AUDITED COMBINED
FINANCIAL STATEMENTS

Members of the Hawai'i Pacific Health Obligated Group
Years Ended June 30, 2013 and 2012
With Report of Independent Auditors

Ernst & Young LLP

Members of the Hawai'i Pacific Health Obligated Group

Audited Combined Financial Statements

Years Ended June 30, 2013 and 2012

Contents

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Report of Independent Auditors

Board of Directors
Hawaii Pacific Health

We have audited the accompanying special-purpose combined financial statements of the Members of the Hawai'i Pacific Health Obligated Group (the Obligated Group), which comprise the special-purpose combined balance sheets as of June 30, 2013 and 2012, and the related special-purpose combined statements of unrestricted revenues, expenses, and other changes in net assets, and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements on the basis of the accounting requirements of the Hawaii Pacific Health Master Indenture between the Trustee and the Obligated Group described in Note 1; 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 combined 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 Obligated Group'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.

Ernst & Young

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 combined financial position of the Obligated Group at June 30, 2013 and 2012, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 1.

Basis of Accounting

As described in Note 1 to the financial statements, the financial statements have been prepared by the Obligated Group on the basis of the accounting requirements of the Master Trust Indenture, which is a basis of accounting other than U.S. generally accepted accounting principles, to comply with the financial reporting provisions of the Master Trust Indenture referred to above. Our opinion is not modified with respect to this matter.

Restriction on Use

Our report is intended solely for the information and use of management and the board of directors of the Obligated Group and Trustee under the Master Trust Indenture and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

October 22, 2013

Members of the Hawai'i Pacific Health Obligated Group

Combined Balance Sheets

	June 30	
	2013	**2012**
Assets		
Current assets:		
Cash and cash equivalents	**$ 73,696,999**	$ 46,186,747
Patient accounts receivable, less allowance for uncollectible accounts (2013 – $11,338,000; 2012 – $10,524,000)	**121,026,689**	104,151,930
Due from third party payors	**2,421,475**	–
Other receivables	**8,348,394**	6,422,050
Inventories	**13,669,151**	13,207,541
Funds held by trustee under bond indenture agreement	**14,282,685**	13,334,432
Prepaid expenses and other	**3,182,714**	3,254,663
Total current assets	**236,628,107**	186,557,363
Assets whose use is limited or restricted:		
Board-designated	**162,003,283**	146,903,065
Funds held by trustee under bond indenture agreement	**26,723,059**	27,703,532
Project funds held by trustee under bond indenture agreement	**2,833,612**	23,309,024
Restricted by donor or grantor	**48,450,146**	37,107,163
Total assets whose use is limited or restricted	**240,010,100**	235,022,784
Investments	**80,684,647**	46,309,290
Property and equipment, net	**323,528,920**	297,343,518
Other assets:		
Investment in unconsolidated subsidiaries	**34,676,323**	27,261,970
Investments in joint ventures	**25,000**	75,186
Beneficial interest in net assets of Foundations	**47,960,463**	45,138,379
Deposits and other	**10,794,281**	10,816,755
Total other assets	**93,456,067**	83,292,290
Total assets	**$ 974,307,841**	$ 848,525,245

	June 30	
	2013	**2012**
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 37,896,780**	$ 36,019,616
Payroll and related liabilities	**55,065,222**	46,117,456
Accrued expenses	**13,639,722**	14,863,684
Due to affiliates	**11,324,433**	3,215,771
Due to third party payors	**–**	1,464,117
Current portion of long-term debt	**7,333,364**	6,846,688
Total current liabilities	**125,259,521**	108,527,332
Long-term debt, less current portion	**249,826,484**	257,159,572
Other long-term liabilities	**28,947,824**	26,409,159
Accrued pension liability	**155,388,694**	194,426,000
Net assets:		
Unrestricted	**363,105,138**	221,830,783
Temporarily restricted	**39,109,706**	27,854,230
Permanently restricted	**12,670,474**	12,318,169
Total net assets	**414,885,318**	262,003,182
Total liabilities and net assets	**$ 974,307,841**	$ 848,525,245

See accompanying notes.

Members of the Hawai'i Pacific Health Obligated Group

Combined Statements of Unrestricted Revenues, Expenses and Other Changes in Net Assets

	Year Ended June 30	
	2013	**2012**
Unrestricted revenues		
Net patient service revenue	**$ 995,680,421**	$ 874,903,656
Provision for bad debts	**(27,299,918)**	(28,549,210)
Net patient service revenue less provision for bad debts	**968,380,503**	846,354,446
Premium revenue	**4,170,324**	3,875,763
Other revenues	**34,273,982**	39,683,453
Temporarily restricted net assets released from restrictions for operations	**9,683,002**	9,667,420
Total unrestricted revenues	**1,016,507,811**	899,581,082
Expenses		
Salaries and employee benefits	**544,385,334**	486,778,545
Services	**129,811,070**	119,523,668
Supplies	**127,340,739**	119,305,100
Other purchases	**55,520,442**	42,702,444
Depreciation and amortization	**39,268,073**	36,200,312
Specific purpose projects/donations	**9,683,002**	9,667,420
Interest	**13,216,980**	12,819,350
Loss on disposal of property and equipment	**2,971,793**	–
Other	**2,194,388**	2,250,303
Total expenses	**924,391,821**	829,247,142
Operating income	**92,115,990**	70,333,940
Equity in income of unconsolidated subsidiaries	**2,414,353**	890,069
Joint venture investment loss	**(242,306)**	(8,847)
Investment income	**15,757,433**	1,682,167
Other non-operating income	**111,430**	127,265
	18,040,910	2,690,654
Excess of revenues over expenses	**110,156,900**	73,024,594
Transfers to affiliates	**(21,531,288)**	(20,363,593)
Change in interest in Foundations	**2,822,084**	(3,684,925)
Change in net unrealized gains (losses) on investments	**2,621,993**	(2,011,486)
Temporarily restricted net assets released from restrictions for purchase of property and equipment	**1,735,908**	877,399
Change in pension liabilities	**40,775,360**	(102,516,019)
Change in interest rate swap value	**4,621,274**	(6,466,798)
Other changes in net assets	**72,124**	(851,462)
Increase (decrease) in unrestricted net assets	**141,274,355**	(61,992,290)

Members of the Hawai'i Pacific Health Obligated Group

Combined Statements of Unrestricted Revenues, Expenses and Other Changes in Net Assets (continued)

	Year Ended June 30	
	2013	**2012**
Temporarily restricted net assets		
Restricted grants and contributions	**$ 11,297,640**	$ 10,267,931
Investment income	**283,587**	47,827
Change in interest in Foundations	**10,990,678**	5,523,416
Net assets released from restrictions	**(11,418,910)**	(10,544,819)
Other changes in temporarily restricted net assets	**102,481**	120,440
Increase in temporarily restricted net assets	**11,255,476**	5,414,795
Permanently restricted net assets		
Change in interest in Foundations	**136,372**	38,525
Change in beneficial interest in perpetual trusts	**215,933**	48,503
Increase in permanently restricted net assets	**352,305**	87,028
Increase (decrease) in net assets	**152,882,136**	(56,490,467)
Net assets at beginning of year	**262,003,182**	318,493,649
Net assets at end of year	**$ 414,885,318**	$ 262,003,182

See accompanying notes.

Members of the Hawai'i Pacific Health Obligated Group

Combined Statements of Cash Flows

	Year Ended June 30	
	2013	**2012**
Operating activities		
Increase (decrease) in net assets	**$ 152,882,136**	$ (56,490,467)
Adjustments to reconcile the increase (decrease) in net assets to net cash provided by operating activities:		
Change in interest in Foundations	**(13,949,134)**	(1,877,016)
Depreciation and amortization	**39,268,073**	36,200,312
Provision for bad debts	**27,299,918**	28,549,210
Equity in income of unconsolidated subsidiaries	**(2,414,353)**	(890,069)
Joint venture investment loss	**242,306**	8,847
Net (gains) losses on alternative investments	**(7,093,035)**	5,127,971
Change in net unrealized (gains) losses on investments	**(2,621,993)**	2,011,486
Realized gains on investments	**(4,957,306)**	(2,304,381)
Loss on disposition of property and equipment	**2,971,793**	–
Changes in operating assets and liabilities:		
Patient accounts receivable	**(44,174,677)**	(44,800,305)
Due from third-party payors, net	**(3,885,592)**	3,873,532
Other receivables	**(1,926,344)**	(595,656)
Inventories and other assets	**(367,187)**	(1,306,442)
Accounts payable and accrued expenses	**9,528,848**	2,534,120
Other long-term liabilities	**2,538,665**	(1,515,576)
Accrued pension liability	**(39,037,306)**	100,328,855
Net cash provided by operating activities	**114,304,812**	68,854,421
Investing activities		
Purchases of property and equipment	**(68,425,268)**	(56,206,230)
Contributions to joint ventures	**(120,000)**	–
Contributions to affiliates	**(5,000,000)**	–
Increase (decrease) in due to affiliates, net	**8,108,662**	(141,740)
Purchases of investment securities	**(58,437,018)**	(20,836,613)
Sales and maturities of investment securities	**26,336,748**	21,814,205
Assets whose use is limited or restricted:		
Decrease (increase) in funds held by trustee under bond indenture agreements	**20,475,412**	(3,348,101)
Net increase in cash and cash equivalents	**–**	(16,125)
Purchases of investment securities	**(78,096,636)**	(89,235,237)
Sales and maturities of investment securities	**75,177,732**	88,047,196
Net decrease in project funds held by trustee under bond indenture agreement	**32,220**	10,641,828
Net cash used in investing activities	**(79,948,148)**	(49,280,817)

Members of the Hawai’i Pacific Health Obligated Group

Combined Statements of Cash Flows (continued)

	Year Ended June 30	
	2013	**2012**
Financing activities		
Payment of long-term debt	**$ (6,846,412)**	$ (6,586,729)
Net cash used in financing activities	**(6,846,412)**	(6,586,729)
Increase in cash and cash equivalents	**27,510,252**	12,986,875
Cash and cash equivalents at beginning of year	**46,186,747**	33,199,872
Cash and cash equivalents at end of year	**$ 73,696,999**	$ 46,186,747

See accompanying notes.

1. Organization and Summary of Accounting Policies

The accompanying combined financial statements include only the accounts of those entities which are obligated under the terms of The Hawai’i Pacific Health Master Trust Indenture (the Obligated Group) and reflect their financial position, operating results and cash flows.

The members of the Obligated Group comprise:

- Hawai’i Pacific Health (HPH)
- Kapi’olani Medical Center for Women and Children (KMCWC)
- Pali Momi Medical Center (PMMC)
- Straub Clinic & Hospital (SCH)
- Wilcox Memorial Hospital (WMH)

HPH is the sole corporate member of KMCWC, PMMC, SCH and WMH. KMCWC, PMMC, SCH and WMH are health care entities located in Hawai’i.

Except with regard to unrelated business income (UBI), which is taxed at corporate income tax rates, the members of the Obligated Group are not-for-profit organizations and are (a) exempt from federal and state income taxes pursuant to Internal Revenue Code Section 501(a) and applicable state laws, and (b) generally exempt from Hawai’i general excise tax on revenue related to their tax-exempt purpose.

As prescribed in The Hawai’i Pacific Health Master Trust Indenture, except as noted below, the accompanying combined financial statements include only the Members of the Obligated Group. All significant intercompany transactions within the Obligated Group have been eliminated upon combination. Non-Obligated Group subsidiaries are presented in the combined financial statements using the equity method of accounting. Non-Obligated Group entities controlled through sole corporate membership and their subsidiaries are excluded from the special-purpose combined financial statements. Accounting principles generally accepted in the United States require that all majority-owned subsidiaries be consolidated and all controlled affiliates be combined with the financial statements of HPH.

Cash Equivalents

Highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents.

1. Organization and Summary of Accounting Policies (continued)

Inventories

Inventories, consisting of medical, surgical and other supplies, are stated at the lower of cost (first-in, first-out method) or market.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, ranging from 2 to 75 years for buildings and improvements, and 3 to 20 years for equipment. Equipment under capital lease obligations is 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 combined statements of unrestricted revenues, expenses and other changes in net assets. Interest incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from the excess of revenues over expenses. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used, and gifts of cash or other assets that must be used to acquire long-lived assets, are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Investments

Investments in equity securities with readily determinable fair values, and all investments in debt securities, are measured at fair value in the combined balance sheets. Fair value is established based on quoted prices from established securities exchanges or based on quoted market prices of similar instruments. The Obligated Group determined that all marketable securities held at June 30, 2013 and 2012, are designated as other than trading. Accordingly, unrealized gains and losses on investments, except for other-than-temporary declines in fair value, are excluded from the excess of revenues over expenses.

1. Organization and Summary of Accounting Policies (continued)

The Obligated Group holds certain investments that are classified as alternative investments and include trust funds and limited partnerships that seek positive returns regardless of market direction and which are not restricted to any particular asset class. Certain of these alternative investments have specific industry focuses in their investment assets. At the investment manager's direction, these alternative investments may invest in both registered and non-registered securities in the U.S. and globally, with exposure to both emerging and developed markets. These entities employ a range of investment strategies including but not limited to long/short equity positions, derivatives, forward and futures contracts, and currency hedges. The Obligated Group accounts for its ownership interests in these alternative investments under the equity method of accounting, which is included in investment income in the combined statements of unrestricted revenues, expenses and other changes in net assets.

As of both June 30, 2013 and 2012, the alternative investments comprised approximately 23% of the Obligated Group's total investments, including assets whose use is limited or restricted.

Money market funds held in the Obligated Group's Investment Fund are considered investments.

Investment income (including realized gains and losses on investments, gains and losses on alternative investments, other-than-temporary declines in fair value, interest and dividends) is included in the excess of revenues over expenses unless restricted by donor or law.

The Obligated Group determines whether a decline in the fair market value of investments below the cost basis is other-than-temporary based on objective evidence as well as subjective factors including knowledge of recent events and assumptions of future events. If the decline in fair value is judged to be other-than-temporary, the cost basis of the individual security is written down to fair value as a new cost basis. The Obligated Group determined that there were no temporary losses in 2013. The Obligated Group recorded other-than-temporary losses of approximately $2,467,000 in 2012.

Income on investments of donor-restricted funds and endowment funds is recorded as an increase in unrestricted net assets, unless restricted by the donor or law. Realized gains and losses are computed using the weighted average method.

The Obligated Group uses multiple investment managers to diversify its investment portfolios. In accordance with Accounting Standards Codification (ASC) 320, *Investments – Debt and Equity Securities*, the Obligated Group reports mutual funds with underlying investments in debt securities as equity securities.

1. Organization and Summary of Accounting Policies (continued)

Investments in joint ventures which are 20–50% owned or where the Obligated Group has the ability to exercise significant influence over the operating and financial activities of the joint venture are recorded under the equity method of accounting which approximates the Obligated Group's equity in their underlying net book values.

Board-Designated Assets

Board-designated assets consist of unrestricted net assets and accumulated income which have been designated by the Board of Directors for expansion and support of fundraising activities. The Board can redesignate these assets at its discretion.

Contributions

Contributions received, including unconditional promises to give, are recognized as revenue in the period received at their fair value. Fair value is measured as the present value of estimated cash flows using a discount rate commensurate with the risks involved. Pledges receivable are stated at their estimated net realizable value.

Temporarily and Permanently Restricted Net Assets

Restricted net assets consist of donations and other funds where donor restrictions have been imposed as to their use for specific purposes. Temporarily restricted net assets consist of those net assets whose use by the Obligated Group has been limited by donors to a specific purpose or time period. When a donor stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the combined statements of unrestricted revenues, expenses and other changes in net assets as net assets released from restrictions. Permanently restricted net assets consist of the principal amount of net assets whose use by donors has been restricted in perpetuity. Investment income related to permanently restricted net assets is reported as temporarily restricted in the combined statements of unrestricted revenues, expenses and other changes in net assets under the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA).

1. Organization and Summary of Accounting Policies (continued)

Beneficial Interest in Net Assets of Kapi'olani Health Foundation, Straub Foundation, Pali Momi Foundation and Wilcox Health Foundation (collectively, the Foundations)

The Obligated Group accounts for the Foundations under the provisions of ASC 958-605, *Not-for-Profit Entities – Revenue Recognition*, which addresses situations in which the recipient organization and the specified beneficiary meet the criteria defining them as financially interrelated organizations. The Foundations solicit funds for the sole benefit of HPH and its affiliates, which include the members of the Obligated Group. As such, the entities are financially interrelated organizations. The Foundations report an asset and contribution revenue when they receive assets from the donor, and the Obligated Group reports its interest in the net assets of the Foundations. The Obligated Group periodically adjusts its interest for its share of the change in net assets of the Foundations.

Net Patient Service Revenue, Provision for Bad Debts, Premium Revenue and Patient Accounts Receivable

Net patient service revenue associated with services provided to patients who have third-party coverage is recognized on the basis of contractual rates for services rendered, including retroactive adjustments in accordance with third party payer agreements. For uninsured patients that do not qualify for charity, net patient service revenues is recognized on the basis of its standard rates less financial assistance policy discounts.

Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), for the years ended June 30, is as follows.

	Year Ended June 30	
	2013	**2012**
Medicare	**$ 250,375,925**	$ 227,308,070
Medicaid/QUEST	**174,217,404**	146,452,240
Commercial and other	**549,886,531**	483,858,344
Self-pay	**21,200,561**	17,285,002
	$ 995,680,421	$ 874,903,656

1. Organization and Summary of Accounting Policies (continued)

The provision for bad debts expense is based upon management’s assessment of historical and expected net collections, taking into consideration historical business and economic trends, trends in healthcare coverages and other collection indicators. Periodically throughout the year, management assesses the adequacy of the allowance for uncollectible accounts to establish an appropriate allowance for uncollectible accounts. Bad debt consists of services for which the Company anticipated but did not receive payment because of patients’ unwillingness to pay. Bad debt also includes services for medically indigent and/or uninsured patients who are unable to pay and who might have qualified for charity care had the patient self-identified themselves as medically indigent along with providing information so that proper means testing could have been accomplished to qualify the patient for charity care.

Patient accounts receivable are reduced by an allowance for doubtful accounts. The allowance for doubtful accounts is the expected uncollectible portion of accounts receivable for which the patient is financially responsible. Management regularly reviews past history and trends for each of its major payer sources of revenues in evaluating the sufficiency of the allowance for doubtful accounts and provision for bad debts.

The Obligated Group has agreements with various health maintenance organizations (HMOs) to provide medical services to subscribing participants. For the majority of its HMO business, the Obligated Group receives fee-for-service payments which are recorded as net patient service revenue in the combined statements of unrestricted revenues, expenses and other changes in net assets.

Significant concentrations of patient accounts receivable include Hawaii Medical Service Association (HMSA) – 19% and 20%, QUEST and QUEST Expanded Access (QEXA) plans – 25% and 23%, Medicaid – 1% and 4%, and Medicare – 31% and 31% as of June 30, 2013 and 2012, respectively.

Government Reimbursement Programs

The Obligated Group renders services to patients under contractual arrangements with the Medicare and Medicaid programs. The percentage of gross patient service revenue applicable to the Medicare and Medicaid programs approximated 33% and 1%, respectively, in 2013 and 34% and 2%, respectively, in 2012. Medicare acute inpatient services are reimbursed based on clinical, diagnostic, and other factors; and for Medicaid a per diem rate for routine services and a per

1. Organization and Summary of Accounting Policies (continued)

discharge rate for ancillary services. Outpatient services and defined capital costs related to Medicare and Medicaid beneficiaries are paid based upon a prospective payment system, fee schedules or a cost reimbursement method. The Obligated Group is reimbursed for these reimbursable items at an interim rate; final settlement is determined after annual cost reports submitted by the Obligated Group are audited by the Medicare and Medicaid contractors. Estimation differences between final settlements and amounts accrued in previous years due to audit adjustments recorded by the fiscal intermediary are reported as current year changes to net patient service revenues and amounted to a net increase of approximately $6,945,000 in 2013 and $3,326,000 in 2012. The Obligated Group has the ability to appeal the adjustments based on a process established by Medicare and Medicaid.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Obligated Group believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigation involving allegations of potential wrongdoing that would have a material impact on the combined financial statements that have not been recorded. 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 Medicaid programs.

The Obligated Group entered into several agreements with health plans to provide health care services to plan members who are eligible to participate in the State of Hawaii's QUEST and QEXA programs, Section 1115 Medicaid waiver programs. The Obligated Group negotiates with health plans contracted by Medicaid for the provision of the health care services. The percentage of gross patient service revenue applicable to the QUEST and QEXA programs approximated 22% in 2013 and 19% in 2012.

In December 2012, the State of Hawaii enacted the Hospital Sustainability Program Act (HSPA) whereby certain healthcare providers will pay a provider tax to the State of Hawaii. The provider tax monies received are, in turn, matched with Federal funds by the Centers for Medicare and Medicaid Services (CMS). The total proceeds received by the State of Hawaii, through provider tax monies and matching Federal funds, are used to supplement payments to hospitals to cover the actual costs of care to Medicaid beneficiaries and to support initiative for Medicaid beneficiaries. For the year ending June 30, 2013, the Obligated Group recorded $20,143,248 of net patient service revenue and $10,400,148 of provider tax payments, recorded within other purchases relating to the HSPA program.

1. Organization and Summary of Accounting Policies (continued)

Electronic Health Records Incentive Payments

Under the American Recovery and Reinvestment Act of 2009, the Centers for Medicare and Medicaid Services (CMS) began providing incentive payments to eligible hospitals and professionals that meaningfully use certified electronic health record (EHR) technology. The incentive payment is recognized when management is reasonably assured that the Obligated Group has complied with the conditions set forth by CMS. EHR incentive payments of approximately $4,003,000 in 2013 and $5,027,000 in 2012 were recognized under the grant accounting model in other revenues in the combined statements of unrestricted revenues, expenses and other changes in net assets. The Obligated Group's attestation of compliance with the meaningful use criteria is subject to audit by the federal government or its designee. Additionally, EHR incentive payments are subject to retrospective adjustment upon final settlement of the applicable cost report and adjustment of the cost report data used to initially calculate the payment amounts. Thus, amounts recognized are subject to change.

Charity Care

The Obligated Group will treat patients regardless of their ability to pay. An established charity care policy sets guidelines to determine which patients qualify for care given at no charge. Since the Obligated Group does not pursue collection from qualified charity care patients, related charges are not reported as revenue. Recorded charity care provided in both 2013 and 2012 comprised less than 1% of total net patient service revenue, as measured by applying the cost to gross charges ratio to gross uncompensated charges associated with providing charity care to patients.

Collective Bargaining Agreements (unaudited)

The Obligated Group has several collective bargaining agreements covering approximately 40% of the Obligated Group's labor force. As of June 30, 2013, two collective bargaining agreements with two unions, or approximately 14% of the Obligated Group's labor force will expire within one year.

Advertising Expense

The Obligated Group expenses advertising costs as incurred. Advertising expense was approximately $2,731,000 in 2013 and $2,630,000 in 2012, respectively, and was recorded in services expense in the combined statements of unrestricted revenues, expenses and other changes in net assets.

1. Organization and Summary of Accounting Policies (continued)

Deferred Financing Costs

Costs incurred in obtaining long-term financing are deferred and amortized over the terms of the related obligations using the effective-interest method.

Accounting for the Impairment or Disposal of Long-Lived Assets

The Obligated Group accounts for the impairment or disposal of long-lived assets in accordance with ASC 360, *Property, Plant and Equipment* (ASC 360). ASC 360 uses a future cash flow model to determine whether assets have been impaired. The Obligated Group reviews long-lived assets for circumstances which could indicate that carrying values may not be recoverable. Management determined that no long-lived assets were impaired as of June 30, 2013 and 2012.

Excess of Revenues Over Expenses

The combined statements of unrestricted revenues, expenses and other changes in net assets include the excess of revenues over expenses. Changes in unrestricted net assets which are excluded from the excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses (except for other-than-temporary declines in fair value) on investments in other than trading securities, contributions of long-lived assets (including assets acquired using contributions which by donor restrictions were to be used for the purposes of acquiring such assets), change in pension and post retirement liabilities and changes in interest rate swap value associated with derivatives that qualify as effective cash flow hedges.

Subsequent Events

The following long-term debt transaction occurred after the report date but before issuance of these financial statements and is reported as a non-recognized subsequent event in accordance with ASC 855. On October 3, 2013, the Obligated Group issued Series 2013 A, B, and C Bonds in the amounts of $122,240,000, $36,740,000, and $50,000,000, respectively. Proceeds from the Series 2013A Bonds established a Project Fund to finance construction of health care facilities and equipment while the proceeds from the Series 2013B and C Bonds were used to refund the

1. Organization and Summary of Accounting Policies (continued)

Series 1998, 2004A, and 2004B Bonds. The 2013A Bonds are a combination of serial and term bonds. The serial bonds have maturity dates of July 1, 2015 through July 1, 2028, with interest rates ranging from 3.00% to 5.00%. The term bonds have maturity dates of July 1, 2033, July 1, 2038, and July 1, 2043, with fixed interest rates of 6.00%, 5.50% and 5.50%, respectively. The 2013B Bonds are serial bonds with maturity dates of July 1, 2014 through July 1, 2033, with interest rates ranging from 2.00% to 5.25%. A Project Fund was established in October 2013, for the Series 2013A Bonds of approximately $125 million. The Series 2013C Bonds are direct bank purchase bonds bearing interest at 67% of one month LIBOR plus 0.80%. Principal payments in varying amounts from $1,900,000 to $4,200,000 are due July 1, 2015 through July 1, 2033. In addition, the floating to fixed interest rate swaps, discussed at Note 12, which were entered into to hedge future variability in cash flows associated with the Series 2004B Bond, continue to be used as an interest rate hedge for the Series 2013C Bonds.

Subsequent events have been evaluated through October 22, 2013, the date these combined financial statements were issued.

Reclassifications

Certain amounts in the 2012 combined financial statements have been reclassified to conform to the 2013 presentation, primarily related to the reclassification of the provision for uncollectible accounts within total revenue, as a result of adopting the patient service revenue accounting standard. These reclassifications did not impact the excess of revenues over expenses or net assets previously reported.

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the combined financial statements and accompanying notes. Actual results could differ from those estimates.

1. Organization and Summary of Accounting Policies (continued)

Adoption of New Accounting Principles

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2011-04, *Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in the U.S. GAAP and IFRSs*, (ASU 2011-04). ASU 2011-04 amended ASC 820, *Fair Value Measurement,* to converge the fair value measurement guidance in U.S. GAAP and International Financial Reporting Standards. Some of the amendments clarify the application of existing fair value measurement requirements, while other amendments change a particular principle in ASC 820. In addition, ASU 2011-04 requires additional fair value disclosures. The amendments are to be applied prospectively and are effective for annual periods beginning after December 15, 2011. The Obligated Group adopted the guidance in ASU 2011-04 for the reporting period ended June 30, 2013. Adoption of ASU 2011-04 did not have a material effect on the combined financials.

In July 2011, the FASB issued Accounting Standards Update 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities* (ASU 2011-07). ASU 2011-07 requires that certain health care entities reclassify the provision for bad debt associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Additionally, those health care entities are required to provide enhanced disclosures about their policies for recognizing revenue and assessing bad debts. ASU 2011-07 also requires disclosures of patient service revenue (net of contractual allowances and discounts) as well as qualitative and quantitative information about changes in the allowance for doubtful accounts. ASU 2011-07 is effective for years beginning after December 15, 2011 with early adoption permitted. The Obligated Group adopted the guidance in ASU 2011-07 for the reporting periods ended June 30, 2013 and 2012. Provision for bad debts is now reflected as a deduction from patient service revenue (net of contractual allowances) in the combined statements of unrestricted revenues, expenses, and other changes in net assets as of June 30, 2013 and 2012.

1. Organization and Summary of Accounting Policies (continued)

In December 2011, the FASB issued Accounting Standards Update 2011-11, *Disclosures About Offsetting Assets and Liabilities* (ASU 2011-11). ASU 2011-11 requires enhanced disclosures about financial instruments and derivative instruments that are offset or subject to a master netting arrangement or similar arrangement. ASU 2011-11 is effective for reporting periods beginning on or after January 1, 2013 with retrospective disclosures for all comparative periods presented. The Obligated Group is currently evaluating the effect of ASU 2011-11 on its combined financial statements.

In October 2012, the FASB issued Accounting Standards Update 2012-05, *Statement of Cash Flows (Topic 230): Not-for-Profit Entities: Classification of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows* (ASU 2012-05). ASU 2012-05 require a not-for-profit entity to classify cash receipts from the sale of donated financial assets consistently with cash donations received in the statement of cash flows if those cash receipts were from the sale of donated financial assets that upon receipt were directed without any not-for-profit imposed limitations for sale and were converted nearly immediately into cash. Accordingly, the cash receipts from the sale of those financial assets should be classified as cash inflows from operating activities, unless the donor restricted the use of the contributed resources to long-term purpose, in which case those cash receipts should be classified as cash flows from financing activities. Otherwise, cash receipts from the sale of donated financial assets should be classified as cash flows from investing activities by the not-for-profit. ASU 2012-05 is effective prospectively for financial statements issued for fiscal years, and interim periods within those years, beginning after June 15, 2013. Retrospective application to all prior periods presented upon the date of adoption is permitted. Early adoption is permitted. The Obligated Group is currently evaluating the effect of ASU 2012-05 on its combined financial statements.

In April 2013, the FASB issued Accounting Standards Update 2013-06 *Not-for-Profit Entities (Topic 958) Services Received from Personnel of an Affiliate* (ASU 2013-06). ASU 2013-06 requires a recipient not-for-profit entity to recognize all services received from personnel of an affiliate that directly benefit the recipient not-for-profit entity. ASU 2013-06 is effective prospectively for fiscal years beginning after June 15, 2014, and interim and annual periods thereafter. Early adoption is permitted. The Obligated Group is currently evaluating the effect of ASU 2013-06 on its combined financial statements.

2. Assets Whose Use is Limited or Restricted and Investments

Assets whose use is limited or restricted and investments consist of the following:

	June 30	
	2013	**2012**
Board-designated:		
Cash and cash equivalents	**$ 54,018**	$ 68,673
Money market funds	**6,681,397**	4,458,443
Equity securities	**88,216,926**	70,741,789
Trust funds and limited partnerships (alternative investments)	**50,960,725**	56,332,552
Cash surrender value of life insurance policies	**16,090,217**	15,301,608
	162,003,283	146,903,065
Funds held by trustee under bond indenture agreement:		
Money market funds	**23,974,169**	23,590,300
Debt securities	**17,031,575**	17,447,664
	41,005,744	41,037,964
Project funds held by trustee under bond indenture agreement – Money market funds	**2,833,612**	23,309,024
Restricted by donor or grantor:		
Certificate of deposit	**600,000**	600,000
Equity securities	**632,200**	588,488
Beneficial interest in perpetual trusts (comprised of fixed income and equity securities)	**4,719,441**	4,503,508
Debt securities	**386,357**	430,069
Beneficial interest in net assets of Foundations	**42,112,148**	30,985,098
	48,450,146	37,107,163
Unrestricted – undesignated investments:		
Certificates of deposit	**–**	10,000,000
Money market funds	**3,344,807**	1,005,416
Equity securities	**46,962,897**	18,475,785
Debt securities	**835,531**	819,786
Trust funds and limited partnerships (alternative investments)	**25,511,697**	12,703,469
Cash surrender value of life insurance policies	**4,029,715**	3,304,834
	80,684,647	46,309,290
	$ 334,977,432	$ 294,666,506

2. Assets Whose Use is Limited or Restricted and Investments (continued)

Investment income for assets limited or restricted as to use, cash equivalents, and other investments are comprised of the following:

	Year Ended June 30 2013	2012
Dividends and interest	**$ 3,707,092**	$ 4,505,757
Realized gains	**4,957,306**	2,304,381
Net gains (losses) on alternative investments	**7,093,035**	(5,127,971)
	$ 15,757,433	$ 1,682,167

The following table summarizes the unrealized losses on investments held at June 30:

	2013					
	Less than Twelve Months		**Twelve Months or More**		**Total**	
Description	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
Equity securities	**$ 22,033,984**	**$ 993,673**	**$ 257,048**	**$ 46,449**	**$ 22,291,032**	**$ 1,040,122**
Debt securities	**26,641,293**	**525,960**	**–**	**–**	**26,641,293**	**525,960**
Total	**$ 48,675,277**	**$ 1,519,633**	**$ 257,048**	**$ 46,449**	**$ 48,932,325**	**$ 1,566,082**

	2012					
	Less than Twelve Months		**Twelve Months or More**		**Total**	
Description	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
Equity securities	$ 16,858,959	$ 1,191,658	$ 560,699	$ 207,372	$ 17,419,658	$ 1,399,030

Management has concluded that the current economic environment will enable the Obligated Group to recover the unrealized losses. This conclusion was based on a number of factors including: (1) the significance of the difference between cost and fair value of the investment; and (2) the time period for which fair value was lower than cost.

3. Fair Value

ASC 820-10 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, ASC 820-10 establishes a three-tier fair value hierarchy and prioritizes the inputs used in measuring fair value as follows:

Level 1 – Pricing inputs are based on quoted prices, unadjusted for identical assets or liabilities, in active markets. Examples of financial assets and liabilities in Level 1 include U.S. Treasury securities, and mutual funds, money market funds, and equities.

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 contractual term of the assets or liabilities. Examples of financial assets and liabilities in Level 2 include certificates of deposit (maturing in 90 or more days), guaranteed investment contracts, asset-backed securities, corporate bonds, foreign bonds, interest rate swaps, and beneficial interests in perpetual trusts.

Level 3 – Pricing inputs are generally unobservable and include situations where there is little, if any, market activity for the instrument. 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. Level 3 fair values are therefore determined using factors that involve considerable judgment and interpretations, including but not limited to private and public comparables, discounted cash flow models, and fund manager estimates.

3. Fair Value (continued)

Assets and liabilities measured at fair value are based on one or more of the three valuation techniques noted in ASC 820-10. The three valuation techniques are identified in the tables below. Where more than one technique is noted, individual assets or liabilities were valued using one or more of the noted techniques. The valuation techniques are as follows:

> Market approach – Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
>
> Cost approach – Amount that would be required to replace the service capacity of an asset (replacement cost).
>
> Income approach – Techniques to convert future amounts to a single present value amount based on market expectations (including present value techniques, option-pricing and excess earnings models for intangibles).

As of June 30, 2013 and 2012, the Obligated Group's alternative investments amounting to approximately $76,473,000 and $69,036,000, respectively, are accounted for using the equity method of accounting. Approximately $50,961,000 and $56,333,000 of the Obligated Group's alternative investments are reported as Board-designated and $25,512,000 and $12,703,000 are unrestricted-undesignated as of June 30, 2013 and 2012, respectively. Since alternative investments are accounted for using the equity method of accounting, which is not a fair value measure, they are omitted from the following tables. As of June 30, 2013 and 2012, the Obligated Group's investments in cash surrender values of life insurance policies amounting to approximately $20,120,000 and $18,607,000, respectively, are also omitted from the following table as they are accounted for as life insurance contracts. Approximately $16,090,000 and $15,302,000 of the Obligated Group's cash surrender values of life insurance policies are reported as Board-designated and $4,030,000 and $3,305,000 are unrestricted-undesignated as of June 30, 2013 and 2012, respectively.

The carrying amounts reported in the combined balance sheets for cash and cash equivalents, receivables, accounts payable and accrued expenses approximate fair value due to the short-term nature of these instruments.

Fair values for long-term debt are estimated using quoted market prices of similar types of borrowings (see Note 7).

3. Fair Value (continued)

The tables below present the Obligated Group's fair value measurements on a recurring basis as of June 30:

	2013				
Description	**Total**	**Level 1**	**Level 2**	**Level 3**	**Valuation Technique**
Board-designated investments:					
Money market funds	**$ 6,681,397**	**$ 6,681,397**	**$ –**	**$ –**	**a**
Equity securities –					
Large cap	**3,337,325**	**3,337,325**	**–**	**–**	**a**
Opportunistic	**4,037,380**	**4,037,380**	**–**	**–**	**a**
Global equity	**17,726,242**	**17,726,242**	**–**	**–**	**a**
Multi alternative	**3,516,496**	**3,516,496**	**–**	**–**	**a**
Fixed income	**16,649,534**	**16,649,534**	**–**	**–**	**a**
Global balanced	**10,986,728**	**10,986,728**	**–**	**–**	**a**
Large blend	**2,488,122**	**2,488,122**	**–**	**–**	**a**
Foreign large blend	**8,369,092**	**8,369,092**	**–**	**–**	**a**
Natural resources	**13,505,699**	**13,505,699**	**–**	**–**	**a**
Emerging markets	**7,600,308**	**7,600,308**	**–**	**–**	**a**
Funds held by trustee under bond indenture agreement:					
Money market funds	**23,974,169**	**23,974,169**	**–**	**–**	**a**
Debt securities –					
Municipals	**15,211,537**	**15,211,537**	**–**	**–**	**a**
Guaranteed investment contracts	**1,820,038**	**–**	**1,820,038**	**–**	**a**
Project funds held by trustee under bond indenture agreement:					
Money market funds	**2,833,612**	**2,833,612**	**–**	**–**	**a**

3. Fair Value (continued)

	2013 (continued)				
Description	**Total**	**Level 1**	**Level 2**	**Level 3**	**Valuation Technique**
Investments restricted by donor or grantor:					
Equity securities –					
Large blend	**$ 584,450**	**$ 584,450**	**$ –**	**$ –**	**a**
Global equity	**47,750**	**47,750**	**–**	**–**	**a**
Debt securities –					
Asset-backed securities	**105,834**	**–**	**105,834**	**–**	**a**
U.S. Treasury obligations	**31,175**	**31,175**	**–**	**–**	**a**
Corporate bonds	**221,608**	**–**	**221,608**	**–**	**a**
Foreign bonds	**27,740**	**–**	**27,740**	**–**	**a**
Certificate of deposit	**600,000**	**–**	**600,000**	**–**	**a**
Beneficial interest in perpetual trusts	**4,719,441**	**–**	**4,719,441**	**–**	**c**
Unrestricted investments:					
Money market funds	**3,344,807**	**3,344,807**	**–**	**–**	**a**
Equity securities –					
Large cap	**1,776,650**	**1,776,650**	**–**	**–**	**a**
Opportunistic	**2,149,329**	**2,149,329**	**–**	**–**	**a**
Global equity	**9,436,697**	**9,436,697**	**–**	**–**	**a**
Multi alternative	**1,872,033**	**1,872,033**	**–**	**–**	**a**
Fixed income	**8,863,503**	**8,863,503**	**–**	**–**	**a**
Global balanced	**5,848,827**	**5,848,827**	**–**	**–**	**a**
Large blend	**1,324,570**	**1,324,570**	**–**	**–**	**a**
Foreign large blend	**4,455,349**	**4,455,349**	**–**	**–**	**a**
Natural resources	**7,189,859**	**7,189,859**	**–**	**–**	**a**
Emerging markets	**4,046,080**	**4,046,080**	**–**	**–**	**a**
Debt securities –					
Asset-backed securities	**67,418**	**–**	**67,418**	**–**	**a**
U.S. Treasury obligations	**228,878**	**228,878**	**–**	**–**	**a**
Corporate bonds	**479,242**	**–**	**479,242**	**–**	**a**
Foreign bonds	**59,993**	**–**	**59,993**	**–**	**a**
2004 Interest rate swaps, including collateral posted	**(5,397,791)**	**–**	**(5,397,791)**	**–**	**a**

3. Fair Value (continued)

Description	2012 Total	Level 1	Level 2	Level 3	Valuation Technique
Board-designated investments:					
Money market funds	$ 4,458,443	$ 4,458,443	$ –	$ –	a
Equity securities –					
Large cap	3,240,355	3,240,355	–	–	a
Opportunistic	6,002,761	6,002,761	–	–	a
Global equity	16,350,152	16,350,152	–	–	a
Fixed income	24,281,459	24,281,459	–	–	a
Foreign large blend	6,719,394	6,719,394	–	–	a
Natural resources	6,232,161	6,232,161	–	–	a
Emerging markets	2,497,699	2,497,699	–	–	a
Inflation hedging	5,417,808	5,417,808	–	–	a
Funds held by trustee under bond indenture agreement:					
Money market funds	23,590,300	23,590,300	–	–	a
Debt securities –					
Municipals	15,627,624	15,627,624	–	–	a
Guaranteed investment contracts	1,820,040	–	1,820,040	–	a
Project funds held by trustee under bond indenture agreement:					
Money market funds	23,309,024	23,309,024	–	–	a
Investments restricted by donor or grantor:					
Equity securities – Large cap	588,488	588,488	–	–	a
Debt securities –					
Asset-backed securities	35,279	–	35,279	–	a
U.S. Treasury obligations	133,082	133,082	–	–	a
Corporate bonds	240,341	–	240,341	–	a
Foreign bonds	21,367	–	21,367	–	a
Certificates of deposit	600,000	–	600,000	–	a
Beneficial interest in perpetual trusts	4,503,508	–	4,503,508	–	c

3. Fair Value (continued)

Description	2012 (continued) Total	Level 1	Level 2	Level 3	Valuation Technique
Unrestricted investments:					
Certificates of deposit	$ 10,000,000	$ –	$ 10,000,000	$ –	a
Money market funds	1,005,416	1,005,416	–	–	a
Equity securities –					
Large cap	2,106,069	2,106,069	–	–	a
Opportunistic	1,353,676	1,353,676	–	–	a
Global equity	3,687,098	3,687,098	–	–	a
Fixed income	6,623,243	6,623,243	–	–	a
Foreign large blend	1,515,280	1,515,280	–	–	a
Natural resources	1,405,405	1,405,405	–	–	a
Emerging markets	563,252	563,252	–	–	a
Inflation hedging	1,221,762	1,221,762	–	–	a
Debt securities –					
Asset-backed securities	67,247	–	67,247	–	a
U.S. Treasury obligations	253,678	253,678	–	–	a
Corporate bonds	458,132	–	458,132	–	a
Foreign bonds	40,729	–	40,729	–	a
2004 Interest rate swaps, including collateral posted	(1,113,473)	–	(1,113,473)	–	a

a) Market approach
b) Cost approach
c) Income approach

The Obligated Group received restricted pledges and contributions amounting to $3,987,853 in 2013 and $1,176,702 in 2012 that were subject to fair value measurement in accordance with ASC 820-10 upon initial measurement. The restricted contributions were measured based on the actual cash received, or for pledge receivables, using discounted cash flow projections as outlined in the income approach.

As of June 30, 2013 and 2012, the uncollateralized portion of the Obligated Group's swaps subject to non-performance risk was approximately $5,398,000 and $2,800,000, respectively. The resulting reduction in unrealized loss on interest swaps due to this non-performance risk arising from the Obligated Group's own credit risk was not material and no adjustment was recorded in the excess of revenue over expenses for the years ended June 30, 2013 and 2012.

4. Property and Equipment

Property and equipment are summarized as follows:

	June 30	
	2013	**2012**
Land and land improvements	**$ 34,992,185**	$ 35,414,179
Buildings and improvements	**373,978,432**	367,041,921
Equipment	**368,650,656**	358,092,830
Construction in progress	**77,412,834**	48,814,620
	855,034,107	809,363,550
Less amortization and accumulated depreciation	**531,505,187**	512,020,032
Property and equipment, net	**$ 323,528,920**	$ 297,343,518

5. Employee Benefit Plans

Eligible employees of the Obligated Group are covered under the Hawai’i Pacific Health Retirement Plan, a noncontributory defined benefit pension plan. Benefits are based on years of service and a percentage of the employee’s compensation. The Obligated Group’s policy is to accrue actuarially determined net periodic pension costs and to annually contribute an amount within regulatory guidelines.

Included in net assets at June 30, 2013 are the following amounts that have not yet been recognized in net periodic pension cost: unrecognized prior service credits of $2,125,367 and unrecognized actuarial losses of $131,291,146. The unrecognized prior service credit and actuarial loss included in net assets and expected to be recognized in net periodic pension cost during the year ending June 30, 2014 is $6,215,066.

5. Employee Benefit Plans (continued)

Reconciliation of Funded Status and Accumulated Benefit Obligation

The reconciliation of the beginning and ending balances of the projected benefit obligation and the fair value of plan assets for the year ended June 30 and the accumulated benefit obligation at June 30 is as follows:

	Year Ended June 30	
	2013	**2012**
Funded Status		
Projected benefit obligation:		
Benefit obligation, at beginning of year	**$ 352,426,000**	$ 247,773,231
Service cost	**15,992,874**	11,072,737
Interest cost	**14,379,330**	13,832,378
Actuarial (gain) loss	**(29,948,559)**	86,941,213
Benefits paid	**(8,975,951)**	(7,193,559)
Benefit obligation at end of year	**343,873,694**	352,426,000
Fair value of plan assets:		
Fair value of plan assets, at beginning of year	**$ 158,000,000**	$ 153,676,086
Contributions	**24,827,767**	16,755,393
Actual return (loss) on plan assets	**14,633,184**	(5,237,920)
Benefits paid	**(8,975,951)**	(7,193,559)
Fair value of plan assets at end of year	**188,485,000**	158,000,000
Funded status, end of year	**$ (155,388,694)**	$ (194,426,000)

	June 30	
	2013	**2012**
Accumulated benefit obligation	**$ 295,337,941**	**$ 297,480,026**

The underfunded status of the plan of $155,388,694 and $194,426,000 at June 30, 2013 and 2012, respectively, is recognized in the accompanying combined balance sheets as accrued pension liability. No plan assets are expected to be returned to the Obligated Group during the year ended June 30, 2014.

5. Employee Benefit Plans (continued)

Components of Net Periodic Benefit Cost

	Year Ended June 30	
	2013	**2012**
Service cost	**$ 15,992,874**	$ 11,072,737
Interest cost	**14,379,330**	13,832,378
Expected return on plan assets	**(13,011,394)**	(12,700,973)
Recognized prior service credit	**(311,434)**	(266,005)
Recognized net loss	**9,447,915**	3,170,220
Net periodic benefit cost	**$ 26,497,291**	$ 15,108,357

Weighted Average Assumptions Used to Determine Benefit Obligations

	June 30	
	2013	**2012**
Discount rate	**4.83%**	4.15%
Rate of compensation increase	**3.50%**	3.50%

Weighted Average Assumptions Used to Determine Net Periodic Benefit Cost

	Year Ended June 30	
	2013	**2012**
Discount rate	**4.15%**	5.70%
Expected return on plan assets	**7.75%**	8.00%
Rate of compensation increase	**3.50%**	3.50%

Asset Allocations

The assets of the plan are held by the plan trustee in the Hawai'i Pacific Health combined pension fund. Oversight of the combined pension fund assets is provided by the Hawai'i Pacific Health Investment Committee and the Hawai'i Pacific Health Finance Committee of the Board of Directors. The long-term financial objectives of the combined pension fund are to comply with regulatory funding requirements and balance liquidity needs to meet benefit and expense obligations when due with long-term investment return goals to satisfy future plan obligations.

5. Employee Benefit Plans (continued)

The long-term investment objective is to earn an average, real return of 5%, after adjusting for inflation and management fees, over long time periods. In order to achieve this objective, the fund needs to exceed the investment objectives in certain periods in order to compensate for shortfalls in other periods. This implies a higher average allocation to equity securities. The Investment Committee's investment policy sets a target for the weighted average asset allocation of 70% equity securities and 30% fixed income securities.

The expected return on plan assets of 7.75% was developed based upon analysis of historical market returns, current market conditions, targeted future asset allocations, the plan assets' past performance, and expectations on potential future market returns. The expected return represents a long-term average view of the performance of the plan assets which may not be achieved during a given plan year.

The weighted average target asset allocations compared to actual asset allocations at June 30, by major asset category, are as follows:

	Target Allocation	Percentage of Actual Plan Assets at June 30	
	2013	**2013**	**2012**
Major Asset Category			
U.S. equity	**21%**	**19%**	20%
Global equity	**18**	**17**	17
Emerging markets equity	**6**	**5**	4
Fixed income	**25**	**21**	25
Inflation hedging	**10**	**8**	8
Marketable alternative investments	**15**	**15**	14
Global tactical asset allocation	**–**	**2**	–
Real estate	**–**	**4**	5
Cash and cash equivalents	**5**	**9**	7
	100%	**100%**	100%

5. Employee Benefit Plans (continued)

The tables below presents the plan's assets measured at fair value on a recurring basis as of June 30:

	2013				
	Total	**Level 1**	**Level 2**	**Level 3**	**Valuation Technique**
Equity securities –					
Core	**$ 12,799,244**	**$ 12,799,244**	**$ –**	**$ –**	**a**
Value	**3,644,268**	**3,644,268**	**–**	**–**	**a**
Opportunistic	**8,118,837**	**8,118,837**	**–**	**–**	**a**
Global	**32,860,254**	**32,860,254**	**–**	**–**	**a**
Fixed income	**40,332,965**	**40,332,965**	**–**	**–**	**a**
Inflation hedging	**14,438,011**	**14,438,011**	**–**	**–**	**a**
Emerging markets	**6,591,191**	**6,591,191**	**–**	**–**	**a**
Global tactical asset allocation	**4,218,071**	**4,218,071**	**–**	**–**	**a**
Alternative investments –					
U.S. equity growth	**10,513,272**	**–**	**10,513,272**	**–**	**a**
Emerging markets equity	**2,826,681**	**–**	**2,826,681**	**–**	**a**
Fixed income	**7,627,478**	**–**	**7,627,478**	**–**	**a**
Global tactical asset allocation	**1,592,874**	**–**	**1,592,874**	**–**	**a**
Diversified arbitrage/ event-driven	**8,675,197**	**–**	**–**	**8,675,197**	**a**
Distressed	**514,648**	**–**	**–**	**514,648**	**a**
Global long/short	**6,276,948**	**–**	**–**	**6,276,948**	**a**
Global macro	**1,588,772**	**–**	**–**	**1,588,772**	**a**
U.S. long/short	**1,167,086**	**–**	**–**	**1,167,086**	**a**
Opportunistic	**1,073,537**	**–**	**–**	**1,073,537**	**a**
Real estate	**7,330,000**	**–**	**7,330,000**	**–**	**a**
Cash and cash equivalents	**16,295,666**	**16,295,666**	**–**	**–**	**a**
Total	**$ 188,485,000**	**$ 139,298,507**	**$ 29,890,305**	**$ 19,296,188**	

5. Employee Benefit Plans (continued)

	2012				
	Total	Level 1	Level 2	Level 3	Valuation Technique
Equity securities -					
Core	$ 10,615,474	$ 10,615,474	$ –	$ –	a
Value	3,052,901	3,052,901	–	–	a
Opportunistic	9,846,976	9,846,976	–	–	a
Global	26,513,414	26,513,414	–	–	a
Fixed income	39,943,064	39,943,064	–	–	a
Inflation hedging	13,071,839	13,071,839	–	–	a
Emerging markets	3,327,989	3,327,989	–	–	a
Government securities -					
Fixed income	167,928	167,928	–	–	a
Alternative investments -					
U.S. equity growth	7,878,880	–	7,878,880	–	a
Emerging markets equity	3,440,118	–	3,440,118	–	a
Diversified arbitrage/ event-driven	11,858,861	–	1,500,000	10,358,861	a
Distressed	863,186	–	–	863,186	a
Global long/short	8,267,879	–	–	8,267,879	a
Opportunistic	954,164	–	–	954,164	a
Real estate	7,340,000	–	7,340,000	–	a
Cash and cash equivalents	10,857,327	10,857,327	–	–	a
Total	$ 158,000,000	$ 117,396,912	$ 20,158,998	$ 20,444,090	

In accordance with ASC 320, the plan's mutual funds with underlying investments in debt securities are reported as equity securities which differ from its target asset allocation reporting.

The plan has classified its common stock, mutual funds, money market funds and U.S. agency securities which are considered highly liquid and easily tradable as Level 1 within the fair value hierarchy. These securities are valued using inputs observable in active markets for identical securities. The plan's investments in real estate and certain alternative investments are classified as Level 2. Real estate is valued based on an appraisal using inputs observable in active markets for similar properties. These alternative investments are valued using net asset value as of the measurement date as a practical expedient and these investments may be redeemed in the near term (defined by the Obligated Group as less than 60 days). Certain alternative investments are

5. Employee Benefit Plans (continued)

classified as Level 3. These alternative investments are valued using net asset value as of the measurement date as a practical expedient and these investments may not be redeemed in the near term.

The following is a summary of changes in the fair value of the plan's Level 3 assets for the years ended June 30:

	2013				
	Fair Value June 30, 2012	**Unrealized Gains (Losses) Related to Assets Held at June 30, 2013**	**Purchases**	**Sales**	**Fair Value June 30, 2013**
Alternative investments:					
Diversified arbitrage/ event-driven	**$ 10,358,861**	**$ 961,386**	**$ –**	**$ (2,645,050)**	**$ 8,675,197**
Distressed	**863,186**	**151,462**	**–**	**(500,000)**	**514,648**
Global long/short	**8,267,879**	**1,114,346**	**–**	**(3,105,277)**	**6,276,948**
Opportunistic	**954,164**	**119,373**	**–**	**–**	**1,073,537**
Global macro	**–**	**(11,228)**	**1,600,000**	**–**	**1,588,772**
U.S. long/short	**–**	**67,086**	**1,100,000**	**–**	**1,167,086**
	$ 20,444,090	**$ 2,402,425**	**$ 2,700,000**	**$ (6,250,327)**	**$ 19,296,188**

	2012				
	Fair Value June 30, 2011	**Unrealized (Losses) Gains Related to Assets Held at June 30, 2012**	**Purchases**	**Sales**	**Fair Value June 30, 2012**
Alternative investments:					
Diversified arbitrage/ event-driven	$ 11,252,091	$ (393,230)	$ –	$ (500,000)	$ 10,358,861
Distressed	1,675,145	51,227	–	(863,186)	863,186
Global long/short	7,466,852	(198,973)	1,000,000	–	8,267,879
Opportunistic	928,630	(160,148)	1,000,000	(814,318)	954,164
	$ 21,322,718	$ (701,124)	$ 2,000,000	$ (2,177,504)	$ 20,444,090

5. Employee Benefit Plans (continued)

Certain of the plan's alternative investments report fair value using a calculated net asset value per share or its equivalent. The following table and explanations identify attributes relating to the nature and risk of such investments at June 30, 2013:

	Fair Value	Redemption Frequency (If Currently Eligible)	Redemption Notice Period (If Currently Eligible)	Redemption Restrictions and Expiration of Restriction
U.S. equity growth	$ 10,513,272	Monthly	Prior to 22nd calendar day of month	–
Emerging markets equity	2,826,681	Monthly	30 days	–
Fixed income	7,627,478	Monthly	5 days	–
Diversified arbitrage/ event-driven	8,675,197	Quarterly, annually, every 24 months	45-65 days	Side pockets, gates, soft lock-up; 3/31/14
Distressed	514,648	Annually December	90 days	Side pockets
Global long/short	6,276,948	Quarterly, annually, 25% quarterly	30-90 days	Side pockets, gates
Global macro	1,588,772	Quarterly	33 days	Gates
U.S. long/short	1,167,086	Quarterly	60 days	Gates, soft lock-up; 12/31/13
Global tactical asset allocation	1,592,874	Monthly	7 days	Side pockets
Opportunistic	1,073,537	Every 24 months	90 days	Hard lock-up; 3/31/14
	$ 41,856,493			

U.S. equity growth: This category has an emphasis on equities of companies with rapid earnings growth and high multiples of earnings, dividends, and book values.

Emerging markets equity: This category has products investing in the equity securities of companies located in emerging and frontier market countries.

Fixed income: This category has portfolios that seek to exploit mispricings in fixed income securities, utilizing a variety of investment instruments, including corporate and municipal bonds, sovereign debt, mortgage-backed securities, swaps and options.

5. Employee Benefit Plans (continued)

Diversified arbitrage: This category has multi-strategy portfolios that have broad investment parameters, seeking to profit from mispricings across asset classes and strategies.

Event-driven: This category has multi-strategy portfolios that seek to exploit security mispricings caused by mergers and acquisitions, spin-offs, tracking stocks, accounting write-offs, reorganizations, bankruptcies, share buybacks and special dividends.

Distressed: This category has portfolios consisting primarily of investments in debt securities of companies that are experiencing business, financial, market or legal uncertainties, attempting to capture the difference between the market price of security or debt obligations and their underlying intrinsic value.

Global long/short equity – This category has portfolios consisting of a core group of long stock positions with short sales of stock and stock indexes in global and global ex. U.S. equity markets (global excluding U.S. equity markets).

Global macro: This category has broad, top-down strategies that seek to capitalize on perceived macroeconomic and political trends, and shifts in investor behavior and market positions. Unconstrained by asset class or geography with implementation through long and short positions and by means of cash, asset purchases (including physical commodities), futures, options, and other instruments. Leverage is often applied and return and volatility targets may vary sharply.

U.S. long/short equity: This category has portfolios consisting of a core group of long stock positions with short sales of stock and stock indexes in U.S. equity markets.

Global tactical asset allocation: This category has broad, top-down strategies that seek to capitalize on perceived macroeconomic trends, shifts in investor behavior and market positions, and relative asset class evaluations. Excess returns come primarily from tactically shifting the mix of long-beta exposures among equities, fixed income, commodities and cash. Additional excess returns may come from relative tilts away from the balanced benchmark by geography, sector, risk factors such as quality, size, value/growth, developed/emerging, and occasionally via dynamic foreign exchange hedging or sometimes security selection within underlying funds.

Opportunistic – This category has multi-strategy portfolios which have a broad mandate and employ an opportunistic investment approach, shifting capital across asset classes and strategies depending on their profitability.

5. Employee Benefit Plans (continued)

The Obligated Group expects to make contributions amounting to approximately $24,180,000 in 2014.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Year Ending June 30:	
2014	$ 12,818,234
2015	11,016,949
2016	11,299,722
2017	12,470,342
2018	13,352,798
2019–2023	81,947,957

The Obligated Group has defined contribution retirement plans (Retirement Plans) which cover substantially all employees of the Obligated Group and provides participants the ability to make pretax payroll deduction contributions for deposit into retirement savings accounts. The participants' contributions are matched at a percentage of their total contributions up to annual dollar limits per participant as defined by the Retirement Plans. The total expense related to the above Retirement Plans was approximately $13,037,000 in 2013 and $11,947,000 in 2012.

6. Line and Letters of Credit

The Obligated Group has a $35,000,000 unsecured revolving line of credit, expiring March 1, 2014. The interest rate on the line is based on the lender's 3-month LIBOR rate plus an applicable margin. There were no outstanding draws on this facility as of June 30, 2013 and June 30, 2012.

During 2011, the Obligated Group entered into a letter of credit arrangement in the amount of $50,904,110 with JPMorgan Chase Bank, National Association (JPMorgan Chase) for an irrevocable transferable letter of credit in favor of the Bank of New York Mellon Trust Company, N.A., bond trustee, to support the payment of currently outstanding principal of the 2004B bonds and 55 days of accrued interest. For Liquidity Advances under the letter of credit, the draw rate is equal to the variable rate subject to a floor of 7.5% per annum, as defined in the Reimbursement Agreement dated April 1, 2011 between the Obligated Group and JPMorgan Chase, from time to time for 120 aggregate days. Commencing on the 121st day to and including the stated letter of credit expiration date, the rate is equal to the sum of the variable rate subject

6. Line and Letters of Credit (continued)

to a floor of 7.5% per annum from time to time in effect plus 1.0%. Any day commencing after the stated letter of credit expiration date, the rate is equal to the sum of the variable rate subject to a floor of 7.5% per annum from time to time in effect plus 2.0%. The letter of credit expires on April 14, 2016. There were no outstanding draws on this facility as of June 30, 2013 and June 30, 2012.

As of June 30, 2013, the Obligated Group's other outstanding letters of credit were as follows:

Coverage	Amount	Expiration Date	Interest Rates
Workers' compensation insurance policies:			
SCH	$ 59,000	October 30, 2013	1.25%
HPH	1,000,000	February 1, 2014	*

* Interest rate would be determined upon draw.

There were no draws on the above letters of credit as of June 30, 2013 and 2012.

7. Long-Term Debt

Long-term debt is summarized as follows:

	June 30	
	2013	**2012**
Series 2010B Special Purpose Revenue Bonds, interest payable semi-annually at rates ranging from 5.00% to 5.75%, principal payments in varying annual amounts ranging from $1,055,000 to $1,410,000 due July 2014 through 2020; $1,480,000 to $2,425,000 due July 2021 through 2030; $2,560,000 to $4,245,000 due July 2013 through 2040	**$ 59,787,803**	$ 59,834,388
Series 2010A Special Purpose Revenue Bonds, interest payable semi-annually at rates ranging from 3.00% to 5.50%, principal payments in varying annual amounts ranging from $545,000 to $2,375,000 due July 2014 through 2021; $335,000 to $1,640,000 due July 2022 through 2030; $1,280,000 to $12,705,000 due July 2031 through 2040	**98,709,106**	98,641,562
Series 2004A Special Purpose Revenue Bonds, interest payable semi-annually at 5.60%, principal payments in varying annual amounts ranging from $1,820,000 to $3,315,000 due July 2022 through 2033	**29,523,948**	29,500,098
Series 2004B Insured Special Purpose Revenue Variable Rate Demand Bonds, issued in a weekly rate period and bearing interest at a weekly rate determined by the Remarketing Agent and paid monthly, principal payments in varying amounts from $1,900,000 to $4,200,000 due July 2015 through 2033	**49,915,310**	49,911,067
Series 1998 Special Purpose Revenue Bonds, interest payable semi-annually at rates ranging from 5.25% to 5.50%, principal payments in varying annual amounts ranging from $1,245,000 to $1,315,000 due July 2012 through 2013; $1,200,000 to $1,615,000 due July 2014 through 2018; $530,000 to $785,000 due July 2019 through 2028	**13,153,681**	14,398,403
Series 1993 Special Purpose Revenue Bonds, interest payable semi-annually at 6.40%, principal payments in varying annual amounts ranging from $5,700,000 to $6,070,000, due July 2012 through 2013	**6,070,000**	11,720,742
Total long-term debt	**257,159,848**	264,006,260
Less current portion	**7,333,364**	6,846,688
Noncurrent portion	**$ 249,826,484**	$ 257,159,572

7. Long-Term Debt (continued)

The 2010, 2004, 1998, and 1993 Series Special Purpose Revenue Bonds are collateralized by a security interest in the gross receipts and pledged assets of the Obligated Group. The 2010B Bonds are subject to optional redemption on or after July 1, 2020 at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the date of redemption, without premium. The 2010B Bonds are subject to mandatory redemption on or after July 1, 2021 payable in annual sinking fund installments from $1,480,000 to $4,245,000. The 2010A Bonds are subject to optional redemption on or after July 2, 2020 at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the date of redemption, without premium. The 2010A Bonds are subject to mandatory redemption on or after July 1, 2022 payable in annual sinking fund installments from $335,000 to $12,705,000. The 2004A Bonds are subject to redemption on or after July 1, 2013 at a redemption price of 100% of the principal amount being redeemed, plus accrued interest to the date of redemption, without premium. The 2004A Bonds are subject to mandatory sinking fund redemption on July 1, 2022 and thereafter ranging from $1,820,000 to $3,315,000. The 2004B Bonds are subject to optional redemption at various terms and to mandatory redemption on or after July 1, 2015 payable in annual amounts of $1,900,000 to $4,200,000. The 1998 Bonds are subject to redemption on or after July 1, 2008, at redemption prices ranging from 100% to 102% of the principal amount of the bonds being redeemed. The 1998 Bonds have mandatory sinking fund requirements effective July 1, 2007 payable in amounts ranging from $600,000 to $1,700,000. The 1993 Bonds are subject to redemption on or after July 1, 2006, at a redemption price of 100% of the principal amount of the bonds being redeemed. The 1993 Bonds have mandatory sinking fund requirements effective July 1, 2009, payable in annual amounts ranging from $4,730,000 to $6,070,000.

As of June 30, 2013 and 2012, $14,282,685 and $13,334,432, respectively, included in current assets, was held by the bond trustee to fund principal maturities and accrued interest payable.

In July 2010, the Company issued Series 2010B Bonds in the amount of $61,210,000 to payoff the outstanding balance of a bank term loan and establish a $35,000,000 Project Fund. The 2010B Bonds are a combination of serial bonds and term bonds. The serial bonds have maturity dates starting July 1, 2014 through 2020 with an interest rate of 5.00%. The term bonds have maturity dates of July 1, 2030 and July 1, 2040 with fixed interest rates of 5.625% and 5.750% respectively. A Reserve Fund was established in July 2010 for the 2010B Bonds of approximately $4,490,000.

7. Long-Term Debt (continued)

Certain bond agreements require the Obligated Group to comply with various covenants, including the maintenance of a minimum long-term debt service coverage ratio. As of June 30, 2013, the Obligated Group was in compliance with all bond covenants.

Long-term debt maturities for the years succeeding June 30, 2013 are as follows. The schedule depicts the long-term debt maturities assuming the entire variable rate demand obligations for the 2004B Bonds were not remarketed as of July 1, 2013 and considering the repayment terms of the underlying letter of credit.

Year Ending June 30:	
2014	$ 7,333,364
2015	26,920,393
2016	25,189,321
2017	8,754,065
2018	3,430,307
Thereafter	185,532,398
	$ 257,159,848

Interest paid was approximately $13,084,000 in 2013 and $14,085,000 in 2012. Interest capitalized was approximately $1,110,000 in 2013 and $1,902,000 in 2012.

The fair value of long-term debt as of June 30, 2013 and 2012 was approximately $269,572,000 and $282,468,000, respectively.

8. Other Long-Term Liabilities

In connection with the acquisition of SCHI by the Obligated Group in 2001, the Obligated Group is obligated to make payments on the deferred compensation and other obligations of SCHI Holdings, Inc., an unrelated for-profit corporation. While certain of the deferred compensation obligations are non-interest bearing, others bear interest at rates ranging from 2% to 7%. The deferred compensation obligations are payable at termination, retirement, or over a period of years beginning at termination or retirement of certain former employees of SCHI. The net present value of the deferred compensation obligation, at 6% interest, is approximately $13,037,000 and $13,617,000 as of June 30, 2013 and 2012, respectively, and is included in other long-term liabilities in the combined balance sheets. Total payments on the deferred compensation obligations and other obligations were approximately $1,518,000 in 2013 and $2,265,000 in 2012.

9. Leases

As Lessee

Leases on various types of office and storage space, office equipment and furniture are classified as operating leases.

Future minimum lease payments under noncancelable operating leases as of June 30, 2013 are as follows:

Year Ending June 30:	
2014	$ 6,164,000
2015	5,769,000
2016	5,516,000
2017	4,930,000
2018	3,014,000
Thereafter	3,408,000
	$ 28,801,000

Minimum rent payments have not been reduced by minimum sublease rentals of $2,241,000 due in the future under noncancelable subleases.

The composition of total rental expense for all operating leases except those with terms of a month or less is as follows:

	Year Ended June 30	
	2013	**2012**
Minimum rentals	**$ 8,368,000**	$ 7,869,000
Less: sublease rentals	**1,343,000**	1,270,000
	$ 7,025,000	$ 6,599,000

9. Leases (continued)

As Lessor

Future minimum rental income to be received under noncancelable operating leases for office space as of June 30, 2013 is as follows:

Year Ending June 30:	
2014	$ 828,000
2015	891,000
2016	313,000
2017	225,000
2018	230,000
Thereafter	14,399,000
	$ 16,886,000

10. Income Taxes

Some of the Obligated Group's not-for-profit members have generated net operating losses (NOL) attributable to revenue generating activities that are not related to their respective tax exempt purposes. The Obligated Group has unused Federal and Hawaii NOL carryforwards as of June 30, 2013 of approximately $12,799,000 and $12,799,000, respectively. The NOL carryforwards begin to expire in 2019. The deferred tax asset associated with these NOL carryforwards at June 30, 2013 and 2012 are offset by a full valuation allowance in the combined balance sheets as management has determined it is more likely than not that the NOLs will not be utilized.

11. Functional Classification of Expenses

The functional classification of expenses by major classes of program services and supporting activities are summarized as follows:

	Year Ended June 30	
	2013	**2012**
Patient services	**$ 654,431,089**	$ 592,717,063
Management and general	**269,960,732**	236,530,079
	$ 924,391,821	$ 829,247,142

12. Commitments and Contingencies

Workers' Compensation Claims

The Obligated Group Members are self-insured for workers' compensation claims. The Obligated Group has an outstanding letter of credit in favor of the State of Hawai'i (as described in Note 6), as required by self-insurance regulations of the State of Hawai'i. The Obligated Group provides its actuary with estimated claims payments and the Obligated Group accrues workers' compensation expense based on an actuarial determined amount. Workers' compensation accruals included in payroll and related liabilities in the combined balance sheets totaled approximately $3,469,000 and $3,776,000 as of June 30, 2013 and 2012, respectively, and were recorded using a 1.50% and 2.03% discount factor as of June 30, 2013 and 2012, respectively. The aforementioned amounts include accruals for known and incurred, but reported workers' compensation claims.

Medical Malpractice Insurance

In June 2002, HPH formed Providers Insurance Corporation (PIC), a captive insurance company covering professional (medical malpractice) and general liability risks. PIC is a not-for-profit Hawaii domiciled pure captive whose sole corporate member is HPH. PIC operates under a Certificate of Authority from the State of Hawaii (Insurance Division) and began operations on July 1, 2002. PIC is a regulated insurance company with reserve, investment, reporting and audit requirements. The Obligated Group is covered for professional and general liability claims under a combined single limit of $76,000,000 through PIC. The professional and general liability coverage from PIC is "claims-made," with PIC providing tail coverage (with certain limitations) to the Obligated Group with claims-made policies prior to July 1, 2002.

For the years ending June 30, 2004 through 2013, PIC renewed its reinsurance coverages. For the years ended June 30, 2004 through 2007, PIC retained the first $1,000,000 in risk and had reinsurance with reinsurers for total coverage of $51,000,000. For the years ended June 30, 2008 through 2013, PIC retained the first $1,000,000 in risk and had reinsurance with reinsurers for total coverage of $76,000,000. For the first reinsurance layer of $10,000,000, PIC entered into a "retrospective rating program". Depending on actual claims experience, the premium is adjusted either down to a minimum of $2,000,000 or up to a maximum of $8,000,000. The amount of premiums charged by PIC to the HPH entities was based on the expected case of $3,600,000 to $5,000,000 in premiums.

12. Commitments and Contingencies (continued)

The Obligated Group does not have a deductible for coverages provided by PIC. PIC's total costs are allocated through a premium charge to the Obligated Group based on actuarial information derived from historical loss experience and expected losses.

Medical malpractice expense totaled approximately $8,660,000 in 2013 and $5,064,000 in 2012. Medical malpractice accruals totaled approximately $6,403,000 and $7,587,000 at June 30, 2013 and 2012, respectively, and were recorded using a 3.13% and 3.29% discount factor at June 30, 2013 and 2012, respectively.

Interest Rate Swap Agreements

During the second quarter of fiscal year 2004, the Obligated Group issued $30,000,000 of fixed rate and $50,000,000 of variable rate bonds for a total of $80,000,000 of 2004 Bonds. In order to hedge future variability in cash flows associated with variable rate debt, two tranches of floating to fixed amortizing interest rate swaps of $25,000,000 each in notional amounts were entered into at the time the variable rate debt was issued. The Obligated Group pays fixed rates ranging between 3.842% and 3.849% and receives a variable rate tied to LIBOR. A component of the fixed rate on these two swaps includes the financing of the loss on a previous, but now terminated $30,000,000 forward starting amortizing interest rate swap on the date of termination. As of June 30, 2013 and 2012, the Obligated Group recorded an accumulated loss of approximately $8,500,000 and $13,000,000, respectively, in unrestricted net assets related to the current amortizing interest rate swaps outstanding. The balance of the unamortized loss as of June 30, 2013 and 2012 amounted to approximately $1,700,000 and $1,750,000, respectively.

The mark-to-market loss on the swap arrangements related to the 2004 Bond was approximately $10,128,000 and $14,773,000 as of June 30, 2013 and 2012, respectively.

ASC 815, *Derivatives and Hedging*, allows the reporting entity to offset derivative fair value and cash collateral amounts executed with the same counter-party under a master netting arrangement. The Obligated Group has chosen to adopt the netting of such amounts under its master agreement with its counterparties. The Obligated Group did not have the right to reclaim cash collateral or obligation to return cash collateral for derivatives under master netting arrangements that have not been offset against net derivative positions as of June 30, 2013 and 2012.

12. Commitments and Contingencies (continued)

Certain of the Obligated Group's derivative instruments contain provisions that require an investment grade credit rating from the major credit rating agencies. If the Obligated Group's credit rating were to change or if an event of default were to occur and continue, the counterparties to the derivative instruments could demand full collateralization on the derivative instruments in net liability positions. The aggregate fair value of all derivatives instruments with credit-risk-related contingent features that are in a liability position as of June 30, 2013, $10,127,791 for which the Obligated Group has posted collateral of $4,730,000 in the normal course of business. If the credit-risk-related contingent features underlying these agreements were triggered on June 30, 2013, the Obligated Group would be required to post an additional $5,398,000 of collateral to its counterparty.

The combined tables below present the location and amounts of derivative fair values in the accompanying combined balance sheets and derivative gains and losses in the combined statements of unrestricted revenues, expenses and other changes in net assets.

Fair Values of Derivative Instruments

	Asset Derivatives				Liability Derivatives			
	June 30, 2013		June 30, 2012		June 30, 2013		June 30, 2012	
Derivatives designated as hedging instruments under ASC 815	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Interest rate contracts	**Other noncurrent assets**	**$ –**	Other noncurrent assets	$ –	**Other long term liabilities**	**$10,127,791**	Other long term liabilities	$14,772,939
Total		**$ –**		$ –		**$10,127,791**		14,772,939

12. Commitments and Contingencies (continued)

The Effect of Derivative Instruments on the Statement of Financial Performance

Derivatives in ASC 815 Cash Flow Hedging Relationships	Amount of (Loss) Gain Recognized in Other Change in Net Assets on Derivative (Effective Portion) Year Ended June 30 2013	2012	Amount of Gain (Loss) Reclassified from Unrestricted Net Assets into Excess of Revenues over Expenses (Effective Portion) Year Ended June 30 2013	2012	Amount of Gain (Loss) Recognized in Excess of Revenues over Expenses on Derivative (Ineffective Portion) and Amount Excluded from Effectiveness Testing Year Ended June 30 2013	2012
Interest rate contracts	**$ 4,621,274**	$ (6,466,798)	**$ –**	$ –	**$ –**	$ –
Total	**$ 4,621,274**	$ (6,466,798)	**$ –**	$ –	**$ –**	$ –

Litigation

The Obligated Group is involved in legal actions in the normal course of business, some of which seek monetary damages, including punitive damages, which are not covered by insurance. These actions, when finally concluded and determined, will not, in the opinion of management and the Obligated Group's counsel, have a material adverse effect on the Obligated Group's financial position, results of operations, or cash flows.

On October 8, 2013, the Obligated Group together with two co-defendants, received from plaintiffs a global settlement demand of $17 million on a malpractice claim relating to a prior year. The Obligated Group is in the process of evaluating and resolving the claim, which will be covered by the Obligated Group reinsurance policies. Management believes that it has adequately provided for the most likely outcome of the malpractice claim based upon the information available at this time, including recognition of reinsurance receivable and related liability for the portion of the claim to be paid by the Obligated Group's reinsurer.

Other (unaudited)

The Obligated Group has outstanding construction commitments of approximately $17,872,000 as of June 30, 2013.

13. Related Party Transactions

A joint venture investment of the Obligated Group provides laundry services to the Obligated Group. Payments for services totaled approximately $3,252,000 in 2013 and $2,979,000 in 2012.

A joint venture investment of the Obligated Group provides collection services to the Obligated Group. Payments to the joint venture totaled approximately $470,000 in 2013 and $617,000 in 2012.

A joint venture investment of the Obligated Group provides radiopharmaceuticals to the Obligated Group. Payments to the joint venture totaled approximately $834,000 in 2013 and $920,000 in 2012.

Physician's services provided by Kapi'olani Medical Specialists, a 100% owned affiliate, totaled approximately $7,343,000 in 2013 and $7,027,000 in 2012.

The Obligated Group made payments of approximately $9,045,000 in 2013 and $9,573,000 in 2012 to PIC for malpractice and general liability insurance coverage.

PIC made a premium refund payment of $2,412,000 in 2013 and $4,789,000 in 2012 to the Obligated Group.

Fees for usage of a portion of the premises charged to Kauai Medical Clinic, a 100% owned affiliate, was approximately $1,400,000 in 2013 and $779,000 in 2012.

SCH leased land from the Hawai'i Pacific Health Retirement Plan (Straub Clinic & Hospital Defined Benefit Pension Plan prior to merger into the Hawaii Pacific Health Retirement Plan on December 31, 2005) for $696,000 in lease rent for both 2013 and 2012. The lease terminates in 2042 and rental payments are renegotiated every five years based on appraisal of the underlying land. Future annual lease payments are $696,000 through December 31, 2016 at which point, the lease agreement will be up for renegotiation and lease terms subject to change. The Office of Pension and Welfare Benefit Programs granted the Straub Clinic & Hospital Defined Benefit Pension Plan an exemption from prohibitions for the aforementioned lease arrangement.

13. Related Party Transactions (continued)

As of June 30, 2013, future minimum lease payments under this lease agreement are as follows:

Year Ending June 30:	
2014	$ 696,000
2015	696,000
2016	696,000
2017	696,000
2018	696,000
Thereafter	16,356,000
	$ 19,836,000

14. Restricted Net Assets

Temporarily restricted net assets are summarized as follows:

	June 30	
	2013	**2012**
Health and hospital care	**$ 7,026,139**	$ 6,951,328
Plant expansion and equipment replacement	**26,042,200**	15,626,224
Research and grants	**5,088,951**	4,390,745
Education and scholarships	**952,416**	885,933
	$ 39,109,706	$ 27,854,230

Permanently restricted net assets are summarized as follows:

	June 30	
	2013	**2012**
Health and hospital care	**$ 9,180,462**	$ 8,828,157
Research and grants	**3,161,757**	3,161,757
Education and scholarships	**328,255**	328,255
	$ 12,670,474	$ 12,318,169

15. Endowment

The Obligated Group's endowment consists of approximately 12 individual funds established for a variety of purposes. The endowment includes both donor-restricted funds and funds designated by the Board of Directors to function as endowments. Net assets associated with the endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

In June 2009, Hawai'i Revised Statute 517E was signed into law, enacting UPMIFA. UPMIFA became effective on July 1, 2009, replacing the Uniform Management of Institutional Funds Act. UPMIFA applies to institutional funds created after July 1, 2009 and to decisions made after July 1, 2009 for existing institutional funds. UPMIFA eliminates the concept of "historic dollar value" and allows an institution to spend or accumulate as the board determines is prudent for the uses, benefits, purposes and duration of the endowment fund unless the gift instrument states a particular rate or formula.

The Obligated Group has interpreted UPMIFA 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 this interpretation, the Obligated Group classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment and (3) 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 characterized as temporarily restricted net assets until those amounts are appropriated for expenditure by the Obligated Group in a manner consistent with the standard for expenditure prescribed by UPMIFA. In accordance with UPMIFA, the Obligated Group considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund.
2. The general purposes of the Obligated Group and the donor-restricted endowment fund.
3. General economic conditions.
4. The possible effect of inflation and deflation.
5. The expected total return from income and the appreciation of investments.
6. Other resources of the Obligated Group.
7. The investment policies of the Obligated Group.

15. Endowment (continued)

Funds with Deficiencies

From time-to-time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires the Obligated Group to retain as a fund of perpetual duration. There were no deficiencies of this nature as of June 30, 2013 and 2012.

Return Objectives and Risk Parameters

The Obligated Group 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. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity. Under this policy the endowment assets are invested in a manner that is intended to produce results that equal or exceed a mix of the Russell 3000, MSCI All Country World, consumer price index plus 5%, Hedge Fund Research, Inc., and Barclays Capital benchmarks. The Obligated Group expects its endowment funds to provide an annual real return, net of inflation and management fees, of approximately 5% over long time periods. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the Obligated Group 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 Obligated Group targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Obligated Group has a policy of appropriating for distribution each year 4.5% of its endowment fund's average fair value using quarter end values for the preceding three years. The amount of the distribution is subject to a 6% cap and 3% floor applied to the most recent quarter end value to account for market volatility. In establishing this policy, the Obligated Group

15. Endowment (continued)

considered the long-term expected return on its endowment. Accordingly, the Obligated Group expects the current spending policy to allow its endowment to grow over long time periods. which is consistent with the Obligated Group'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 returns.

The endowment net asset composition by type of fund consists of the following at June 30:

	2013			
	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Donor-restricted funds	**$ –**	**$ 2,289,677**	**$ 6,337,997**	**$ 8,627,674**
Board-designated funds	**162,003,283**	**–**	**–**	**162,003,283**
Total funds	**$ 162,003,283**	**$ 2,289,677**	**$ 6,337,997**	**$ 170,630,957**

	2012			
	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Donor-restricted funds	$ –	$ 2,025,245	$ 6,122,064	$ 8,147,309
Board-designated funds	146,903,065	–	–	146,903,065
Total funds	$ 146,903,065	$ 2,025,245	$ 6,122,064	$ 155,050,374

15. Endowment (continued)

Changes in endowment net assets for the years ended June 30 consists of the following:

	2013			
	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Endowment net assets, beginning of year	**$ 146,903,065**	**$ 2,025,245**	**$ 6,122,064**	**$ 155,050,374**
Investment income:				
Investment income	**1,914,361**	**67,583**	**215,933**	**2,197,877**
Net appreciation (realized and unrealized)	**13,185,857**	**216,004**	**–**	**13,401,861**
Total investment income	**15,100,218**	**283,587**	**215,933**	**15,599,738**
Appropriation of endowment assets for expenditure	**–**	**(19,155)**	**–**	**(19,155)**
Endowment net assets, end of year	**$ 162,003,283**	**$ 2,289,677**	**$ 6,337,997**	**$ 170,630,957**

	2012			
	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Endowment net assets, beginning of year	$ 151,039,801	$ 1,989,832	$ 6,073,562	$ 159,103,195
Investment income (loss):				
Investment income	2,284,935	70,613	48,502	2,404,050
Net depreciation (realized and unrealized)	(6,421,671)	(22,800)	–	(6,444,471)
Total investment (loss) income	(4,136,736)	47,813	48,502	(4,040,421)
Appropriation of endowment assets for expenditure	–	(12,400)	–	(12,400)
Endowment net assets, end of year	$ 146,903,065	$ 2,025,245	$ 6,122,064	$ 155,050,374

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