Audited Consolidated Financial Statements and Supplementary Information

Scripps Health and Affiliates
Years Ended September 30, 2018 and 2017
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, 2018 and 2017

Contents

Building a better
working world

Ernst & Young LLP
Suite 1600
4365 Executive Drive
San Diego CA 92121

Tel: +1 858 535 7200
Fax: +1 858 535 7777
ey.com

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, which comprise the consolidated statements of financial position as of September 30, 2018 and 2017, 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, 2018 and 2017, 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 audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating financial statement information for 2018 and Scripps Health Plan Services financial statements for 2018 are presented for purposes of additional analysis and are 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 audits 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 14, 2018

Scripps Health and Affiliates

Consolidated Statements of Financial Position
(In Thousands)

	September 30 2018	September 30 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 373,876	$ 356,903
Patient accounts receivable, net	385,458	368,899
Assets limited as to use	71,184	12,557
Other current assets	184,001	152,205
Total current assets	1,014,519	890,564
Assets limited as to use	199,546	215,917
Investments	2,367,418	2,313,349
Property and equipment, net	1,815,970	1,768,538
Other assets	160,649	105,804
Total assets	$ 5,558,102	$ 5,294,172
Liabilities and net assets		
Current liabilities:		
Current portion of debt	$ 182,852	$ 33,270
Accounts payable	146,438	109,219
Accrued liabilities	304,739	312,879
Total current liabilities	634,029	455,368
Long-term debt, less current portion	814,118	994,604
Other liabilities	133,707	118,516
Total liabilities	1,581,854	1,568,488
Net assets:		
Unrestricted:		
Controlling interests	3,773,397	3,518,942
Non-controlling interests in subsidiaries	3,481	3,392
	3,776,878	3,522,334
Temporarily restricted	117,115	115,727
Permanently restricted	82,255	87,623
Total net assets	3,976,248	3,725,684
Total liabilities and net assets	$ 5,558,102	$ 5,294,172

See accompanying notes.

Scripps Health and Affiliates

Consolidated Statements of Operations

(In Thousands)

	Year Ended September 30	
	2018	**2017**
Unrestricted revenues, gains, and other support:		
Patient service revenue, net of contractual allowances and discounts	$ 2,288,695	$ 2,224,632
Provision for bad debts	(44,399)	(47,632)
Net patient service revenue less provision for bad debts before provider fee	2,244,296	2,177,000
Provider fee	241,538	41,804
Net patient service revenue	2,485,834	2,218,804
Capitation premium	592,558	532,931
Management services	39,178	38,214
Other	103,542	102,361
Net assets released from restrictions used for operations	21,934	28,047
Total operating revenues	3,243,046	2,920,357
Operating expenses:		
Wages and benefits	1,237,813	1,210,703
Supplies	515,528	492,960
Services	1,005,894	925,705
Provider fee	186,285	36,458
Depreciation and amortization	170,905	161,673
Interest	26,623	24,493
Restructuring	14,272	14
Total operating expenses	3,157,320	2,852,006
Operating income	85,726	68,351
Nonoperating gains (losses):		
Investment income	132,497	276,816
Contributions	4,313	1,943
Interest rate swaps	4,273	6,030
Loss on early extinguishment of debt	–	(1,323)
Excess of revenues over expenses	226,809	351,817
Less excess of revenues over expenses attributable to non-controlling interests	(1,346)	(1,649)
Excess of revenues over expenses attributable to controlling interests	$ 225,463	$ 350,168

See accompanying notes.

Scripps Health and Affiliates

Consolidated Statements of Changes in Net Assets

(In Thousands)

	Year Ended September 30 2018	2017
Unrestricted net assets:		
Excess of revenues over expenses attributable to controlling interests	$ 225,463	$ 350,168
Net assets released from restrictions used for purchases of property and equipment	28,453	28,774
Other	539	(404)
Increase in unrestricted net assets attributable to controlling interests	254,455	378,538
Non-controlling interests:		
Excess of revenues over expenses attributable to non-controlling interests	1,346	1,649
Distributions to non-controlling members	(1,257)	(1,441)
Increase in non-controlling interests	89	208
Increase in unrestricted net assets	254,544	378,746
Temporarily restricted net assets:		
Contributions	46,487	48,695
Investment income	7,685	14,909
Net assets released from restrictions used for operations	(21,934)	(28,047)
Net assets released from restrictions used for purchases of property and equipment	(28,453)	(28,774)
Change in value of deferred gifts	(475)	28
Other	(1,922)	(100)
Increase in temporarily restricted net assets	1,388	6,711
Permanently restricted net assets:		
Contributions	711	294
Change in value of deferred gifts	148	93
Other	(6,227)	(69)
(Decrease) increase in permanently restricted net assets	(5,368)	318
Total increase in net assets	250,564	385,775
Net assets at beginning of year	3,725,684	3,339,909
Net assets at end of year	$ 3,976,248	$ 3,725,684

See accompanying notes.

Scripps Health and Affiliates

Consolidated Statements of Cash Flows

(In Thousands)

	Year Ended September 30	
	2018	**2017**
Operating activities and nonoperating gains		
Total increase in net assets	$ 250,564	$ 385,775
Reconciliation of total increase in net assets to net cash provided by operating activities and nonoperating gains:		
Depreciation and amortization	170,905	161,673
Amortization of debt issuance costs	347	376
Amortization of original issue premium	(590)	(596)
Provision for bad debts	44,410	47,632
Realized and unrealized gains on investments	(94,401)	(256,736)
Purchases of investments designated as trading	(459,325)	(797,441)
Proceeds from sale of investments designated as trading	499,657	928,212
Interest rate swaps	(6,878)	(9,083)
Gain on disposal of property	(1,609)	(293)
Loss on early extinguishment of debt	–	1,323
Restricted contributions and investment income	(52,700)	(53,512)
Distributions to non-controlling interest	1,257	1,441
Change in assets and liabilities:		
Accounts receivable	(60,969)	(113,909)
Other current assets	(31,796)	(1,476)
Other assets	(59,383)	(3,100)
Accounts payable and accrued liabilities	35,278	(2,431)
Other liabilities	15,191	(1,935)
Net cash provided by operating activities and nonoperating gains	249,958	285,920
Investing activities		
Purchases of property and equipment	(214,189)	(256,559)
Purchases of investments designated as assets limited as to use	(60,691)	(10,735)
Sales of investments designated as assets limited as to use	18,435	–
Net cash used in investing activities	(256,445)	(267,294)

(continued on next page)

Scripps Health and Affiliates

Consolidated Statements of Cash Flows (continued)

(In Thousands)

	Year Ended September 30 2018	2017
Financing activities		
Proceeds from restricted contributions and investment income	$ 53,879	$ 55,827
Debt issuance costs	–	(499)
Proceeds from long-term debt	–	160,000
Payments on borrowings	(32,393)	(190,689)
Proceeds from sale of donated financial assets	3,231	188
Distributions to non-controlling interest	(1,257)	(1,441)
Net cash provided by financing activities	23,460	23,386
Increase in cash and cash equivalents	16,973	42,012
Cash and cash equivalents at beginning of year	356,903	314,891
Cash and cash equivalents at end of year	$ 373,876	$ 356,903
Supplemental disclosure of cash flow information		
Cash paid during the year for interest	$ 29,222	$ 26,222
Assets acquired through capital lease or note payable	1,731	555
Accrued obligations for property and equipment	23,045	23,725

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 accompanying consolidated financial statements for Scripps Health include the financial position and results of continuing operations of Scripps Health Plan Services (SHPS), which was granted a license under the Knox-Keene Health Care Service Plan Act to operate as a healthcare service plan with waivers in California; Gluck Child Care Center (Gluck), a single member LLC that provides child care services; and Imaging Healthcare Specialists Holding Company (IHS), a single-member LLC and the holding company for Imaging Healthcare Specialists, which provides management services for radiology medical groups.

Horizon Hospice (Hospice) is a wholly-owned subsidiary and licensed provider of hospice services. Effective August 22, 2017, Scripps Health entered into a transition agreement with a regional hospice provider for the transfer of Scripps hospice patient care responsibilities.

The entities of Scripps Health are exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and from state income taxes under Section 23701(d) of the California Revenue and Taxation Code. As single-member limited liability companies, IHS and Gluck are subject to a California annual limited liability company tax.

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 (U.S. 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 estimates 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.

2. Summary of Significant Accounting Policies (continued)

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 $8,534,000 and $3,025,000 at September 30, 2018 and 2017, respectively, are included in other current assets. Adjustments from the finalization of prior year cost reports and changes in estimates recognized by the Organization as net patient service revenue were $2,001,000 and $17,636,000 for the years ended September 30, 2018 and 2017, 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.

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

2. Summary of Significant Accounting Policies (continued)

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 increased as a percentage of self-pay accounts receivable from $36,710,000 or 21.0% at September 30, 2017 to $41,461,000 or 28.3% at September 30, 2018, due to slower cash collections of self-pay payors. In addition, the Organization's self-pay write-offs were $39,652,000 and $42,368,000 for fiscal years 2018 and 2017. The Organization had no changes in its charity care or uninsured discount policies in fiscal year 2018 or 2017. 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 2018 or 2017.

Patient service and capitation premium revenue recognized for the years ended September 30 are as follows (in thousands):

	2018	2017
Government	$ 706,765	$ 681,653
Contracted	1,442,137	1,435,417
Self-pay and others	139,793	107,562
Patient service revenue, net of contractual allowances and discounts	2,288,695	2,224,632
Provider fee	241,538	41,804
Provision for bad debts	(44,399)	(47,632)
Net patient service revenue	2,485,834	2,218,804
Commercial capitation premium revenue	237,784	196,240
Senior capitation premium revenue	354,774	336,691
Capitation premium revenue	592,558	532,931
Total patient service and capitation premium revenue	$ 3,078,392	$ 2,751,735

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 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

The State of California enacted legislation for a hospital fee program to fund certain Medi-Cal coverage expansions. The program charges hospitals a quality assurance fee that is used to obtain federal matching funds for Medi-Cal with the proceeds redistributed as supplemental payments to California hospitals that treat Medi-Cal patients. There are two hospital fee programs that had activity in 2017 and 2018: a 36-month hospital fee program covering the period from January 1, 2014 through December 31, 2016, and a 30-month hospital fee program covering the period from January 1, 2017 through June 30, 2019. Historically, the Organization's policy was to record revenue and expense upon approval of the program. During 2018, the Organization determined that, for all hospital fee programs through 2018, the supplemental payments met all criteria related to revenue recognition and the quality assurance fees are both probable and estimable. Accordingly, all related supplemental payments have been recognized as revenue and related quality assurance fees have been recognized as expense as of September 30, 2018. Federal and state payments received from these programs are included as provider fee revenue in net patient

2. Summary of Significant Accounting Policies (continued)

revenue, and fees paid or payable to the state and California Health Foundation and Trust (CHFT) are included in provider fee expense in operating expenses. The Organization recorded a net benefit of $55,253,000 during 2018, with $20,401,000 from the 36-month program, and $34,852,000 from the 30-month program.

Provider fee program revenue recorded for the years ended September 30 is summarized below (in thousands):

	2018	2017
Provider fee revenue	$ 241,538	$ 41,804
Provider fee expense	(183,990)	(36,368)
CHFT fee	(2,295)	(90)
Net operating income from provider fee	$ 55,253	$ 5,346

Management Service Revenue

The Organization's wholly-owned subsidiary, IHS, has a management service agreement with IHS Radiology Medical Group, Inc. in which IHS provides management and administrative services for radiology medical groups. The Organization recorded management service revenue of $39,178,000 and $38,214,000 for the years ended September 30, 2018 and 2017, respectively.

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 (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 (nontrusteed), the contribution is recognized in the period in which the Organization becomes aware of the arrangement. The assets are recorded

2. Summary of Significant Accounting Policies (continued)

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 discount rates that range between 2.01% to 7.50% at September 30, 2018 and 2017, respectively. The fair value of the trusteed arrangements is $25,818,000 and $24,921,000 as of September 30, 2018 and 2017, respectively, and is included in assets limited as to use, noncurrent. The net present value of the related liabilities is $10,637,000 and $10,977,000 as of September 30, 2018 and 2017, respectively, and is included in other liabilities.

The net beneficial interest in nontrusteed arrangements is $4,497,000 and $4,065,000 as of September 30, 2018 and 2017, respectively, and is included in assets limited as to use, noncurrent.

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 nonoperating 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 at net asset value, with the related changes in value reported in earnings as investment income.

Inventory

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

2. Summary of Significant Accounting Policies (continued)

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. 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. All of the Organization's capitalized software represents development costs for software that is intended for its internal use. Direct costs of time and material incurred for the development of application software for internal use are capitalized and depreciated using the straight-line method over the estimated useful life of the software, ranging from 3 to 12 years. Costs incurred for upgrades and enhancements that do not result in additional functionality are expensed as incurred.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of net assets acquired. Goodwill is recorded for Scripps Medical Foundation (SMF) and IHS and is evaluated annually for potential impairment (see Note 9).

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 recorded as a direct deduction from the debt liability and amortized over the term of the debt using the effective-interest method.

2. Summary of Significant Accounting Policies (continued)

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 nonoperating gains 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.

Temporarily restricted contributions are generally limited for time or 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.

2. Summary of Significant Accounting Policies (continued)

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, 2018 and 2017, was $27,401,000 and $28,804,000, respectively, and is included in accrued liabilities in the accompanying consolidated statements of financial position.

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 Standards Codification Topic (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 nonoperating 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):

	2018	2017
Total interest costs incurred	$ 29,837	$ 29,331
Less capitalized interest	(3,214)	(4,838)
	$ 26,623	$ 24,493

2. Summary of Significant Accounting Policies (continued)

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 non-controlling interest is recorded in unrestricted net assets.

When there is no 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.

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 nonoperating. Nonoperating gains and losses include gifts, grants, and bequests not restricted by donors; investment income; realized and unrealized gains and losses on trading securities; and market adjustments on interest rate swaps. 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

2. Summary of Significant Accounting Policies (continued)

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, 2018 or 2017.

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 2014 in major tax jurisdictions.

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 10, and the fair value of assets limited as to use and investments is disclosed in Note 16.

Adoption of Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which will supersede virtually all revenue recognition guidance in U.S. 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 U.S. 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. Effective October 1, 2018, the Organization adopted the provisions ASC 606. ASC 606 is a single comprehensive principles-based standard through the application of a five-step process. The adoption of the provisions of this ASC has no impact on the Organization's current or historical financial position, results of operations or cash flows and Management does not believe it will impact the amount or timing of revenue recognition prospectively.

2. Summary of Significant Accounting Policies (continued)

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. This update addresses the following eight specific cash flows issues: debt prepayments or debt extinguishment costs, settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies (including bank-owned life insurance policies), distributions received from equity method investees, beneficial interests in securitization transactions, and separately identifiable cash flows and applications of the predominance principle. The amendments in this update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The adoption of ASU 2016-15 is not expected to have a material impact on the Organization's consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, a new accounting standard that amends the accounting and disclosures of financial instruments, including a provision that requires equity investments (except for investments accounted for under the equity method of accounting) to be measured at fair value, with changes in fair value recognized in current earnings. The new standard is effective for interim and annual periods beginning after December 15, 2018. The Organization is currently evaluating the impact of this new standard on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash, which amends ASC 230 Statement of Cash Flows* to add or clarify guidance on the classification and presentation of restricted cash on the statement of cash flows. The standard will require an entity to include in its cash and cash equivalent balances on the statement of cash flows those amounts that are deemed to be restricted cash and restricted cash equivalents as well as to disclose a reconciliation between the statement of financial position and the statement of cash flows when the statement of financial position includes more than one line item for cash, cash equivalents, restricted cash, and restricted cash equivalents. ASU 2016-18 is effective for fiscal years beginning after December 15, 2017. The Organization does not anticipate that the implementation will have a material impact on the consolidated financial statements.

2. Summary of Significant Accounting Policies (continued)

In January 2017, the FASB issued ASU 2017-04, *Intangibles, Goodwill and other (Topic 350) – Simplifying the Test for Goodwill Impairment*. ASU 2017-04 eliminates the requirement to calculate the implied fair value of goodwill (i.e., Step 2 of the current goodwill impairment test) to measure a goodwill impairment charge. Instead, entities will record an impairment charge based on the excess of a reporting unit's carrying amount over its fair value (i.e., measure the charge based on the current Step 1). ASU 2017-04 is effective for annual and any interim impairment test for periods beginning after December 15, 2019, with early adoption permitted. The Organization adopted ASU 2017-04 in 2018. The adoption of ASU 2017-04 did not have material impact on the Organization's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU 2016-02 amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. The new standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. The amendments in this update are effective for fiscal years (and interim reporting periods within fiscal years) beginning after December 15, 2018. The Organization will adopt the new standard effective October 1, 2019, with a modified retrospective approach. Early adoption of the amendments is permitted for all entities. The Organization is currently evaluating the impact of this new standard on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements for Not-for-Profit Entities*, which will require not-for-profit entities to revise financial presentation to include net asset classifications, provide quantitative and qualitative information as to available resources and management of liquidity and liquidity risk, information on investment expenses and returns, and the presentation of operating cash flows. The standard aims to help the reader of the financial statements to better understand the financial position of the organization and enhance consistency among similar organizations. ASU 2016-14 is effective for annual periods beginning after December 15, 2017. Early adoption is permitted. Effective October 1, 2018, the Organization adopted ASU 2016-14. The adoption of ASU 2016-14 did not have a material impact on the Organization's consolidated financial statements.

The FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958)*: *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made.* ASU 2018-08 clarifies and improves the scope and accounting guidance for contributions received and contributions made. The ASU assists not for profit entities in evaluations whether transactions should be

2. Summary of Significant Accounting Policies (continued)

accounted for as contributions (nonreciprocal transactions) within the scope of ASC 958, *Not-for-Profit Entities*, or as exchange (reciprocal) transactions subject to other guidance and whether the contribution is conditional. The amendments in this update are effective for fiscal year (and interim reporting periods within fiscal years) beginning after June 15, 2018. Early adoption is permitted. The Organization adopted the new standard effective October 1, 2018, with a modified prospective approach. A modified prospective approach is applied to agreements that are either (a) not completed as of the effective date or (b) entered into after the effective date. The adoption of ASU 2018-08 did not have a material impact on the Organization's consolidated financial statements.

3. Patient Accounts Receivable

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

	2018	2017
Government	54%	48%
Contract	37	41
Self-pay and other	9	11

The Organization believes there is no significant credit risk associated with receivables from government programs. Receivables from health maintenance organizations, preferred provider organizations, 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 $17,988,000 and $19,015,000 for the years ended September 30, 2018 and 2017, respectively. Charity care is calculated based on a ratio of cost to gross charges. Estimated costs for which the Organization is underreimbursed by various state and county indigent programs (unaudited) were $111,236,000 and $102,316,000 for the years ended September 30, 2018 and 2017, respectively, net of Medi-Cal disproportionate share receipts (unaudited) of $18,333,000 and $28,460,000 for the years ended September 30, 2018 and 2017, respectively.

3. Patient Accounts Receivable (continued)

Funds received to offset costs of underreimbursed Medi-Cal from the Provider Fee program (unaudited) were $55,253,000 and $5,346,000 for the years ended September 30, 2018 and 2017, respectively. Unpaid costs of Medicare (unaudited) were $303,672,000 and $275,147,000 for the years ended September 30, 2018 and 2017, respectively.

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 risk-sharing arrangements of $11,567,000 and $14,580,000 as of September 30, 2018 and 2017, 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):

	2018	2017
Provider fee receivable/prepaid	$ 51,223	$ 34,342
Inventory	47,507	45,280
Accounts receivable – other	32,790	26,769
Prepaid expenses	21,622	19,658
Third-party settlements	8,463	3,025
Management fee receivable	6,928	8,627
Contract accounts receivable	5,140	5,315
Disproportionate share hospital receivable	4,214	5,740
Medicare Access and CHIP Reauthorization Act (MACRA)	4,000	–
Prepaid insurance	1,275	1,366
Deposits	839	695
Meaningful use receivable	–	1,388
	$ 184,001	$ 152,205

5. Assets Limited as to Use

The following is a summary of assets limited as to use at September 30 (in thousands):

	2018	2017
Assets included in restricted net assets	$ 168,506	$ 168,587
Charitable trusts and life estate tenancies	30,333	29,121
Investments held by trustees for debt service	71,200	22,459
Assets held in trust for supplemental retirement plan	358	7,974
Other assets limited as to use	333	333
	270,730	228,474
Less amounts held by trustees for debt service required to pay current liabilities	(71,184)	(12,557)
	$ 199,546	$ 215,917

6. Property and Equipment

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

	Estimated Useful Lives	2018	2017
Land	–	$ 112,419	$ 112,419
Buildings and improvements	5 to 40 years	1,755,548	1,704,860
Leasehold improvements	5 to 15 years	94,247	92,650
Equipment	5 to 15 years	1,055,911	1,054,575
Capitalized software	1 to 12 years	456,238	378,584
Construction- and software-in-progress	–	128,769	90,960
Capital lease equipment	5 years	20,455	20,686
		3,623,587	3,454,734
Less accumulated amortization and depreciation		(1,807,617)	(1,686,196)
Property and equipment, net		$ 1,815,970	$ 1,768,538

Depreciation expense was $170,777,000 and $161,163,000 for the years ended September 30, 2018 and 2017, respectively.

6. Property and Equipment (continued)

Construction-in-progress at September 30, 2018 and 2017, is related to various construction and information technology projects. As of September 30, 2018, there is approximately $154,100,000 (unaudited) of outstanding commitments to complete projects in progress.

7. Other Assets

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

	2018	2017
Provider fee receivable	$ 65,510	$ –
Goodwill, net	41,303	41,303
Cash surrender value of life insurance, net	20,707	18,955
Pledges receivable, net	12,505	16,915
Malpractice reinsurance receivable	6,207	7,462
Workers' compensation reinsurance receivable	6,199	8,499
Intangible assets, net	3,865	4,482
Real estate held for resale	1,460	3,333
Prepaid insurance contracts	1,136	2,568
Other	1,757	2,287
	$ 160,649	$ 105,804

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

	2018	2017
Unconditional promises to give	$ 14,978	$ 20,015
Less allowance for uncollectible pledges	(1,253)	(1,767)
Less unamortized discount	(1,220)	(1,333)
Pledges receivable, net	$ 12,505	$ 16,915
Amounts due in:		
Less than one year	$ 7,140	$ 9,213
One to five years	3,468	5,940
More than five years	1,897	1,762
Total	$ 12,505	$ 16,915

7. Other Assets (continued)

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 0.23% to 6.78%.

8. Accrued Liabilities

At September 30, accrued liabilities were comprised of the following (in thousands):

	2018	2017
Accrued payroll and related payroll liabilities	$ 118,766	$ 116,572
Accrued retirement plan liabilities	36,530	31,726
Due to medical groups, net	30,329	26,839
Accrued health insurance claims and reserves	27,401	28,804
Swap hedge	13,202	20,080
Third party risk pool liabilities	11,567	14,431
Accrued malpractice insurance claims and reserves	11,505	12,277
Deferred revenue	10,371	17,739
Accrued interest payables	10,311	10,638
Accrued group health insurance claims and reserves	6,254	6,196
Accrued workers compensation claims and reserves	5,955	6,118
Other	22,548	21,459
	$ 304,739	$ 312,879

9. Intangible Assets

Intangible Assets (Including 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 IHS. No goodwill impairment was recorded during 2018 or 2017. The balance in goodwill is $65,180,000 as of September 30, 2018 and 2017.

10. Debt

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

	2018	2017
Tax-exempt bonds sponsored by the California Health Facilities Financing Authority (CHFFA):		
Fixed rate bonds:		
Series 2017 A, principal due in varying annual installments through October 2031; interest payable semiannually at a fixed rate of 2.07% (including unamortized debt issuance costs of $426 at September 30, 2018)	$ 159,574	$ 159,530
Series 2016 A, principal due in varying annual installments through October 2025; interest payable at a fixed rate of 1.44% (including unamortized debt issuance costs of $90 at September 30, 2018)	44,970	47,303
Series 2016 B, principal due in varying annual installments through October 2025; interest payable semiannually at a fixed rate of 1.84% (including unamortized debt issuance costs of $226 at September 30, 2018)	79,774	89,736
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 $9,404 and unamortized debt issuance costs of $1,174 at September 30, 2018)	183,231	183,707
Series 2010 A, principal due in varying annual installments through November 2036; interest payable at a fixed rate of 5.00%, adjusting annually (including unamortized discount of $325 and unamortized debt issuance costs of $473 at September 30, 2018)	104,913	107,897
Series 2008 A, principal due in varying annual installments through October 2022; interest payable at a fixed rate of 5.10%, adjusting annually (including unamortized premium of $107 and unamortized debt issuance costs of $63 at September 30, 2018)	69,450	79,986

10. Debt (continued)

	2018	2017
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 1.13% during the period from October 1, 2017 through September 30, 2018 (1.24% at September 30, 2018, including unamortized debt issuance costs of $718 at September 30, 2018)	$ 99,282	$ 99,249
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 1.14% during the period from October 1, 2017 through September 30, 2018 (1.24% at September 30, 2018, including unamortized debt issuance costs of $1,464 at September 30, 2018)	98,536	98,484
Series 2008 G, principal due in varying annual installments through October 2019; interest payable weekly, at a variable rate averaging 1.14% during the period from October 1, 2017 through September 30, 2018 (1.24% at September 30, 2018)	3,650	6,893
Series 2001 A, principal due in varying annual installments through October 2023; interest payable monthly, at a variable rate averaging 1.16% during the period from October 1, 2017 through September 30, 2018 (1.17% at September 30, 2018)	11,100	11,100

10. Debt (continued)

	2018	2017
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 1.15% during the period from October 1, 2017 through September 30, 2018 (1.22% at September 30, 2018)	$ 49,995	$ 49,995
Taxable term loan, principal due in varying annual installments commencing in 2019 through October 1, 2025, interest payable at fixed rate of 2.31% per annum	50,000	50,000
Total fixed and variable rate debt	954,475	983,880
Obligations under capital leases	6,215	7,841
Line of credit	35,976	35,976
Other notes payable	304	177
Total debt	996,970	1,027,874
Less current liabilities	182,852	33,270
Total long-term debt	$ 814,118	$ 994,604

10. Debt (continued)

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, 2017 (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, bond series 2001A, 2007A, and 2008G are secured by credit facilities (principally letters of credit) issued by various banking institutions. At September 30, 2018, amounts available under the credit facilities issued total approximately $65,754,000. The credit facilities generally fund both principal and interest 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 2018 or 2017. Scheduled principal repayments of long-term debt for the next five fiscal years and thereafter are as follows (in thousands):

2019	$ 91,489
2020	70,966
2021	34,192
2022	34,595
2023	35,446
Thereafter	730,282
	$ 996,970

In February 2018, the Organization converted $100,000,000 of the 2010B-C tax-exempt bonds from credit enhanced liquidity to self-liquidity bonds. As part of this transition, the JP Morgan letter of credit (LOC) supporting the 2010B bonds and the Northern Trust LOC supporting the 2010C bonds were both terminated effective February 28, 2018. Accordingly, $91,362,000 of the Organization's variable rate demand bonds was classified as current liabilities in accordance with FASB ASC 470, *Debt*, after consideration of the terms of the related liquidity facilities if draws were to occur in accordance with FASB ASC 210, *Short-Term Obligations-Balance Sheet*.

In January 2017, the Organization issued Series 2017 A bonds in the amount of $160,000,000, which were used to advance refund the Series 2008 B-F bonds.

10. Debt (continued)

In September 2018, the Organization exercised its option to prepay and redeem Series 2008A bonds maturing on October 1 of the years 2019, 2020, 2021, and 2022 on October 1, 2018, in the principal amount of $69,405,000, without premium, together with interest accrued to October 1, 2018 (redemption date). Accordingly, $58,100,000 has been reclassed from long-term debt to current portion at September 30, 2018. To facilitate this redemption, the Organization wired $61,153,000 to a trustee-held fund on September 28, 2018.

Bond reserve funds are used to fund principal and interest payments. At September 30, 2018 and 2017, bond reserve funds held by trustees were $71,200,000 and $22,459,000, 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 index.

The Organization is party to six interest rate swap agreements with an aggregate current notional amount of $125,650,000 to convert a portion of the variable interest rate bonds to fixed rate debt. Under the interest rate swap agreement for the Series 2008 G bonds, with a current notional amount of $3,650,000, the Organization pays a fixed amount of 3.086% and receives a floating rate of 54.70% of London Interbank Offered Rates (LIBOR) plus 0.32%. Under the interest rate swap agreements for the Series 2010 B-C and 2012 B 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 54.70% of LIBOR plus 0.32%. The Organization has the right to terminate the agreements prior to maturity, and the counterparty has the right to terminate under certain events of default. At September 30, 2018 and 2017, the fair value of these swap agreements was recorded in the accompanying consolidated statements of financial position at $13,202,000 and $20,080,000, respectively, in accrued liabilities.

The Organization has no restricted collateral held for the swap counterparty at September 30, 2018 or 2017.

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.

10. Debt (continued)

The Organization maintains a credit facility arrangement that includes revolving lines of credit totaling $150,000,000. There was $35,976,000 outstanding under this revolving line of credit at September 30, 2018 and 2017. No amounts are due and payable under this line of credit until the expiration date of January 31, 2020. There are two letters of credit issued under this facility totaling $5,386,000 at September 30, 2018. As of September 30, 2018, no funds have been drawn on these letters. The CHFFA 2010 B-C and 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 $967,315,000 and $1,010,958,000 at September 30, 2018 and 2017, respectively. Long-term debt obligations are considered to be in Level 2 (see Note 16) of the fair value hierarchy.

11. Other Liabilities

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

	2018	2017
Provider fee	$ 35,379	$ –
Accrued liability for workers' compensation, net of current portion of $5,955 and $6,118 in 2018 and 2017, respectively	31,727	35,730
Asset retirement	15,987	15,392
Accrued liability for professional and general liability self-insurance, net of current portion of $5,333 and $5,792 in 2018 and 2017, respectively	14,907	17,476
Deferred rent liability	13,018	13,829
Supplemental executive retirement plan liability	–	12,080
Accrued liability for physician malpractice, net of current portion of $5,774 and $6,087 in 2018 and 2017, respectively	11,820	9,942
Annuity/unit trust liabilities	10,637	10,977
Other	232	3,090
	$ 133,707	$ 118,516

11. Other Liabilities (continued)

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 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 $15,987,000 and $15,392,000 at September 30, 2018 and 2017, respectively, which reflects the future value, discounted at an annual rate of 3.5% for 2018 and 2017, of the estimated asbestos removal and disposal liability.

12. Retirement Plans

Defined Contribution Savings Plan (401(a) 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 service. 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 $39,417,000 and $38,651,000 in 2018 and 2017, respectively.

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. 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. In December 2017, the Board voted to approve termination of SERP plan. On December 29, 2017, a $6,874,000 was paid out to participants.

12. Retirement Plans (continued)

The assets are invested in a Rabbi Trust and are not included in plan assets. As a result, the Plan is unfunded.

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

	2018	2017
Change in benefit obligation:		
Obligation at beginning of year	$ 14,061	$ 14,672
Benefit payments	(8,218)	(635)
Interest cost	173	229
Experience (gain) loss:		
Census data	460	–
Discount rate change	68	(167)
Other assumption change	–	(38)
Obligation at end of year	$ 6,544	$ 14,061

The amount of net pension liability recognized as current liabilities in the consolidated statements of financial position is $6,544,000 and $1,981,000 as of September 30, 2018 and 2017, respectively.

12. Retirement Plans (continued)

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

	2018	2017
Assumption used to determine benefit obligations:		
Discount rate	0.00%	2.10%
Rate of compensation increase	n/a	n/a
Assumption used to determine net periodic cost:		
Discount rate	2.10%	1.60%
Rate of compensation increase	n/a	n/a
Average future working lifetime (years)	1.75	2.50
Estimated future benefit payments (in thousands):		
Year 1	$ 6,544	$ 2,001
Year 2	–	4,348
Year 3	–	4,348
Year 4	–	2,558
Year 5	–	64
Years 6–10	–	1,466

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

Executive Deferred Compensation Plan

The Organization has 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 CSV of the life insurance contracts, which can be drawn by the executives from ages 65 to 81. Once the insurance contracts mature, Scripps will receive accumulated death benefits less amounts due to each beneficiary under the Agreements.

12. Retirement Plans (continued)

The Organization has recorded $1,136,000 and $2,568,000 as prepaid insurance contracts and $19,806,000 and $16,593,000 of cash surrender value in other assets as of September 30, 2018 and 2017, respectively, in the accompanying consolidated statements of financial position. The Organization recorded $493,000 benefit and $1,412,000 of compensation expense in 2018 and 2017, respectively, related to the Agreements.

13. 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 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 $75,000,000 per occurrence, subject to a $75,000,000 aggregate. The provision for estimated self-insured professional liability claims includes estimates of the ultimate liability and defense costs for both reported claims and incurred but not reported claims. There is also an additional $25,000,000 per occurrence and aggregate coverage for catastrophic premises 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 aggregate and additional excess policies in the amount of $100,000,000 per occurrence and aggregate.

13. Risk Management and Contingencies (continued)

SHPS is insured for managed care liability through a primary policy with limits of $5,000,000 per occurrence and $5,000,000 annual aggregate and is insured through excess policies for an additional $75,000,000 per occurrence and $75,000,000 aggregate.

Scripps Clinic is insured for professional liability through a master policy with Scripps Clinic Medical Group (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 annual aggregate subject to a self-insured retention of $500,000 per claim and $2,900,000 annual 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 Centers are 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 insured in the entity coverage for SCMG with limits of $1,000,000 per occurrence and $5,000,000 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.

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 be 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

13. Risk Management and Contingencies (continued)

is not aware of any significant allegations of potential wrongdoing, other than as disclosed here. The Organization has received, and is in the process of responding to, requests from governmental agencies that may include the California Department of Public Health and the Office of Civil Rights. 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.

The Organization is the object of a putative class action lawsuit alleging that the Organization has failed to follow state wage and hour laws regarding payment to employees. The Organization will vigorously defend the claims. An estimate of the possible loss or range of loss cannot be made; however, management does not believe the liability relating to these claims will result in a material impact to the consolidated financial statements.

Seismic Standards (Unaudited)

The state of California issued seismic safety standards (SB1953) in 1994 that 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 Hazards US (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 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 extended compliance to 2030. The Organization expended $35,512,000 (unaudited) to complete all remediation work to meet HAZUS and SB499 requirements.

13. Risk Management and Contingencies (continued)

Subsequent to accomplishing the above tasks related to seismic safety, the state of California adopted a new seismic safety standard, called SPC-4D. SPC-4D is a new performance category that will allow hospitals the possibility of upgrading some current SPC-1 and SPC-2 buildings to a new performance level that is not as rigorous as the current requirement to upgrade to SPC-5. Under SPC-4D, buildings undergoing a retrofit to this level can continue functioning indefinitely (beyond 2030). Investigatory and design work is progressing to establish the viability of applying the SPC-4D regulations to the Organization's campuses. Details, analytical data, and design information is being discussed with the authority having jurisdiction, the California Office of Statewide Health Planning and Development, to approve, in concept, the planned solutions.

In addition, several of the buildings that require compliance with SB1953 are likely to be demolished rather than upgraded as new inpatient facilities are proposed. Scripps Health is in the early stages of these master plan site evaluations and replacement solutions.

14. 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 approximately $30,659,000 and $32,496,000 in 2018 and 2017, respectively. The following is a schedule of future minimum lease payments as of September 30, 2018, under operating leases that have initial or remaining terms in excess of one year (in thousands):

	Facilities	Equipment	Total
2019	$ 29,847	$ 62	$ 29,909
2020	28,725	–	28,725
2021	23,969	–	23,969
2022	16,789	–	16,789
2023	14,583	–	14,583
Thereafter	55,907	–	55,907
	$ 169,820	$ 62	$ 169,882

15. Temporarily and Permanently Restricted Net Assets

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

	2018	2017
Healthcare operations – specific purpose	$ 26,513	$ 28,386
Research	32,333	33,016
Building, construction, and equipment	20,202	16,801
Deferred gifts, available for use in future periods	17,292	17,307
Education	14,898	14,585
Indigent care	5,877	5,632
	$ 117,115	$ 115,727

During 2018 and 2017, temporarily restricted net assets of $50,387,000 and $56,821,000, 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):

	2018	2017
Healthcare operations – specific purpose	$ 38,757	$ 44,273
Education	16,791	16,791
Research	12,225	12,225
Indigent care	12,785	12,785
Building, construction and equipment	636	636
Deferred gifts, the income from which will be available for use in future periods	1,061	913
	$ 82,255	$ 87,623

15. Temporarily and Permanently Restricted Net Assets (continued)

Endowments

The Organization's endowments consist of 88 individual funds for 2018 and 2017, 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.

California Senate Bill No. 1329 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.

15. 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 4% (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.

15. Temporarily and Permanently Restricted Net Assets (continued)

Changes in endowment net assets for the year ended September 30, 2018, are as follows (in thousands):

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets as of September 30, 2017	$ 37,218	$ 87,623	$ 124,841
Investment return:			
Investment income	2,181	–	2,181
Net appreciation (realized and unrealized)	4,309	–	4,309
Total investment return	6,490		6,490
Contributions	–	711	711
Appropriation of endowment assets for expenditure	(6,574)	–	(6,574)
Other changes	–	(6,079)	(6,079)
Endowment net assets as of September 30, 2018	$ 37,134	$ 82,255	$ 119,389

In February 2018, the Organization transferred an endowment to another organization as the Organization no longer provided the services for which the monies were donated to support. This transfer included $5,000,000 of corpus and $2,330,000 of undistributed accumulated investment earnings thereon.

15. Temporarily and Permanently Restricted Net Assets (continued)

Changes in endowment net assets for the year ended September 30, 2017, are as follows (in thousands):

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets as of September 30, 2016	$ 29,019	$ 87,305	$ 116,324
Investment return:			
Investment income	1,737	–	1,737
Net appreciation (realized and unrealized)	11,274	–	11,274
Total investment return	13,011	–	13,011
Contributions	–	294	294
Appropriation of endowment assets for expenditure	(4,812)	–	(4,812)
Other changes	–	24	24
Endowment net assets as of September 30, 2017	$ 37,218	$ 87,623	$ 124,841

16. 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 as follows:

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.

16. Fair Value Measurements (continued)

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, real estate held for sale, 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, 2018 or 2017.

Assets and liabilities measured at fair value are based on one or more of the three valuation techniques. 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) 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).

16. Fair Value Measurements (continued)

The following represents financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2018 (in thousands). Alternative investments are accounted for using net asset value (NAV) of accounting, which is not a fair value measurement.

		Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	NAV	Valuation Technique (a,b)
Investments					
Liquid investments:					
Cash equivalents	$ 76,659	$ 76,659	$ –	$ –	a
Equity securities:					
U.S. equity	562,681	562,681	–	–	a
Foreign equity	433,558	433,558	–	–	a
Foreign equity (commingled)	288,122	-	288,122	–	a
	1,284,361	996,239	288,122	–	
Fixed income securities:					
U.S. government	68,359	–	68,359	–	a
U.S. government agencies	7,042	–	7,042	–	a
U.S. federal agency mortgage-backed	70,514	–	70,514	–	a
U.S. corporate	440,783	–	440,783	–	a
U.S. corporate (commingled)	242,536	–	242,536	–	a
Foreign corporate	12,189	–	12,189	–	a
	841,423	–	841,423	–	
Other investments:					
Multi-strategy hedge funds	325,408	–	–	325,408	
Private equity funds	56,290	–	–	56,290	
Defensive equity funds	47,198	–	–	47,198	
Real estate	6,809	–	6,809	-	a
	435,705	–	6,809	428,896	
Total investments	2,638,148	1,072,898	1,136,354	428,896	
Other assets:					
Real estate held for sale	1,460	–	1,460	–	a
Total assets	$ 2,639,608	$ 1,072,898	$ 1,137,814	$ 428,896	
Current liabilities:					
Swap hedge	$ 13,202	$ –	$ 13,202	$ –	b
Other liabilities:					
Annuity/unitrust liabilities	10,637	–	10,637	–	b
Total liabilities	$ 23,839	$ –	$ 23,839	$ –	

16. Fair Value Measurements (continued)

The following represents financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2017 (in thousands). Alternative investments are accounted for using NAV, which is not a fair value measurement.

		Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	NAV	Valuation Technique (a,b)
Investments					
Liquid investments:					
Cash equivalents	$ 23,270	$ 23,270	$ –	$ –	a
Equity securities:					
U.S. equity	546,306	546,306	–	–	a
Foreign equity	431,779	431,779	–	–	a
Foreign equity (commingled)	236,952	–	236,952	–	a
	1,215,037	978,085	236,952	–	
Fixed income securities:					
U.S. government	60,132	–	60,132	–	a
U.S. government agencies	6,134	–	6,134	–	a
U.S. federal agency mortgage-backed	57,024	–	57,024	–	a
U.S. corporate	471,026	–	471,026	–	a
U.S. corporate (commingled)	245,745	–	245,745	–	a
Foreign corporate	16,326	–	16,326	–	a
	856,387	–	856,387	–	
Other investments:					
Multi-strategy hedge funds	391,231	–	–	391,231	
Private equity funds	49,089	–	–	49,089	
Real estate	6,809	–	6,809	–	a
	447,129	–	6,809	440,320	
Total investments	2,541,823	1,001,355	1,100,148	440,320	
Other assets:					
Real estate held for sale	$ 3,333	–	3,333	–	a
Total assets	$ 2,545,156	$ 1,001,355	$ 1,103,481	$ 440,320	
Current liabilities:					
Swap hedge	$ 20,080	$ –	$ 20,080	$ –	b
Other liabilities:					
Annuity/unitrust liabilities	10,977	–	10,977	–	b
Total liabilities	$ 31,057	$ –	$ 31,057	$ –	

16. Fair Value Measurements (continued)

Transfers to/from Levels 1 and 2 are recognized at the end of the reporting period. There were no transfers for the years ended September 30, 2018 or 2017.

As of September 30, 2018 and 2017, the Level 2 instruments listed in the fair value hierarchy table above use the following valuation techniques and inputs:

U.S. Government Securities

The fair value of investments in U.S. 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 – Investments and Held for Sale

The fair values of the real estate investments and real estate held for sale were classified as Level 2 and were 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.

Annuity/Unitrust Liabilities

The fair value of the 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.

16. Fair Value Measurements (continued)

Commingled Funds

The fair value of commingled fund investments classified as Level 2 was determined using fair value. 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.

Included within the assets above are investments in certain entities that report fair value. The following table (dollar figures in thousands) and explanations identify attributes relating to the nature and risk of such investments:

	September 30, 2018	Unfunded Commitments	Redemption Frequency (if Currently Eligible)	Redemption Notice Period
Commingled:				
Equity securities[1]	$ 288,122	$ –	Monthly	10 days
Fixed income securities[2]	242,536	–	Daily	15 days
	$ 530,658	$ –		
Alternative investments:				
Hedge funds[3]	$ 325,408	$ –	Monthly to Biannually	45 to 120 days
Private equity[4]	56,290	39,245	N/A	N/A
Defensive equity [5]	47,198	–	Monthly	
	$ 428,896	$ 39,245		

16. Fair Value Measurements (continued)

(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 monthly basis.

(2) Commingled funds: Fixed income – This category includes investments in one commingled fund 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 basis. As of September 30, 2018, the category consisted of 100% daily liquidity.

(3) Hedge funds – This category includes investments in 13 multi-strategy funds with underlying investments that are fair value estimates determined by a third-party administrator 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 monthly, quarterly, biannual, and annual basis. As of September 30, 2018, the category consisted of 38.5% monthly liquidity, 46.2% quarterly liquidity, 7.7% annual liquidity, and 7.7% biannual liquidity.

(4) Private equity – This category includes investments in five private equity funds with underlying investments that are fair value estimates determined either internally or by a third-party administrator 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. All funds have liquidity in excess of one year.

(5) Defensive equity – This category includes an investment in a defensive equity fund with underlying investments that are fair value estimates determined by a third-party administrator as of the end of each calendar month (or more frequently in the event that Interests are purchased or withdrawn intra-month), determined by its assets less its liabilities. The underlying investments consist primarily of money market funds and/or Cash; short term investments, including U.S. Treasuries and other high-quality government or corporate bonds; and written options. Liquidity is provided on a monthly basis.

17. 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.

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, 2018, 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.

18. 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 $11,254,000 and $10,605,000 in 2018 and 2017, respectively, and is included in other operating revenue in the consolidated statements of operations.

18. Rental Income (continued)

The following is a schedule of future minimum rentals to be received as of September 30, 2018, under operating leases that have initial or remaining terms in excess of one year (in thousands):

2019	$ 6,116
2020	5,426
2021	3,544
2022	2,732
2023	1,286
	$ 19,104

19. 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.

	2018	2017
Patient care services	$ 2,671,285	$ 2,510,882
Provider tax fee	186,285	36,458
General and administrative	290,699	295,988
Fundraising	9,051	8,678
Total operating expenses	$ 3,157,320	$ 2,852,006

20. Investment Income (Loss)

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

	2018	2017
Nonoperating gains:		
Interest income and dividends	$ 43,439	$ 33,094
Net realized gains on sale of investments	47,502	8,098
Realized gain on insurance contracts	1,780	1,618
Net unrealized gains on trading portfolio	39,776	234,006
	132,497	276,816
Other changes in net assets:		
Interest and dividends on temporarily restricted assets	2,342	1,895
Net realized gains on temporarily restricted net assets	3,160	2,628
Net unrealized gain on temporarily restricted net assets	2,183	10,386
	7,685	14,909
Total investment return	$ 140,182	$ 291,725

21. Subsequent Events

The Organization has evaluated subsequent events occurring between the end of the most recent fiscal year ended September 30, 2018 and December 14, 2018, the date the accompanying consolidated financial statements were issued.

Supplementary Information

Scripps Health and Affiliates

2018 Consolidating Statement of Financial Position

(In Thousands)

September 30, 2018

	Obligated Group	Hospice	SHPS	IHS	Gluck	Accountable Care	Joint Ventures	Eliminations	Consolidated
Assets									
Current assets:									
Cash and cash equivalents	$ 251,491	$ –	$ 115,292	$ 4,712	$ 190	$ –	$ 2,191	$ –	$ 373,876
Patient accounts receivable, net	421,403	1	1,439	–	–	–	2,801	(40,186)	385,458
Assets limited as to use	71,184	–	–	–	–	–	–	–	71,184
Other current assets	171,814	–	2,527	8,273	–	164	1,265	(42)	184,001
Total current assets	915,892	1	119,258	12,985	190	164	6,257	(40,228)	1,014,519
Assets limited as to use	198,038	–	303	–	1,205	–	–	–	199,546
Investments	2,367,418		–	–	–	–	–	–	2,367,418
Property and equipment, net	1,791,693	85	922	16,341	156	4,382	2,391	–	1,815,970
Other assets	213,575	–	–	10,698	–		2,588	(66,212)	160,649
Total assets	$ 5,486,616	$ 86	$ 120,483	$ 40,024	$ 1,551	$ 4,546	$ 11,236	$ (106,440)	$ 5,558,102
Liabilities and net assets									
Current liabilities:									
Current portion of debt	$ 182,674	$ –	$ –	$ –	$ –	$ –	$ 178	$ –	$ 182,852
Accounts payable	143,929	–	1,095	629	13	28	766	(22)	146,438
Accrued liabilities	259,769	357	81,665	2,179	153	225	577	(40,186)	304,739
Total current liabilities	586,372	357	82,760	2,808	166	253	1,521	(40,208)	634,029
Long-term debt, less current portion	813,990		–	–	–	–	128	–	814,118
Other liabilities	123,683	341	148	1,542	(686)	8,702	(3)	(20)	133,707
Total liabilities	1,524,045	698	82,908	4,350	(520)	8,955	1,646	(40,228)	1,581,854
Net assets (deficit):									
Unrestricted:									
Controlling interests	3,764,372	(612)	37,575	35,674	900	(4,409)	6,109	(66,212)	3,773,397
Non-controlling interests in subsidiaries	–	–	–	–	–		3,481	–	3,481
	3,764,372	(612)	37,575	35,674	900	(4,409)	9,590	(66,212)	3,776,878
Temporarily restricted	116,743	–	–	–	372	–	–	–	117,115
Permanently restricted	81,456	–	–	–	799	–	–	–	82,255
Total net assets (deficit)	3,962,571	(612)	37,575	35,674	2,071	(4,409)	9,590	(66,212)	3,976,248
Total liabilities and net assets	$ 5,486,616	$ 86	$ 120,483	$ 40,024	$ 1,551	$ 4,546	$ 11,236	$ (106,440)	$ 5,558,102

Scripps Health and Affiliates

2018 Consolidating Statement of Operations
(In Thousands)

Year Ended September 30, 2018

	Obligated Group	Hospice	SHPS	IHS	Gluck	Accountable Care	Joint Ventures	Eliminations	Consolidated
Unrestricted revenues, gains, and other support:									
Patient service revenue, net of contractual allowances and discounts	$ 2,553,958	$ 1,217	$ –	$ –	$ –	$ –	$ 20,243	$ (286,723)	$ 2,288,695
Provision for bad debts	(44,304)	–	–	–	–	–	(95)	–	(44,399)
Net patient service revenue less provision for bad debts before provider fee	2,509,654	1,217	–	–	–	–	20,148	(286,723)	2,244,296
Provider fee	241,538	–	–	–	–	–	–	–	241,538
Net patient service revenue	2,751,192	1,217	–	–	–	–	20,148	(286,723)	2,485,834
Capitation premium	159,307	–	660,232	–	–	–	–	(226,981)	592,558
Management services	–	–	–	39,178	–	–	–	–	39,178
Other	90,937	(214)	22,882	–	1,705	171	14	(11,953)	103,542
Net assets released from restrictions used for operations	21,887	3	–	–	45	–	–	(1)	21,934
Total operating revenues	3,023,323	1,006	683,114	39,178	1,750	171	20,162	(525,658)	3,243,046
Operating expenses:									
Wages and benefits	1,260,325	266	15,490	22,639	1,201	1,970	5,471	(69,549)	1,237,813
Supplies	509,966	(31)	150	2,221	111	31	7,221	(4,141)	515,528
Services	776,326	425	666,612	9,651	(13)	1,429	3,432	(451,968)	1,005,894
Provider fee	186,285	–	–	–	–	–	–	–	186,285
Depreciation and amortization	165,259	279	290	4,296	8	133	640	–	170,905
Interest	26,273	–	272	123	–	–	(6)	(39)	26,623
Restructuring	14,272	–	–	–	–	–	–	–	14,272
Total operating expenses	2,938,706	939	682,814	38,930	1,307	3,563	16,758	(525,697)	3,157,320
Operating income (loss)	84,617	67	300	248	443	(3,392)	3,404	39	85,726
Nonoperating gains (losses):									
Investment income	130,870	–	1,666	–	–	–	–	(39)	132,497
Contributions	4,313	–	–	–	–	–	–	–	4,313
Interest rate swaps	4,273	–	–	–	–	–	–	–	4,273
Excess (deficiency) of revenues over expenses	224,073	67	1,966	248	443	(3,392)	3,404	–	226,809
Less excess of revenues over expenses attributable to non-controlling interests	–	–	–	–	–	–	(1,346)	–	(1,346)
Excess (deficiency) of revenues over expenses attributable to controlling interests	$ 224,073	$ 67	$ 1,966	$ 248	$ 443	$ (3,392)	$ 2,058	$ –	$ 225,463

Scripps Health Plan Services

Statements of Financial Position
(In Thousands)

	September 30 2018	September 30 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 115,292	$ 116,863
Patient accounts receivable, net	1,439	6,754
Other current assets	2,527	1,765
Total current assets	119,258	125,382
Assets limited as to use	303	303
Property and equipment, net	922	1,131
Total assets	$ 120,483	$ 126,816
Liabilities and net assets		
Current liabilities:		
Accounts payable	$ 1,095	$ 618
Accrued liabilities	81,665	92,019
Other liabilities	148	1,070
Total current liabilities	82,908	93,707
Net assets:		
Unrestricted	37,575	33,109
Total liabilities and net assets	$ 120,483	$ 126,816

Scripps Health Plan Services

Statements of Operations and Change in Net Assets

(In Thousands)

	Year Ended September 30	
	2018	**2017**
Unrestricted revenues, gains, and other support:		
Capitation premium	$ 660,232	$ 581,914
Administrative fees from affiliate	15,180	15,667
Other	7,702	4,314
Total operating revenues	683,114	601,895
Operating expenses:		
Medical claims expenses, net	462,281	395,769
Capitated services	196,656	183,444
Wages and benefits	15,495	13,708
Administrative and other	7,521	5,214
Depreciation and amortization	290	331
Interest	272	347
Rent and utilities	299	1,212
Total operating expenses	682,814	600,025
Operating income	300	1,870
Nonoperating gains:		
Investment income	1,666	542
Excess of revenues over expenses	1,966	2,412
Transfers from affiliates	2,500	1,575
Net assets at beginning of year	33,109	29,122
Net assets at end of year	$ 37,575	$ 33,109

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