Derivative assets:		
Future contracts	\$ 14,285	19,181
Other derivatives and forward setting contracts	933	1,661
	15,218	20,842
Derivative liabilities:		
Future contracts	(14,285)	(19,181)
Other derivatives and forward setting contracts	(390)	(433)
	(14,675)	(19,614)
Net investment derivative assets	\$ 543	1,228

(iii) Cash Flows

Legacy's policy with respect to funding the qualified plans is to fund at least the minimum required by the Employee Retirement Income Security Act of 1974, as amended, plus such additional amounts as deemed appropriate.

Benefit payments are expected to be paid as follows for the years ending December 31:

2020	\$	51,870
2021		50,693
2022		52,280
2023		52,948
2024		55,368
2025–2029		282,737

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

(12) Commitments and Contingencies

(a) Professional and General Liability

Legacy is self-insured for professional and general liability coverage. Legacy accrues estimated general and professional liability claims based upon management's estimate of the ultimate costs for both reported claims and actuarially determined estimates of claims incurred but not reported. Coverage in excess of self-insurance limits is provided on a claims-made basis through Legacy's captive insurance company, LHSIC.

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

(b) Employee Benefits

Legacy is self-insured for workers' compensation, employee health, and long-term and short-term disability. Legacy accrues the unpaid portion of claims that have been reported and estimates of claims that have been incurred but not reported based on an actuarial study.

(c) Operating Leases

Legacy leases various equipment and real property under operating leases. Future minimum lease commitments under noncancelable operating leases for the years ending March 31 are as follows:

2020	\$	8,697
2021		7,220
2022		6,901
2023		6,478
2024		6,150
Thereafter		<u>21,268</u>
	\$	<u>56,714</u>

Rent expense for 2019 and 2018 totaled \$16,182 and \$15,706, respectively.

(d) Collective Bargaining Agreements

Approximately 10% of Legacy employees were covered under collective bargaining agreements at March 31, 2019, including certain service and maintenance employees. Approximately 36 employees are covered by collective bargaining agreements that expire within one year.

(13) Compliance with Laws and Regulations

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

Management is aware of certain asserted and unasserted claims and regulatory matters arising in the ordinary course of business. After consultation with legal counsel, management estimates these matters will be resolved without material adverse effect to Legacy's consolidated financial statements.

LEGACY HEALTH

Notes to Consolidated Financial Statements

March 31, 2019 and 2018

(Dollars in thousands)

(14) Subsequent Events

Legacy evaluated and disclosed all material subsequent events through June 20, 2019, the date the consolidated financial statements were issued.

LEGACY HEALTH

Consolidating Schedule of Balance Sheet Information

March 31, 2019 and 2018

(Dollars in thousands)

Assets	Credit reporting group	Other affiliates and eliminations	March 31, 2019 consolidated	March 31, 2018 consolidated
Current assets:				
Cash and cash equivalents	\$ 89,057	200	89,257	67,256
Short-term investments	10	—	10	31,158
Accounts receivable from patients, net	264,069	15,594	279,663	254,574
Settlements receivable from third-party payors, net	24,365	2,058	26,423	12,438
Other receivables	59,480	11,143	70,623	52,770
Inventories	22,398	1,312	23,710	23,390
Prepaid expenses	14,195	648	14,843	14,064
Total current assets	473,574	30,955	504,529	455,650
Assets limited as to use	140,854	—	140,854	157,328
Property, plant, and equipment, net	783,583	27,376	810,959	840,329
Noncurrent investments	938,425	—	938,425	867,443
Investments in unconsolidated affiliates	216,385	(5,130)	211,255	172,188
Other assets	9,681	26,182	35,863	36,250
Interaffiliate receivable (payable)	(3,587)	3,587	—	—
Total assets	\$ 2,558,915	82,970	2,641,885	2,529,188
Liabilities and Net Assets				
Current liabilities:				
Accounts payable	\$ 51,294	3,551	54,845	53,745
Accrued wages, salaries, and benefits	143,740	7,352	151,092	131,319
Accrued interest	6,060	—	6,060	6,244
Other current liabilities	53,185	14,068	67,253	61,688
Current portion of long-term debt	22,105	285	22,390	11,532
Total current liabilities	276,384	25,256	301,640	264,528
Long-term debt, less current portion	552,831	700	553,531	577,067
General and professional claims liability	39,303	3,942	43,245	41,482
Pension liability	113,876	—	113,876	103,660
Other liabilities	47,355	416	47,771	43,486
Total liabilities	1,029,749	30,314	1,060,063	1,030,223
Net assets:				
Without donor restrictions, controlling	1,467,165	31,230	1,498,395	1,414,039
Without donor restrictions, noncontrolling	—	20,614	20,614	20,918
With donor restrictions	62,001	812	62,813	64,008
Total net assets	1,529,166	52,656	1,581,822	1,498,965
Total liabilities and net assets	\$ 2,558,915	82,970	2,641,885	2,529,188

See accompanying independent auditors' report.

LEGACY HEALTH

Consolidating Schedule of Operations Information

Years ended March 31, 2019 and 2018

(Dollars in thousands)

	<u>Credit reporting group</u>	<u>Other affiliates and eliminations</u>	<u>Year ended March 31, 2019 consolidated</u>	<u>Year ended March 31, 2018 consolidated</u>
Operating revenues:				
Net patient service revenue	\$ 1,936,273	130,400	2,066,673	1,979,603
Capitation revenue	164	47,474	47,638	39,435
Other revenue	<u>112,663</u>	<u>(7,606)</u>	<u>105,057</u>	<u>98,832</u>
Total operating revenues	<u>2,049,100</u>	<u>170,268</u>	<u>2,219,368</u>	<u>2,117,870</u>
Operating expenses:				
Wages, salaries, and benefits	1,233,774	81,705	1,315,479	1,248,477
Supplies	316,603	17,500	334,103	328,045
Professional fees	47,925	5,015	52,940	54,482
Purchased services	116,803	12,383	129,186	131,102
Purchased medical services	—	43,183	43,183	27,406
Utilities, insurance, and other expenses	156,966	12,659	169,625	161,957
Depreciation	95,592	3,353	98,945	102,867
Interest and amortization	16,481	54	16,535	18,536
Management fees	<u>(1,100)</u>	<u>1,100</u>	<u>—</u>	<u>—</u>
Total operating expenses	<u>1,983,044</u>	<u>176,952</u>	<u>2,159,996</u>	<u>2,072,872</u>
Income from operations	<u>66,056</u>	<u>(6,684)</u>	<u>59,372</u>	<u>44,998</u>
Nonoperating income (loss):				
Investment income, net	54,251	130	54,381	67,996
Other, net	<u>(9,971)</u>	<u>(277)</u>	<u>(10,248)</u>	<u>(12,817)</u>
Total nonoperating income	<u>44,280</u>	<u>(147)</u>	<u>44,133</u>	<u>55,179</u>
Excess of revenues over expenses	110,336	(6,831)	103,505	100,177
Change in pension liability	(19,208)	(157)	(19,365)	4,579
Net assets released from restriction	2,832	—	2,832	8,598
Distributions to joint venture partners	—	(2,920)	(2,920)	(2,528)
Other	<u>—</u>	<u>—</u>	<u>—</u>	<u>(19)</u>
Change in net assets without donor restrictions	<u>\$ 93,960</u>	<u>(9,908)</u>	<u>84,052</u>	<u>110,807</u>

See accompanying independent auditors' report.

LEGACY HEALTH

Consolidated Financial and Statistical Highlights

Years ended March 31

(Unaudited)

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>
Utilization:				
Average number of available beds	1,253	1,236	1,177	1,093
Discharges	62,746	64,280	62,798	59,308
Adjusted discharges	125,605	122,602	115,117	106,274
Patient days	304,398	315,073	297,537	274,338
Average length of stay	4.9	4.9	4.7	4.6
Percentage occupancy	66.6 %	69.8 %	69.3 %	68.8 %
Emergency room visits	290,940	294,135	233,215	216,518
Clinic visits	1,267,733	1,163,784	1,040,401	879,296
Surgical cases – inpatient	16,572	17,059	17,666	16,967
Surgical cases – outpatient	29,153	28,076	26,631	24,841
Average full-time equivalent (FTE) employees:				
Number of paid FTEs	11,310	11,249	10,675	9,473
FTEs per adjusted occupied bed	6.8	6.8	7.1	7.1
Ratios:				
Operating margin	2.7 %	2.1 %	2.9 %	5.0 %
Net days in accounts receivable	45.9	45.7	51.7	47.4
Days cash on hand	180.6	177.7	175.8	192.6
Capitalization	26.9 %	28.4 %	30.5 %	27.2 %

See accompanying independent auditors' report.