# Audited Consolidated Financial Statements and Supplementary Information

Scripps Health and Affiliates
Years Ended September 30, 2014 and 2013
With Report of Independent Auditors

Ernst & Young LLP

Building a better working world

Scripps Health and Affiliates

Audited Consolidated Financial Statements
and Supplementary Information

Years Ended September 30, 2014 and 2013

## Contents

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# Report of Independent Auditors

The Board of Trustees
Scripps Health and Affiliates

We have audited the accompanying consolidated financial statements of Scripps Health and Affiliates (collectively, the Organization), which comprise the consolidated statements of financial position as of September 30, 2014 and 2013, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

## Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity 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 financial statements that are free of material misstatement, whether due to fraud or error.

## Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Scripps Health and Affiliates at September 30, 2014 and 2013, and the consolidated results of their operations, changes in their net assets, and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

**Supplementary Information**

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating financial statement information for 2014 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. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Ernst & Young LLP

December 12, 2014

Scripps Health and Affiliates

# Consolidated Statements of Financial Position

*(In Thousands)*

| | September 30 2014 | 2013 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 367,175 | $ 530,648 |
| Patient accounts receivable, net | 243,138 | 274,154 |
| Assets limited as to use | 5,357 | 9 |
| Other current assets | 100,308 | 122,600 |
| Total current assets | 715,978 | 927,411 |
| | | |
| Assets limited as to use | 219,942 | 212,419 |
| Investments | 1,827,715 | 1,531,267 |
| Property and equipment, net | 1,436,997 | 1,266,520 |
| Other assets | 97,300 | 90,593 |
| Total assets | $ 4,297,932 | $ 4,028,210 |
| | | |
| **Liabilities and net assets** | | |
| Current liabilities: | | |
| Current portion of long-term debt | $ 21,434 | $ 18,797 |
| Accounts payable | 114,080 | 142,852 |
| Accrued liabilities | 244,904 | 240,520 |
| Total current liabilities | 380,418 | 402,169 |
| | | |
| Long-term debt, less current portion | 847,997 | 866,256 |
| Other liabilities | 111,370 | 118,282 |
| Total liabilities | 1,339,785 | 1,386,707 |
| | | |
| Net assets: | | |
| Unrestricted: | | |
| Controlling interests | 2,747,636 | 2,430,254 |
| Noncontrolling interests in subsidiaries | 2,620 | 2,358 |
| | 2,750,256 | 2,432,612 |
| Temporarily restricted | 128,258 | 130,730 |
| Permanently restricted | 79,633 | 78,161 |
| Total net assets | 2,958,147 | 2,641,503 |
| Total liabilities and net assets | $ 4,297,932 | $ 4,028,210 |

*See accompanying notes.*

## Scripps Health and Affiliates

# Consolidated Statements of Operations

*(In Thousands)*

| | **Year Ended September 30 2014** | **2013** |
|---|---|---|
| Unrestricted revenues, gains, and other support: | | |
| Patient service revenue, net of contractual allowances and discounts | $ 2,142,221 | $ 2,207,669 |
| Provision for bad debts | (53,702) | (59,253) |
| Net patient service revenue less provision for bad debts before provider fee | 2,088,519 | 2,148,416 |
| Provider fee | 21,047 | 100,947 |
| Net patient service revenue | 2,109,566 | 2,249,363 |
| Capitation premium | 341,078 | 250,737 |
| Meaningful use | 14,476 | 20,790 |
| Other | 81,076 | 68,452 |
| Net assets released from restrictions used for operations | 18,619 | 19,877 |
| Total operating revenues | 2,564,815 | 2,609,219 |
| | | |
| Operating expenses: | | |
| Wages and benefits | 1,165,283 | 1,149,618 |
| Supplies | 397,113 | 394,210 |
| Services | 710,408 | 667,919 |
| Provider fee | 14,778 | 92,213 |
| Depreciation and amortization | 102,455 | 98,923 |
| Interest | 15,266 | 14,683 |
| Loss on impairment | 4,730 | 698 |
| Total operating expenses | 2,410,033 | 2,418,264 |
| | | |
| Operating income | 154,782 | 190,955 |
| | | |
| Nonoperating gains (losses): | | |
| Investment income | 190,727 | 95,165 |
| Unrealized (loss) gain on trading portfolio | (51,301) | 72,060 |
| Contributions | 971 | 1,323 |
| Unrealized gain on affiliations | – | 1,123 |
| Market adjustment on interest rate swaps | (1,657) | 11,361 |
| Excess of revenues over expenses | 293,522 | 371,987 |
| Less excess of revenues over expenses attributable to noncontrolling interests | (1,952) | (1,227) |
| Excess of revenues over expenses attributable to controlling interests | $ 291,570 | $ 370,760 |

*See accompanying notes.*

# Scripps Health and Affiliates

## Consolidated Statements of Changes in Net Assets
*(In Thousands)*

| | Year Ended September 30 2014 | 2013 |
|---|---|---|
| Unrestricted net assets: | | |
| Excess of revenues over expenses attributable to controlling interests | $ 291,570 | $ 370,760 |
| Net assets released from restrictions used for purchases of property and equipment | 21,791 | 21,236 |
| Other | 4,021 | (4,512) |
| Increase in unrestricted net assets attributable to controlling interests | 317,382 | 387,484 |
| | | |
| Noncontrolling interests: | | |
| Excess of revenues over expenses attributable to noncontrolling interests | 1,952 | 1,227 |
| Distributions to noncontrolling members | (1,690) | (1,204) |
| Increase in noncontrolling interests | 262 | 23 |
| Increase in unrestricted net assets | 317,644 | 387,507 |
| | | |
| Temporarily restricted net assets: | | |
| Contributions | 26,997 | 36,611 |
| Investment income | 13,288 | 7,586 |
| Unrealized (loss) gain on investments | (2,601) | 6,307 |
| Net assets released from restrictions used for operations | (18,619) | (19,877) |
| Net assets released from restrictions used for purchases of property and equipment | (21,791) | (21,236) |
| Change in value of deferred gifts | 60 | 1,566 |
| Other | 194 | 1,588 |
| (Decrease) increase in temporarily restricted net assets | (2,472) | 12,545 |
| | | |
| Permanently restricted net assets: | | |
| Contributions | 528 | 127 |
| Change in value of deferred gifts | 73 | 78 |
| Other | 871 | (1,263) |
| Increase (decrease) in permanently restricted net assets | 1,472 | (1,058) |
| Total increase in net assets | 316,644 | 398,994 |
| | | |
| Net assets at beginning of year | 2,641,503 | 2,242,509 |
| Net assets at end of year | $ 2,958,147 | $ 2,641,503 |

*See accompanying notes.*

# Scripps Health and Affiliates

## Consolidated Statements of Cash Flows

*(In Thousands)*

| | Year Ended September 30 2014 | 2013 |
|---|---|---|
| **Operating activities and nonoperating gains** | | |
| Total increase in net assets | $ 316,644 | $ 398,994 |
| Reconciliation of total increase in net assets to net cash provided by operating activities and nonoperating gains: | | |
| Depreciation and amortization | 102,455 | 98,923 |
| Amortization of debt issuance costs | 451 | 485 |
| Amortization of original issue premium | (608) | (609) |
| Provision for bad debts | 53,738 | 59,196 |
| Realized and unrealized gains on investments | (121,522) | (156,350) |
| Increase in investments designated as trading | (187,797) | (9,353) |
| Market adjustment on interest rate swaps | 1,657 | (11,361) |
| Loss on impairment | 4,730 | 698 |
| (Gain) loss on disposal of property | (43) | 1,100 |
| Restricted contributions and investment income | (40,813) | (44,324) |
| Distributions to noncontrolling interest | 1,690 | 1,204 |
| Change in assets and liabilities: | | |
| Accounts receivable | (22,722) | (72,189) |
| Other current assets | 22,292 | 1,213 |
| Other assets | (4,848) | 3,609 |
| Accounts payable and accrued liabilities | (30,752) | 24,795 |
| Other liabilities | (6,912) | 3,372 |
| Net cash provided by operating activities and nonoperating gains | 87,640 | 299,403 |
| **Investing activities** | | |
| Acquisition of Horizon Hospice | – | (622) |
| Investment in life insurance policies, net | (9,892) | – |
| Purchases of property and equipment | (269,664) | (335,382) |
| Net cash used in investing activities | (279,556) | (336,004) |
| **Financing activities** | | |
| Proceeds from restricted contributions and investment income | 47,938 | 40,158 |
| Payments on borrowings | (18,214) | (15,151) |
| Proceeds from sale of donated financial assets | 409 | 148 |
| Distribution to noncontrolling interest | (1,690) | (1,204) |
| Net cash provided by financing activities | 28,443 | 23,951 |
| Decrease in cash and cash equivalents | (163,473) | (12,650) |
| Cash and cash equivalents at beginning of year | 530,648 | 543,298 |
| Cash and cash equivalents at end of year | $ 367,175 | $ 530,648 |
| **Supplemental disclosure of cash flow information** | | |
| Cash paid during the year for interest | $ 26,629 | $ 27,327 |
| Assets acquired through capital lease or note payable | 3,200 | 1,683 |
| Accrued obligations for property and equipment | 20,000 | 15,293 |

*See accompanying notes.*

## 1. Organization and Nature of Operations

Scripps Health and Affiliates (Scripps Health) is a California not-for-profit public benefit corporation that provides healthcare services through a network of hospitals and related healthcare operations located in San Diego County.

The consolidated financial statements for Scripps Health include the financial position and results of operations of Scripps Medical Foundation (SMF), operated by Scripps Health as a 1206(1) foundation; Scripps Clinic Physicians Organization (SCPO); Scripps Health Plan Services (SHPS) that was granted a license under the Knox-Keene Health Care Service Plan Act to operate as a healthcare service plan with waivers in California; Horizon Hospice (Hospice), a wholly owned subsidiary and licensed provider of hospice services; and Gluck Child Care Center (Gluck), a wholly owned subsidiary and a California nonprofit public benefit corporation, which provides child care services. Hospice was acquired effective February 2013, and Gluck was acquired effective August 2013.

The entities of Scripps Health, with the exception of SCPO, SHPS, and Hospice, are exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and are exempt from state income taxes under Section 23701(d) of the California Revenue and Taxation Code. During fiscal year 2014, IRS Forms 1023, *Application for Status of Exemption,* were filed for both Hospice and SHPS with the effective dates of March 25, 2013, and June 27, 2014, respectively. SCPO was dissolved effective June 27, 2014.

## 2. Summary of Significant Accounting Policies

### Basis of Presentation

The accompanying consolidated financial statements include the accounts of the entities that Scripps Health controls (collectively, the Organization). All significant transactions among these entities have been eliminated in the accompanying consolidated financial statements.

### Use of Estimates

The preparation of the Organization's consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) 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. Significant items subject to such estimates

## 2. Summary of Significant Accounting Policies (continued)

include the carrying amounts for goodwill and property and equipment; valuation of deferred gifts; valuation allowances for receivables; and liabilities for medical claims incurred but not reported, third-party payables and receivables, and self-insured programs. Actual results could differ from those estimates.

### Cash and Cash Equivalents

The Organization considers highly liquid investments with original maturities of three months or less, excluding those whose use is limited, to be cash equivalents. The carrying amount approximates fair value because of the short maturity of the investments.

### Healthcare Delivery Revenue and Accounts Receivable

Healthcare delivery revenues consist primarily of (1) patient service revenue provided under contracts with various government-sponsored healthcare programs (Medicare and Medi-Cal), insurance companies, other third parties, and self-pay and (2) capitation premium revenue received under contracts with managed care payors.

Net patient service revenue is recognized as services are delivered. Contracts usually involve discounts from established rates. Payment arrangements consist of prospectively determined rates per discharge, discounted charges, per diem payments, and reimbursed costs. The Organization is reimbursed by Medicare for cost-reimbursable items at a tentative rate, with final settlement determined after submission of annual Medicare cost reports by the Organization and audits thereof by the fiscal intermediary. Estimated net third-party settlements receivable of $9,462,000 and $5,684,000 at September 30, 2014 and 2013, respectively, are included in other current assets. The Organization recognized $6,690,000 and $6,928,000 from final third-party settlements as net patient service revenue for the years ended September 30, 2014 and 2013, respectively.

Revenue and related accounts receivable are recorded net of contractual discounts and provisions for bad debts. Provisions for contractual discounts and uncollectible accounts are estimated based upon an evaluation of historical collection experience. Adjustments and changes in estimates are recorded in the period in which they are determined.

## 2. Summary of Significant Accounting Policies (continued)

In evaluating the collectibility of accounts receivable, the Organization analyzes its historical experience and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. The Organization regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, the Organization analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary. For receivables associated with self-pay patients, which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill, the Organization records a significant provision for bad debts in the period of service on the basis of its past experience. The difference between the standard rates, or the discounted rates if negotiated, and the amounts actually collected after all reasonable collection efforts have been exhausted is recorded against the allowance for doubtful accounts.

The Organization's allowance for doubtful accounts for self-pay patients decreased from $53,136,000 or 20% of self-pay accounts receivable at September 30, 2013, to $43,990,000 or 23% of self-pay accounts receivable at September 30, 2014, as a result of improved cash collection efforts and more hospital patients qualifying for governmental programs. In addition, the Organization's self-pay write-offs were $62,809,000 for fiscal year 2014 and $63,014,000 for fiscal year 2013. The Organization had no changes in its charity care or uninsured discount policies in fiscal year 2014 or 2013. The Organization does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors in fiscal year 2014 or 2013.

Patient service revenues, net of contractual allowances and discounts, recognized for the year ended September 30 are as follows (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Government | $ 588,082 | $ 525,396 |
| Contracted | 1,435,550 | 1,529,937 |
| Self-pay and others | 118,589 | 152,336 |
| | $ 2,142,221 | $ 2,207,669 |

## 2. Summary of Significant Accounting Policies (continued)

The Organization is reimbursed for services provided to patients under certain programs administered by governmental agencies. Laws and regulations governing the Medicare and Medi-Cal programs are complex and subject to interpretation. The Organization believes it is in compliance with all applicable laws and regulations, and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medi-Cal programs.

The Organization provides healthcare services at no cost or at amounts less than its established rates to unfunded self-pay patients that meet criteria under the Organization's financial assistance policy (charity care). Because the Organization does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Capitation premium revenue of $341,078,000 and $250,737,000 for the years ended September 30, 2014 and 2013, respectively, is recognized during the period enrollees are entitled to receive services and is generally calculated and paid to the Organization as a fixed premium per enrollee (member) per month. Therefore, there are no accounts receivable from patients related to these types of contracts.

### Hospital Fee Program

*Thirty-Month Hospital Fee Program*

In September 2011, the state of California enacted legislation that continues the Hospital Fee Program covering the period from July 1, 2011 through December 31, 2013. For the entire thirty-month period, the Organization expects to pay quality assurance fees of $171,953,000 and receive Medi-Cal fee-for-service payments of $191,474,000 and managed care payments of $27,404,000. Net of contributions to CHFT of $2,735,000, the expected net benefit to the Organization is $44,190,000.

The thirty-month program design allows recognition of the fee-for-service portion of the Program in advance of final approval by the Centers for Medicare and Medicaid Services (CMS) of managed care payments.

## 2. Summary of Significant Accounting Policies (continued)

CMS approved a portion of the managed care program in May 2013 for the twelve-month period ended June 30, 2012. In June 2013, CMS approved the managed care program portion of the Hospital Fee Program from July 1, 2012 through June 30, 2013. The managed care program from July 1, 2013 through December 31, 2013, was approved in November 2014. The expected loss of the managed care program for the period from July 1, 2013 through December 31, 2013, is $3,289,000 and is expected to be recognized in November 2014.

Supplemental amounts recognized totaled $21,047,000 and $100,947,000 for the years ended September 30, 2014 and 2013, respectively. These amounts were recognized as net patient service revenue in the consolidated statements of operations. Quality assurance fees assessed and paid by the Organization related to the thirty-month program during the years ended September 30, 2014 and 2013, were $14,391,000 and $91,673,000, respectively, and were recorded as provider fee expenses in the consolidated statements of operations.

The Organization was assessed and paid charitable contributions related to the thirty-month program to CHFT of $387,000 and $540,000 and were recorded as provider fee expenses in the consolidated statements of operations for the years ended September 30, 2014 and 2013, respectively.

### Meaningful Use Incentives

The American Recovery and Reinvestment Act of 2009 established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record (EHR) technology. The Medicare incentive payments are paid to qualifying hospitals over four consecutive years on a transitional schedule. To qualify for Medicare incentives, hospitals and physicians must annually meet EHR “meaningful use” criteria that become more stringent over three stages as determined by CMS.

The Medicaid programs in California require hospitals to register for the program prior to 2016, to engage in efforts to adopt, implement, or upgrade certified EHR technology in order to qualify for the initial year of participation, and to demonstrate meaningful use of certified EHR technology in order to qualify for payment for up to three additional years through 2021.

## 2. Summary of Significant Accounting Policies (continued)

During the years ended September 30, 2014 and 2013, the Organization recorded meaningful use incentive revenue of $13,786,000 and $16,274,000, respectively, related to the Medicare program. In addition, the Organization recorded meaningful use incentive revenue of $690,000 and $4,516,000 related to Medicaid programs in FY2014 and FY2013, respectively. These incentives have been recognized separately in operating revenues following the contingency accounting model, recognizing income after the resolution of uncertainties confirms that an asset has been acquired. Amounts recognized represent management's best estimates for payments ultimately expected to be received based on estimated discharges, charity care, and other input data. Subsequent changes to these estimates will be recognized in the period in which additional information is available.

### Assets Limited as to Use

Assets limited as to use include assets that are held by trustees under indenture agreements, assets limited as to use by donor, assets held in trust for supplemental retirement plans, assets held in trust and as swap collateral, and assets designated by management for capital expenditures over which management retains control and may at its discretion subsequently use for other purposes (see Note 5).

### Charitable Remainder Trusts

Charitable remainder trusts are arrangements in which a donor establishes and funds an irrevocable trust with specified distributions to be made to a designated beneficiary or beneficiaries over the trust term. For the arrangements for which the Organization serves as trustee (trusteed), the contribution is recognized in the period in which the trust is established. For the arrangements for which another organization serves as the trustee (non-trusteed), the contribution is recognized in the period in which the Organization becomes aware of the arrangement. The assets are recorded at fair value when received or when the Organization is notified of the arrangement. The liability to the designated beneficiary is recorded at the net present value of the estimated future payments to be distributed over the expected life of the beneficiary using a discount rate of 3.43% and 2.40% at September 30, 2014 and 2013, respectively. The fair value of the trusteed arrangements is $27,372,000 and $29,535,000 as of September 30, 2014 and 2013, respectively, and is included in assets limited as to use, non-current and other assets. The net present value of the related liabilities is $11,711,000 and $11,229,000 as of September 30, 2014 and 2013, respectively, and is included in other liabilities.

## 2. Summary of Significant Accounting Policies (continued)

The net beneficial interest in non-trusteed arrangements is $7,186,000 and $4,616,000 as of September 30, 2014 and 2013, respectively, and is included in assets limited as to use, non-current.

### Investments

The Organization classifies its investments in debt and equity securities as trading.

Investments in equity securities with readily determinable fair values and all investments in debt securities are recorded at fair value based on quoted market prices in the consolidated statements of financial position. Investment income or loss on trading securities (including realized and unrealized gains and losses, interest, and dividends) is included as non-operating gains (losses), within the excess of revenues over expenses, unless the income or loss is restricted by donor or law, in which case the investment income or loss is recorded directly to temporarily restricted net assets.

Alternative investments represent ownership interests in limited partnerships and limited liability companies. Alternative investments are recorded using the equity method of accounting, with the related changes in value reported in earnings as investment income.

### Inventory

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

### Property and Equipment

Property and equipment are recorded at cost when purchased or at fair market value if contributed. Depreciation and amortization of these assets are recorded on a straight-line basis over the period in which the assets are estimated to be in service and of value to the Organization. Leases that have been capitalized are amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated statements of operations. Property and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

## 2. Summary of Significant Accounting Policies (continued)

Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

The Organization recognized $4,730,000 and $698,000 of asset impairment charges for long-term assets with no future benefit as of September 30, 2014 and 2013, respectively.

### Goodwill

Goodwill represents the excess of the purchase price over the fair value of net assets acquired. Goodwill is recorded for SMF and is evaluated annually for potential impairment (see Note 8).

### Cost of Borrowing

Interest expense is recorded as incurred; however, when money is borrowed for construction or renovation of facilities, the interest cost on that debt during the period of construction is capitalized as part of the asset. Any interest income earned on borrowed funds during construction is accounted for as a reduction of interest cost. Costs associated with issuing debt are capitalized and amortized over the term of the debt using the effective-interest method.

### Contributions and Restricted Net Assets

Contributions are recorded at estimated fair value as of the date the contribution is received. Unconditional promises (pledges) to contribute cash and other assets are recorded at fair value at the date the promise is received. Pledges and other deferred gifts are discounted to their net present value. In addition, gifts received as irrevocable trusts, which usually provide for payments to the donor until the donor’s death, are reduced by the present value of estimated payments to the donor.

Contributions that are not restricted as to use are reported as unrestricted revenue in the consolidated statements of operations. If the donor restricts the use of the gift, contributions are reported as increases in temporarily or permanently restricted net assets in the consolidated statements of changes in net assets.

## 2. Summary of Significant Accounting Policies (continued)

Temporarily restricted contributions are generally limited by a time or for a specific purpose. When restrictions are met, temporarily restricted net assets are transferred to unrestricted net assets and recorded as net assets released from restrictions in the consolidated statements of operations and changes in net assets.

Permanently restricted contributions have been restricted by donors to be maintained in perpetuity. Income from such gifts is recorded as temporarily restricted net assets and transferred to unrestricted net assets when restrictions are met.

### Unbilled Services and Deferred Revenue

The Organization is engaged in contractual research activities and continuing medical education programs. The majority of the contracts have a fixed budget with some variable components and range in duration from a few months to several years. Generally, a portion of the contract fee is paid at the time the contract is initiated, with performance-based installments payable over the contract duration. In general, prerequisites for billings are established by contractual provisions, including predetermined payment schedules, the achievement of contract milestones, or submission of appropriate billing detail. Unbilled services arise when services have been rendered but clients have not been invoiced. Similarly, deferred revenue represents cash receipts for services that have not been rendered. The Organization recognizes net revenue from its contracts based primarily on the individual contract specification such as patent enrollment or related billable activities for the clinical trial. Management believes that this methodology appropriately reflects revenue earned for clinical trials in the period in which services are provided.

### Cost of Healthcare Services

The cost of healthcare services is recognized in the period in which services are delivered. Under capitation contracts, the Organization is responsible for the costs of certain services delivered to enrollees, but may not always be the provider of those services. Healthcare service costs are based in part on estimates, including estimates of medical services provided but not yet reported to the Organization. The Organization accrues expenses for medical costs incurred but not yet reported (IBNR) by outside providers using historical studies of claims paid and trend factors. IBNR at September 30, 2014 and 2013, was $17,565,000 and $14,579,000, respectively, and is included in accrued liabilities in the accompanying consolidated statements of financial position. Healthcare services costs are based in part on estimates, including estimates of medical services provided but not yet reported to the Organization.

## 2. Summary of Significant Accounting Policies (continued)

### Derivative Instruments

The Organization uses derivative instruments to manage the fluctuations in cash flows resulting from interest rate risk on variable-rate debt financing. Financial Accounting Standards Board (FASB) Accounting Standard Codification (ASC) 815, *Derivatives and Hedging*, requires that all derivative instruments be recorded in the consolidated statements of financial position at fair value. Gains or losses resulting from changes in the values of those derivatives are accounted for depending upon the use of the derivative and whether it qualifies for hedge accounting. The Organization's interest rate swaps do not qualify for hedge accounting, and as such, subsequent changes in fair value of hedge instruments are recognized as non-operating gains (losses) in the excess of revenues over expenses.

### Interest Expense

Interest expense on debt issued for construction projects is capitalized until the projects are placed in service. Interest components include the following for the years ended September 30 (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Total interest costs incurred | $ 26,992 | $ 27,983 |
| Less: capitalized interest | (11,726) | (13,300) |
| | $ 15,266 | $ 14,683 |

### Ownership Interests in Other Health-Related Activities

Generally, when the Organization has a controlling ownership interest in health-related activities, the activities are consolidated and a noncontrolling interest is recorded in unrestricted net assets (see Note 8). When there is not a controlling ownership interest, but the Organization has significant influence, the activities are accounted for under the equity method, and the income or loss is reflected in other operating revenue. Activities where the Organization does not have significant influence are carried at the lower of cost or estimated net realizable value. Ownership interests in other health-related activities are not significant to the consolidated financial statements.

## 2. Summary of Significant Accounting Policies (continued)

### Operating Income

The Organization's primary purpose is to provide diversified healthcare services to the community it serves. Only those activities directly associated with the furtherance of this purpose are considered operating activities and classified as unrestricted operating revenues and expenses. Operating revenues include those generated from direct patient care, related support services, and other revenues related to the operation of the Organization. Other activities that result in gains or losses unrelated to the Organization's primary purpose are considered to be non-operating. Non-operating gains and losses include gifts, grants, and bequests not restricted by donors; investment income; realized and unrealized gains and losses on trading securities; market adjustments on interest rate swaps; and gains and losses on extinguishment of debt. The Organization considers the performance indicator to be the excess of revenues over expenses.

### Income Taxes

Scripps Health is generally not subject to federal or state income taxes. However, Scripps Health is subject to income taxes on any net income that is derived from a trade or business, regularly carried on, and not in furtherance of the purpose for which it was granted exemption. Under FASB ASC 740, *Income Taxes,* the tax benefit from uncertain tax positions may be recognized only if it is more likely than not the tax position will be sustained, based solely on its technical merits, with the taxing authority having full knowledge of all relevant information. The Organization records a liability for unrecognized tax benefits from uncertain tax positions as discrete tax adjustments in the first interim period that the more-likely-than-not threshold is not met. The Organization recognizes deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of its assets and liabilities along with net operating loss and tax credit carryovers only for tax positions that meet the more-likely-than-not recognition criteria. No significant tax liability for tax benefits, interest, or penalties was accrued at September 30, 2014 or 2013.

Scripps Health currently files Form 990 (informational return of organizations exempt from income taxes) and Form 990-T (business income tax return for an exempt organization) in the U.S. federal jurisdiction and the state of California. Scripps Health is not subject to income tax examinations prior to 2007 in major tax jurisdictions.

**2. Summary of Significant Accounting Policies (continued)**

Scripps Health converted two of its subsidiaries, SHPS and Hospice, to tax-exempt entities in 2014. Any existing tax liabilities that existed as of the conversion date were accrued as of September 30, 2014. The third for-profit subsidiary, SCPO, was dissolved prior to September 30, 2014.

**Fair Value of Financial Instruments**

The carrying amount reported in the accompanying consolidated statements of financial position for cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximates fair value. The fair value of debt and interest rate derivatives is disclosed in Note 9, and the fair value of assets limited as to use and investments is disclosed in Note 15.

**Adoption of Accounting Pronouncements**

In February 2013, the FASB issued ASU 2013-04, *Liabilities* (Topic 405), *Obligations Resulting from Joint and Several Liability Arrangement for Which the Total Amount of the Obligation Is Fixed at the Reporting Date*, which requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of the guidance is fixed at the reporting date. The ASU also requires that the nature of the obligation be disclosed. The guidance is effective for fiscal year 2015, and the Organization will consider the impact and adopt in a timely manner.

In April 2013, the FASB issued ASU 2013-06, *Services Received from Personnel of an Affiliate*, which requires a recipient not-for-profit entity to recognize all services received from personnel of an affiliate that directly benefit the recipient not-for-profit entity. Those services should be measured at the cost recognized by the affiliate for the personnel providing those services. The guidance is effective prospectively for fiscal years beginning after June 15, 2014, and the Organization is currently evaluating the impact of ASU 2013-06 on the consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. The ASU is intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. For all entities, the ASU is effective for annual periods ending after December 15, 2016, and interim periods within

## 2. Summary of Significant Accounting Policies (continued)

annual periods beginning after December 15, 2016. Early adoption is permitted. The Organization does not expect the adoption of ASU 2014-15 to have a material impact on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, which will supersede virtually all revenue recognition guidance in US GAAP. The new standard provides accounting guidance for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to their customers (unless the contracts are in the scope of other US GAAP requirements). The guidance also provides a model for the measurement and recognition of gains and losses on the sale of certain nonfinancial assets, such as property and equipment, including real estate. The new standard is effective for public entities for fiscal years beginning after December 15, 2016, and for interim periods therein. Early adoption is not permitted for public entities. The Organization is currently evaluating the impact of the adoption of ASU 2014-09 on the consolidated financial statements.

### Subsequent Events

The Organization has evaluated subsequent events occurring between the end of the most recent fiscal year ended September 30, 2014, and December 12, 2014, the date the financial statements were issued.

## 3. Patient Accounts Receivable

Gross accounts receivable relating to patient service revenue consisted of the following payor mix at September 30:

| | 2014 | 2013 |
|---|---|---|
| Government | 50% | 45% |
| Contract | 34 | 35 |
| Self-pay and other | 16 | 20 |
| | 100% | 100% |

**3. Patient Accounts Receivable (continued)**

Accounts receivable of $243,138,000 and $274,154,000 at September 30, 2014 and 2013, respectively, are presented net of an allowance for doubtful accounts of $43,990,000 and $53,136,000 at September 30, 2014 and 2013, respectively.

The Organization believes there is no significant credit risk associated with receivables from government programs. Receivables from HMOs, PPOs, and others are from various payors who are subject to differing economic conditions and, therefore, do not represent any concentrated risk to the Organization. The Organization continually monitors and adjusts the reserves associated with receivables.

The Organization provides low- and no-cost healthcare services to persons in need. Estimated costs to provide charity care were $40,727,000 and $43,063,000 for the years ended September 30, 2014 and 2013, respectively. Charity care is calculated based on a ratio of cost to gross charges. Estimated costs for which the Organization is under-reimbursed by various state and county indigent programs were $73,497,000 and $72,062,000 for the years ended September 30, 2014 and 2013 (unaudited), respectively, net of Medi-Cal disproportionate share receipts of $23,448,000 and $15,708,000 for the years ended September 30, 2014 and 2013 (unaudited), respectively.

Funds received to offset costs of under-reimbursed Medi-Cal from the Provider Fee program were $6,270,000 and $8,734,000 for the years ended September 30, 2014 and 2013 (unaudited), respectively. Unpaid costs of Medicare were $213,434,000 and $191,557,000 for the years ended September 30, 2014 and 2013 (unaudited), respectively.

Funds received to offset or subsidize charity services were $261,000 and $260,000 for the years ended September 30, 2014 and 2013 (unaudited), respectively. Community benefits provided by the Organization also include the cost of health education, health clinics and screenings, and medical research. The cost of such benefits for the broader community is not included in the uncompensated costs reported above.

Capitation contracts with managed care payors generally have automatic renewal provisions unless terminated by prior notice to either party. Commercial capitation contracts are generally negotiated annually via the termination notice provision. Medicare HMO capitation is based on a percentage of Medicare revenue and does not require negotiation on an annual basis unless there are material changes in the risk or scope of services. The Organization has agreements with various third parties that govern how financial risk is shared. Estimated amounts to be paid under

### 3. Patient Accounts Receivable (continued)

risk-sharing arrangements of $3,459,000 and $733,000 as of September 30, 2014 and 2013, respectively, are included in accrued liabilities in the accompanying consolidated statements of financial position.

### 4. Other Current Assets

Other current assets at September 30 are summarized below (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Inventory | $ 36,708 | $ 33,683 |
| Prepaid expenses | 18,318 | 16,410 |
| Accounts receivable – other | 14,618 | 20,100 |
| Meaningful use receivable | 10,562 | 10,760 |
| Third-party settlements | 9,462 | 5,684 |
| Contract accounts receivable | 4,714 | 2,841 |
| Prepaid provider fee | 3,481 | – |
| Deposits | 1,379 | 1,305 |
| Prepaid insurance | 1,066 | 1,087 |
| Provider fees receivable | – | 30,730 |
| | $ 100,308 | $ 122,600 |

### 5. Assets Limited as to Use

The following is a summary of assets limited as to use (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Assets included in restricted equity | $ 166,148 | $ 160,724 |
| Charitable trusts and life estate tenancies | 34,693 | 33,394 |
| Investments held by trustees for debt service | 15,264 | 9,918 |
| Assets held in trust for supplemental retirement plan | 8,863 | 7,947 |
| Other assets limited as to use | 331 | 445 |
| | 225,299 | 212,428 |
| Less amounts held by trustees for debt service required to pay current liabilities | (5,357) | (9) |
| | $ 219,942 | $ 212,419 |

**6. Property and Equipment**

Property and equipment at September 30 are summarized below (in thousands):

| | Estimated Useful Lives | 2014 | 2013 |
|---|---|---|---|
| Land | – | $ 111,095 | $ 104,359 |
| Buildings and improvements | 5 to 40 years | 1,108,440 | 983,482 |
| Leasehold improvements | 5 to 15 years | 78,196 | 78,891 |
| Equipment | 5 to 15 years | 906,459 | 833,785 |
| Construction in progress | – | 488,388 | 427,446 |
| Capital lease equipment | 5 years | 17,663 | 14,572 |
| | | 2,710,241 | 2,442,535 |
| Less accumulated amortization and depreciation | | (1,273,244) | (1,176,015) |
| Property and equipment, net | | $ 1,436,997 | $ 1,266,520 |

Depreciation expense was $102,407,000 and $98,895,000 for the years ended September 30, 2014 and 2013, respectively.

Construction in progress at September 30, 2014 and 2013, is related to various construction and information technology projects. As of September 30, 2014, there is approximately $176,451,000 (unaudited) of outstanding commitments to complete projects in progress.

**7. Other Assets**

Other assets at September 30 are summarized below (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Goodwill and intangible, net | $ 34,598 | $ 34,646 |
| Pledges receivable, net | 18,291 | 25,825 |
| Cash surrender value of life insurance, net | 16,617 | 6,869 |
| Workers' compensation reinsurance receivable | 9,406 | 10,153 |
| Prepaid insurance contracts | 6,818 | – |
| Debt issuance costs, net | 6,517 | 6,968 |
| Malpractice reinsurance receivable | 3,772 | 3,375 |
| Land held for sale | – | 173 |
| Other | 1,281 | 2,584 |
| | $ 97,300 | $ 90,593 |

The net amount of pledges receivable at September 30 is as follows (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Unconditional promises to give | $ 21,706 | $ 29,448 |
| Less allowance for uncollectible pledges | (1,317) | (1,473) |
| Less unamortized discount | (2,098) | (2,150) |
| Pledges receivable, net | $ 18,291 | $ 25,825 |
| | | |
| Amounts due in: | | |
| Less than one year | $ 5,216 | $ 10,993 |
| One to five years | 10,098 | 11,736 |
| More than five years | 2,977 | 3,096 |
| Total | $ 18,291 | $ 25,825 |

The fair value of these pledges was determined by calculating the net present value of the estimated future cash flows using discount rates at the date of the pledge ranging from 0.02% to 6.78%.

## 8. Goodwill and Noncontrolling Interest

### Goodwill

Impairment assessments of the carrying amount of goodwill are completed annually, or whenever impairment indicators are present for SMF, which includes Scripps Clinic and Scripps Coastal Medical Centers, and is the Organization's only reporting unit with goodwill recorded. No goodwill impairment was recorded during 2014 or 2013.

### Scripps Clinic

In 2000, Scripps Health acquired all the outstanding shares of SCPO and its wholly owned subsidiaries and substantially all the assets and liabilities of Scripps Clinic Medical Group (SCMG). As a result of the SCMG acquisition, the excess of the purchase price over the fair value of the net assets acquired was recorded as goodwill in the accompanying consolidated statements of financial position in the amount of $50,216,000. Accumulated amortization of goodwill totaled $20,421,000 at September 30, 2014 and 2013. Amortization ceased in fiscal 2011.

### Scripps Coastal Medical Centers

In 2008, Scripps Health purchased substantially all of the net assets of Sharp Mission Park Medical Clinic. As a result of the acquisition, the excess of the purchase price over the fair value of the net assets acquired was recorded as goodwill in the accompanying consolidated statements of financial position in the amount of $6,884,000. Accumulated amortization of goodwill totaled $2,983,000, at September 30, 2014 and 2013. Amortization ceased in fiscal 2011.

## 8. Goodwill and Noncontrolling Interest (continued)

### Changes in Consolidated Unrestricted Net Assets

Changes in consolidated unrestricted net assets that are attributable to the Organization and the noncontrolling interest in Scripps Mercy Ambulatory Surgery Center and Scripps Encinitas Surgery Center, are as follows (in thousands):

| | Total | Controlling Interest | Non-controlling Interest |
|---|---|---|---|
| Balance October 1, 2013 | $ 6,813 | $ 4,455 | $ 2,358 |
| Excess of revenues over expenses | 5,075 | 3,123 | 1,952 |
| Distributions | (4,283) | (2,593) | (1,690) |
| Balance September 30, 2014 | $ 7,605 | $ 4,985 | $ 2,620 |

| | Total | Controlling Interest | Non-controlling Interest |
|---|---|---|---|
| Balance October 1, 2012 | $ 7,015 | $ 4,680 | $ 2,335 |
| Excess of revenues over expenses | 3,352 | 2,125 | 1,227 |
| Distributions | (3,554) | (2,350) | (1,204) |
| Balance September 30, 2013 | $ 6,813 | $ 4,455 | $ 2,358 |

## 9. Long-Term Debt

A summary of long-term debt at September 30 is as follows (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Tax-exempt bonds sponsored by the California Health Facilities Financing Authority (CHFFA): | | |
| Fixed rate bonds: | | |
| Series 2012 A, principal due in varying annual installments through November 2040; interest payable at a fixed rate of 4.84%, adjusting annually (including unamortized premium of $11,647 at September 30, 2014) | $ 186,647 | $ 187,208 |
| Series 2010 A, principal due in varying annual installments through November 2036; interest payable at a fixed rate of 4.95%, adjusting annually (including unamortized discount of $420 at September 30, 2014) | 116,940 | 119,555 |
| Series 2008 A, principal due in varying annual installments through October 2022; interest payable at a fixed rate of 5.04%, adjusting annually (including unamortized premium of $356 at September 30, 2014) | 96,221 | 97,144 |
| Variable rate bonds: | | |
| Series 2012 B-C, principal due in varying annual installments through October 2042; Series B ($60,000), Series C ($40,000); interest payable weekly at variable interest rates averaging 0.05% during the period from October 1, 2013 through September 30, 2014 (0.03% at September 30, 2014) | 100,000 | 100,000 |
| Series 2010 B-C, principal due in varying annual installments through October 2040; Series B ($60,000), Series C ($40,000); interest payable weekly at variable interest rates averaging 0.05% during the period from October 1, 2013 through September 30, 2014 (0.03% at September 30, 2014) | 100,000 | 100,000 |
| Series 2008 B-F, principal due in varying annual installments through October 2031; Series B, C, and E ($33,670), Series D ($33,645) and Series F ($33,840); interest payable weekly at variable interest rates averaging 0.05% during the period from October 1, 2013 through September 30, 2014 (0.04% at September 30, 2014) | 168,495 | 168,495 |

**9. Long-Term Debt (continued)**

| | 2014 | 2013 |
|---|---|---|
| Series 2008 G, principal due in varying annual installments through October 2019; interest payable weekly, at a variable rate averaging 0.06% during the period from October 1, 2013 through September 30, 2014 (0.03% at September 30, 2014) | $ 28,850 | $ 39,850 |
| Series 2001 A, principal due in varying annual installments through October 2023; interest payable monthly, at a variable rate averaging 0.05% during the period from October 1, 2013 through September 30, 2014 (0.03% at September 30, 2014) | 11,100 | 11,100 |
| Tax-exempt bonds sponsored by the California Statewide Communities Development Authority: | | |
| Variable rate revenue refunding bonds: | | |
| Series 2007 A State-wide Easy Equipment Program (SWEEP), principal due August 2035; interest payable weekly at a variable interest rate averaging 0.04% during the period from October 1, 2013 through September 30, 2014 (0.03% at September 30, 2014) | 49,995 | 49,995 |
| Total fixed and variable rate debt | 858,248 | 873,347 |
| | | |
| Obligations under capital leases | 10,491 | 10,575 |
| Other notes payable | 692 | 1,131 |
| Total debt | 869,431 | 885,053 |
| Less current liabilities | 21,434 | 18,797 |
| Total long-term debt | $ 847,997 | $ 866,256 |

Notes issued under a Master Indenture of Trust, dated as of December 1, 1985, as amended and restated May 1, 1998, and supplemented through February 1, 2012 (Indenture), between members of an Obligated Group created thereby, of which Scripps Health is currently the sole member (the “Obligated Group”), and the Trustee secure substantially all of the Organization’s outstanding debt obligations. In addition, the Organization’s payment obligations with respect to bonds issued on its behalf, with the exception of the Series 2008 A, 2010 A, and 2012 A-C bonds, are secured by credit facilities (principally letters of credit) issued by various banking institutions. At September 30, 2014, amounts available under the credit facilities issued total approximately $363,811,000. The credit facilities generally fund both principal and interest

**9. Long-Term Debt (continued)**

payments on the bonds when due and also fund optional tenders from bondholders. Credit facilities are used to reduce overall borrowing costs and, among other things, provide liquidity support in times of market disruption. There were no liquidity draws on the various facilities in 2014 and 2013. Scheduled principal repayments of long-term debt for the next five fiscal years and thereafter are as follows (in thousands):

| | |
|---|---|
| 2015 | $ 19,583 |
| 2016 | 20,024 |
| 2017 | 18,926 |
| 2018 | 18,051 |
| 2019 | 18,456 |
| Thereafter | 774,391 |
| | $ 869,431 |

At September 30, 2014 and 2013, approximately $1,851,000 and $793,000, respectively, of the Organization's variable rate demand bonds were classified as current liabilities in accordance with FASB ASC 470, *Debt*, after consideration of the repayment terms of the related liquidity facilities if draws were to occur in accordance with FASB ASC 210, *Short-Term Obligations.*

Bond reserve funds are used to fund principal and interest payments. At September 30, 2014 and 2013, bond reserve funds held by trustees were $15,255,000 and $9,909,000, respectively.

The interest rates on variable debt are reset weekly by the remarketing agent in accordance with the Indenture depending on prevailing market conditions. The rates are highly correlated with the Securities Industry and Financial Markets Association (SIFMA) index.

The Organization is party to six interest rate swap agreements with an aggregate current notional amount of $150,850,000 to convert a portion of the variable interest rate bonds to fixed rate debt of approximately 3.19% per annum. In August 2008, the Series 2005 swap agreements were assigned to the Series 2008 bonds. Under the interest rate swap agreement for the Series 2008 G bonds, with a current notional amount of $28,850,000, the Organization pays a fixed amount of 3.086% and receives a floating rate of 54.7% of LIBOR plus 0.32%. Under the interest rate swap agreements for the Series 2008 B-F bonds, with a total current notional amount of $122,000,000, the Organization pays a fixed rate of 3.21% and receives a floating rate of 54.7% of LIBOR plus 0.32%. The Organization has the right to terminate the agreement prior to maturity, and the

**9. Long-Term Debt (continued)**

counterparty has the right to terminate under certain events of default. At September 30, 2014 and 2013, the fair value of these swap agreements was recorded in the accompanying consolidated statements of financial position at $20,365,000 and $18,708,000, respectively, in accrued liabilities.

The Organization has no restricted collateral held for the swap counterparty at September 30, 2014 and 2013, respectively.

Under the terms of the Indenture and various letter of credit agreements, the Organization is required to meet certain financial ratios. The Indenture also places limits on the Organization's ability to obtain additional borrowings. Under supplemental master indenture implementing amendments, dated August 1, 2008, the Obligated Group instituted a gross revenue pledge.

The Organization maintains a credit facility arrangement that includes a revolving line of credit of $150,000,000. The revolving credit facility expires on September 5, 2017. There were no amounts outstanding under this revolving line of credit at either September 30, 2014 or 2013. There are two letters of credit issued under this facility totaling $697,000 at September 30, 2014. As of September 30, 2014, no funds have been drawn on these letters. The CHFFA 2012 B-C bonds are supported by the Organization's self liquidity as evidenced by the revolving line of credit.

Based on the borrowing rates currently available to the Organization for loans with similar terms and maturities, the estimated fair value of long-term debt was approximately $891,573,000 and $878,704,000 at September 30, 2014 and 2013, respectively. Long-term debt obligations are considered to be in Level 2 of the fair value hierarchy.

## 10. Other Liabilities

Other liabilities at September 30 are summarized below (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Accrued liability for professional and general liability self-insurance, net of current portion of $4,121 in 2014 and $4,457 in 2013 | $ 11,107 | $ 11,568 |
| Accrued liability for physician malpractice, net of current portion of $3,091 in 2014 and $3,519 in 2013 | 7,388 | 6,680 |
| Annuity/unit trust liabilities (discounted at a range of 3.4% to 2.4% in 2014 and 2013) | 11,711 | 11,229 |
| Accrued liability for workers' compensation, net of current portion of $7,365 in 2014 and $7,253 in 2013 | 38,074 | 39,337 |
| Asset retirement obligation | 13,888 | 13,888 |
| Supplemental executive retirement plan liability | 14,208 | 20,616 |
| Deferred rent liability | 14,886 | 14,812 |
| Other | 108 | 152 |
| | $ 111,370 | $ 118,282 |

The Organization follows the guidance of FASB ASC 410, *Asset Retirement and Environmental Obligations*. FASB ASC 410 requires that a legal obligation to perform an asset retirement activity that is not conditional on a future event and that is within the control of the Organization must be recognized as a liability at fair value if it can be reasonably estimated. Because asbestos abatement is mandated under the laws of the state of California, the Organization will eventually be required to remove and dispose of asbestos in all of its facilities. The Organization has recorded a liability totaling $13,888,000 at September 30, 2014 and 2013, respectively, which reflects the future value, discounted at an annual rate of 0% for 2014 and 1.5% for 2013, of the estimated asbestos removal and disposal liability.

## 11. Retirement Plans

### Defined Contribution Savings Plan (401a Plan)

The Organization provides a defined contribution savings plan for all eligible employees who have completed six months of service and attained age 21. Plan participants may contribute up to 60% of eligible compensation on an after-tax basis. The Organization matches employee contributions up to 3% of pay with increased matching contribution for employees with ten or more years of services. Employees with ten or more years of service contributing at least 3% receive a 4%, 5%, or 6% matching contribution, depending on their years of service. All eligible employees receive an additional annual contribution of 1% of their eligible compensation. Employee contributions are immediately vested; employer contributions vest on a graded schedule with 100% vesting at three years of service. The Organization recorded plan expense in the amount of $35,658,000 in 2014 and $34,373,000 in 2013.

### Nonqualified Supplemental Executive Retirement Plan (SERP)

The Organization maintains a nonqualified supplemental executive retirement plan (the Plan) for certain key executives. The Plan provides defined benefits to the participants. The Plan has six participants and has been closed to new membership since 2002. The Plan is actuarially evaluated and involves various assumptions, including the discount rate. Effective April 2014, Scripps Health exercised the right to freeze four of six participants' benefits accrued as of January 1, 2014, under the existing SERP. Participants continue to participate in the Plan solely for the frozen benefit. Entitlement to payment of the benefit, the time and form of benefit payments, and circumstances under which the benefit would be forfeited remain as described in the Plan.

The assets are invested in a Rabbi Trust and are not included in plan assets.

**11. Retirement Plans (continued)**

The following summarizes the benefit obligation and funded status for the Plan as of September 30 (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Change in benefit obligation: | | |
| Obligation at beginning of year | $ 22,112 | $ 17,505 |
| Service cost | 299 | 601 |
| Benefit payments | (1,140) | (855) |
| Interest cost | 529 | 443 |
| Experience (gain) loss: | | |
| Census data | 323 | 2,676 |
| Discount rate change | 238 | (715) |
| Gain due to plan curtailment | (3,157) | – |
| Plan amendment | (3,182) | 2,457 |
| Obligation at end of year | 16,022 | 22,112 |
| Change in plan assets (fair value) | – | – |
| Funded status at end of year | $ (16,022) | $ (22,112) |

The following summarizes the components of net periodic benefit cost for the years ended September 30 (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Service cost | $ 299 | $ 601 |
| Interest cost | 529 | 443 |
| Plan amendment | – | 2,157 |
| Amortization of prior service cost | (333) | – |
| Amortization of actuarial loss | 311 | 362 |
| Total net periodic benefit cost | $ 806 | $ 3,563 |

**11. Retirement Plans (continued)**

The following summarizes the other changes in benefit obligations recognized in other changes in unrestricted net assets for the years ended September 30 (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Net (gain) loss emerging | $ (2,596) | $ 1,961 |
| Prior service credit | (3,182) | – |
| Amortization of prior service cost | 333 | – |
| Amortization of actuarial net loss | (311) | (362) |
| Total recognized in other changes in net assets | (5,756) | 1,599 |
| Total periodic cost and other changes in net assets | $ (4,950) | $ 5,162 |

The following summarizes the amounts recognized in other changes in unrestricted net assets for the years ended September 30 (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Total net (loss) gain | $ (5,756) | $ 1,599 |
| | | |
| Additional information: | | |
| Projected benefit obligation | $ 16,022 | $ 22,112 |
| Accumulated benefit obligation | 16,022 | 18,514 |

The net periodic benefit for the year ending September 30, 2015, is projected to be $143,000.

The amount of net pension liability recognized as current liabilities in the consolidated statements of financial position is $1,814,000 and $1,496,000 as of September 30, 2014 and 2013, respectively. The amount of net pension liability recognized as noncurrent liabilities in the consolidated statements of financial position is $14,208,000 and $20,616,000 as of September 30, 2014 and 2013, respectively.

**11. Retirement Plans (continued)**

The following summarizes the weighted-average assumptions used to determine benefit obligations as of September 30:

| | 2014 | 2013 |
|---|---|---|
| Assumption used to determine benefit obligations: | | |
| Discount rate | 2.46% | 2.82% |
| Rate of compensation increase | 3.00% | 3.00% |
| | | |
| Assumption used to determine net periodic cost: | | |
| Discount rate | 2.82% | 2.22% |
| Rate of compensation increase | 3.00% | 3.00% |
| Average future working lifetime (years) | 4.32 | 4.33 |
| | | |
| Estimated future benefit payments (in thousands): | | |
| Year 1 | $ 1,814 | $ 1,496 |
| Year 2 | 1,150 | 1,995 |
| Year 3 | 1,115 | 784 |
| Year 4 | 2,605 | 1,112 |
| Year 5 | 4,348 | 3,928 |
| Year 6–10 | 6,805 | 15,510 |

Net periodic benefit cost is included in wages and benefits in the consolidated statements of operations.

**Executive Deferred Compensation Plan**

Effective April 1, 2014, the Organization implemented new deferred compensation agreements (the Agreements) with four Executives. The Agreements are structured such that the Organization will have no future obligation to fund any additional amounts beyond an initial $19,525,000 the Organization set aside to fund the premium payments on various split dollar life insurance policies. The $19,525,000 was used to prefund the payments for the first seven years of premium funding for these Agreements. The final three annual premium payments for these Agreements are projected to be funded by the future cash surrender value (CSV) of the life insurance products. The cash flows received by the Executives following their retirement will be partially funded with loans taken against the cash surrender value of the life insurance contracts, which can be drawn by the executives from ages 65 to 81. The Organization has recorded

## 11. Retirement Plans (continued)

$6,818,000 as prepaid insurance contracts and $9,892,000 of cash surrender value in other assets as of September 30, 2014 in the accompanying consolidated statements of financial position. The Organization recorded $759,000 of compensation expense in 2014 related to the Agreements.

### Executive Benefit Plan

During 2003, the Organization implemented an annual pretax benefit plan for executives, which includes a flexible benefit allowance based on a percentage of each participant's annual salary, from which the participant may purchase various benefits, including long-term care coverage and supplemental survivor and spouse life insurance coverage. For the participants who select the split dollar life insurance benefit, the Organization advances certain life insurance premiums and retains an interest in the applicable policies until the earliest of termination, retirement, disability, or death. The remaining benefit allowance may be invested in a supplemental accumulation retirement account (SARA). The participants vest in the SARA over a minimum of two years. The Organization recorded plan expense in the amount of $2,814,000 in 2014 and $2,815,000 in 2013.

## 12. Risk Management and Contingencies

### Insurance Coverage

The Organization has a comprehensive insurance program designed to safeguard its assets and properties. The Organization takes a large retention for those risks that it can mitigate to offset risk transfer costs. Risk transfer is used to mitigate various exposures and losses to a third-party insurer when it is appropriate. In addition, the Organization purchases excess liability coverage to cover losses that exceed its self-insurance program.

The Organization is self-insured for hospital professional and hospital general liability risks for the first $2,000,000 of loss per occurrence subject to a self-insurance retention aggregate of $10,000,000. Losses in excess of this amount are insured through modified claims-made professional liability policies that provide for a seven-year built-in extended reporting period. Total limits purchased for hospital professional liability is $50,000,000 per occurrence subject to a $50,000,000 aggregate. The provision for estimated self-insured professional liability claims includes estimates of the ultimate liability and defense costs for both reported claims and

**12. Risk Management and Contingencies (continued)**

incurred but not reported claims. There is also an additional $50,000,000 per occurrence and aggregate coverage for catastrophic premise liability loss for both hospital and non-hospital locations for a total of $100,000,000 per occurrence and aggregate.

The Organization is self-insured for workers' compensation risks for the first $1,000,000 of loss per occurrence. Losses in excess of this amount are insured through policies of insurance that provide coverage up to statutory amounts. The Part B coverage for workers' compensation, employer's liability, is covered with primary excess occurrence policies totaling $2,000,000 limits per occurrence and in the aggregate and additional excess policies in the amount of $100,000,000 per occurrence and aggregate.

SHPS is insured for managed care liability through a primary policy with limits of $2,000,000 per occurrence and $2,000,000 annual aggregate and is insured through excess policies for an additional $50,000,000 per occurrence and $50,000,000 aggregate.

Scripps Clinic is insured for professional liability through a master policy with SCMG on a claims-made basis, and Scripps Health is acknowledged as an administrative insured of this policy. Scripps Health employees working in Scripps Clinic are insured under the entity coverage for SCMG with limits of $5,000,000 per occurrence and $10,000,000 in the annual aggregate subject to a self-insured retention of $500,000 per claim and $2,900,000 per year in the aggregate. Claims-made coverage covers only those claims reported during the policy period, and Scripps Health records an accrual for losses incurred but not reported.

Scripps Coastal Medical Center is insured for professional liability through a master policy with San Diego Coastal Medical Group on a claims-made basis, and Scripps Health is acknowledged as an administrative insured of this policy.

Scripps Health employees working in the medical centers are insureds in the entity coverage for Scripps Coastal Medical Group with limits of $1,000,000 per occurrence and $5,000,000 in the annual aggregate.

The Organization is self-insured for employee health benefits, and records an accrual for claims incurred but not reported. Stop loss coverage is maintained that caps the maximum payable per calendar year at $750,000 per individual.

## 12. Risk Management and Contingencies (continued)

### Legal

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations is subject to government review and interpretation, as well as regulatory actions. Claims for payment for services rendered to Medicare and Medi-Cal beneficiaries must meet applicable billing laws and regulations, which, among other things, require that the services are medically necessary, accurately coded, and sufficiently documented in the beneficiaries' medical records. Allegations concerning possible violations of regulations can result in the imposition of significant fines and penalties, as well as significant repayment of previously billed and collected revenues for patient services. Management believes that the Organization is in substantial compliance with all applicable laws and regulations, and it is not aware of any significant allegations of potential wrongdoing, other than as disclosed here. The Organization is a party to certain legal and regulatory actions in the ordinary course of business. It is the opinion of management that there will not be a material adverse effect on the consolidated financial position or results of operations of the Organization as a result of such actions.

On June 21, 2010, a class action complaint was filed against the Organization in the Superior Court of San Diego entitled *Miranda Britt, et al. v. Scripps Health, et al*. The lawsuit alleged causes of action for certain wage and hour violations. On October 3, 2013, the parties participated in mediation and negotiated a class action settlement of approximately $1,900,000 which has been recorded in accounts payable in the consolidated statement of financial position as of September 30, 2014. The payment to satisfy this settlement was made in November 2014.

### Seismic Standards (Unaudited)

The state of California issued seismic safety standards (SB1953) in 1994 which have been amended on several occasions since then. These standards affect all five of the Organization's hospital campuses. Emergency regulations adopted in January 2010 (SB499) as well as the ability to apply for HAZUS certification have and will continue to provide some legislative relief for the Organization by modifying the level of Structural Performance Category (SPC) and Non-Structural Performance Category (NPC) seismic retrofit required as well as extending the compliance deadlines. The 2007 HAZUS regulations allow for hospitals to meet a standard of 0.75% collapse probability given the ground motions specific to the site, and thus are not as

**12. Risk Management and Contingencies (continued)**

rigorous as the full SB1953 regulations due to more precise estimations. HAZUS specifically addresses SPC requirements. SB499 legislation addresses the NPC requirements and allows for hospitals to delay NPC-3 upgrades until 2030, at which time the work will then be completed or the facility removed from service.

The Organization has received HAZUS relief and SB499 waivers, which reduced total projected costs and extend compliance to 2030. The Organization expended $35,512,000 (unaudited), to complete all remediation work to meet HAZUS and SB499 requirements.

**13. Lease Commitments**

The Organization leases various equipment and facilities under operating leases expiring at various dates through 2043. Total rental expense for operating leases was $32,834,000 in 2014 and $31,965,000 in 2013. The following is a schedule of future minimum lease payments as of September 30, 2014, under operating leases that have initial or remaining terms in excess of one year (in thousands):

| | Facilities | Equipment | Total |
|---|---|---|---|
| 2015 | $ 30,178 | $ 893 | $ 31,071 |
| 2016 | 27,276 | 495 | 27,771 |
| 2017 | 22,607 | 260 | 22,867 |
| 2018 | 20,908 | – | 20,908 |
| 2019 | 17,117 | – | 17,117 |
| Thereafter | 97,287 | – | 97,287 |
| | $ 215,373 | $ 1,648 | $ 217,021 |

**14. Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are available for the following purposes or periods as of September 30 (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Healthcare operations – specific purpose | $ 29,777 | $ 24,738 |
| Research | 27,894 | 26,298 |
| Building, construction and equipment | 24,850 | 35,730 |
| Deferred gifts, available for use in future periods | 20,516 | 19,654 |
| Education | 19,591 | 19,113 |
| Indigent care | 5,630 | 5,197 |
| | $ 128,258 | $ 130,730 |

During 2014 and 2013, temporarily restricted net assets of $40,410,000 and $41,113,000, respectively, were released from restrictions by incurring expenditures that satisfied the donor's purpose or time restriction.

Permanently restricted net assets at September 30 are restricted to investments in perpetuity, the income from which is expendable to support the Organization and is available for the following purposes or periods (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Healthcare operations – specific purpose | $ 29,851 | $ 29,290 |
| Education | 17,551 | 16,727 |
| Research | 17,176 | 17,172 |
| Indigent care | 13,149 | 13,138 |
| Building, construction and equipment | 1,086 | 1,086 |
| Deferred gifts, the income from which will be available for use in future periods | 820 | 748 |
| | $ 79,633 | $ 78,161 |

## 14. Temporarily and Permanently Restricted Net Assets (continued)

### Endowments

The Organization's endowments consist of 85 individual funds for 2014 and 2013, respectively, established for a variety of purposes. Net assets associated with the endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

On September 30, 2008, California Senate Bill No. 1329 was signed into law which enacted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) for California. The Board of Trustees of the Organization has interpreted this as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of the interpretation, the Organization classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Organization in a manner consistent with the standard of prudence described by UPMIFA. In accordance with UPMIFA, the Organization considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) duration and preservation of the fund, (2) purposes of the Organization and the donor-restricted endowment fund, (3) general economic conditions, (4) possible effect of inflation or deflation, (5) expected total return from income and the appreciation of investments, (6) other resources of the Organization, and (7) investment policies of the Organization.

From time to time, the fair value of assets associated with individual endowment funds may fall below the level that the donor or UPMIFA requires the Organization to retain as a fund of perpetual duration.

**14. Temporarily and Permanently Restricted Net Assets (continued)**

The Organization has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results while assuming a moderate level of investment risk. The Organization expects its endowment funds, over time, to provide an average rate of return of approximately 5% over the rate of inflation annually. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate-of-return objectives, the Organization relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Organization targets a diversified asset allocation that places an emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

The Organization has a policy of appropriating for distribution 6% in fiscal year 2014 and 4% in fiscal year 2013 (with an additional 1% administrative fee) of its endowment fund's average fair value over the prior three-year rolling average market values. In establishing this policy, the Organization considered the long-term expected return on its endowment. Accordingly, over the long term, the Organization expects the current spending policy to allow its endowment to grow at an average of 3% to 4% annually, above inflation. This is consistent with the Organization's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

**14. Temporarily and Permanently Restricted Net Assets (continued)**

Changes in endowment net assets for the year ended September 30, 2014, are as follows (in thousands):

| | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|
| Endowment net assets as of September 30, 2013 | $ 34,129 | $ 78,161 | $ 112,290 |
| Investment return: | | | |
| Investment income | 1,862 | – | 1,862 |
| Net appreciation (realized and unrealized) | 7,205 | – | 7,205 |
| Total investment return | 43,196 | 78,161 | 121,357 |
| Contributions | – | 528 | 528 |
| Appropriation of endowment assets for expenditure | (5,662) | – | (5,662) |
| Other changes | – | 944 | 944 |
| Endowment net assets as of September 30, 2014 | $ 37,534 | $ 79,633 | $ 117,167 |

## 14. Temporarily and Permanently Restricted Net Assets (continued)

Changes in endowment net assets for the year ended September 30, 2013, are as follows (in thousands):

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Endowment net assets as of September 30, 2012 | $ (30) | $ 24,630 | $ 79,219 | $ 103,819 |
| Investment return: | | | | |
| Investment income | – | 1,948 | – | 1,948 |
| Net appreciation (realized and unrealized) | 30 | 12,087 | – | 12,117 |
| Total investment return | 30 | 14,035 | – | 14,065 |
| Contributions | – | – | 127 | 127 |
| Appropriation of endowment assets for expenditure | – | (4,536) | – | (4,536) |
| Other changes | – | – | (1,185) | (1,185) |
| Endowment net assets as of September 30, 2013 | $ – | $ 34,129 | $ 78,161 | $ 112,290 |

Temporarily restricted endowment net assets are as follows at September 30 (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Temporarily restricted net assets: | | |
| The portion of perpetual endowment funds subject to a time restriction under UPMIFA: | | |
| Without purpose restrictions | $ 2,184 | $ 4,981 |
| With purpose restrictions | 35,350 | 29,148 |
| Total endowment funds classified as temporarily restricted net assets | $ 37,534 | $ 34,129 |

## 15. Fair Value Measurements

The Organization accounts for certain assets and liabilities at fair value. A fair value hierarchy for valuation inputs prioritizes the inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels and is determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1: Quoted prices are available in active markets for identical assets or liabilities as of the measurement date. Financial assets and liabilities in Level 1 include U.S. and foreign equity securities, as well as mutual funds.

Level 2: Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the asset or liabilities. Financial assets and liabilities in this category generally include U.S. and foreign government securities, asset-backed securities, U.S. and foreign corporate bonds and loans, municipal bonds, commingled funds, interest rate swaps, real estate, pledges receivable, interest rate swaps, and annuity/unitrust liabilities.

Level 3: Pricing inputs are generally unobservable for the assets or liabilities and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management’s judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using factors that involve considerable judgment and interpretations, including but not limited to, private and public comparables, third-party appraisals, discounted cash flow models, and fund manager estimates. There are no Level 3 financial assets or liabilities at September 30, 2014 and 2013.

**15. Fair Value Measurements (continued)**

Assets and liabilities measured at fair value are based on one or more of the three valuation techniques. The three valuation techniques are identified in the tables below. Where more than one technique is noted, individual assets or liabilities were valued using one or more of the noted techniques. The valuation techniques are as follows:

a) Market approach. Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

b) Cost approach. Amount that would be required to replace the service capacity of asset (replacement cost).

c) Income approach. Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing, and excess earnings models).

## 15. Fair Value Measurements (continued)

The following represents financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2014 (in thousands). Alternative investments are accounted for using the equity method of accounting, which is not a fair value measurement.

| | September 30, 2014 | Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Fair Value | Equity Method | Valuation Technique (a,b,c) |
|---|---|---|---|---|---|---|
| **Investments** | | | | | | |
| Liquid investments: | | | | | | |
| Cash equivalents | $ 16,059 | $ 16,059 | $ – | $ 16,059 | $ – | a |
| Equity securities: | | | | | | |
| U.S. equity | 183,594 | 183,594 | – | 183,594 | – | a |
| U.S. equity (commingled) | 262,508 | – | 262,508 | 262,508 | – | a |
| Foreign equity | 389,777 | 389,777 | – | 389,777 | – | a |
| Foreign equity (commingled) | 95,445 | – | 95,445 | 95,445 | – | a |
| | 931,324 | 573,371 | 357,953 | 931,324 | – | |
| Fixed income securities: | | | | | | |
| U.S. government | 21,793 | – | 21,793 | 21,793 | – | a |
| U.S. government agencies | 1,997 | – | 1,997 | 1,997 | – | a |
| U.S. federal agency mortgage-backed | 11,822 | – | 11,822 | 11,822 | – | a |
| Foreign government | 1,285 | – | 1,285 | 1,285 | – | a |
| Foreign government (commingled) | 143,687 | – | 143,687 | 143,687 | – | a |
| U.S. corporate | 271,176 | – | 271,176 | 271,176 | – | a |
| U.S. corporate (commingled) | 254,113 | – | 254,113 | 254,113 | – | a |
| Foreign corporate | 9,192 | – | 9,192 | 9,192 | – | a |
| | 715,065 | – | 715,065 | 715,065 | – | |
| Other investments: | | | | | | |
| Multi-strategy hedge funds | 368,328 | – | – | – | 368,328 | a |
| Private equity funds | 13,488 | – | – | – | 13,488 | a |
| Real estate | 8,750 | – | 8,750 | 8,750 | – | a |
| | 390,566 | – | 8,750 | 8,750 | 381,816 | |
| Total investments | 2,053,014 | 589,430 | 1,081,768 | 1,671,198 | 381,816 | |
| Other assets: | | | | | | |
| Pledges receivable, net | 18,291 | – | 18,291 | 18,291 | – | c |
| | 18,291 | – | 18,291 | 18,291 | – | |
| Total assets at fair value | $ 2,071,305 | $ 589,430 | $ 1,100,059 | $ 1,689,489 | $ 381,816 | |
| Current liabilities: | | | | | | |
| Swap hedge | $ 20,365 | $ – | $ 20,365 | $ 20,365 | $ – | c |
| | 20,365 | – | 20,365 | 20,365 | – | |
| Other liabilities: | | | | | | |
| Annuity/unitrust liabilities | 11,711 | – | 11,711 | 11,711 | – | c |
| | 11,711 | – | 11,711 | 11,711 | – | |
| Total liabilities at fair value | $ 32,076 | $ – | $ 32,076 | $ 32,076 | $ – | |

## 15. Fair Value Measurements (continued)

The following represents financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2013 (in thousands). Alternative investments are accounted for using the equity method of accounting, which is not a fair value measurement.

| | September 30, 2013 | Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Fair Value | Equity Method | Valuation Technique (a,b,c) |
|---|---|---|---|---|---|---|
| **Investments** | | | | | | |
| Liquid investments: | | | | | | |
| Cash equivalents | $ 10,869 | $ 10,869 | $ – | $ 10,869 | $ – | a |
| Equity securities: | | | | | | |
| U.S. equity | 371,585 | 371,585 | – | 371,585 | – | a |
| U.S. equity (commingled) | 194,002 | – | 194,002 | 194,002 | – | a |
| Foreign equity | 154,465 | 154,465 | – | 154,465 | – | a |
| Foreign equity (commingled) | 150,121 | – | 150,121 | 150,121 | – | a |
| | 870,173 | 526,050 | 344,123 | 870,173 | – | |
| Fixed income securities: | | | | | | |
| U.S. government | 17,299 | – | 17,299 | 17,299 | – | a |
| U.S. government agencies | 195 | – | 195 | 195 | – | a |
| U.S. state and local government | 230 | – | 230 | 230 | – | a |
| U.S. federal agency mortgage-backed | 13,033 | – | 13,033 | 13,033 | – | a |
| Foreign government | 1,774 | – | 1,774 | 1,774 | – | a |
| Foreign government (commingled) | 148,616 | – | 148,616 | 148,616 | – | a |
| U.S. corporate | 261,139 | – | 261,139 | 261,139 | – | a |
| U.S. corporate (commingled) | 241,505 | – | 241,505 | 241,505 | – | a |
| Foreign corporate | 10,804 | – | 10,804 | 10,804 | – | a |
| | 694,595 | – | 694,595 | 694,595 | – | |
| Other investments: | | | | | | |
| Multi-strategy hedge funds | 154,853 | – | – | – | 154,853 | a |
| Private equity funds | 5,100 | – | – | – | 5,100 | a |
| Real estate | 8,105 | – | 8,105 | 8,105 | – | a |
| | 168,058 | – | 8,105 | 8,105 | 159,953 | |
| Total investments | 1,743,695 | 536,919 | 1,046,823 | 1,583,742 | 159,953 | |
| Other assets: | | | | | | |
| Pledges receivable, net | 25,825 | | 25,825 | 25,825 | – | c |
| Land held for sale | 173 | – | 173 | 173 | – | b |
| | 25,998 | – | 25,998 | 25,998 | – | |
| Total assets at fair value | $ 1,769,693 | $ 536,919 | $ 1,072,821 | $ 1,609,740 | $ 159,953 | |
| Current liabilities: | | | | | | |
| Swap hedge | $ 18,708 | $ – | $ 18,708 | $ 18,708 | $ – | c |
| | 18,708 | – | 18,708 | 18,708 | – | |
| Other liabilities: | | | | | | |
| Annuity/unitrust liabilities | 11,229 | – | 11,229 | 11,229 | – | c |
| | 11,229 | – | 11,229 | 11,229 | – | |
| Total liabilities at fair value | $ 29,937 | $ – | $ 29,937 | $ 29,937 | $ – | |

## 15. Fair Value Measurements (continued)

Transfers to/from Levels 1, 2, and 3 are recognized at the end of the reporting period. There were no transfers for the years ended September 30, 2014 and 2013.

As of September 30, 2014 and 2013, the Level 2 instruments listed in the fair value hierarchy table above use the following valuation techniques and inputs:

### U.S. and Foreign Government Securities

The fair value of investments in U.S. and foreign government securities, classified as Level 2, was primarily determined using techniques consistent with the market approach. Significant observable inputs to the income approach include data points for benchmark constant maturity curves and spreads.

### U.S. and Foreign Corporate Bonds

The fair value of the investments in U.S. and foreign corporate bonds, including mutual and commingled funds that invest primarily in such bonds, classified as Level 2 was primarily determined using techniques that are consistent with the market approach. Significant observable inputs include benchmark yields, reported trades, observable broker/dealer quotes, issuer spreads, and security specific characteristics (such as early redemption options).

### Real Estate and Land Held for Sale

The fair value of the real estate investments classified as Level 2 was primarily determined using techniques that are consistent with the market approach. Significant observable inputs include sales of comparable properties, market rents and market rent growth trends.

### Pledges Receivable and Annuity/Unitrust Liabilities

The fair value of the pledges receivable and annuity/unitrust liabilities as Level 2 was primarily determined using techniques that are consistent with the income approach. Significant observable inputs to the income approach include data points for benchmark constant maturity curves and spreads.

## 15. Fair Value Measurements (continued)

### Commingled Funds

The fair value of investments in U.S. equity commingled funds, classified as Level 2, was primarily determined using the calculated net asset value per share (NAV). The values for underlying investments are fair value estimates determined either internally or by an external fund manager based on recent filings, operating results, balance sheet stability, growth, and other business and market sector fundamentals.

The fair value of all other commingled fund investments classified as Level 2 was determined using the calculated NAV. The values for underlying investments are fair value estimates determined either internally or by an external fund manager based on recent filings, operating results, balance sheet stability, growth, and other business and market sector fundamentals. Due to the significant unobservable inputs present in these valuations, Scripps Health classifies all such investments as Level 2.

### Swap Hedge

The fair value of the Swap hedge liability classified as Level 2 is based on independent valuations obtained and is determined by calculating the fair value of the discounted cash flows of the differences between the fixed interest rate of the interest rate swaps and the counterparty's forward LIBOR curve, which is the input used in the valuation, taking also into account any nonperformance risk.

## 15. Fair Value Measurements (continued)

Included within the assets above are investments in certain entities that report fair value using a calculated NAV or its equivalent. The following table and explanations identify attributes relating to the nature and risk of such investments as of September 30, 2014 (in thousands):

| NAV Valuation | Fair Value | Unfunded Commitments | Redemption Frequency (if Currently Eligible) | Redemption Notice Period |
|---|---|---|---|---|
| Commingled: | | | | |
| Equity securities[1] | $ 95,445 | $ – | Daily to monthly | 1–6 days |
| Fixed income securities[2] | 397,800 | – | Daily to monthly liquidity | 2–15 days |
| | $ 493,245 | $ – | | |

(1) Commingled Funds: Equity – This category includes investments in commingled funds with underlying investments that are fair value estimates determined either internally or by an external fund manager based on recent filings, operating results, balance sheet stability, growth and other business and market sector fundamentals. The investments are diversified by geography, sector, and organization. Liquidity is provided on a semimonthly to monthly basis.

(2) Commingled Funds: Fixed Income – This category includes investments in three commingled funds with underlying investments that are fair value estimates determined either internally or by an external fund manager based on recent filings, operating results, balance sheet stability, growth and other business and market sector fundamentals. The investments are diversified by geography, sector, maturity, and issue. Liquidity is provided on a daily and/or monthly basis. As of September 30, 2014, the category consisted of 67% daily and 33% monthly liquidity.

## 16. Affiliation With Dignity Health

In August 1995, Scripps Health and Dignity Health (formerly Catholic Healthcare West) entered into an affiliation agreement to enhance their mutual ability to serve the San Diego community. Through the affiliation, Dignity Health transferred the sole voting membership of one of its subordinate corporations, Mercy Healthcare San Diego (MHSD), to Scripps Health, along with the responsibility for its operations and governance. MHSD's principal activity is the operation of a hospital and a network of clinics. MHSD was subsequently merged into Scripps Health.

## 16. Affiliation With Dignity Health (continued)

Pursuant to the affiliation agreement, Dignity Health, among other things, obtained the right to receive a 20% interest in the annual change in unrestricted net assets of Scripps Health and the right to 20% of the net proceeds, with certain restrictions, upon the liquidation of Scripps Health. Scripps Health has the right to receive from Dignity Health an amount equal to Dignity Health's percentage interest in (i) the annual capital expenditures of Scripps Health and (ii) the annual amortization of debt principal of Scripps Health. Scripps Health and Dignity Health may make an election annually to receive all or a portion of the accumulated, but not previously paid amounts under the affiliation agreement, subject to certain conditions. No payments have ever been paid by either party under these provisions, and as of September 30, 2014, no amounts are due. Of the members of the Scripps Health Board of Trustees, 20% are required to be elected from a slate of nominees proposed by Dignity Health.

Under the terms of the affiliation agreement, Scripps Health was required to contribute $2,000,000 per year, adjusted annually for inflation, to a Strategic Capital Reserve Pool (the Pool), up to a maximum aggregate contribution of $20,000,000. During 2005, the parties agreed that Scripps Health had fulfilled the terms of the agreement and would therefore cease making contributions. Funds in the Pool may be used to undertake capital projects that are of mutual benefit to Scripps Health and Dignity Health in support of healthcare in the San Diego community.

Projects funded through the Pool require the approval of both Scripps Health and Dignity Health. During 2009, Scripps Health received full reimbursement from the Pool and the account was closed.

## 17. Rental Income

The Organization leases medical office space to various physicians and other healthcare-related entities under operating leases. The leases provide for minimum rentals and additional amounts for real estate taxes and common area expenses. Total rental income was $9,234,000 in 2014 and $9,200,000 in 2013, and is included in other operating revenue in the consolidated statements of operations.

## 17. Rental Income (continued)

The following is a schedule of future minimum rentals to be received as of September 30, 2014, under operating leases that have initial or remaining terms in excess of one year (in thousands):

| | |
|---|---|
| 2015 | $ 6,315 |
| 2016 | 4,120 |
| 2017 | 3,071 |
| 2018 | 1,573 |
| 2019 | 665 |
| | $ 15,744 |

## 18. Functional Expenses

Operating expenses for the years ended September 30, are grouped into functional classifications as summarized below (in thousands). Patient care services include expenses incurred by departments directly delivering patient care or directly supporting the delivery of patient care. General and administrative services include information services, financial services, employee relations services, insurance, and administration and related services.

| | 2014 | 2013 |
|---|---|---|
| Patient care services | $ 2,135,520 | $ 2,166,895 |
| General and administrative | 265,353 | 242,011 |
| Fund-raising | 9,160 | 9,358 |
| Total operating expenses | $ 2,410,033 | $ 2,418,264 |

## 19. Investment Income

The composition of investment return for the years ended September 30 includes the following (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Nonoperating gains: | | |
| Interest income and dividends | $ 26,565 | $ 22,660 |
| Net realized gains on sale of investments | 166,977 | 72,505 |
| Realized loss on insurance contracts | (2,815) | – |
| Unrealized gain on trading portfolio | (51,301) | 72,060 |
| | 139,426 | 167,225 |
| Other changes in net assets: | | |
| Interest and dividends on temporarily restricted assets | 2,027 | 2,108 |
| Net realized gains on temporarily restricted net assets | 11,261 | 5,478 |
| Net unrealized gains on temporarily restricted net assets | (2,601) | 6,307 |
| Total investment return | $ 150,113 | $ 181,118 |

# Supplementary Information

# Scripps Health and Affiliates

## 2014 Consolidating Statement of Financial Position
*(In Thousands)*

September 30, 2014

| | Obligated Group | Hospice | SHPS | Joint Ventures | Gluck | Eliminations | Consolidated |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Current assets: | | | | | | | |
| Cash and cash equivalents | $ 283,239 | $ 3,900 | $ 76,906 | $ 2,940 | $ 190 | $ – | $ 367,175 |
| Patient accounts receivable, net | 273,844 | 3,392 | 933 | 1,562 | – | (36,593) | 243,138 |
| Assets limited as to use | 5,357 | – | – | – | – | – | 5,357 |
| Other current assets | 98,963 | 68 | 451 | 825 | – | 1 | 100,308 |
| Total current assets | 661,403 | 7,360 | 78,290 | 5,327 | 190 | (36,592) | 715,978 |
| Assets limited as to use | 218,443 | – | 300 | – | 1,199 | – | 219,942 |
| Investments | 1,827,712 | – | 3 | – | – | – | 1,827,715 |
| Property and equipment, net | 1,432,923 | 2,390 | 215 | 1,469 | – | – | 1,436,997 |
| Other assets | 112,777 | – | – | 2,588 | – | (18,065) | 97,300 |
| Total assets | $ 4,253,258 | $ 9,750 | $ 78,808 | $ 9,384 | $ 1,389 | $ (54,657) | $ 4,297,932 |
| **Liabilities and net assets** | | | | | | | |
| Current liabilities: | | | | | | | |
| Current portion of long-term debt | $ 20,967 | $ – | $ – | $ 467 | $ – | $ – | $ 21,434 |
| Accounts payable | 112,904 | 461 | 276 | 423 | 15 | 1 | 114,080 |
| Accrued liabilities | 220,749 | 705 | 59,313 | 614 | 116 | (36,593) | 244,904 |
| Total current liabilities | 354,620 | 1,166 | 59,589 | 1,504 | 131 | (36,592) | 380,418 |
| Long-term debt, less current portion | 847,745 | – | – | 252 | – | – | 847,997 |
| Other liabilities | 96,396 | 14,300 | 548 | 24 | 102 | – | 111,370 |
| Total liabilities | 1,298,761 | 15,466 | 60,137 | 1,780 | 233 | (36,592) | 1,339,785 |
| Net assets: | | | | | | | |
| Unrestricted: | | | | | | | |
| Controlling interests | 2,747,775 | (5,716) | 18,671 | 4,984 | (13) | (18,065) | 2,747,636 |
| Noncontrolling interests in subsidiaries | – | – | – | 2,620 | – | – | 2,620 |
| | 2,747,775 | (5,716) | 18,671 | 7,604 | (13) | (18,065) | 2,750,256 |
| Temporarily restricted | 127,888 | – | – | – | 370 | – | 128,258 |
| Permanently restricted | 78,834 | – | – | – | 799 | – | 79,633 |
| Total net assets | 2,954,497 | (5,716) | 18,671 | 7,604 | 1,156 | (18,065) | 2,958,147 |
| Total liabilities and net assets | $ 4,253,258 | $ 9,750 | $ 78,808 | $ 9,384 | $ 1,389 | $ (54,657) | $ 4,297,932 |

# Scripps Health and Affiliates

## 2014 Consolidating Statement of Operations

*(In Thousands)*

### Year Ended September 30, 2014

| | Obligated Group | Hospice | SHPS | Joint Ventures | Gluck | Eliminations | Consolidated |
|---|---|---|---|---|---|---|---|
| Unrestricted revenues, gains and other support: | | | | | | | |
| Patient service revenue, net of contractual allowances and discounts | $ 2,273,597 | $ 10,607 | $ – | $ 17,265 | $ – | $ (159,248) | $ 2,142,221 |
| Provision for bad debts | (53,583) | – | – | (119) | – | – | (53,702) |
| Net patient service revenue less provision for bad debts before provider fee | 2,220,014 | 10,607 | – | 17,146 | – | (159,248) | 2,088,519 |
| Provider fee | 21,047 | – | – | – | – | – | 21,047 |
| Net patient service revenue | 2,241,061 | 10,607 | – | 17,146 | – | (159,248) | 2,109,566 |
| Capitation premium | 98,075 | – | 338,142 | – | – | (95,139) | 341,078 |
| Meaningful use | 14,476 | – | – | – | – | – | 14,476 |
| Other | 80,568 | 61 | 12,641 | 151 | 1,404 | (13,749) | 81,076 |
| Net assets released from restrictions used for operations | 18,445 | 174 | – | – | – | – | 18,619 |
| Total operating revenues | 2,452,625 | 10,842 | 350,783 | 17,297 | 1,404 | (268,136) | 2,564,815 |
| | | | | | | | |
| Operating expenses: | | | | | | | |
| Wages and benefits | 1,141,210 | 9,949 | 8,895 | 4,371 | 1,155 | (297) | 1,165,283 |
| Supplies | 391,441 | 1,213 | 140 | 4,198 | 119 | 2 | 397,113 |
| Services | 630,763 | 2,962 | 341,262 | 3,114 | 148 | (267,841) | 710,408 |
| Provider fee | 14,778 | – | – | – | – | – | 14,778 |
| Depreciation and amortization | 101,597 | 303 | 67 | 488 | – | – | 102,455 |
| Interest | 15,207 | – | – | 59 | – | – | 15,266 |
| Loss on impairment | 4,518 | – | 212 | – | – | – | 4,730 |
| Total operating expenses | 2,299,514 | 14,427 | 350,576 | 12,230 | 1,422 | (268,136) | 2,410,033 |
| Operating income (loss) | 153,111 | (3,585) | 207 | 5,067 | (18) | – | 154,782 |
| Nonoperating gains (losses): | | | | | | | |
| Investment income | 190,721 | – | 6 | – | – | – | 190,727 |
| Unrealized loss on trading portfolio | (51,301) | – | – | – | – | – | (51,301) |
| Contributions | 971 | – | – | – | – | – | 971 |
| Market adjustment on interest rate swaps | (1,657) | – | – | – | – | – | (1,657) |
| Excess (deficiency) of revenues over expenses | 291,845 | (3,585) | 213 | 5,067 | (18) | – | 293,522 |
| Less excess of revenues over expenses attributable to noncontrolling interests | – | – | – | (1,952) | – | – | (1,952) |
| Excess (deficiency) of revenues over expenses attributable to controlling interests | $ 291,845 | $ (3,585) | $ 213 | $ 3,115 | $ (18) | $ – | $ 291,570 |

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