Banner Health

Unaudited Consolidated
Financial Statements and Supplementary Information

Banner Health and Subsidiaries

Nine Months Ended September 30, 2018

Banner Health and Subsidiaries

Unaudited Consolidated Financial Statements

As of September 30, 2018

Contents

Review Report of Independent Auditors

The Board of Directors
Banner Health

We have reviewed the consolidated financial information of Banner Health and Subsidiaries, which comprise the consolidated balance sheet as of September 30, 2018, and the related consolidated statement of income, changes in net assets and cash flows for the nine-month period ended September 30, 2018. The accompanying consolidated financial information of Banner Health and Subsidiaries for the nine-month period ended September 30, 2017, was not reviewed by us, and accordingly, we do not express any form of assurance on it.

Management's Responsibility for the Financial Information

Management is responsible for the preparation and fair presentation of the consolidated financial information in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in conformity with U.S. generally accepted accounting principles.

Auditor's Responsibility

Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.

Conclusion

Based on our review, we are not aware of any material modifications that should be made to the 2018 consolidated financial information referred to above for it to be in conformity with U.S. generally accepted accounting principles.

Report on Balance Sheet as of December 31, 2017

We have previously audited, in accordance with auditing standards generally accepted in the United States, the consolidated balance sheet of Banner Health and Subsidiaries as of December 31, 2017, and the related consolidated statements of income, changes in net assets and cash flows for the year then ended (not presented herein), and we expressed an unmodified audit opinion on those consolidated financial statements in our report dated March 16, 2018. In our opinion, the accompanying consolidated balance sheet of Banner Health and Subsidiaries as of December 31, 2017, is consistent, in all material respects, with the consolidated balance sheet from which it has been derived.

Ernst + Young LLP

November 27, 2018

Banner Health and Subsidiaries

Consolidated Balance Sheets

	September 30 2018	December 31 2017
	(In Thousands)	
	Unaudited	
Assets		
Current assets:		
Cash and cash equivalents	**$ 317,229**	$ 292,911
Short-term investments	**93,340**	59,114
Collateral held under securities lending program and repurchase agreements	**602,037**	452,770
Patient receivables, net	**844,227**	907,212
Inventories	**206,233**	192,877
Other receivables	**289,751**	264,295
Assets limited as to use	**45,954**	120,567
Other, primarily prepaid expenses	**89,063**	64,590
Total current assets	**2,487,834**	2,354,336
Assets limited as to use:		
Funds designated by:		
Board of Directors	**2,161,868**	2,101,134
Lease agreements	**1,914**	1,901
Funds held by trustees under:		
Self-insurance funding arrangements	**107,582**	119,952
Project fund	**-**	44,957
Other funds	**133,586**	222,155
Total assets limited as to use, less current portion	**2,404,950**	2,490,099
Assets held for sale	**2,140**	2,140
Property and equipment, net	**3,641,519**	3,493,785
Leased hospital assets	**213,342**	226,907
Other assets:		
Long-term investments	**2,299,672**	2,374,808
Other	**804,321**	727,993
Total other assets	**3,103,993**	3,102,801
Total assets	**$ 11,853,778**	$ 11,670,068

Banner Health and Subsidiaries

Consolidated Balance Sheets

	September 30 2018	December 31 2017
	(In Thousands)	
	Unaudited	
Liabilities and net assets		
Current liabilities		
Trade accounts payable	**$ 181,693**	$ 222,269
Current portion of long-term debt	**59,081**	187,970
Debt subject to self-liquidity	**200,000**	200,000
Current portion of hospital lease obligation	**22,907**	22,907
Payable under securities lending program and repurchase agreements	**602,037**	452,770
Estimated current portion of third-party payor settlements	**2,805**	10,313
Accrued expenses:		
Salaries and benefits	**376,706**	424,527
Medical claims payable	**172,196**	162,843
Other	**231,509**	268,004
Total current liabilities	**1,848,934**	1,951,603
Long-term debt, less current portion	**3,068,090**	3,004,176
Hospital lease obligation	**214,382**	223,061
Estimated self-insurance liabilities, less current portion	**198,249**	178,014
Estimated third-party payor settlements, less current portion	**33,256**	32,434
Interest rate swaps	**224,216**	311,004
Other	**189,938**	185,296
Total liabilities	**5,777,065**	5,885,588
Net assets:		
Unrestricted	**5,844,627**	5,569,307
Temporarily restricted	**188,830**	183,361
Total Banner Health net assets	**6,033,457**	5,752,668
Non-controlling interests - unrestricted	**43,256**	31,812
Total net assets	**6,076,713**	5,784,480
Total liabilities and net assets	**$ 11,853,778**	$ 11,670,068

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Income

Unaudited

	Nine Months Ended September 30 2018	2017
	(In Thousands)	
Revenues:		
Net patient service revenue	**$ 4,868,122**	$ 4,944,794
Provision for doubtful accounts	**-**	225,260
Net patient service revenue, less provision for doubtful accounts	**4,868,122**	4,719,534
Medical insurance premiums	**1,100,479**	855,252
Other revenue	**286,915**	262,139
Total other operating revenue	**1,387,394**	1,117,391
Total revenues	**6,255,516**	5,836,925
Expenses:		
Salaries and benefits	**2,997,648**	2,850,132
Supplies	**1,015,970**	947,106
Physician and professional fees	**152,175**	136,952
Medical claims cost, net of Banner claims of $280,412 and $307,973 in 2018 and 2017, respectively	**810,242**	606,159
Depreciation and amortization	**305,889**	306,540
Interest	**95,016**	88,167
Other	**756,439**	708,938
Total expenses	**6,133,379**	5,643,994
Operating income	**122,137**	192,931
Other income (loss):		
Investment income - realized	**112,478**	98,758
Investment (loss) gain - unrealized	**(41,605)**	166,719
Income from alternative investments	**24,565**	62,368
Investment income	**95,438**	327,845
Unrealized gain on interest rate swaps	**86,617**	8,849
Other	**(5,929)**	(9,978)
	176,126	326,716
Excess of revenues over expenses	**298,263**	519,647
Less excess of revenues over expenses attributable to non-controlling interest	**19,916**	19,213
Excess of revenues over expenses attributable to Banner Health	**278,347**	500,434
Amortization of cumulative loss on interest rate swaps	**170**	170
Cumulative effect of change in accounting principle	**(7,323)**	-
Contribution for property and equipment acquisitions	**4,124**	3,988
Other changes in unrestricted net assets	**2**	5
Increase in unrestricted net assets	**$ 275,320**	$ 504,597

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Changes in Net Assets

Unaudited

	Nine Months Ended September 30	
	2018	2017
	(In Thousands)	
Unrestricted net assets:		
Excess of revenues over expenses	**$ 278,347**	$ 500,434
Amortization of cumulative loss on interest rate swaps	**170**	170
Cumulative effect of change in accounting principle	**(7,323)**	-
Contributions for property and equipment acquisitions	**4,124**	3,988
Other	**2**	5
Increase in unrestricted net assets	**275,320**	504,597
Temporarily restricted net assets:		
Contributions	**16,740**	20,071
Net unrealized gain on investments	**230**	1,290
Net assets released from restrictions	**(11,501)**	(13,531)
Increase in temporarily restricted net assets	**5,469**	7,830
Non-controlling interests:		
Excess of revenue over expenses attributable to non-controlling interests	**19,916**	19,213
Other changes, primarily distributions of earnings to non-controlling interests	**(8,472)**	(17,581)
Increase in non-controlling interests	**11,444**	1,632
Increase in net assets	**292,233**	514,059
Net assets, beginning of year	**5,784,480**	5,056,480
Net assets, end of period	**$ 6,076,713**	$ 5,570,539

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Cash Flows

Unaudited

	Nine Months Ended September 30 2018	2017
	(In Thousands)	
Operating activities		
Increase in net assets	**$ 292,233**	$ 514,059
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Cumulative effect of change in accounting principle	**7,323**	-
Depreciation and amortization	**305,889**	306,540
Decrease (increase) in investments designated as trading	**155,715**	(42,234)
Net unrealized gain on interest rate swaps	**(86,788)**	(9,019)
Gain on sale of assets	**(635)**	(21)
Contributions for purchase of property and equipment	**(4,124)**	(3,988)
Temporarily restricted contributions	**(16,740)**	(20,071)
Noncontrolling interest	**20,335**	18,130
Changes in operating elements:		
Patient receivables	**55,662**	2,537
Inventories and other current assets	**(63,070)**	9,247
Accounts payable and accrued expenses	**(115,539)**	(111,819)
Estimated third-party payor settlements	**(6,901)**	5,990
Estimated self-insurance liabilities	**20,235**	10,711
Other liabilities	**4,029**	10,096
Net cash provided by operating activities	**567,624**	690,158
Investing activities		
Net purchases of property and equipment	**(424,567)**	(464,791)
Decrease in project fund	**44,957**	-
Increase in other assets	**(77,942)**	(96,029)
Net cash used in investing activities	**(457,552)**	(560,820)
Financing activities		
Proceeds from temporarily restricted contributions	**16,740**	20,071
Proceeds from issuance of debt	**298**	-
Payments of hospital lease obligations	**(17,184)**	(18,035)
Payments of long-term debt	**(65,273)**	(59,621)
Cash distributions to noncontrolling interests	**(20,335)**	(18,130)
Net cash used in financing activities	**(85,754)**	(75,715)
Net increase in cash and cash equivalents	**24,318**	53,623
Cash and cash equivalents at beginning of year	**292,911**	175,799
Cash and cash equivalents at end of period	**$ 317,229**	$ 229,422
Supplemental disclosure of cash flow information		
Interest paid, including amounts capitalized	**$ 121,776**	$ 99,428
Non-cash activities		
Leased facility asset additions	**$ 8,505**	$ 12,840

See accompanying notes.

1. Description of Business

Banner Health is a nonprofit corporation exempt from income taxes under Internal Revenue Code Section 501(c)(3) and applicable state income tax codes. Banner Health and its subsidiaries (collectively, Banner) own, control, or lease hospitals, clinics, nursing homes, clinical laboratories, ambulatory surgery centers, urgent care centers, home health agencies, a captive insurance company, a foundation, an accountable health care organization, a Medicaid managed care health plan and related Medicare Advantage health plan, and other health care-related organizations in six western states. Banner also holds financial interests in several health care-related organizations, including a 51% controlling interest in Sonora Quest Laboratories (SQL); the financial results of SQL have been included in Banner's consolidated financial statements as of September 30, 2018 and December 31, 2017 and for the nine months ended September 30, 2018 and September 30, 2017. Banner records the unrelated investors' ownership share of consolidated business ventures as non-controlling interest. Banner also holds non-controlling financial interests in several entities that are accounted for under the equity method of accounting. Financial information from the most significant non-controlled entities is included in a subsequent footnote.

In December 2017, Banner entered into a business venture with Select Medical (Select) that will own and operate Banner's and Select's Arizona inpatient and outpatient rehabilitation services. The business venture, Banner Health Select Medical Rehabilitation, LLC (BHSM), began outpatient operations on May 1, 2018. Banner holds a 51% controlling interest in BHSM and Select holds a 49% non-controlling interest. Accordingly, the financial results of BHSM are included in Banner's consolidated financial statements as of September 30, 2018 and the financial operations are also included in Banner's consolidated financial statements since May 1, 2018. Banner records Select's ownership share of BHSM as non-controlling interest in the consolidated financial statements. BHSM has recorded approximately $9,892,000 of goodwill as of September 30, 2018 primarily representing the difference between the estimated fair value of consideration contributed as compared to the net identifiable assets assumed. The BHSM business venture agreement also provides for the construction of three new inpatient rehabilitation hospitals. Two of the three will break ground in the first half of 2019, while the third won't commence until mid-2020. Construction is expected to take eighteen months to complete. As these hospitals are completed, Banner will contribute its inpatient rehabilitation assets to BHSM and as part of this contribution Banner is expected to receive approximately $11,027,000 from Select representing 49% of the estimated fair value of the inpatient operations to be contributed. Banner expects to make total working capital contributions of $61,395,000 to facilitate the construction of the three new inpatient rehabilitation hospitals and growth of the outpatient rehabilitation business.

Banner entered into a new business venture with Atlas Healthcare Partners, LLC (Atlas), effective September 1, 2018, that will own and operate Banner's ambulatory surgery centers. The business venture is named Banner Atlas JV, LLC with Banner holding a 75% controlling interest and Atlas holding a 25% non-controlling interest. Atlas will manage the ambulatory surgery centers via a management service agreement and will work with Banner to develop additional ambulatory surgical facilities in Banner's primary markets. The initial capitalization of the joint venture occurred in October 2018 with Banner and Atlas contributing $270,000 and $90,000, respectively. The existing eight Banner ambulatory surgery centers will be contributed to the joint venture as each center is re-syndicated to include physician non-controlling ownership, which is expected to start in 2019. The Banner Atlas JV will always maintain a controlling interest in each surgery center. Atlas has entered into a $7.5M line of credit with Banner in which Atlas has not drawn any monies as of September 30, 2018.

2. Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial reporting, applied on a basis substantially consistent with that of the 2017 audited financial statements of Banner. They do not include all the information and footnotes required by GAAP for annual financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2018 are not necessarily indicative of the results to be expected for the year ending December 31, 2018. For more information, refer to the audited consolidated financial statements and notes thereto as of and for the year ended December 31, 2017.

Subsequent events have been evaluated through November 27, 2018, the date of the issuance of the unaudited consolidated financial statements.

Basis of Consolidation

The accompanying consolidated financial statements reflect the consolidated operations of all owned, controlled business ventures and leased operating units of Banner and its wholly owned subsidiaries.

All significant intercompany accounts and transactions have been eliminated in consolidation.

Short-Term Investments

Short-term investments primarily include debt securities with maturity dates of one year or less from the balance sheet date, US Treasury government obligations and actively traded equity securities that are expected to be used on a short-term basis for working capital needs. These investments are stated at fair value (Refer to Note 3).

2. Significant Accounting Policies (continued)

Investments

Banner invests in alternative investments, mainly hedge funds, through limited partnerships. Banner accounts for its ownership share in these alternative investments under the equity method based on the hedge funds' net asset value per share of the fund held by Banner. The hedge fund net asset value is provided to Banner by each of the hedge fund managers. The net asset value is determined based on the estimated fair value of each of the underlying investments held in the hedge fund. However, the hedge fund investment holdings may include investment in private investment funds whose values have been estimated by the hedge fund manager in the absence of readily ascertainable fair values. Due to the inherent uncertainty of these estimates, these values may differ from the values that would have been used had a ready market for these investments existed. Banner's share of the alternative investments' unrestricted realized and unrealized gains approximated $24,565,000 and $62,368,000 for the nine months ended September 30, 2018 and 2017, respectively. The restricted share of alternative investment realized and unrealized gains is approximately $523,000 and $937,000 for the nine months ended September 30, 2018 and 2017, respectively.

Banner uses derivative financial instruments in its investment portfolio to moderate changes in value due to fluctuations in the financial markets. Banner has not designated its derivatives related to marketable securities as hedged financial instruments. Accordingly, the change in fair value of derivatives is recognized as a component of investment income. Banner offsets the fair value for various derivative instruments including forwards, interest rate swaps, currency swaps, options and other conditional or exchange contracts, if they are executed with the same counterparty under a master netting arrangement. Banner invests in a variety of derivative instruments through fixed income managers that have executed a master netting arrangement with each of its forward and future purchase and sale contracts, interest and credit swap agreements and option agreements, whereby the financial instruments are held by the same counterparty and are legally offset as the instrument is settled. Banner's derivative contracts in a net loss position were immaterial at September 30, 2018 and December 31, 2017 and were reported on the accompanying consolidated balance sheets on a net basis. As of September 30, 2018, the gross derivative assets and liabilities held and netted together within the investment accounts amounted to assets of approximately $1,199,963,000 and liabilities of approximately $1,189,984,000. As of December 31, 2017, the gross derivative assets and liabilities held and netted together within the investment accounts amounted to assets of approximately $1,380,750,000 and liabilities of approximately $1,374,913,000. (See Note 3 for a more complete description of derivative assets and liabilities.)

Banner has entered into repurchase agreements amounting to approximately $392,947,000 and $163,931,000 as of September 30, 2018 and December 31, 2017, respectively, which are included in long-term investments on the accompanying consolidated balance sheets. In connection with the repurchase agreements, Banner has loaned cash to certain financial institutions in exchange for collateral. Collateral provided by the financial institutions amounted to approximately $403,406,000 and $164,777,000 as of September 30, 2018 and December 31, 2017, respectively, and is recorded in the consolidated balance sheets within collateral held under securities lending program and repurchase agreements.

2. Significant Accounting Policies (continued)

Banner participates in securities lending transactions through its custodian whereby Banner lends a portion of its investments to various brokers in exchange for collateral for the securities loaned, usually on a short-term basis. Collateral provided by the brokers consists of cash and securities and is maintained at levels approximating 104% and 103% of the fair value of the securities on loan, adjusted for market fluctuations as of September 30, 2018 and December 31, 2017, respectively. Banner maintains effective control of the loaned securities through its custodian during the term of the arrangement in that they may be recalled at any time. Under the terms of the agreement, the borrower must return the same, or substantially the same, investments that were borrowed. The value of collateral held for loaned securities is reported in current assets as collateral held under securities lending program and repurchase agreements, and a corresponding obligation is reported in current liabilities as a payable under securities lending program and repurchase agreements in the accompanying consolidated balance sheets. At September 30, 2018 and December 31, 2017, the fair value of the collateral provided on behalf of Banner was approximately $198,631,000 and $287,993,000, respectively. At September 30, 2018 and December 31, 2017, the fair value of securities on loan was approximately $189,780,000 and $279,360,000, respectively, and is included in assets limited as to use on the accompanying consolidated balance sheets.

Investments in Unconsolidated Affiliates

Banner records its share of earnings in non-controlled affiliates in other revenue. Banner accounts for the investment in these non-controlled affiliates under the equity method of accounting. The equity method investment is recorded in other long term assets on the consolidated balance sheet. Summarized financial information (unaudited) for significant unconsolidated joint ventures is as follows:

9/30/2018 (In Thousands)	Veritage	Banner-Core Ortho	Banner|Aetna	Cenpatico
Current assets	$ 107,479	$ 15,161	$ 205,742	$ 42,637
Non-current assets	13,090	–	101,552	92,060
Total assets	$ 120,569	$ 15,161	$ 307,294	$ 134,697
Current liabilities	$ 35,647	$ 8,111	$ 105,613	$ 54,760
Non-current liabilities	367	–	17,603	8,294
Capital	84,555	7,050	184,078	71,643
Total liabilities and capital	$ 120,569	$ 15,161	$ 307,294	$ 134,697
Excess of revenues over expenses – nine months ended September 30, 2018	$ 14,762	$ 11,957	$ 466	$ 2,032

12/31/2017 (In Thousands)	Veritage	Banner-Core Ortho	Banner|Aetna	Cenpatico
Current assets	$ 87,655	$ 27,108	$ 137,664	$ 60,588
Non-current assets	22,779	–	80,826	70,087
Total assets	$ 110,434	$ 27,108	$ 218,490	$ 130,675
Current liabilities	$ 40,641	$ 9,805	$ 33,921	$ 66,134
Non-current liabilities	–	–	20,212	474
Capital	69,793	17,303	164,357	64,067
Total liabilities and capital	$ 110,434	$ 27,108	$ 218,490	$ 130,675
Excess (deficit) of revenues over expenses – twelve months ended December 31, 2017	$ 12,425	$ 18,927	$ 20,808	$ (5,306)

2. Significant Accounting Policies (continued)

Net Patient Service Revenue

Banner adopted Accounting Standards Update 2014-09, *Revenue from Contracts with Customers (Topic 606)* on January 1, 2018 and has elected to use the modified retrospective adoption method. The modified retrospective adoption method requires a company to record the transition adjustment for the new revenue standard, if any, as a cumulative effect adjustment to the beginning unrestricted net assets recorded as of the date of adoption. Banner has recorded a transition adjustment of approximately $7,323,000 that was recorded as a reduction to the January 1, 2018 unrestricted net assets. As of January 1, 2018, net patient service revenue is reported at the amount that reflects the consideration to which Banner expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and include variable consideration (reductions to revenue) for retroactive revenue adjustments due to settlement of ongoing and future audits, reviews, and investigations. In addition, as of January 1, 2018, the net patient service revenue reported includes an implicit price concession which was previously reported as provision for doubtful accounts on the consolidated statements of income.

Banner uses a portfolio approach to account for categories of patient contracts as a collective group rather than recognizing revenue on an individual contract basis. The portfolios consist of major payor classes for inpatient revenue and major payor classes and types of services provided for outpatient revenue. Based on historical collection trends and other analyses, Banner believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach were used.

Banner’s initial estimate of the transaction price for services provided to patients is determined by reducing the total standard charges related to the patient services provided by various elements of variable consideration, including contractual adjustments, discounts, implicit price concessions, and other reductions to Banner’s standard charges. Banner determines the transaction price associated with services provided to patients who have third-party payor coverage based on the reimbursement terms outlined in contractual agreements, Banner’s discount policies and historical experience. For uninsured and under-insured patients who do not qualify for charity care, Banner determines the transaction price associated with services on the basis of charges reduced by implicit price concessions. Implicit price concessions included in the estimate of the transaction price are based on Banner’s historical collection experience for applicable patient portfolios. Patients who meet Banner’s criteria for free care are provided care without charge; such amounts are not reported as revenue. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to net patient service revenue in the period of the change.

For the nine months ended September 30, 2018, changes in Banner’s estimates of implicit price concessions, discounts, contractual adjustments or other reductions to expected payments for performance obligations satisfied in prior years were not significant.

Net patient service revenue is recognized as performance obligations are satisfied, despite the fact that Banner bills patients and third-party payors several days after the services are performed and/or the patient is discharged. Performance obligations are determined based on the nature of the services provided by Banner. Net patient service revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total charges. Banner believes that this method provides a reasonable depiction of the transfer of services over the term of the performance obligation based on the services needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients receiving inpatient acute care services. Banner measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time is recognized when goods or services are provided, and Banner does not believe it is required to provide additional goods or services to the patient.

2. Significant Accounting Policies (continued)

Banner has determined that the nature, amount, timing and uncertainty of revenue and cash flows are affected by the payors, the lines of business that render services to patients and the timing of when revenue is recognized and billed. Net patient service revenue for the nine months ended September 30, 2018, by payor, under the new revenue standard effective January 1, 2018, and net patient service revenue for the nine months ended September 30, 2018 and 2017, under the accounting revenue standards prior to January 1, 2018 in which the net patient service revenue is presented net of the provision for doubtful accounts, is as follows (in thousands):

	9/30/18 – New Standard	9/30/18 – Prior Standard	9/30/17 – Prior Standard
Medicare	$ 1,118,754	$ 1,114,350	$ 1,139,613
Medicaid	730,891	749,334	694,010
Commercial payors	368,097	371,824	323,157
Contracted payors	2,564,026	2,556,899	2,521,215
Self pay	86,354	75,715	41,540
	$ 4,868,122	$ 4,868,122	$ 4,719,535

Deductibles, copayments and coinsurance under third-party payment programs which are the patient's responsibility are included within the primary payor category in the table above.

Net patient service revenue for the nine months ended September 30, 2018 by line of business is as follows (in thousands):

Hospital	$ 4,137,306
Physician services	414,186
Home care	36,830
Laboratory	210,294
Other	69,506
	$ 4,868,122

Premium Revenues and Claims Costs

Premium revenues and claims costs of Banner Health Network (BHN), an accountable care organization, and the Banner--University Health Plans (BUHP) are as follows for the nine-months ended (in thousands):

	9/30/2018	9/30/2017
Net premium revenue	**$ 1,100,479**	$ 855,252
Net claims cost	**810,242**	606,160
BHN and BUHP eliminations	**280,412**	307,973
Less: premium deficiency reserve	**(7,520)**	27,098
Gross claims cost, including claims paid to Banner facilities and providers	**$ 1,098,174**	$ 887,035
Claims cost as a percent of premiums	**99.8%**	103.7%

2. Significant Accounting Policies (continued)

Both BHN and BUHP recorded premium deficiency reserves (PDR) in prior years. The PDR is an accrual of anticipated future losses under existing insurance contracts. As losses are incurred in future periods, the PDR accrual is reversed against the recorded losses. PDR amortization of $7,520,000 was recorded in the nine months ending September 30, 2018.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements.

Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates are made in the areas of patient accounts receivable, accruals for settlements with third-party payors, risk pool and insurance settlements, medical claim liabilities, contingent liabilities, and accrued liabilities resulting from self-insurance programs. For the nine months ended September 30, 2018 and 2017, net patient services revenue increased by $23,995,000 and $17,394,000, respectively, for prior year third party settlements and increased $3,583,000 and $23,728,000, respectively, for changes in reimbursement for the state of Arizona graduate medical education programs. For the nine months ended September 30, 2018 and 2017, other revenue increased by $5,271,000 and $22,729,000, respectively, due to adjustments to BHN's prior year's risk contract sharing arrangements including Banner's estimated settlement with the Medicare Shared Savings Program. For the nine months ended September 30, 2018, medical insurance premiums increased by $19,629,000 relating to prior year capitation risk adjustments for Banner's contracted Medicaid and Medicare Advantage plans. For the nine months ended September 30, 2018 and 2017, Banner recorded an increase to claim expense of $6,287,000 and $814,000, respectively, relating to adjustments to the prior year claim liabilities. For the nine months ended September 30, 2018 and 2017, salary expense decreased by $5,114,000 and $1,312,000, respectively, relating to adjustments to the previous years' incentive programs.

New Accounting Pronouncements Adopted

In September 2017, the Financial Accounting Standard Board (FASB) issued a new accounting standard related to improving the presentation of net periodic pension cost and net periodic postretirement benefit cost. This accounting standard changes how employers that sponsor defined benefit pension and/or other postretirement benefit plans present the cost of the benefits in the income statement. Banner adopted this standard January 1, 2018, which has the effect of moving the non-service component of the defined benefit pension plan cost from salaries and benefits to other non-operating expenses. Total pension cost recorded in non-operating expenses, for the nine months ended September 30, 2018 and 2017, amounted to $1,733,000 and $1,725,000, respectively.

In August 2016, the FASB issued a new financial statement accounting standard for not-for-profit entities. This accounting standard will change the presentation of net assets into two categories, net assets with donor restrictions and net assets without donor restrictions. This accounting standard will also allow companies to elect to use either the direct or indirect cash flow method and requires additional disclosures and presentation of expenses by both natural and functional classification. This accounting standard is effective for fiscal years beginning after December 15, 2017. Banner will adopt the new financial statement accounting standard in the December 31, 2018 annual financial statements, in which the standard will require additional disclosure surrounding liquidity and functional expenditures. Banner has elected to continue to use the indirect cash flow method.

2. Significant Accounting Policies (continued)

Pending Accounting Pronouncements

In February 2016, the FASB issued a new lease accounting standard. This accounting standard requires companies that lease assets to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in its balance sheet. This accounting standard will also require additional disclosures about the amount, timing and uncertainty of cash flows arising from leases. This accounting standard is effective for fiscal years beginning after December 15, 2018. Management is currently evaluating the impact of adopting this accounting standard.

In January 2017, the FASB issued a new intangibles-goodwill accounting standard. The accounting standard simplified the test used to evaluate goodwill and other intangibles for impairment. Under the new accounting standard, a company will perform its annual goodwill impairment test by comparing the fair value of the reporting unit with its carrying amount. An impairment charge will be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value, however, the impairment loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. A company will still have the option to perform the qualitative assessment for a reporting unit. This accounting standard is effective for fiscal years beginning after December 15, 2020. Management is currently evaluating the impact of adopting this accounting standard.

In September 2018, the FASB issued a new grant contribution accounting standard. The accounting standard clarified how organizations should account for contributions received and made. The accounting standard provides additional clarification as to whether a contribution is a nonreciprocal transaction, and therefore should be reported under the not-for-profit contribution guidance, or an exchange transaction, which would be reported under the new revenue accounting standard. This accounting standard is effective for fiscal years beginning after September 15, 2018. Management is currently evaluating the impact of adopting this accounting standard.

Reclassifications

Prior year amounts have been reclassified to conform to the current year presentation. Minor reclassifications were made to September 30, 2017 revenues and expenses to properly reflect intercompany transfers, and $1,725,000 was reclassified from salaries and benefits expense to other non-operating costs, consistent with the 2018 presentation of defined benefit pension costs due to the adoption of the pension accounting standard.

3. Fair Value of Financial Instruments

Fair value is defined as 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, Banner utilizes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1. Pricing inputs into the determination of fair value are generally observable inputs such as quoted prices in active markets. Financial assets in Level 1 primarily include cash and cash equivalents, mutual funds, and listed 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 term of the assets or liabilities.

Level 3. Pricing inputs are generally unobservable and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of

3. Fair Value of Financial Instruments (continued)

assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using factors that involve considerable judgment and interpretations, including but not limited to private and public comparables, third party appraisals, discounted cash flow models, and fund manager estimates.

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

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

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

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

Banner's investment in alternative investments, amounting to approximately $1,095,222,000 and $1,015,320,000 as of September 30, 2018 and December 31, 2017, respectively, are accounted for using the equity method of accounting. Accordingly, the alternative investments are omitted from the following schedule of financial instruments measured at fair value. Also, included in assets limited as to use are premium payments to be received from Banner's split dollar life insurance policies amounting to $3,534,000 and $6,114,000 as of September 30, 2018 and December 31, 2017, respectively, which are not measured at fair value. The decrease in split dollar receivables is due to the program winding down and policies being surrendered. Further decreases are expected over the next several years. There have not been any changes in any financial instruments' fair value classification between Level 1 and Level 2 since December 31, 2017. Banner has no Level 3 financial instruments.

3. Fair Value of Financial Instruments (continued)

	September 30, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b, c)
	(In Thousands)				
Cash and cash equivalents	$ 56,344	$ 56,344	$ -	$ -	a
Commercial paper	7,174	-	7,174	-	a
Collateral held under securities lending and repurchase agreement (primarily cash and debt securities)	602,037	171,764	430,273	-	a
Mutual funds:					a
Mutual funds – U.S. funds	1,645,201	1,645,201	-	-	a
Mutual funds – International	716,025	716,025	-	-	a
Total mutual funds	2,361,226	2,361,226	-	-	
Debt securities:					
U.S. Treasury/government obligations	434,432	-	434,432	-	a
Corporate bonds/Non-U.S. government bonds	177,799	-	177,799	-	a
Asset-backed securities	73,890	-	73,890	-	a
Commercial mortgage-backed securities	8,568	-	8,568	-	a
Non-government-backed collateralized mortgages	6,329	-	6,329	-	a
Government mortgage-backed securities		-	-	-	a
Government commercial backed	5,963	-	5,963	-	a
Total debt securities	706,981	-	706,981	-	
Repurchase agreements	392,947	-	392,947	-	a
Equity securities:					
U. S. equity securities	97,891	97,891	-	-	a
International equity securities	202,364	202,364	-	-	a
Total equity securities	300,255	300,255	-	-	
Derivative securities					
Future contracts	149,185	149,185	-	-	a
Forward contracts	1,038,575	-	1,038,575	-	a
Interest rate swap agreements	6,987	-	6,987	-	a
Net credit swaps	5,216	-	5,216	-	a
Subtotal derivative assets	1,199,963	149,185	1,050,778	-	
Future contracts	(149,185)	(149,185)	-	-	a
Forward contracts	(1,040,282)	-	(1,040,282)	-	a
Interest rate swap agreements	(298)	-	(298)	-	a
Option agreements	(35)	-	(35)	-	a
Net credit swaps	(184)	-	(184)	-	a
Subtotal derivative liabilities	(1,189,984)	(149,185)	(1,040,799)	-	
Total fair value investments	$ 4,436,943	$ 2,889,589	$ 1,547,354	$ -	
Short-term investments	$ 93,340				
Collateral held under securities lending and repurchase agreements	602,037				
Assets limited as to use	2,450,904				
Long-term investments	2,299,672				
Other assets – Banner Foundation restricted funds	89,746				
Less: alternative investments	1,095,222				
Less: split dollar life insurance	3,534				
Total fair value investments	$ 4,436,943				
Interest rate swaps	$ (224,216)	$ -	$ (224,216)	$ -	c

3. Fair Value of Financial Instruments (continued)

	December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b, c)
	(In Thousands)				
Cash and cash equivalents	$ 445,490	$ 396,314	$ 49,176	$ –	a
Collateral held under securities lending and repurchase agreement (primarily cash and debt securities)	452,770	337,931	114,839	–	a
Mutual funds:					
Mutual funds – U.S. funds	1,337,830	1,337,830	–	–	a
Mutual funds – International	641,160	641,160	–	–	a
Total mutual funds	1,978,990	1,978,990	–	–	
Debt securities:					
U.S. Treasury/government obligations	293,005	–	293,005	–	a
Corporate bonds/non-U.S. government bonds	288,847	–	288,847	–	a
Asset-backed securities	160,792	–	160,792	–	a
Commercial mortgage-backed securities	13,888	–	13,888	–	a
Non-government-backed collateralized mortgages	21,567	–	21,567	–	a
Government mortgage-backed securities	392,670	–	392,670	–	a
Government commercial-backed	11,598	–	11,598	–	a
Total debt securities	1,182,367	–	1,182,367	–	
Repurchase agreements	163,931	–	163,931	–	a
Equity securities:					
U.S. equity securities	113,611	113,611	–	–	a
International equity securities	219,698	219,698	–	–	a
Total equity securities	333,309	333,309	–	–	
Derivative securities:					
Future contracts	344,681	344,681	–	–	a
Forward contracts	996,920	–	996,920	–	a
Interest rate swap agreements	18,183	–	18,183	–	a
Option agreements	19	–	19	–	a
Net credit swaps	20,947	–	20,947	–	a
Subtotal derivative assets	1,380,750	344,681	1,036,069	–	
Future contracts	(344,681)	(344,681)	–	–	a
Forward contracts	(999,429)	–	(999,429)	–	a
Interest rate swap agreements	(15,044)	–	(15,044)	–	a
Option agreements	(151)	–	(151)	–	a
Net credit swaps	(15,608)	–	(15,608)	–	a
Subtotal derivative liabilities	(1,374,913)	(344,681)	(1,030,232)	–	
Total fair value investments	$ 4,562,694	$ 3,046,544	$ 1,516,150	$ –	
Short-term investments	$ 59,114				
Collateral held under securities lending and repurchase agreements	452,770				
Assets limited as to use	2,610,666				
Long-term investments	2,374,808				
Other assets – Banner Foundation restricted funds	86,770				
Less alternative investments	1,015,320				
Less split-dollar life insurance	6,114				
Total fair value investments	$ 4,562,694				
Interest rate swaps included in other long-term liabilities	$ (311,004)	$ –	$ (311,004)	$ –	c

3. Fair Value of Financial Instruments (continued)

Investment income consisted of the following for the nine months ended September 30:

(In Thousands)

	2018	2017
Interest and dividend income	$ 47,873	$ 38,958
Net realized gain on sales of investments	69,885	64,897
Gain from alternative investments	25,088	63,305
Net realized (loss) gain on sales of future contracts	(3,846)	1,275
Net realized (loss) on sales of interest rate swap agreements	(394)	(4,123)
Net realized gain on sales of option agreements	890	616
Net realized gain on sales of net credit swaps	926	89
Net unrealized (loss) gain on investments	(49,785)	162,547
Net unrealized gain on interest rate swap agreements	6,663	2,887
Net unrealized gain (loss) on option agreements	70	(112)
Net unrealized gain on net credit swaps	1,387	2,500
	98,757	332,839
Less: Investment income credited to other revenue, restricted funds, and capitalized bond project funds	3,319	4,994
Investment income	$ 95,438	$ 327,845

4. Debt

On September 14, 2018, Banner extended the direct pay letter of credit with The Northern Trust Company for the Series 2008H bonds until September 13, 2022. Simultaneously, Banner reclassified $53,215,000 of current debt to long-term debt.

5. Interest Rate Swap Agreements

Banner entered into multiple interest rate swaps that currently do not qualify for hedge accounting. For the nine months ended September 30, 2018 and 2017, the mark-to-market adjustment resulted in an unrealized gain of $86,617,000 and $8,849,000 respectively, recorded in excess of revenue over expenses. The net effect of the interest rate swaps, recorded in interest expense, was to increase the overall cost of borrowing for the nine months ended September 30, 2018 and 2017, by $22,491,000 and $28,525,000, respectively.

Each of the interest rate swap agreements has collateral posting thresholds based on the counterparties' bond ratings. At the AA- rating level, Banner and its counterparties must post collateral when the mark-to-market adjustment exceeds between $35,000,000 and $75,000,000 depending on the counterparty. At September 30, 2018 and December 31, 2017, Banner had $29,227,000 and $120,045,000 of collateral outstanding with its counterparties, respectively. The fair value of the collateral is reported as other funds under the assets limited as to use category in the accompanying consolidated balance sheets.

6. Commitments and Contingencies

Compliance with Laws and Regulations

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers.

Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties as well as significant repayments for patient services previously billed. Compliance with such laws and regulations can be subject to future review and interpretation as well as regulatory actions unknown or unasserted at this time.

In addition to general and professional liability claims, Banner is involved in litigation and regulatory investigations arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, these matters are expected to be resolved without material adverse effect on Banner's consolidated financial position, results of operations, or cash flows.

6. Commitments and Contingencies (continued)

Short-Stay Settlement and CIA Disclosure Statement

On April 10, 2018, Banner agreed to a final settlement with the United States Department of Justice (the “D.O.J.”) to resolve the previously disclosed D.O.J. investigation into allegations that Banner submitted claims for inpatient services provided at several hospitals between late 2007 and 2016 that should have been claimed as outpatient or observation services. Banner agreed to pay approximately $18.3 million to resolve all federal government civil claims related to this matter, including claims that had been brought in a civil qui tam action under the Federal False Claims Act, avoiding further expense and potential distraction from protracted litigation. Banner’s settlement of the federal government’s claims does not constitute an admission or determination of improper conduct in the matter. In connection with the resolution of this matter, Banner has entered into a Corporate Integrity Agreement (the “Agreement”) with the Office of Inspector General of the Department of Health and Human Services (the “O.I.G.”), which is customary at the conclusion of many government healthcare investigations.

Debt Guarantee

Banner has subleased North Colorado Medical Center (NCMC) and other real and personal property comprising substantially all of the assets located in Weld County, Colorado, and used by Banner for health care operations from NCMC, Inc. since 1995. Effective as of January 1, 2012, Banner entered into a Second Amended and Restated Operating Agreement (the Second Amended Operating Agreement) with NCMC, Inc. The Second Amended Operating Agreement extended the term of the sublease through December 31, 2027.

Banner has guaranteed payment of the principal and interest on various debt offerings of NCMC, Inc. pursuant to the limited guaranty agreements entered into with the bond trustee. Under the limited guaranty agreements applicable to the NCMC, Inc. Series 2016, 2013, and 2012 bonds, Banner agrees to pay the principal and interest on such bonds in the event of default by NCMC, Inc.; however, the aggregate amount payable under the limited guaranty agreements applicable to the Series 2016, 2013, and 2012 bonds is limited to the rent otherwise payable under the Second Amended Operating Agreement. As of September 30, 2018, $201,200,000 was outstanding under the NCMC, Inc. Series 2016, 2013, and 2012 bonds, net of an amount held in escrow. The maximum annual debt service on the NCMC, Inc. Series 2016, 2013, and 2012 bonds is approximately $17,692,000. Actual rent paid to NCMC, Inc. in the first nine months of 2018 was $28,423,000. In the event of default by NCMC, Inc., Banner has agreed to pay directly to the trustee, monthly, the portion of the rent equal to NCMC, Inc.’s debt service obligation. Such payments are to be credited against rent and all other payment obligations to NCMC, Inc. under the Second Amended Operating Agreement. Banner is not obligated to pay any amounts that become due on such bonds as a result of acceleration of the principal of the bonds under the Master Indenture. Banner’s obligations under the limited guaranty agreements cease upon the termination of the Second Amended Operating Agreement. Banner did not record a liability for the limited guaranty agreements at September 30, 2018 or December 31, 2017.

7.Subsequent Events

On October 22, 2018, Banner extended the direct pay letter of credit with Wells Fargo Bank, N.A. for the Series 2008G bonds until November 11, 2021. As such, the long-term portion of the 2008G bonds has been reclassed from current to long term debt in September 2018.

Supplementary Information

Banner Health

Balance Sheet - Obligated and Non-Obligated Group Details of Consolidation

September 30, 2018

Unaudited

	Obligated Group	Non-Obligated Group	Eliminations	Total Consolidated
	(In Thousands)			
Assets				
Current assets:				
Cash and cash equivalents	$ 22,672	$ 294,557	$ -	$ 317,229
Short-term investments	93,322	18	-	93,340
Collateral held under securities lending program and repurchase agreements	602,037	-	-	602,037
Patient receivables, net	799,494	101,468	(56,735)	844,227
Inventories	178,527	27,706	-	206,233
Other receivables	185,993	112,095	(8,337)	289,751
Assets limited as to use	9,883	36,071	-	45,954
Other, primarily prepaid expenses	422,134	(333,071)	-	89,063
Total current assets	2,314,062	238,844	(65,072)	2,487,834
Assets limited as to use:				
Funds designated by:				
Board of Directors	2,161,868	-	-	2,161,868
Lease agreements	1,914	-	-	1,914
Funds held by trustees under:				
Self-insurance funding arrangements	(271)	107,853	-	107,582
Other funds	132,645	941	-	133,586
Total assets limited as to use, less current portion	2,296,156	108,794	-	2,404,950
Assets held for sale	2,140	-	-	2,140
Property and equipment, net	3,530,606	110,913	-	3,641,519
Leased hospital assets	213,342	-	-	213,342
Other assets:				
Long-term investments	2,269,496	30,176	-	2,299,672
Other	546,368	197,995	59,958	804,321
Total other assets	2,815,864	228,171	59,958	3,103,993
Total assets	$ 11,172,170	$ 686,722	$ (5,114)	$ 11,853,778

Banner Health

Balance Sheet - Obligated and Non-Obligated Group Details of Consolidation

September 30, 2018

Unaudited

	Obligated Group	Non-Obligated Group	Eliminations	Total Consolidated
	(In Thousands)			
Liabilities and net assets				
Current liabilities				
Trade accounts payable	$ 156,676	$ 25,017	$ -	$ 181,693
Current portion of long-term debt	58,473	608	-	59,081
Debt subject to self-liquidity	200,000	-	-	200,000
Current portion of hospital lease obligation	22,907	-	-	22,907
Payable under securities lending program and repurchase agreements	602,037	-	-	602,037
Estimated current portion of third-party payor settlements	2,805	-	-	2,805
Accrued expenses:				
Salaries and benefits	322,788	71,597	(17,679)	376,706
Medical claims payable	-	212,541	(40,345)	172,196
Other	162,272	72,245	(3,008)	231,509
Total current liabilities	1,527,958	382,008	(61,032)	1,848,934
Long-term debt, less current portion	3,063,110	4,980	-	3,068,090
Hospital lease obligation	214,382	-	-	214,382
Estimated self-insurance liabilities, less current portion	74,704	127,585	(4,040)	198,249
Estimated third-party payor settlements, less current portion	33,256	-	-	33,256
Interest rate swaps	224,216	-	-	224,216
Other	185,619	4,319	-	189,938
Total liabilities	5,323,245	518,892	(65,072)	5,777,065
Net assets:				
Unrestricted	5,773,299	11,370	59,958	5,844,627
Temporarily restricted	75,626	113,204	-	188,830
Total Banner Health net assets	5,848,925	124,574	59,958	6,033,457
Non-controlling interests - unrestricted	-	43,256	-	43,256
Total net assets	5,848,925	167,830	59,958	6,076,713
Total liabilities and net assets	$ 11,172,170	$ 686,722	$ (5,114)	$ 11,853,778

Banner Health

Statement of Income and Changes in Net Assets -

Obligated and Non-Obligated Group Details of Consolidation

Nine Months Ended September 30, 2018

Unaudited

	Obligated Group	Non-Obligated Group	Eliminations	Total Consolidated
		(In Thousands)		
Revenues:				
Net patient service revenue	$ 4,459,348	$ 739,796	$ (331,022)	$ 4,868,122
Medical insurance premiums	-	1,100,479	-	1,100,479
Other revenue	174,591	248,249	(135,925)	286,915
Total other operating revenue	174,591	1,348,728	(135,925)	1,387,394
Total revenues	4,633,939	2,088,524	(466,947)	6,255,516
Expenses:				
Salaries and benefits	2,146,135	941,609	(90,096)	2,997,648
Supplies	850,825	167,750	(2,605)	1,015,970
Physician and professional fees	119,655	57,194	(24,674)	152,175
Medical claims costs	-	1,054,368	(244,126)	810,242
Depreciation and amortization	294,827	11,062	-	305,889
Interest	90,573	4,467	(24)	95,016
Other	736,067	125,308	(104,936)	756,439
Total expenses	4,238,082	2,361,758	(466,461)	6,133,379
Operating income (loss)	395,857	(273,234)	(486)	122,137
Other income (loss):				
Investment income - realized	108,524	3,978	(24)	112,478
Investment loss - unrealized	(40,921)	(684)	-	(41,605)
Income from alternative investments	22,990	1,575	-	24,565
Investment income	90,593	4,869	(24)	95,438
Unrealized gain on interest rate swaps	86,617	-	-	86,617
Other	(6,065)	(1,454)	1,590	(5,929)
	171,145	3,415	1,566	176,126
Excess (deficiency) of revenues over expenses	567,002	(269,819)	1,080	298,263
Less excess of revenues over expenses attributable to non-controlling interest	-	19,916	-	19,916
Excess (deficiency) of revenues over expenses attributable to Banner Health	567,002	(289,735)	1,080	278,347
Amortization of cumulative loss on interest rate swaps	170	-	-	170
Equity transfers	(352,151)	352,151	-	-
Cumulative effect of change in accounting principle	(7,323)	-	-	(7,323)
Contribution for property and equipment acquisitions	4,773	431	(1,080)	4,124
Other changes in unrestricted net assets	7,125	3,246	(10,369)	2
Increase in unrestricted net assets	219,596	66,093	(10,369)	275,320
Temporarily restricted net assets:				
Contributions	4,898	11,842	-	16,740
Net unrealized loss on investments	(6)	236	-	230
Net assets released from restriction	(1,410)	(10,091)	-	(11,501)
Increase in temporarily restricted net assets	3,482	1,987	-	5,469
Non-controlling interests:				
Excess of revenue over expenses attributable to non-controlling interests	-	19,916	-	19,916
Other changes, primarily distributions of earnings to non-controlling interests	-	(8,472)	-	(8,472)
Increase in non-controlling interests	-	11,444	-	11,444
Increase in net assets	223,078	79,524	(10,369)	292,233
Net assets, beginning of year	5,625,847	88,306	70,327	5,784,480
Net assets, end of period	$ 5,848,925	$ 167,830	$ 59,958	$ 6,076,713

Banner Health

Statement of Cash Flows -

Obligated and Non-Obligated Group Details of Consolidation

Nine Months Ended September 30, 2018

Unaudited

	Obligated Group	Non-Obligated Group	Eliminations	Total Consolidated
	(In Thousands)			
Operating activities				
Increase in net assets	$ 223,078	$ 79,524	$ (10,369)	$ 292,233
Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities:				
Equity transfers	352,151	(352,151)	-	-
Cumulative effect of change in accounting principle	7,323	-	-	7,323
Depreciation and amortization	294,827	11,062	-	305,889
Decrease in investments designated as trading	144,881	10,834	-	155,715
Net unrealized gain on interest rate swaps	(86,788)	-	-	(86,788)
Gain on sale of assets	(332)	(303)	-	(635)
Contributions for purchase of property and equipment	(4,773)	(431)	1,080	(4,124)
Temporarily restricted contributions	(4,898)	(11,842)	-	(16,740)
Noncontrolling interest	20,335	-	-	20,335
Changes in operating elements:				
Patient receivables	39,874	(386)	16,174	55,662
Inventories and other current assets	(12,975)	(50,475)	380	(63,070)
Accounts payable and accrued expenses	(94,383)	(4,721)	(16,435)	(115,539)
Estimated third-party payor settlements	(6,964)	63	-	(6,901)
Estimated self-insurance liabilities	9,288	11,066	(119)	20,235
Other liabilities	4,562	(533)	-	4,029
Net cash provided by (used in) operating activities	885,206	(308,293)	(9,289)	567,624
Investing activities				
Net purchases of property and equipment	(404,635)	(18,852)	(1,080)	(424,567)
Decrease in project fund	44,957	-	-	44,957
Increase in other assets	(56,966)	(31,345)	10,369	(77,942)
Net cash used in investing activities	(416,644)	(50,197)	9,289	(457,552)
Financing activities				
Proceeds from temporarily restricted contributions	4,898	11,842	-	16,740
Proceeds from issuance of debt	-	298	-	298
Intercompany activity, including equity transfers	(374,012)	374,012	-	-
Payments of hospital lease obligations	(17,184)	-	-	(17,184)
Payments of long-term debt	(65,237)	(36)	-	(65,273)
Cash distributions to noncontrolling interests	(20,335)	-	-	(20,335)
Net cash (used in) provided by financing activities	(471,870)	386,116	-	(85,754)
Net increase in cash and cash equivalents	(3,308)	27,626	-	24,318
Cash and cash equivalents at beginning of year	25,980	266,931	-	292,911
Cash and cash equivalents at end of period	$ 22,672	$ 294,557	$ -	$ 317,229