



PEACEHEALTH

Consolidated Financial Statements

June 30, 2013 and 2012

(With Independent Auditors' Report Thereon)

PEACEHEALTH
Consolidated Financial Statements
June 30, 2013 and 2012

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

Independent Auditors' Report

The Board of Directors
PeaceHealth:

We have audited the accompanying consolidated financial statements of PeaceHealth (a Washington not-for-profit corporation), which comprise the consolidated balance sheets as of June 30, 2013 and 2012, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly in all material respects, the financial position of PeaceHealth as of June 30, 2013 and 2012, and the results of its operations, changes in net assets, and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.



Other Matters

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The additional information included on pages 38 to 41 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 as a whole.

The unaudited information on pages 42 and 43 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.

KPMG LLP

Portland, Oregon
October 1, 2013

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Consolidated Balance Sheets

June 30, 2013 and 2012

(In thousands)

Assets	2013	2012
Current assets:		
Cash and cash equivalents	\$ 92,689	147,179
Short-term investments	276,979	300,926
Accounts receivable, net of allowance for doubtful accounts of \$95,196 and \$82,009	265,512	253,312
Other receivables	38,707	28,127
Inventory of supplies	36,581	33,820
Prepaid expenses and other	18,725	20,912
Assets whose use is limited that are required for current liabilities	29,770	23,258
Total current assets	<u>758,963</u>	<u>807,534</u>
Assets whose use is limited:		
Cash and investments	908,423	642,736
Investments in joint ventures and other	34,952	40,838
Total assets whose use is limited	<u>943,375</u>	<u>683,574</u>
Less current portion	<u>(29,770)</u>	<u>(23,258)</u>
Net assets whose use is limited	<u>913,605</u>	<u>660,316</u>
Property, plant, and equipment:		
Land and improvements	120,838	118,297
Buildings, fixed equipment, and other	1,612,140	1,565,987
Moveable equipment	640,378	570,371
Construction in progress	27,921	61,236
Total property, plant, and equipment	<u>2,401,277</u>	<u>2,315,891</u>
Less accumulated depreciation	<u>(1,064,262)</u>	<u>(928,722)</u>
Net property, plant, and equipment	1,337,015	1,387,169
Interest in net assets of related foundations	44,439	32,663
Other assets	30,671	38,092
Total assets	<u>\$ 3,084,693</u>	<u>2,925,774</u>

See accompanying notes to consolidated financial statements.

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Consolidated Balance Sheets

June 30, 2013 and 2012

(In thousands)

Liabilities and Net Assets	2013	2012
Current liabilities:		
Accounts payable	\$ 79,418	70,644
Accrued payroll, payroll taxes, and employee benefits	150,694	136,200
Accrued interest payable	5,138	4,545
Other current liabilities	26,504	40,745
Medical claims payable	5,986	6,533
Reimbursement settlements payable	9,768	18,596
Current portion of long-term debt	20,683	18,033
Total current liabilities	<u>298,191</u>	<u>295,296</u>
Other long-term liabilities	263,816	324,921
Long-term debt due after one year	905,858	830,381
Net assets:		
Unrestricted	1,552,980	1,428,152
Temporarily restricted	37,798	35,644
Permanently restricted	26,050	11,380
Total net assets	<u>1,616,828</u>	<u>1,475,176</u>
Total liabilities and net assets	<u>\$ 3,084,693</u>	<u>2,925,774</u>

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Operations

Years ended June 30, 2013 and 2012

(In thousands)

	2013	2012
Revenues:		
Net patient service revenue before provision for bad debts	\$ 2,145,535	2,103,580
Provision for bad debts	(161,192)	(133,814)
Net patient service revenue	1,984,343	1,969,766
Premium revenue	92,358	141,598
Other operating revenue	94,056	74,152
Total revenues	2,170,757	2,185,516
Expenses:		
Salaries and wages	989,540	975,830
Payroll taxes and benefits	251,407	221,755
Professional fees	36,065	26,274
Medical claims expense	59,126	97,121
Supplies and other expenses	650,211	657,502
Depreciation and amortization of other assets	150,299	146,517
Interest and amortization of deferred financing costs	24,261	25,997
Total expenses	2,160,909	2,150,996
Income from operations	9,848	34,520
Other income (loss):		
Investment income, net	61,538	15,777
(Loss) gain on investments recorded on the equity method	(1,138)	149
Change in valuation of interest rate swaps	35,317	(95,377)
Other	(9,124)	1,628
Excess (deficiency) of revenues over expenses	96,441	(43,303)
Net assets released from restrictions for property, plant and equipment	6,571	23,016
Change in interest in net assets of related foundations	547	653
Change in pension liability	27,964	(57,499)
Other changes in unrestricted net assets	(6,695)	656
Increase (decrease) in unrestricted net assets	\$ 124,828	(76,477)

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Changes in Net Assets

Years ended June 30, 2013 and 2012

(In thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Net assets at June 30, 2011	\$ 1,504,629	46,295	11,168	1,562,092
Deficiency of revenues over expenses	(43,303)	—	—	(43,303)
Other restricted contributions	—	8,202	8	8,210
Net assets released from restrictions	23,016	(20,322)	—	2,694
Change in interest in net assets of related foundations	653	1,708	203	2,564
Change in pension liability	(57,499)	—	—	(57,499)
Other changes in net assets	656	(239)	1	418
Change in net assets	<u>(76,477)</u>	<u>(10,651)</u>	<u>212</u>	<u>(86,916)</u>
Net assets at June 30, 2012	<u>1,428,152</u>	<u>35,644</u>	<u>11,380</u>	<u>1,475,176</u>
Excess of revenues over expenses	96,441	—	—	96,441
Other restricted contributions	—	11,070	1,708	12,778
Net assets released from restrictions	6,571	(8,666)	—	(2,095)
Change in interest in net assets of related foundations	547	(463)	11,692	11,776
Change in pension liability	27,964	—	—	27,964
Other changes in net assets	(6,695)	213	1,270	(5,212)
Change in net assets	<u>124,828</u>	<u>2,154</u>	<u>14,670</u>	<u>141,652</u>
Net assets at June 30, 2013	\$ <u><u>1,552,980</u></u>	<u><u>37,798</u></u>	<u><u>26,050</u></u>	<u><u>1,616,828</u></u>

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows

Years ended June 30, 2013 and 2012

(In thousands)

	<u>2013</u>	<u>2012</u>
Cash flows from operating activities:		
Change in net assets	\$ 141,652	(86,916)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	151,482	149,648
Gain on sale of land held for sale and property, plant, and equipment	(2,524)	(2,180)
Provision for bad debts	161,192	133,814
Change in pension liability	(27,964)	57,499
Restricted contributions	(12,778)	(10,300)
Net change in unrealized (gains) losses on investments	(32,091)	7,920
Realized gains on investments	(3,615)	(471)
Valuation adjustments on swap arrangements	(50,809)	77,564
Impairment of intangible assets	6,600	—
Equity investment loss (gain)	1,138	(6,474)
Increase in interest in net assets of related foundations	(11,776)	(2,564)
Distributions of earnings from joint ventures	9,405	7,678
Changes in operating assets and liabilities:		
Increase in:		
Accounts receivable, net	(183,972)	(139,191)
Other assets	(1,598)	(12,629)
Increase in:		
Accounts payable	8,774	(17,082)
Accrued payroll, payroll taxes, and employee benefits	14,494	(2,384)
Other liabilities	6,810	22,204
Net cash provided by operating activities	<u>174,420</u>	<u>176,136</u>
Cash flows from investing activities:		
Purchase of property, plant, and equipment	(107,490)	(82,257)
Proceeds from sale of land held for sale and property, plant, and equipment	11,262	3,383
Capital contributions to joint ventures	(2,535)	—
Purchase of investments	(383,654)	(303,915)
Sales and maturities of investments	175,498	193,879
Change in securities lending asset	—	23,459
Decrease in assets whose use is limited, other	—	5,186
Net cash used in investing activities	<u>(306,919)</u>	<u>(160,265)</u>
Cash flows from financing activities:		
Proceeds from long-term borrowings	156,910	213,500
Principal payments on long-term debt	(79,097)	(216,378)
Proceeds from restricted contributions	12,778	10,300
Deferred financing costs expended	(417)	—
Swap contract termination fees expended	(12,165)	—
Change in securities lending liability	—	(23,459)
Net cash provided by (used in) financing activities	<u>78,009</u>	<u>(16,037)</u>
Net decrease in cash and cash equivalents	(54,490)	(166)
Cash and cash equivalents at beginning of year	<u>147,179</u>	<u>147,345</u>
Cash and cash equivalents at end of year	\$ <u>92,689</u>	\$ <u>147,179</u>

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

(1) Organization

(a) Corporate Structure

PeaceHealth (the Corporation) is a Washington not-for-profit corporation with its corporate office located in Vancouver, Washington, which is sponsored by the Sisters of St. Joseph of Peace, and is recognized to be a Private Pontifical Juridic Person by the Roman Catholic Church. At June 30, 2013, the following regional healthcare delivery systems and operating divisions were components of the Corporation:

Northwest Network:

- PeaceHealth Ketchikan Medical Center
- PeaceHealth St. Joseph Medical Center
- Peace Island Medical Center

Columbia Network:

- PeaceHealth St. John Medical Center
- PeaceHealth Southwest Medical Center (Southwest)

Oregon Network:

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

Systemwide Organizations:

- PeaceHealth Medical Group
- PeaceHealth Laboratories
- PeaceHealth Self-insured Trusts
- Columbia United Providers (CUP)

These healthcare delivery systems and operating divisions, provide inpatient, outpatient, primary care and home care services in Alaska, Washington and Oregon. The Corporation operates these businesses primarily in Ketchikan, Alaska; Bellingham, Longview and Vancouver, Washington; Springfield, Eugene, Florence and Cottage Grove, Oregon.

The Corporation included the following controlled affiliates at June 30, 2013:

- Southwest Washington Health System
- Property and Buildings, LLC
- Health Ventures
- Pooled Income Funds (including Charitable Life Income Funds)
- PeaceHealth Southwest Medical Center Foundation

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

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Notes to Consolidated Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

(b) Future Affiliations

The Corporation has entered into an agreement to affiliate with United General Hospital in Sedro Wooley, Washington. United General Hospital is a Critical Access Hospital with approximately \$40,000 in net operating revenue annually. Management anticipates this affiliation will be completed during fiscal year 2014.

(2) Summary of Significant Accounting Policies

(a) Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates. The significant estimates in the Corporation's consolidated financial statements include accounts receivable allowances, reimbursement settlements payable, valuation of alternative investments, interest rate swaps, pension obligations, incurred but not reported amounts related to accrued healthcare costs, and liabilities related to self-insurance programs.

(b) Cash and Cash Equivalents

Cash and cash equivalents consist of petty cash, cash in demand bank accounts, and all highly liquid debt instruments purchased with an original maturity of three months or less other than those amounts included in assets whose use is limited by the board of directors. The Corporation held cash equivalents of approximately \$83,567 and \$117,787 as of June 30, 2013 and 2012, respectively.

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

(c) Short-Term Investments

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

(d) Inventory of Supplies

Inventory is valued on weighted average cost.

(e) Other Receivables

Other receivables primarily consist of amounts receivable from the federal government related to grants for electronic health record implementation, amounts receivable from the state of Oregon and

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Notes to Consolidated Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

third-party payors related to Medicaid programs, amounts receivable from excess insurance carriers and other miscellaneous amounts due.

(f) *Assets Whose Use is Limited*

The majority of these assets have been set aside by management of the Corporation for future capital improvements and other purposes, over which management retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of the Corporation have been reclassified as current in the consolidated balance sheets at June 30, 2013 and 2012. These items consist primarily of investments in marketable equity and fixed income securities, mutual funds, and investments in joint ventures. Money market funds and all marketable securities have readily determinable market values and are, therefore, carried at fair value. The investments in joint ventures and other are accounted for using the equity or cost method.

(g) *Property, Plant and Equipment*

Property, plant and equipment are stated at cost at the date of acquisition or fair value at the date of donation. Improvements and replacements of plant and equipment are capitalized. Maintenance and repairs are expensed as they are incurred. When property, plant and equipment is sold or retired, the cost and the related accumulated depreciation are removed from the accounts, and the resulting gain or loss is recorded.

The Corporation assesses potential impairment of its long-lived assets when there is evidence that events or changes in circumstances have made recovery of the asset's carrying value unlikely. An impairment loss is indicated when the sum of expected undiscounted future net cash flows is less than the carrying amount. The loss recognized is the difference between the fair value and the carrying amount. No impairment losses related to property, plant and equipment were recognized during the years ended June 30, 2013 and 2012.

In addition to consideration of impairment due to the events or changes in circumstances described above, management regularly evaluates the remaining lives of long-lived assets. If estimates are revised, the carrying value of affected assets is depreciated or amortized over remaining lives.

The Corporation has capitalized salary and wages along with related benefit costs in the amount of \$3,897 during fiscal year 2013 related to the development of software for internal use.

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Notes to Consolidated Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

(h) Depreciation

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

Land improvements	5 – 25 years
Buildings and improvements	5 – 80 years
Fixed equipment	10 – 25 years
Leasehold improvements	Shorter of remaining length of the lease or useful life
Moveable equipment	3 – 20 years

(i) Other Assets

Other assets include intangible assets, primarily deferred financing costs, trade names and goodwill. The deferred financing costs are amortized over the lives of the related debt issuances using the effective interest method. The intangibles have indefinite useful lives. Intangible assets with indefinite lives are evaluated annually for impairment. Impairment losses of \$6,600 and \$0 were recognized during the years ended June 30, 2013 and 2012, which is included in other income (loss) on the consolidated statements of operations.

(j) Other Long-Term Liabilities

The caption other long-term liabilities on the consolidated balance sheets consists primarily of the estimated fair value associated with the Corporation's interest rate swaps of approximately \$91,617 and \$154,591 at June 30, 2013 and 2012, respectively; the liability for the Southwest pension plan of approximately \$57,620 and \$85,857 at June 30, 2013 and June 30, 2012, respectively; and the long-term portion of the liability for the self-insurance programs of approximately \$51,850 and \$47,746 at June 30, 2013 and 2012, respectively.

(k) Contributions and Grants

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

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

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Notes to Consolidated Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

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

(l) Interest in Net Assets of Related Foundations

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

(m) Net Patient Service Revenues

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

	2013	2012
Medicare	36%	36%
Medicaid	11	10
Commercial and other	52	52
Private pay	1	2
	100%	100%

There is a corresponding significant concentration of credit risk in net accounts receivable balances at June 30, 2013 and 2012:

	2013	2012
Medicare	30%	27%
Medicaid	9	9
Commercial and other	59	63
Private pay	2	1
	100%	100%

Reimbursement for inpatient services rendered to Medicare recipients has been made principally under a prospective pricing system based on diagnosis-related groups. Most outpatient services provided to Medicare patients are reimbursed based on prospectively determined rates. Services to Medicaid patients are also reimbursed based on a combination of prospectively determined rates and cost reimbursement methodology. Continuation of these reimbursement programs at the present level, and on the present basis, is dependent upon future policies of federal and state governmental agencies. The Corporation has four critical access hospitals that are exempt from both inpatient and outpatient prospective payment systems. Inpatient and outpatient services rendered to Medicare and Medicaid program beneficiaries at critical access hospitals are reimbursed based on costs. Interim

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June 30, 2013 and 2012

(In thousands of dollars)

reimbursement to critical access hospitals is based upon tentative rates and retroactive adjustment is made to actual cost during final settlement by either the Medicare fiscal intermediary or the applicable state's Medicaid agency. Charges made on behalf of providers employed by the medical groups in the Corporation are generally reimbursed on a fee schedule.

The Corporation has estimated payments for services rendered to Medicare and Medicaid patients during the year by applying the payment principles of the applicable governmental agencies and believes that an adequate provision has been made in the accompanying consolidated financial statements for final settlement. Estimates of final settlements due to and due from Medicare, Medicaid, and other third-party payors have been reflected net as reimbursement settlement payable in the accompanying consolidated balance sheets. Differences between the net amounts accrued and subsequent settlements are recorded in operations at the time of settlement. The net amount of adjustments from finalization and adjustment of prior years' cost reports and other third-party settlements resulted in an decrease in net patient service revenue of \$3,500 in 2013 and an increase in net patient service revenue of \$13,700 in 2012.

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

The Corporation has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Corporation under these agreements includes prospectively determined rates per unit of service and discounts from established charges. Most arrangements provide for payment or reimbursement to the Corporation at amounts different than established rates. Contractual discounts represent the difference between established rates for services and amounts paid or reimbursed by these third-party payors.

The Corporation provides for an allowance against patient accounts receivable for amounts that could become uncollectible. The Corporation estimates this allowance based on the aging of accounts receivable, historical collection experience by payor, and other relevant factors. There are various factors that can impact the collection trends, such as changes in the economy, which in turn have an impact on unemployment rates and the number of uninsured and underinsured patients, the increased burden of copayments to be made by patients with insurance coverage and business practices related to collection efforts. These factors continuously change and can have an impact on collection trends and the estimation process used by the Corporation. Net bad debt write-offs during fiscal year 2013 were \$148,005.

(n) *Premium Revenue and Accrued Healthcare Costs*

The Corporation's majority-owned subsidiary, CUP, receives premium revenues that consist of premiums paid by the State of Washington for healthcare services. Premium revenues are received on a prepaid basis and are recognized as revenue during the month with which the premiums are associated. CUP's premium revenues were received under two primary contract sources at the State of Washington (the State), the Basic Health Plan and Healthy Options.

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Notes to Consolidated Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

The contract with the State expired on July 1, 2012. CUP has entered into an agreement with another health plan that has been awarded the contract from the State for the period July 1, 2012 through December 31, 2013. Under this contract, in return for receiving a defined premium amount from the other health plan, CUP will be responsible for providing medical, hospital, pharmaceutical and related medical services to Healthy Options and Basic Health Plan members assigned to CUP from the other plan. Under the terms of its contract with the other health plan, CUP will continue to perform most of the administrative services for assigned members that it previously performed under the expiring contract.

Under these contracts, the Corporation recognized premium revenues of \$92,358 and \$141,598 for the years ended June 30, 2013 and 2012, respectively, which is included as premium revenue in the accompanying consolidated statements of operations. The related medical expense recognized by CUP was \$59,126 and \$97,121 for the years ended June 30, 2013 and 2012, respectively, and is included in medical claims expense in the consolidated statements of operations.

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

(o) Other Operating Revenue

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

(p) Meaningful Use

The Health Information Technology for Economic and Clinical Health Act, part of the American Recovery and Reinvestment Act of 2009, created an incentive program, beginning in 2011, to promote the “meaningful use” of Electronic Health Records (EHR). To qualify, providers must attest that they are using certified EHR in a “meaningful” way by meeting objectives at established thresholds, as defined by the Centers for Medicare and Medicaid Services. Meaningful use revenues are recognized as grant revenue. Grant revenue is recognized when there is reasonable assurance that the grant will be received and that the organization will comply with the conditions attached to the grant. Meaningful use revenues of \$18,730 and \$7,111 were recognized for the years ended June 30, 2013 and 2012, respectively, and are included in other operating revenue in the accompanying consolidated statements of operations. The amount recognized is based on management’s best estimate and is subject to audit and potential retrospective adjustments.

(q) Income from Operations

Income from operations excludes certain items that the Corporation deems outside the scope of its primary business.

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Notes to Consolidated Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

(r) *Excess of Revenues over Expenses*

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

(s) *Federal and State Income Taxes*

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

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

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

(t) *Oregon State Provider Tax and Washington State Safety Net Assessment*

Effective July 1, 2004, the State of Oregon instituted a provider tax on certain patient service revenues at qualifying hospitals. The State of Washington enacted the safety net program in 2009 involving Washington State hospitals to increase funding from other sources and obtain additional Federal funds to support increased payments to providers for Medicaid services. These programs resulted in enhanced payments from the states in the way of lump sum payments and per claim increases. PeaceHealth expensed \$47,873 and \$48,593 in provider tax and safety net assessments during the fiscal year ending June 30, 2013 and 2012, respectively, which is included in supplies and other expenses in the accompanying consolidated statements of operations. At June 30, 2013 and 2012, a receivable of \$7,105 and \$5,498, respectively, was included in other receivables on the accompanying consolidated balance sheets for enhanced lump sum payments.

(u) *Recently Adopted or Issued Accounting Standards*

In 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*, which provides financial statement users with greater transparency about a healthcare entity's net patient service revenue and the related allowance for doubtful accounts. This update provides information to assist financial statement users in assessing an entity's sources of net patient service revenue and related changes in its allowance for doubtful accounts. The amendments require healthcare entities that recognize

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significant amounts of patient service revenue at the time the services are rendered even though they do not assess the patient's ability to pay, to present the provision for bad debts related to patient service revenue as a deduction from patient service revenue (net of contractual allowances and discounts) on their statement of operations. This standard is effective for the 2013 fiscal year. The adoption of this standard resulted in a change in presentation of balances previously reported as of June 30, 2012.

(v) ***Healthcare Reform***

As enacted, the Health Reform Law will change how healthcare services are covered, delivered and reimbursed through expanded coverage of uninsured individuals, reduced growth in Medicare program spending, reductions in Medicare and Medicaid Disproportionate Share Hospital payments, and the establishment of programs in which reimbursement is tied to quality and integration. In addition, the law reforms certain aspects of health insurance, expands existing efforts to tie Medicare and Medicaid payments to performance and quality, and contains provisions intended to strengthen fraud and abuse enforcement. Further, it provides for a value-based purchasing program, the establishment of Accountable Care Organizations (ACO's) and bundled payment pilot programs, which may create sources of additional revenue. On June 28, 2012, the United States Supreme Court upheld the constitutionality of the individual mandate provisions of the Health Reform Law but struck down the provisions that would have allowed Health and Human Services to penalize states that do not implement the Medicaid expansion provisions with the loss of existing federal Medicaid funding. States that choose not to implement the Medicaid expansion will forego funding established by the Health Reform Law to cover most of the expansion costs.

(w) ***Reclassifications***

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

(3) **Fair Value of Financial Instruments**

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

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

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

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

The fair value of long-term debt is based on Level 2 inputs, such as the discounted value of the future cash flows using current rates for debt with the same remaining maturities, considering the existing call premium and protection. When available, quoted market prices are also used. The carrying value and fair value of debt, was approximately \$910,334 and \$920,679, respectively, as of June 30, 2013, and approximately \$826,216 and \$847,046, respectively, as of June 30, 2012.

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

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(4) Investments

The composition of cash and investments carried at fair value on a recurring basis at June 30, 2013 is set forth in the following table.

	<u>June 30, 2013</u>	<u>Fair value measurements at reporting date using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets:				
Short-term investments:				
Cash and money market funds	\$ 2,663	2,663	—	—
Fixed income:				
Government obligations	48,130	—	48,130	—
Corporate obligations	39,428	—	39,428	—
Mortgage-backed securities:				
Commercial	9,391	—	9,391	—
Residential	42,692	—	42,692	—
Municipal, foreign, and other fixed income	6,223	—	6,223	—
Mutual funds:				
Domestic debt securities	118,883	118,883	—	—
International debt securities	8,768	8,768	—	—
Other short-term investments	801	—	801	—
Total	<u>276,979</u>	<u>130,314</u>	<u>146,665</u>	<u>—</u>
Designated for capital acquisition:				
Cash and money market funds	11,978	7,468	4,510	—
Fixed income:				
Government obligations	44,919	—	44,919	—
Corporate obligations	68,273	—	68,273	—
Mortgage-backed securities:				
Commercial	10,139	—	10,139	—
Residential	53,612	—	53,612	—
Municipal, foreign, and other fixed income	16,521	—	16,521	—
Mutual funds:				
Fixed income	80,804	80,804	—	—
Domestic equities:				
Large capitalization	177,227	177,227	—	—
Medium-small capitalization	75,077	75,077	—	—

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	June 30, 2013	Fair value measurements at reporting date using		
		Level 1	Level 2	Level 3
International equities:				
Foreign stock	\$ 94,188	94,188	—	—
Emerging markets	32,639	32,639	—	—
Real estate trusts	21,180	21,180	—	—
Commodities	31,859	6,264	25,595	—
Total	718,416	494,847	223,569	—
Funds designated for 457 plans:				
Cash and short term	601	601	—	—
Mutual funds:				
Equity	12,720	12,720	—	—
Fixed income	5,449	5,449	—	—
Target/blended/other	13,337	13,337	—	—
Total	32,107	32,107	—	—
Trustee-held funds:				
Cash and money market funds	25,103	25,103	—	—
Fixed income:				
Government obligations and other	3,461	—	3,461	—
Mortgage-backed securities:				
Residential	5,764	—	5,764	—
Mutual funds:				
Domestic equities:				
Large capitalization	30,610	30,610	—	—
Medium-small capitalization	12,773	12,773	—	—
International equities:				
Foreign stock and emerging markets	21,388	21,388	—	—
Domestic debt securities	34,170	34,170	—	—
International debt securities	3,377	3,377	—	—
Real estate	4,238	4,238	—	—
Total	140,884	131,659	9,225	—
Total assets	\$ 1,168,386	788,927	379,459	—
Liabilities:				
Interest rate swaps	\$ 91,617	—	91,617	—
Total liabilities	\$ 91,617	—	91,617	—

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The composition of cash and investments carried at fair value on a recurring basis at June 30, 2012 is set forth in the following table.

	June 30, 2012	Fair value measurements at reporting date using		
		Level 1	Level 2	Level 3
Assets:				
Short-term investments:				
Cash and money market funds	\$ 4,152	—	4,152	—
Fixed income:				
Government obligations	59,564	—	59,564	—
Corporate obligations	43,281	—	43,281	—
Mortgage-backed securities:				
Commercial	9,343	—	9,343	—
Residential	53,434	—	53,434	—
Municipal, foreign, and other fixed income	10,902	—	10,902	—
Mutual funds:				
Domestic debt securities	112,122	112,122	—	—
International debt securities	7,327	7,327	—	—
Other short-term investments	801	—	801	—
Total	300,926	119,449	181,477	—
Designated for capital acquisition:				
Cash and money market funds	11,595	6,426	5,169	—
Fixed income:				
Government obligations	59,329	—	59,329	—
Corporate obligations	57,621	—	57,621	—
Mortgage-backed securities:				
Commercial	10,383	—	10,383	—
Residential	55,153	—	55,153	—
Municipal, foreign, and other fixed income	9,091	—	9,091	—
Mutual funds:				
Fixed income	48,646	48,646	—	—
Domestic equities:				
Large capitalization	99,975	99,975	—	—
Medium-small capitalization	38,935	38,935	—	—

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	June 30, 2012	Fair value measurements at reporting date using		
		Level 1	Level 2	Level 3
International equities:				
Foreign stock	\$ 64,474	64,474	—	—
Emerging markets	18,796	18,796	—	—
Real estate trusts	12,573	12,573	—	—
Real estate	423	—	423	—
Commodities	20,784	—	20,784	—
Total	<u>507,778</u>	<u>289,825</u>	<u>217,953</u>	<u>—</u>
Funds designated for 457 plans:				
Cash and short term	572	572	—	—
Mutual funds:				
Equity	8,070	8,070	—	—
Fixed income	5,092	5,092	—	—
Target/blended/other	10,863	10,863	—	—
Total	<u>24,597</u>	<u>24,597</u>	<u>—</u>	<u>—</u>
Trustee-held funds:				
Cash and money market funds	27,729	27,424	305	—
Fixed income:				
Government obligations and other	3,725	—	3,725	—
Mortgage-backed securities:				
Residential	6,042	—	6,042	—
Mutual funds:				
Domestic equities:				
Large capitalization	11,177	11,177	—	—
Medium-small capitalization	6,244	6,244	—	—
International equities:				
Foreign stock and emerging markets	10,682	10,682	—	—
Domestic debt securities	19,467	19,467	—	—
International debt securities	2,038	2,038	—	—
Real estate	960	960	—	—
Total	<u>88,064</u>	<u>77,992</u>	<u>10,072</u>	<u>—</u>
Total assets	<u>\$ 921,365</u>	<u>511,863</u>	<u>409,502</u>	<u>—</u>
Liabilities:				
Interest rate swaps	\$ 154,591	—	154,591	—
Total liabilities	<u>\$ 154,591</u>	<u>—</u>	<u>154,591</u>	<u>—</u>

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The Corporation holds alternative investments, as defined by the American Institute of Certified Public Accountants, in two limited partnerships of \$25,220 and \$20,423 at June 30, 2013 and 2012 respectively, which are not publicly traded. These amounts are included as a part of commodities in the tables above. The underlying assets in the limited partnerships are based on fair market values, and the redemption period related to these investments is between 3 to 30 days.

At June 30, 2013 and 2012, the Corporation had \$17,016 and \$22,297, respectively, in alternative investments, referred to as Private Equity, Real Estate Trusts and Distressed Debt, accounted for using the equity method, which are not publicly traded. These amounts are not included in the tables above. These investment instruments contain elements of both credit and market risk. Such risks may include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, emphasis on speculative investments (nonmarketable investments), and nondisclosure of portfolio composition. Because these investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a readily available market for such investments existed. These investments represented 1.4% and 2.3% of total investments and 1.1% and 1.5% of total net assets of the Corporation at June 30, 2013 and 2012, respectively.

Investment income is comprised of the following for the years ended June 30, 2013 and 2012.

	<u>2013</u>	<u>2012</u>
Interest and dividend income	\$ 25,832	23,141
Net realized gains (losses) on sales of investments	3,615	2,371
Change in net unrealized gains (losses) on investments	<u>32,091</u>	<u>(9,735)</u>
Investment income, net	<u>\$ 61,538</u>	<u>15,777</u>

Other Investments

Health Ventures is a not-for-profit corporation that has entered into joint ventures to provide radiology, oncology, and surgery services. The Corporation is the sole member of Health Ventures. Health Ventures is included in the consolidated financial statements but is not part of the obligated group. The Corporation accounts for these joint ventures on the equity method. As of June 30, 2013 and 2012, the carrying value of the joint ventures was approximately \$14,823 and \$11,378, respectively and is recorded in investments in joint ventures and other on the consolidated balance sheets. Investment income from the joint ventures of \$7,586 and \$6,704 for the years ended June 30, 2013 and June 30, 2012, respectively, is included in other operating revenue. The assets, liabilities and equity of these joint ventures at June 30, 2013 were \$41,007, \$10,372 and \$30,635, respectively.

The Corporation is a minority investor in Premier Purchasing Partners (Premier). The Corporation has invested in Premier with other healthcare providers for the purpose of lowering costs through group purchasing. The Corporation accounts for its interest in Premier on the cost method.

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(5) Charity Care

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

The Corporation maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies under its charity care policy. Estimated costs (based on the proportion of overall costs to charges foregone for charity care) for services and supplies furnished under the charity care policy for the years ended June 30, 2013 and 2012 were approximately \$68,050 and \$72,158, respectively.

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(6) Long-Term Debt

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

	<u>2013</u>	<u>2012</u>
Series 1995 (PeaceHealth) Oregon Bonds, variable interest rate (0.04% at June 30, 2013) payable each December 1, due in annual installments through December 2015	\$ 3,675	4,770
Series 1999 (Southwest) Washington bonds, 3.00% to 5.00% payable annually through September 2028.	46,025	47,885
Series 2001 (PeaceHealth) Oregon Bonds, 5.00% to 5.25%, interest payable each May 15 and November 15, due in annual installments from 2016 through November 2032	70,000	70,000
Series 2004 (PeaceHealth) Oregon Bonds, Series A, 3.00% to 5.00%, interest payable each February 1 and August 1, due in annual installments from 2010 through August 2014, called during fiscal year 2013	—	9,280
Series 2008 (PeaceHealth) Washington Bonds, Series A, fixed interest rate of 5% payable on each May 1 and November 1, through November 2018.	80,650	80,650
Series 2008 (PeaceHealth) Oregon Bonds, Series A-B, variable interest rate (0.05% at June 30, 2013), principal payable each August, due in annual installments from 2030 to 2034 for Series A and B	145,975	145,975
Series 2008 (Southwest) Washington Bonds, Series A, variable interest rate, principal payable each September, due in annual installments through 2034, called during fiscal year 2013	—	54,500
Series 2009 (PeaceHealth) Oregon Bonds, Series A, fixed interest rates of 3.25% to 5.00% payable each May and November, due in installments from 2013 to 2039.	100,795	100,795
Series 2009 (PeaceHealth) Washington Bonds, Series A, fixed interest rates of 3.0% to 5.0% payable each in May and November, due in installments through 2028	83,245	87,550
Series 2011 (PeaceHealth) Oregon Bonds, Series A-B, variable interest rates (0.83% at June 30, 2013) principal payable each May, due in installments from 2036 to 2047	150,000	150,000
2011 (PeaceHealth) Direct Note Obligation to Union Bank 2.46% payable monthly based on a ten-year amortization with remaining amount due November 2016	8,500	9,500

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	2013	2012
2012 (Southwest) Bridge Loan Obligation to Bank of America, variable interest rate (0.84% at June 30, 2013) due on July 31, 2014	\$ 54,000	54,000
2012 (PeaceHealth) Direct Note Obligation to US Bank, variable interest rate (0.90% at June 30, 2013), due on February 28, 2015	50,000	—
2012 Direct Note Obligation to Bank of America, fixed interest rate of 2.2%, due on December 1, 2022	53,445	—
2013 Washington Bonds, Series A, variable interest rate (0.83% at June 30, 2013), principal payable each September, in annual installments from 2013 to 2034	53,465	—
Long-term debt at par value	899,775	814,905
Premium and other on long-term debt	10,559	8,927
Other long-term debt	16,207	24,582
Total long-term debt	926,541	848,414
Less amounts due within one year	(20,683)	(18,033)
Total long-term debt due after one year	\$ 905,858	830,381

On January 1, 2013, the legal entity formerly known as Southwest Washington Medical Center was merged into the Corporation. The Corporation became liable for all outstanding debts of Southwest Washington Medical Center on the date of the merger.

The Corporation is the sole member of the PeaceHealth Obligated Group. The assets of the Obligated Group are available for the satisfaction of debts of the Corporation under the terms of its Master Trust Indenture. The controlled affiliates of PeaceHealth are not members of the Obligated Group.

The Series 1995 Oregon Variable Rate Demand Bonds, the Series 2008 Oregon Series A-B Variable Rate Demand Bonds, the Series 2011 Oregon Series A-B Direct Placement Bonds, and the Washington 2013(A) Direct Placement Bonds have variable interest rates that may bear interest at a daily, weekly, 28-day, monthly, semiannual, or annual rates. The rate determination mode may be changed upon request of the Corporation. The bonds are subject to optional redemption by PeaceHealth, in whole or in part at 100% of the principal amount plus accrued interest. The Variable Rate Demand Bonds are backed by letters of credit in the amount of approximately \$147,600 for the 2008 Oregon bonds and \$3,700 for the 1995 Oregon bonds. The letter of credit for Series A-B of the 2008 Oregon bonds will expire in June 2017. The letter of credit for the 1995 Oregon bonds will expire in January 2017. The 2011 Oregon bonds are held directly by two financial institutions subject to continuing covenant agreements, which contain substantially the same credit terms as the letters of credit, but which are not subject to the same

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remarketing and put risk as the 1995 and 2008 bonds. The 2011 Oregon bonds and Washington 2013(A) bonds can be converted to publicly held variable rate demand bonds if the Corporation chooses. The continuing covenant agreements for the Oregon 2011 Direct Placement Bonds expire in August 2015 for Series (A) and August 2017 for Series (B). The continuing covenant agreement for the Washington 2013(A) bonds expires February 2016. The letters of credit and the continuing covenant agreements are extendable annually at the option of the bank upon request from the Corporation for an additional year. The 2008, 2011 and 2013(A) bonds are matched to fixed payor swaps ranging between 3.60% and 4.10% for approximately their par value, the notional amounts of swaps amortizing proportionately to the bonds.

The Series 1995 Oregon and Series 2008 Oregon variable rate demand bonds, which have long-term amortization periods, may be put back to the letter of credit bank on any interest rate reset date if the bonds fail to be remarketed. In the event of a failed remarketing, the letter of credit bank is obligated under the terms of the letter of credit agreement to buy the bonds. If the bonds continue to fail to be remarketed, and become a term loan from the letter of credit bank to the Corporation, the payments commence not less than 367 days after the purchase of the bonds by the letter of credit bank, and are payable in equal quarterly installments thereafter. The Series 1999 Washington bonds are currently redeemable at par.

The Series 2008 Washington bonds Series A were redeemed during the 2013 fiscal year with proceeds from the WHCFA 2013 bonds, which is matched to a fixed payor swap bearing a rate of 3.60%.

Other long-term debt primarily includes an \$11,000 note payable paying interest of 6% with principal due and payable through 2017, as well as amounts related to capital lease obligations.

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

	Long-term debt	Capitalized Leases	Other	Total
Year ending June 30:				
2014	\$ 18,754	1,412	695	20,861
2015	123,520	1,042	771	125,333
2016	18,921	922	610	20,453
2017	23,310	492	634	24,436
2018	19,144	507	8,855	28,506
Thereafter	696,126	837	-	696,963
Total	\$ 899,775	5,212	11,565	916,552
Less amounts representing interest Present value of net minimum		(570)		(570)
capital lease payments		4,642		
Less current installments of obligations under capital leases		(1,234)		
Obligations under capital leases, excluding current installments		3,408		
Total long-term debt				915,982

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

Cash paid for interest totaled approximately \$24,261 and \$23,447 for the years ended June 30, 2013 and 2012, respectively. Interest totaling approximately \$1,347 and \$663 was capitalized in connection with construction projects during the years ended June 30, 2013 and 2012, respectively.

(7) Accounting for Derivative Instruments and Hedging Activities

In accordance with the policy adopted by the Board of Directors, the Corporation may use interest rate swap contracts to manage its net exposure to interest rate changes in attempting to reduce its overall cost of borrowing over time. Interest rate swap contracts generally involve the exchange of fixed and floating interest rate payments without the exchange of underlying principal (the swap of fixed or floating rates are on a notional amount). The Corporation accounts for its interest rate hedging transactions in accordance with FASB ASC 815 – *Derivatives and Hedging*. That standard requires that every derivative instrument be recorded on the balance sheet as either an asset or a liability measured at its estimated fair value. The

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interest rate swaps do not meet the criteria for hedge accounting and all changes in the valuation of the interest rate swaps are recognized in the consolidated statements of operations.

The Corporation had the following interest rate swap contracts outstanding as of June 30, 2013 with a total current notional amount of approximately \$434,200: a \$40,000 basis swap where the Corporation receives 81.9% of 30 day LIBOR and pays a 30 day tax-exempt index rate, and approximately \$394,200 (fixed payer swaps) which the Corporation uses to convert a portion of the outstanding variable rate bonds to fixed rates ranging from 3.5% to 4.1%. The fixed payer interest rate swaps are associated with the variable rate bonds, but have not been integrated to any of the underlying debt for the purpose of hedge accounting.

Change in valuation of interest rate swaps consists of the non-cash change in the liability and the cash payments and receipts associated with the swaps. The non-cash change in the fair value of the interest rate swaps, was a decrease of \$50,809 and an increase of \$77,564 in the liability for the years ended June 30, 2013 and 2012, respectively. Net cash settlement cost for the interest rate swaps was \$15,492 and \$17,813, for the years ended June 30, 2013 and 2012, respectively.

Derivative instruments are recorded at fair value taking into consideration the Corporation's nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. The impact of taking into account the nonperformance risk on the estimated fair value of the interest rate swaps was a benefit of approximately \$13,399 and \$19,644, as of June 30, 2013 and June 30, 2012, respectively. Recording the interest rate swaps at fair value results in a total liability of \$91,617 and \$154,591 as of June 30, 2013 and June 30, 2012, respectively in other long-term liabilities in the accompanying consolidated balance sheets rather than the \$105,016 and \$174,235 that would be paid if all of the swaps were terminated as of June 30, 2013 and June 30, 2012, respectively. The inputs used to determine the impact of the counterparty nonperformance risk are Level 2 inputs; as such derivative liabilities have been recorded as Level 2 in the Corporation's disclosure of fair value instruments, see note 4.

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

(8) Benefit Plans

Defined Benefit Pension Plan

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

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paid as participants qualify to receive benefits. All related charges related to this event were recorded prior to the affiliation of Southwest with PeaceHealth.

The following table sets forth disclosures related to the Plan in accordance with FASB ASC 715-20-65, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, as of June 30, 2013 and 2012.

	Years ended June 30	
	2013	2012
Change in projected benefit obligation:		
Projected benefit obligation (PBO) at beginning of period	\$ 218,246	168,844
Service cost	572	—
Interest cost	8,615	9,150
Actuarial (gain) loss on PBO	(20,009)	44,484
Benefits and administrative expenses paid	(5,732)	(4,232)
Projected benefit obligation at June 30	<u>\$ 201,692</u>	<u>218,246</u>
Change in fair value of plan assets:		
Fair value of assets at beginning of period	\$ 132,389	127,743
Actual return on plan assets	14,069	(2,966)
Employer contribution	3,346	11,844
Benefits paid	(5,033)	(4,232)
Administrative expenses	(699)	—
Fair value of assets at June 30	<u>\$ 144,072</u>	<u>132,389</u>
Reconciliation of funded status:		
Funded status	<u>\$ (57,620)</u>	<u>(85,857)</u>
Net amount recognized	<u>\$ (57,620)</u>	<u>(85,857)</u>
Amounts recognized in the consolidated balance sheets consist of:		
Accrued pension liability	\$ 57,620	85,857
Accumulated change in net assets	(30,961)	(59,198)

The accumulated benefit obligation for the Plan was \$201,692 and \$218,246 at June 30, 2013 and 2012, respectively.

PEACEHEALTH

Notes to Consolidated Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

Net periodic benefit cost for the years ended June 30, 2013 and 2012 included the following components and is included in payroll taxes and benefits in the accompanying consolidated statements of operations and changes in net assets:

	2013	2012
Service cost	\$ 572	—
Interest cost	8,615	9,150
Expected return on plan assets	(10,702)	(10,837)
Amortization of loss	4,588	788
Net periodic pension cost (benefit)	\$ 3,073	(899)

(a) Assumptions

The Corporation used the following actuarial assumptions to determine its benefit obligations at June 30, 2013 and 2012, with measurement dates of June 30, 2013 and 2012:

	2013	2012
Discount rate	4.65%	4.0%

The Corporation used the following actuarial assumptions to determine its net periodic benefit cost for the years ended June 30, 2013 and 2012:

	2013	2012
Discount rate	4.0%	5.5%
Expected long-term rate of return on plan assets	7.5%	8.5

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

The expected long-term rate of return on plan assets was based on the asset allocation mix and the long-term historical return for each asset class, taking into account current and expected market conditions. The actual return (loss) on pension plan assets was approximately 10.9% and (1.8)% during the years ended June 30, 2013 and 2012, respectively. In the calculation of pension plan expense, the expected long-term rate of return on plan assets is applied to a calculated value of plan assets that recognizes changes in fair value over a four-year period. This practice is intended to reduce year-to-year volatility in pension expense, but it can have the effect of delaying the recognition of differences between actual returns and expected returns based on the long-term rate of return assumptions.

PEACEHEALTH

Notes to Consolidated Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

(b) Pension Plan Assets

The asset allocation of the Corporation's pension plan at June 30, 2013 and 2012 is as follows:

	<u>2013</u>	<u>2012</u>
Equity securities	\$ 82,725	76,763
Debt securities	59,192	46,931
Other	2,155	8,695
Total	<u>\$ 144,072</u>	<u>132,389</u>

Pension plan assets are managed according to an investment policy adopted by the Plan's trustees. Professional investment managers are retained to manage specific asset classes and professional consulting is utilized for investment performance reporting. The primary objective of the Plan's trustees is to achieve the highest possible total return commensurate with safety and preservation of capital in real, inflation-adjusted terms. The objective includes having funds invested in the long term, which protect the principal and produce returns sufficient to meet future benefit obligations. The investment policy includes an asset allocation that includes equity securities, debt securities, and cash/other investments. The target allocations are 7% cash and bonds, 19% low volatility hedge, 54% global equity, and 20% long-short hedge. Assets are rebalanced quarterly when balances fall outside of the approved range for each asset class.

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

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

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

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

PEACEHEALTH

Notes to Consolidated Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of June 30, 2013:

<u>Assets</u>	<u>Total fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash and money markets	\$ 2,155	2,155	—	—
Mutual funds:				
Fixed income	34,833	34,833	—	—
Large cap	28,098	9,761	—	18,337
Mid cap	7,782	7,782	—	—
Small cap	4,991	4,991	—	—
Foreign stock and emerging markets	31,142	25,757	—	5,385
Hedge capital appreciation fund	24,359	—	—	24,359
Long-short hedge	9,205	—	—	9,205
Private equity	1,507	—	—	1,507
Total plan assets at fair value	\$ <u>144,072</u>	<u>85,279</u>	<u>—</u>	<u>58,793</u>

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of June 30, 2012:

<u>Assets</u>	<u>Total fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash and money markets	\$ 8,695	8,695	—	—
Mutual funds:				
Fixed income	24,506	24,506	—	—
Large cap	23,418	8,083	—	15,335
Mid cap	6,176	6,176	—	—
Small cap	4,027	4,027	—	—
Emerging market funds	27,180	22,381	—	4,799
Hedge capital appreciation Fund	22,425	—	—	22,425
Long-short hedge	8,410	—	—	8,410
Distressed debt	6,459	—	—	6,459
Private equity	1,093	—	—	1,093
Total plan assets at fair value	\$ <u>132,389</u>	<u>73,868</u>	<u>—</u>	<u>58,521</u>

PEACEHEALTH

Notes to Consolidated Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

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

	Fair value measurements Level 3
Fair value June 30, 2011	\$ 42,610
Realized and unrealized gains, net	2,052
Purchases, issuances, and settlements, net	13,859
Fair value June 30, 2012	58,521
Realized and unrealized gains, net	6,880
Purchases, issuances, and settlements, net	(6,608)
Fair value June 30, 2013	\$ 58,793

At June 30, 2013 and 2012, the Plan held \$58,793 and \$58,521, respectively, in alternative investments, reflected as Level 3 assets in the above table, which are not publicly traded. These investment instruments contain elements of both credit and market risk. Such risks may include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, emphasis on speculative investments (nonmarketable investments), and nondisclosure of portfolio composition. Because these investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a readily available market for such investments existed. These investments represented 40.8% and 44.2% of Plan assets at June 30, 2013 and 2012, respectively.

(c) Cash Flows

The Corporation's policy with respect to funding the Plan is to fund at least the minimum required by the Employee Retirement Income Security Act of 1974, as amended, plus such additional amounts deemed appropriate. In fiscal year 2014, Southwest expects to contribute approximately \$6,300 to the Plan.

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

	Pension benefits
2014	\$ 6,645
2015	7,265
2016	8,097
2017	8,789
2018	9,620
2019 – 2023	58,138

PEACEHEALTH

Notes to Consolidated Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

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

Management is not aware of any settlements or curtailments that would require additional recognition during 2013.

(9) Defined Contribution Retirement Plans

The Corporation sponsors two defined contribution retirement plans for the employees of PeaceHealth and Southwest. At June 30, 2013, employees of Southwest are eligible for the Southwest Plan and employees of the PeaceHealth operating divisions are eligible for the PeaceHealth Plan. There had not been an integration of the plans as of June 30, 2013 or 2012. These plans cover substantially all employees of PeaceHealth meeting certain age and length of service requirements. Total defined contribution retirement plan costs charged to operations were approximately \$66,912 and \$65,221 for the years ended June 30, 2013 and 2012, respectively, and are included in payroll taxes and benefits in the accompanying consolidated statements of operations.

PeaceHealth Deferred Compensation Plans

The estimated fair value associated with the plan assets of the Corporation's 457(b) and 457(f) postretirement savings plans, in the amount of approximately \$32,107 and \$24,597 at June 30, 2013 and 2012, respectively, is included in assets whose use is limited, cash and investments, with a corresponding amount included in other long-term liabilities.

(10) Restricted Net Assets

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

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

	<u>2013</u>	<u>2012</u>
Purchase of property, plant, and equipment	\$ 16,986	14,015
Hospice and indigent care	3,430	2,946
Patient care	12,846	13,993
Other	4,536	4,690
	<u>\$ 37,798</u>	<u>35,644</u>

PEACEHEALTH

Notes to Consolidated Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

The income on the following permanently restricted net assets is available for these purposes at June 30:

	<u>2013</u>	<u>2012</u>
Purchase of property, plant, and equipment	\$ 699	545
Hospice and indigent care	8,085	7,322
Patient care operating activities	16,476	2,543
Other	790	970
	<u>\$ 26,050</u>	<u>11,380</u>

Approximately \$6,571 and \$23,016 were released from restriction for capital expenditures made during 2013 and 2012, respectively.

Charitable Gift Annuities

The Corporation has been granted a license by the State of Washington, Office of Insurance Commissioner, to issue Charitable Gift Annuities in support of its charitable activities. The Corporation has delegated all its charitable fund raising activities to several fund raising foundations whose net assets, held for the beneficial interest of the Corporation, are shown on the consolidated balance sheets of the Corporation. In fiscal 2013, the liability for annuity contracts issued under the PeaceHealth license and the separately maintained reserve accounts are recorded on the books of PeaceHealth. In fiscal 2012 the liability for annuity contracts and the separately maintained reserve accounts were recorded by the foundations which support the hospitals that the donors designated to benefit from their charitable gift annuity contributions. As of June 30, 2013 and 2012, the following liabilities for annuity contracts issued under the Corporation license and reserve account investments were recorded:

	<u>2013</u>	<u>2012</u>
State of Washington gift annuity liabilities (other long-term liabilities)	\$ 887	597
Gift annuity reserve accounts (other assets whose use is limited, cash and investments)	1,089	702

During the fiscal 2013 the gift annuities issued under the license held by PeaceHealth Southwest Medical Center Foundation were transferred to the PeaceHealth license and are included in the above table.

(11) Commitments and Contingent Liabilities

(a) Litigation

Various laws and regulations of federal, state, and local governments govern the healthcare industry. These laws and regulations are subject to ongoing government review and interpretation, as well as regulatory actions unknown or unasserted at this time. The Corporation is also involved in litigation

PEACEHEALTH

Notes to Consolidated Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

and regulatory investigations arising in the normal course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Corporation's future financial position or results of operations.

(b) *Operating Leases*

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

Rent and lease expense Future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) as of June 30, 2013 are as follows:

	<u>Operating leases</u>
Year ending June 30:	
2014	\$ 18,758
2015	17,404
2016	16,020
2017	14,683
2018	11,384
Later years, 2019 through 2023	<u>50,290</u>
Total minimum lease payments	<u>\$ 128,539</u>

Rent expense related to all operating leases was \$35,119 and \$34,482 during the years ended June 30, 2013 and June 30, 2012, respectively, and was included in supplies and other expenses in the consolidated statements of operations.

(c) *Collective Bargaining Agreements*

Approximately 26% and 27% of the Corporation's employees are covered under collective bargaining agreements, including nurses, professional employees, and service employees as of June 30, 2013 and 2012, respectively. The Corporation's various collective bargaining agreements expire between September 2013 and March 2016.

(12) **Insurance Coverages**

The Corporation has a self-insurance program for hospital and physician professional and general liability claims under which the Corporation contributes actuarially determined amounts to a trust to fund estimated ultimate losses. In connection with the self-insurance program, the Corporation has accrued estimates for asserted and incurred but not reported claims, including both the expected liability under each claim and the cost to administer the claim. Self-insured professional and general liability retention in 2013 and 2012 was \$5,000 per occurrence and \$20,000 in aggregate. Individual general and professional liability claims in excess of the above self-insured retention levels are insured through a claims-made excess insurance policy.

PEACEHEALTH

Notes to Consolidated Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

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

Based on the actuarial studies, the Corporation has recorded a liability for all of the self-insurance programs of approximately \$74,006 and \$68,671 at June 30, 2013 and 2012, respectively. The liabilities are classified within other current liabilities and other long-term liabilities based on the historical amounts paid within one year. Total current amounts included in other current liabilities were approximately \$22,156 and \$20,925 at June 30, 2013 and 2012, respectively. In accordance with the adoption of ASU No. 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries*, management has recorded amounts receivable from excess insurance carriers totaling \$5,384 and \$5,587 as of June 30, 2013 and June 30, 2012, respectively, which is included in other receivables in the accompanying consolidated balance sheets.

The Corporation is a minority investor in American Excess Insurance Exchange (AEIX). AEIX is a risk retention group owned by a group of healthcare providers and provides them with excess professional liability insurance coverage. The Corporation accounts for its interest in AEIX on the equity method of accounting less mandatory withdrawal penalties and an estimated discount to present value. As of June 30, 2013 and 2012, the carrying value of AEIX was approximately \$10,673 and \$14,868, respectively, and is recorded in investments in joint ventures and other on the consolidated balance sheets. Investment income from AEIX is recorded as an adjustment to supplies and other operating expenses in the accompanying consolidated statements of operations.

(13) Functional Expenses

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

	<u>2013</u>	<u>2012</u>
Healthcare services	\$ 1,878,664	1,877,186
General and administrative	<u>282,245</u>	<u>273,810</u>
	<u>\$ 2,160,909</u>	<u>2,150,996</u>

(14) Subsequent Events

In connection with the preparation of the consolidated financial statements in accordance with FASB ASC Topic 855, *Subsequent Events*, the Corporation has evaluated subsequent events through October 1, 2013, which is the date the consolidated financial statements were issued.

ADDITIONAL INFORMATION

PEACEHEALTH
Consolidating Balance Sheet
June 30, 2013
(In thousands)

Assets	Obligated Group	PeaceHealth Southwest Foundation	Other Nonobligated group	Eliminating or consolidating adjustments	PeaceHealth 2013 Consolidated
Current assets:					
Cash and cash equivalents	\$ 70,952	2,057	19,680	—	92,689
Short-term investments	276,979	—	—	—	276,979
Accounts receivable, net	264,803	—	4,321	(3,612)	265,512
Other receivables	36,982	(230)	2,092	(137)	38,707
Inventory of supplies	36,581	—	—	—	36,581
Prepaid expenses and other	18,332	—	393	—	18,725
Assets whose use is limited that are required for current liabilities	29,770	—	—	—	29,770
Total current assets	<u>734,399</u>	<u>1,827</u>	<u>26,486</u>	<u>(3,749)</u>	<u>758,963</u>
Assets whose use is limited by board designation and indenture agreements:					
Cash and investments	882,395	13,047	12,981	—	908,423
Investment in affiliates	17,852	—	—	(17,852)	—
Investments in joint ventures and other	24,362	6,971	14,824	(11,205)	34,952
Total assets whose use is limited	<u>924,609</u>	<u>20,018</u>	<u>27,805</u>	<u>(29,057)</u>	<u>943,375</u>
Less current portion	<u>(29,770)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(29,770)</u>
Net assets whose use is limited	<u>894,839</u>	<u>20,018</u>	<u>27,805</u>	<u>(29,057)</u>	<u>913,605</u>
Property, plant, and equipment:					
Land and improvements	120,838	—	—	—	120,838
Buildings, fixed equipment, and other	1,606,677	—	26,904	(21,441)	1,612,140
Moveable equipment	637,629	—	2,749	—	640,378
Construction in progress	27,615	—	306	—	27,921
Total property, plant, and equipment	<u>2,392,759</u>	<u>—</u>	<u>29,959</u>	<u>(21,441)</u>	<u>2,401,277</u>
Less accumulated depreciation	<u>(1,057,785)</u>	<u>—</u>	<u>(8,750)</u>	<u>2,273</u>	<u>(1,064,262)</u>
Net property, plant, and equipment	<u>1,334,974</u>	<u>—</u>	<u>21,209</u>	<u>(19,168)</u>	<u>1,337,015</u>
Interest in net assets of related foundations	63,547	105	—	(19,213)	44,439
Other assets	30,393	35	243	—	30,671
Total assets	<u>\$ 3,058,152</u>	<u>21,985</u>	<u>75,743</u>	<u>(71,187)</u>	<u>3,084,693</u>

See accompanying independent auditors' report.

PEACEHEALTH
Consolidating Balance Sheet
June 30, 2013
(In thousands)

Liabilities and Net Assets	Obligated Group	PeaceHealth Southwest Foundation	Other Nonobligated group	Eliminating or consolidating adjustments	PeaceHealth 2013 Consolidated
Current liabilities:					
Accounts payable	\$ 79,134	—	495	(211)	79,418
Accrued payroll, payroll taxes, and employee benefits	150,037	—	657	—	150,694
Accrued interest payable	5,138	—	—	—	5,138
Other current liabilities	25,588	—	917	(1)	26,504
Medical claims payable	—	—	9,597	(3,611)	5,986
Reimbursement settlements payable	9,768	—	—	—	9,768
Current portion of long-term debt	21,858	—	—	(1,175)	20,683
Total current liabilities	<u>291,523</u>	<u>—</u>	<u>11,666</u>	<u>(4,998)</u>	<u>298,191</u>
Other long-term liabilities	254,314	—	9,502	—	263,816
Long-term debt due after one year	922,699	—	11,205	(28,046)	905,858
Net assets:					
Unrestricted	1,533,358	1,854	43,370	(25,602)	1,552,980
Temporarily restricted	32,129	9,722	—	(4,053)	37,798
Permanently restricted	24,129	10,409	—	(8,488)	26,050
Total net assets	<u>1,589,616</u>	<u>21,985</u>	<u>43,370</u>	<u>(38,143)</u>	<u>1,616,828</u>
Total liabilities and net assets	<u>\$ 3,058,152</u>	<u>21,985</u>	<u>75,743</u>	<u>(71,187)</u>	<u>3,084,693</u>

See accompanying independent auditors' report.

PEACEHEALTH

Consolidating Statement of Operations

Year ended June 30, 2013

(In thousands)

	Obligated Group	PeaceHealth Southwest Foundation	Other Nonobligated group	Eliminating or consolidating adjustments	PeaceHealth 2013 Consolidated
Revenues:					
Net patient service revenue before provision for bad debts	\$ 2,168,873	—	—	(23,338)	2,145,535
Provision for bad debts	(161,192)	—	—	—	(161,192)
Net patient service revenue	<u>2,007,681</u>	<u>—</u>	<u>—</u>	<u>(23,338)</u>	<u>1,984,343</u>
Premium revenue	—	—	92,358	—	92,358
Other operating revenue	<u>94,242</u>	<u>403</u>	<u>12,873</u>	<u>(13,462)</u>	<u>94,056</u>
Total revenues	<u>2,101,923</u>	<u>403</u>	<u>105,231</u>	<u>(36,800)</u>	<u>2,170,757</u>
Expenses:					
Salaries and wages	983,952	—	5,588	—	989,540
Payroll taxes and benefits	249,884	—	1,523	—	251,407
Professional fees	34,984	—	1,081	—	36,065
Medical claims expense	—	—	82,464	(23,338)	59,126
Supplies and other expenses	646,908	789	3,886	(1,372)	650,211
Depreciation and amortization of other assets	149,761	—	1,242	(704)	150,299
Interest and amortization of deferred financing costs	<u>24,850</u>	<u>—</u>	<u>1,034</u>	<u>(1,623)</u>	<u>24,261</u>
Total expenses	<u>2,090,339</u>	<u>789</u>	<u>96,818</u>	<u>(27,037)</u>	<u>2,160,909</u>
Income from operations	<u>11,584</u>	<u>(386)</u>	<u>8,413</u>	<u>(9,763)</u>	<u>9,848</u>
Other income (loss):					
Investment income, net	61,518	912	142	(1,034)	61,538
Loss on investments recorded on the equity method	(1,138)	—	—	—	(1,138)
Change in valuation of interest rate swaps	35,317	—	—	—	35,317
Other	<u>(9,124)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(9,124)</u>
Total other income (loss), net	<u>86,573</u>	<u>912</u>	<u>142</u>	<u>(1,034)</u>	<u>86,593</u>
Excess (deficiency) of revenues over expenses	98,157	526	8,555	(10,797)	96,441
Net assets released from restrictions for property, plant and equipment	9,044	—	—	(2,473)	6,571
Transfer (to) from related division	697	—	(7,132)	6,435	—
Change in interest in net assets of related foundations	287	—	—	260	547
Change in pension liability	27,964	—	—	—	27,964
Other changes in net assets	<u>(900)</u>	<u>—</u>	<u>(6,046)</u>	<u>251</u>	<u>(6,695)</u>
Increase (decrease) in unrestricted net assets	\$ <u>135,249</u>	<u>526</u>	<u>(4,623)</u>	<u>(6,324)</u>	<u>124,828</u>

See accompanying independent auditors' report.

PEACEHEALTH

Consolidating Statement of Changes in Net Assets

Year ended June 30, 2013

(In thousands)

	Obligated Group	PeaceHealth Southwest Foundation	Other Nonobligated group	Eliminating or consolidating adjustments	PeaceHealth 2013 Consolidated
Net assets at June 30, 2012	\$ 1,442,007	22,083	48,095	(37,009)	1,475,176
Excess (deficiency) of revenues over expenses	98,157	526	8,555	(10,797)	96,441
Other restricted contributions	9,312	3,466	—	—	12,778
Net assets released from restrictions	(275)	(3,932)	—	2,112	(2,095)
Transfer (to) from related division	697	—	(7,132)	6,435	—
Change in interest in net assets of related foundations	11,505	—	—	271	11,776
Change in pension liability	27,964	—	—	—	27,964
Other changes in net assets	249	(158)	(6,148)	845	(5,212)
Net assets at June 30, 2013	\$ <u>1,589,616</u>	<u>21,985</u>	<u>43,370</u>	<u>(38,143)</u>	<u>1,616,828</u>

See accompanying independent auditors' report.

PEACEHEALTH
 Inpatient Statistics
 Years ended June 30, 2013 and 2012
 (Unaudited)

	Alaska Region		Whatcom Region		Lower Columbia Region		Oregon Region		Siuslaw Region		Southwest		PeaceHealth total	
	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012
Adult and pediatric:														
Licensed beds	25	25	253	253	346	346	465	465	21	21	450	450	1,560	1,560
Beds in use	25	25	253	253	180	180	454	454	21	21	316	316	1,249	1,249
Admissions	1,216	1,257	15,138	15,410	8,517	8,958	26,023	26,728	989	970	24,486	24,744	76,369	78,067
Patient days	3,903	4,000	59,353	58,790	33,901	36,099	118,307	119,525	2,890	3,158	97,792	92,937	316,146	314,509
Average daily census	11	11	163	161	93	99	324	327	8	9	268	254	867	861
Length of stay	3	3	4	4	4	4	5	4	3	3	4	4	4	4
Nursery:														
Licensed beds	6	6	20	20	27	27	—	—	3	3	40	40	96	96
Bassinets in use	6	6	20	20	20	20	32	32	3	3	40	40	121	121
Admissions	221	252	1,818	1,773	985	1,059	2,480	2,404	72	57	2,620	2,680	8,196	8,225
Patient days	489	534	3,439	3,438	1,969	2,056	4,930	4,814	101	106	5,282	5,220	16,210	16,168
Average daily census	1	1	9	9	5	6	14	13	—	—	14	14	43	43
Length of stay	2	2	2	2	2	2	2	2	1	2	2	2	2	2
Long-term care:														
Licensed beds	29	29	—	—	—	—	—	—	—	—	—	—	29	29
Beds in use	29	29	—	—	—	—	—	—	—	—	—	—	29	29
Admissions	150	159	—	—	—	—	—	—	—	—	—	—	150	159
Patient days	7,065	7,436	—	—	—	—	—	—	—	—	—	—	7,065	7,436
Average daily census	19	20	—	—	—	—	—	—	—	—	—	—	19	20
Length of stay	47	47	—	—	—	—	—	—	—	—	—	—	47	47

See accompanying independent auditors' report.

PEACEHEALTH
Ancillary and Other Statistics
Years ended June 30, 2013 and 2012
(Unaudited)

	Alaska Region		Whatcom Region		Lower Columbia Region		Oregon Region		Siuslaw Region		Southwest		PeaceHealth total	
	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012
Total surgeries	1,456	1,484	7,329	7,246	5,018	5,704	15,015	15,330	1,348	1,579	10,129	10,834	40,295	42,177
Surgery minutes	115,378	115,603	917,499	929,540	434,988	489,615	1,934,280	1,976,160	98,520	116,280	1,161,674	1,250,660	4,662,339	4,877,858
Emergency visits	9,172	9,379	56,556	56,947	50,076	50,727	91,813	90,159	8,144	7,385	78,835	82,416	294,596	297,013
Outpatient registrations	36,433	36,464	115,594	98,300	182,081	189,617	165,872	167,956	22,185	23,627	230,658	233,209	752,823	749,173
Physician clinic RBRVS work RVU's	70,273	69,713	355,349	383,906	387,896	392,243	853,763	615,159	81,721	85,768	596,819	544,507	2,345,821	2,091,296
Full-time equivalent employees	336	350	1,899	2,041	1,286	1,461	3,318	3,703	377	412	3,071	3,261	12,633	12,916

Notes: Certain PeaceHealth divisions are not shown separately, but are included in the Corporation's totals.

See accompanying independent auditors' report.