Allegheny Health Network

Consolidated Financial Statements
December 31, 2021 and 2020

Allegheny Health Network
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December 31, 2021 and 2020

Report of Independent Auditors

To the Boards of Directors of Highmark Health and Allegheny Health Network:

Opinion

We have audited the accompanying consolidated financial statements of Allegheny Health Network and its subsidiaries (the "Health Network"), which comprise the consolidated balance sheets as of December 31, 2021 and 2020, and the related consolidated statements of operations, of changes in net assets and of cash flows for the years then ended, including the related notes (collectively referred to as the "consolidated financial statements").

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Allegheny Health Network as of December 31, 2021 and 2020, and the results of its operations, changes in their net assets, and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (US GAAS). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are required to be independent of the Health Network and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Consolidated Financial Statements

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Health Network's ability to continue as a going concern for one year after the date the financial statements are available to be issued.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with US GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with US GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Health Network's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Health Network's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

PricewaterhouseCoopers LLP

Philadelphia, Pennsylvania
March 23, 2022

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Allegheny Health Network
Consolidated Balance Sheets
Years Ended December 31, 2021 and 2020

(in thousands of dollars)

	2021	2020
Assets		
Current assets		
Cash and cash equivalents	$ 259,127	$ 260,438
Accounts receivable		
Patient accounts	453,827	435,182
Other	60,888	283,153
Inventory, net	111,426	112,196
Estimated third-party payor settlements	1,749	-
Prepaid expenses and other current assets	43,339	37,130
Total current assets	930,356	1,128,099
Investments		
Debt securities, available-for-sale at fair value	98,879	83,676
Equity securities at fair value	19,538	15,195
Board designated, restricted and other investments at fair value	708,495	573,016
Beneficial interest in perpetual trusts	325,806	292,248
Equity method investments	42,650	39,501
Property and equipment, net	1,862,066	1,761,018
Operating lease right to use assets	238,174	289,253
Financing lease right to use assets	65,903	67,609
Deferred tax asset, net	7,140	8,006
Goodwill and other intangible assets, net	117,482	120,243
Other assets	79,828	72,005
Total assets	$ 4,496,317	$ 4,449,869

The accompanying notes are an integral part of these consolidated financial statements.

Allegheny Health Network
Consolidated Balance Sheets
Years Ended December 31, 2021 and 2020

(in thousands of dollars)

	2021	2020
Liabilities and Net Assets		
Current liabilities		
Accounts payable	$ 318,302	$ 312,234
Accrued salaries and benefits	188,328	149,172
Accrued expenses	48,586	85,995
Estimated third-party payor settlements	-	1,206
Current portion of:		
CMS advances	135,124	94,504
Long-term debt	25,911	9,546
Deferred revenue	31,715	29,734
Self-insurance liabilities	23,042	22,577
Operating lease liabilities	35,823	42,567
Financing lease liabilities	3,264	2,720
Other liabilities	2,077	1,139
Total current liabilities	812,172	751,394
Accrued pension obligation	152,740	238,950
Self-insurance liabilities	114,742	97,479
Long-term debt	960,502	1,002,433
CMS advances	-	137,986
Deferred revenue	30,621	30,619
Operating lease liabilities	212,569	255,156
Financing lease liabilities	70,385	66,092
Other liabilities	70,702	91,213
Total liabilities	2,424,433	2,671,322
Net assets		
Without donor restrictions	1,622,333	1,376,196
Without donor restrictions - noncontrolling interest	41,009	34,394
Total net assets without donor restrictions	1,663,342	1,410,590
With donor restrictions	408,542	367,957
Total net assets	2,071,884	1,778,547
Total liabilities and net assets	$ 4,496,317	$ 4,449,869

The accompanying notes are an integral part of these consolidated financial statements.

Allegheny Health Network
Consolidated Statements of Operations
Years Ended December 31, 2021 and 2020

(in thousands of dollars)

	2021	2020
Revenue and other support		
Net patient service revenue	$ 3,736,161	$ 3,348,637
Other operating revenue	279,635	290,920
Net assets released from restriction	4,515	5,782
Total revenue and other support	4,020,311	3,645,339
Expenses		
Salaries, wages and fringe benefits	2,214,670	2,086,339
Patient care supplies	906,859	791,999
Professional fees and purchased services	483,879	439,463
Depreciation and amortization	202,799	181,578
Other operating expenses	332,082	314,465
Total operating expenses	4,140,289	3,813,844
Operating loss	(119,978)	(168,505)
Net investment income	42,067	50,059
Interest expense	(23,854)	(24,411)
Income attributed to non-controlling interest	(7,083)	(1,184)
Other components of net periodic benefit credit	34,243	21,574
Non-operating income (expense), net	2,351	(2,230)
Deficit of revenue over expenses before income taxes	(72,254)	(124,697)
Income tax (expense) benefit	(2,136)	2,906
Deficit of revenue over expenses	$ (74,390)	$ (121,791)
Other changes in net assets without donor restrictions:		
Pension liability adjustments	60,836	(8,868)
Change in non-controlling interest	6,615	7,642
Net assets released from restriction for acquisition of equipment	1,827	651
Transfers from affiliate	266,191	264,125
Other, net	(8,327)	(5,521)
Increase in other changes in net assets without donor restrictions	327,142	258,029
Increase in net assets without donor restrictions	$ 252,752	$ 136,238

The accompanying notes are an integral part of these consolidated financial statements.

Allegheny Health Network
Consolidated Statements of Changes in Net Assets
Years Ended December 31, 2021 and 2020

(in thousands of dollars)

	2021	2020
Net assets without donor restrictions		
Deficit of revenue over expenses	$ (74,390)	$ (121,791)
Pension-related changes other than net periodic pension cost	60,836	(8,868)
Change in non-controlling interest	6,615	7,642
Net assets released from restriction for acquisition of equipment	1,827	651
Transfers from affiliate	266,191	264,125
Other, net	(8,327)	(5,521)
Increase in net assets without donor restrictions	252,752	136,238
Net assets with donor restrictions		
Contributions	7,866	6,985
Net investment income	48,116	44,316
Net assets released from restriction used for:		
Operations	(4,515)	(5,782)
Acquisition of equipment	(1,827)	(651)
Transfer out of trusts to net investment income	(9,482)	(9,955)
Other, net	427	(148)
Increase in net assets with donor restrictions	40,585	34,765
Increase in net assets	293,337	171,003
Net assets		
Beginning of the year	1,778,547	1,607,544
End of the year	$ 2,071,884	$ 1,778,547

The accompanying notes are an integral part of these consolidated financial statements.

Allegheny Health Network
Consolidated Statements of Cash Flows
Years Ended December 31, 2021 and 2020

(in thousands of dollars)

	2021	2020
Cash flows from operating activities		
Increase in net assets	$ 293,337	$ 171,003
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Transfers from affiliate	(266,191)	(264,125)
Depreciation and amortization	202,799	181,578
Pension liability adjustments	(60,836)	8,868
Noncash pension income	(25,374)	(12,498)
Net realized and unrealized gain on investments	(11,345)	(37,018)
Dividends received from equity method investments	4,506	7,087
Undistributed gains of equity method investments	(8,032)	(6,136)
Change in beneficial interest in perpetual trusts	(33,558)	(29,246)
Loss on OTT impairment	-	5,760
Deferred taxes	866	(3,749)
Restricted contributions	(7,866)	(6,985)
(Decrease) increase due to change in:		
Accounts receivable	(18,645)	(38,235)
Other receivables	222,265	(11,220)
Inventory, prepaids and other current assets	1,012	(40,235)
Other long-term assets	44,872	(1,953)
Accounts payable, accrued expenses and other current liabilities	(6,835)	82,861
Accrued pension obligation	-	(46,000)
CMS advances	(97,366)	232,490
Other liabilities	(51,248)	47,703
Net cash provided by operating activities	182,361	239,950
Cash flows from investing activities		
Purchases of investments	(311,742)	(194,483)
Proceeds from sales of investments	159,243	307,820
Proceeds from maturities of investments	20,342	31,883
Cash paid for acquisitions, net	-	(5,220)
Purchases of property and equipment	(293,065)	(322,760)
Net cash used in investing activities	(425,222)	(182,760)
Cash flows from financing activities		
Restricted contributions	7,866	6,985
Proceeds from issuance of debt	4,924	4,381
Repayment of debt	(24,805)	(5,495)
Transfers from affiliate	266,191	46,270
Net cash provided by financing activities	254,176	52,141
Increase in cash and cash equivalents	11,315	109,331
Cash and cash equivalents and restricted cash		
Beginning of year	316,543	207,212
End of year	$ 327,858	$ 316,543

The accompanying notes are an integral part of these consolidated financial statements.

Allegheny Health Network
Consolidated Statements of Cash Flows
Years Ended December 31, 2021 and 2020

(in thousands of dollars)

	2021	2020
Supplemental disclosure of cash flow information		
Interest paid, net	$ 45,626	$ 45,499
Income taxes paid, net	$ 818	$ 1,678
Supplemental disclosure of noncash investing and financing		
Assets acquired through payables	$ 14,650	$ 4,048
Equity transfers from related parties	$ -	$ 217,855
Supplemental disclosure of restricted cash		
Cash and cash equivalents	$ 259,127	$ 260,438
Restricted cash included in board designated, restricted and other investments at fair value	68,731	56,105
Total cash and cash equivalents and restricted cash shown in the consolidated statements of cash flows	$ 327,858	$ 316,543

The accompanying notes are an integral part of these consolidated financial statements.

(in thousands of dollars)

1. Nature of Operations

Allegheny Health Network ("AHN"), formed in 2013, is incorporated as a nonprofit corporation in the Commonwealth of Pennsylvania and is federally recognized as a 501(c)(3). Highmark Health, the sole corporate member of AHN, is a diversified health and wellness enterprise that includes: Highmark Inc. - a hospital plan corporation and professional health services plan in the Commonwealth of Pennsylvania; HM Health Solutions Inc.; and HM Health Holdings Company. AHN was formed to act as the parent company of West Penn Allegheny Health System, Inc. ("WPAHS"), Jefferson Regional Medical Center ("JRMC"), as well as Saint Vincent Health Center and Saint Vincent Health System, collectively "SVHS." Effective December 31, 2019, AHN finalized an affiliation agreement with Grove City Health System (Grove City), causing AHN to become the sole corporate member of Grove City. AHN, WPAHS, JRMC, SVHS, Grove City and their other subsidiaries and consolidated affiliates are herein referred to as the "Health Network."

The Health Network is a western Pennsylvania-based, patient-centered and physician-led academic healthcare system that provides charitable care and high-quality, comprehensive health care services to patients from western Pennsylvania and the adjacent regions of Ohio, West Virginia, New York, and Maryland.

The Health Network is comprised of fourteen hospitals, of which one is a quaternary academic medical center, nine are tertiary/community hospitals that provide a wide array of general and advanced clinical services and four are emergency access with limited inpatient services. The Health Network operates more than 300 additional healthcare sites, including surgery centers, comprehensive Health + Wellness Pavilions and physician practices; and a physician organization that includes more than 2,800 employed and affiliated physicians. The Health Network's consolidated financial statements include HMPG Inc., a for-profit holding company whose subsidiaries and affiliates include, among other things, a group purchasing organization, a captive insurance company (Palladium Risk Retention Group Inc. - "Palladium"), real estate companies, and a surgery center. The Health Network also includes joint ventures that offer durable medical equipment, home infusion services, home health and hospice services, and a clinically integrated physician network. Additionally, the Health Network operates a research institute and charitable foundations.

The Health Network provides a comprehensive array of advanced clinical and research programs across all medical specialties, including orthopedic surgery and sports medicine, cardiology and cardiovascular surgery, neurosurgery and neurology, women's health, cancer, emergency medicine, trauma and burn care, bariatric and metabolic disease, primary care, psychiatric care, general surgery, diabetes, autoimmune diseases, critical care, digestive diseases, men's health/urology, lung and esophageal diseases, rehabilitation services and a complete spectrum of diagnostic care.

The Health Network offers forty-six graduate medical programs and has two medical school affiliations with Drexel University and the Lake Erie College of Osteopathic Medicine, allowing medical residents and fellows to receive advanced training at AHN hospitals. The Health Network also operates two nursing education programs, including the West Penn Hospital School of Nursing and the Citizens School of Nursing.

Approximately 25% of the Health Network employees are covered by collective bargaining agreements, through participation in various bargaining units, with varying expiration dates through 2024.

2. COVID-19

In March 2020, the World Health Organization declared the COVID-19 outbreak a pandemic and the United States federal government declared COVID-19 a national emergency. Shortly thereafter, in cooperation with state and local governmental requirements, the Health Network postponed all inpatient and outpatient elective and non-essential surgical and procedural cases, and non-urgent and routine provider appointments. The Health Network did so to preserve personal protective equipment ("PPE"), ICU beds, ventilators, and other needed supplies to be better positioned for a potential surge in COVID-19 patients. On April 27, 2020 governmental restrictions were lifted, however due to the heightened concern of patients regarding the risk of exposure to COVID-19 during treatment, the Health Network has continued to see a

(in thousands of dollars)

decrease in volume from historical levels. These disruptions to our ability to provide expected levels of patient care have, and are likely to continue to have, an adverse effect on our operations and could have a material adverse effect on our results of operations, financial condition and cash flows.

On March 27, 2020, the President of the United States signed into law the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") to provide economic assistance to a wide array of industries to ease the financial impact of COVID-19. As part of the CARES Act, the Centers for Medicare and Medicaid Services ("CMS") expanded its Accelerated and Advance Payment Program which allows participants to receive expedited payments during periods of national emergencies.

During 2020, the Health Network received $72,181 in governmental assistance including funding under the CARES Act. This includes recognition of $68,453 of grant revenue recorded as a component of other operating revenue in the consolidated statements of operations as a result of satisfying the conditions of general and targeted grant funding under the Provider Relief Fund established by the CARES Act. In 2021, the Health Network recognized $3,623 of deferred CARES Act grants as a component of other operating revenue in the consolidated statements of operations.

Additionally, CMS increased the Diagnosis Related Group weighting factor by 20% for inpatients diagnosed with COVID-19, which represented approximately $3,000 of additional revenue to the Health Network through December 31, 2020. During 2021, this represented $4,623 of additional revenue. The previously planned 2% Medicare sequestration adjustment from May 1 through December 31, 2020 was suspended. The suspension represented approximately $9,400 of revenue to the Health Network through December 31, 2020. During 2021, this represented $10,440 of additional revenue. These enhanced reimbursements are accounted for as patient revenue and are included in the consolidated statements of operations.

In 2020, the Health Network recorded $232,490 attributable to the Medicare Accelerated and Advance Payment Program representing working capital financing to be repaid through the provision of future services and is recorded as a contract liability as a payment received before performing services. This amount is reported as a component of CMS advances in the consolidated balance sheet and as cash provided by operating activities in the statements of cash flows. The repayment terms specify that for the first eleven months after repayment begins, repayment will occur through an automatic recoupment of 25% of Medicare payments otherwise owed to the provider or supplier. At the end of the eleventh month, recoupment will increase to 50% for six months. If a balance remains at the end of the six months (29 months after receipt of advance), a demand letter will be issued for the full repayment of the remaining balance. If payment is not received within 30 days, interest will accrue at the rate of 4% from the date the letter was issued, and will be assessed for each full 30-day period that the balance remains unpaid. AHN repaid $97,366 of advance payments in 2021. The remaining amounts are expected to be repaid by September 30, 2022.

The CARES Act also provided for payroll tax relief, including employee retention tax credits and the deferral of all employer Social Security tax payments to help employers in the face of economic hardship related to the COVID-19 pandemic. As of December 31, 2020, the Health Network deferred approximately $55,405 attributable to the employer portion of Social Security wage taxes. These deferred payroll taxes are to be repaid in two equal installments of 50%, the first of which is due by December 31, 2021 and the second due by December 31, 2022. AHN repaid $27,707 of deferred employer taxes in December 2021. The consolidated balance sheet at December 31, 2020 includes the 2021 portion of these deferred payroll tax payments in accrued expenses and the 2022 portion in other liabilities. At December 31, 2021, the remaining $27,698 are reported in accrued expenses.

(in thousands of dollars)

3. Summary of Significant Accounting Policies

Basis of Financial Presentation
The accompanying consolidated financial statements include the accounts of the Health Network.

The consolidated financial statements are presented on the accrual basis of accounting, in accordance with accounting principles generally accepted in the United States of America ("GAAP"). All significant intercompany balances and transactions have been eliminated from the consolidated financial statements.

The Health Network uses the equity method of accounting for 50% or less owned affiliates or those affiliates for which the Health Network does not hold a controlling financial interest but may influence operating or financial decisions as well as 50% or more owned affiliates for which the Health Network does not hold a financial interest.

New Accounting Pronouncements

Implemented

In March 2020, FASB issued new guidance regarding reference rate reform on financial reporting. The guidance provides optional expedients to companies for a limited period of time to ease the potential burden in accounting reference rate reform on financial reporting. The expedients are available to be applied from March 12, 2020 through December 31, 2022. As of December 31, 2021, the Health Network has not yet applied any of the optional expedients under this new guidance. The Health Network will continue evaluating the impact of adoption through the application period.

Under Evaluation

In August 2018, FASB issued new guidance to modify the disclosure requirements on defined benefit plans. The new guidance is effective for fiscal years beginning after December 15, 2021. The adoption of this new guidance will not materially impact the financial position, results of operations or cash flows of the Health Network. The Health Network is evaluating the impact of the new guidance on its financial statement disclosures.

In December 2019, FASB issued new guidance to simplify the accounting for income taxes. The new guidance is effective for fiscal years beginning after December 15, 2021. The Health Network is evaluating the impact of the new guidance on its financial position, results of operations and cash flows.

In June 2016, FASB issued guidance introducing a new model for recognizing credit losses on financial instruments based on an estimate of current expected credit losses. The new guidance replaces the current incurred loss model for measuring expected credit losses, requiring immediate recognition of all expected credit losses and applies to loans, accounts receivables, debt securities, and other financial assets. The new guidance is effective for fiscal years beginning after December 15, 2022. The Health Network is evaluating the impact of the new guidance on its financial position, results of operations and cash flows.

Use of Estimates
The preparation of the Health Network's consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Liquidity and Availability of Financial Assets
The Health Network's working capital and cash flows are subject to variability during the year attributable to changes in volume and cash receipts. The Health Network maintains investment portfolios without donor restrictions to manage fluctuations in cash flow.

(in thousands of dollars)

The following table reflects the Health Network's financial assets for the years ending December 31, 2021 and 2020, reduced by amounts not available for general use within one year because of contractual or donor-imposed restrictions or internal designations. Amounts available include donor-restricted amounts that are available for general expenditures. Amounts not available include amounts set aside for operating and other reserves that could be drawn upon if the Board of Directors ("Board") approves the action.

	2021	2020
Cash and cash equivalents	$ 259,127	$ 260,438
Investments	1,195,368	1,003,636
Receivables	514,715	718,335
Total financial assets	**1,969,210**	**1,982,409**
Contractual or donor-imposed restrictions:		
Beneficial interest in perpetual trusts	(325,806)	(292,248)
Endowment funds	(74,497)	(65,361)
Equity method investments	(42,650)	(39,501)
Grant funds	(35,086)	(31,135)
Board designations:		
Capital improvements	(39,378)	(37,246)
Financial assets available to meet cash needs for general expenditures within one year	**$ 1,451,793**	**$1,516,918**

Cash and Cash Equivalents
The Health Network considers all highly-liquid investments with maturities of three months or less when purchased, excluding assets limited or restricted as to use, to be cash equivalents.

Investments and Assets Limited or Restricted as to Use
Debt and equity securities are carried at fair value (based on quoted or estimated market prices). Unrealized gains and losses on investments (excluding available for sale-debt securities) are reported in net investment income in the consolidated statements of operations. Unrealized gains and losses on available-for-sale debt securities are reported in net assets without donor restrictions, net of deferred income taxes. Premiums and discounts are amortized using the effective interest method. Realized gains and losses on debt securities are based on amortized cost. Realized gains and losses on equity securities are based on cost (specific identification method). Realized gains and losses on equity securities and available-for-sale debt securities are reported in net investment income in the consolidated statements of operations.

The Health Network monitors its available-for-sale debt securities for unrealized losses that appear to be other-than-temporary. In determining if an available-for-sale debt security is other-than-temporarily impaired, the Health Network considers whether it has intent to sell the available-for-sale debt security or whether it is more likely than not that the Health Network will be required to sell the available-for-sale debt security before recovery of its amortized cost basis, which may be at maturity. If the Health Network intends to sell the debt security or it is more likely than not that the Health Network will be required to sell the debt security before recovery of its amortized cost basis, an other-than-temporary impairment is recorded as a realized loss in net investment income in the consolidated statements of operations for the difference between fair value and amortized cost.

If the Health Network does not have the intent to sell and it does not believe that it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost, the Health Network performs a detailed review to determine the underlying cause of the unrealized loss and whether an other-than-temporary impairment is warranted. At the time a debt security is determined to be other-than-temporarily impaired, the credit component of the other-than-temporary impairment is recognized as income

(in thousands of dollars)

in the consolidated statements of operations and the non-credit component of the other-than-temporary impairment is recognized in the statement of changes in net assets, net of deferred income taxes.

Board designated and restricted investments include assets whose use is contractually limited by external parties, assets set aside by the Board for future capital improvements or liquidity, over which the Board retains control and may at its discretion subsequently use for other purposes, as well as assets held by trustees under indenture agreements. Other investments consist primarily of marketable debt and equity securities and marketable securities maintained in a master trust fund. Investment income or loss (including realized gains and losses, interest and dividends, and unrealized gains and losses) is recorded in net investment income in the consolidated statements of operations unless restricted by donor or law. Investment income related to restricted gifts is recorded based on donor restriction as part of net assets with donor restrictions in the consolidated statements of changes in net assets.

The Health Network's assets are invested in a variety of financial instruments. Accordingly, the related values as presented in the consolidated financial statements are subject to various market fluctuations, which include changes in the interest rate environment, equity markets and general economic conditions.

Beneficial Interest in Perpetual Trusts
Beneficial interest in perpetual trusts represents assets subject to restrictions that are perpetual in nature, are managed by donor-selected trustees and are recorded at the fair value of the underlying assets in the trusts.

Fair Value of Financial Instruments
In accordance with FASB fair value measurement guidance, financial assets and liabilities recorded at fair value in the consolidated balance sheets are categorized based upon the level inputs used to measure their fair value.

Inventory, Net
Inventory consists primarily of healthcare delivery-related drugs, medical supplies and surgical supplies. Inventory is stated at the lower of cost or market. Inventory cost is determined using the first-in first-out basis or the average cost method. Obsolescence reserves were $2,738 and $2,424 at December 31, 2021 and 2020, respectively.

Prepaid Expenses, Other Current Assets and Other Assets
Prepaid expenses, other current assets and other assets primarily include prepaid expenses, insurance recoveries, interests in net assets of foundations and 457(b) plan assets.

Property and Equipment, Net
Property and equipment is recorded at cost, net of accumulated depreciation. If a donor contributes property and equipment, it is recorded at the fair market value on the date contributed. Maintenance, repairs and minor improvements are expensed as incurred. Certain costs related to the internal development of software or software purchased for internal use are capitalized. Gains or losses on sales or disposals of property and equipment are included in operations.

Depreciation is computed under the straight-line method by annual charges to expense over the estimated useful lives of the various asset types as follows: buildings and building or land improvements, up to 40 years; leasehold improvements, lesser of lease term or useful life; office furniture and equipment, 3 to 30 years; and capitalized software, 3 to 10 years.

Property and equipment is reviewed for impairment whenever changes in circumstances indicate that the carrying value of the assets may not be recoverable. Impairment losses are recognized to the extent the carrying amount of an asset exceeds determined market value. No impairment losses were recorded in 2021 or 2020.

(in thousands of dollars)

Goodwill and Other Intangible Assets, Net
Intangible assets with finite lives are amortized using the straight-line method over their estimated lives, which range from 3 to 20 years. The Health Network has intangible assets of $12,815 and $15,576 for the years ended December 31, 2021 and 2020, respectively. Amortization expenses related to these assets were $3,099 and $2,574 in 2021 and 2020, respectively.

Intangible assets with indefinite useful lives, including goodwill, are not amortized, but are tested for impairment at least annually and more frequently if events or changes in circumstances indicate that an asset may be impaired. If fair value is less than carrying value, the asset is adjusted to the fair value and an impairment loss is recorded in the consolidated statements of operations. Goodwill consisted of $104,667 at December 31, 2021 and 2020. Management tested goodwill using the one-step method as of December 31, 2021 and 2020 and concluded that no impairment existed.

Lease Right to Use Assets and Liabilities
In accordance with ASC 842, the Health Network recognizes the operating and financing lease right to use assets and liabilities on the consolidated balance sheets.

Self-Insurance Liabilities
Self-insurance liabilities are based on actuarial methods and loss experience data and are considered by management to be adequate. Such liabilities are determined, in the aggregate, based on a reasonable estimation of the ultimate settlement of reported losses, including individual case estimates for reported losses plus supplemental amounts for losses incurred but not reported.

Palladium, as further discussed in Note 13, provides medical professional and general liability coverage. There is uncertainty associated with the loss estimates, and actual results could differ significantly from the estimates. Changes in loss and loss adjustment expense liabilities relating to prior years are recorded in the year determined.

Self-insurance liabilities are recorded at the present value of the estimated future cash flows for payments of those losses and loss adjustment expenses. The present value of those losses and loss adjustment expenses is discounted using a risk-free rate which is equivalent to the current interest rate on United States government obligations at the time of the loss and for the duration of expected payout of the loss.

Medical malpractice exposure can be subject to long settlement delays and can include large single event claims. This type of exposure has higher inherent volatility than typical insurance exposures. Palladium has insurance exposure only for the years beginning January 1, 2015 and thereafter.

In the normal course of business, Palladium seeks to reduce losses that may arise from risks or occurrences of an unexpected nature that may cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers.

Other Liabilities
Other liabilities include among other things, deferred grant revenue, payor advances, and 457(b) plan obligations.

Net Assets Without Donor Restrictions
Net assets without donor restrictions include investments and board designated assets set aside by the Board for future capital improvements or liquidity, over which the Board retains control and may at its discretion subsequently use for other purposes.

(in thousands of dollars)

Net assets without donor restrictions at December 31, include:

	2021	2020
Undesignated	$ 1,582,955	$1,338,950
Undesignated - Non-controlling interests	41,009	34,394
Board designated assets:		
Capital improvements	39,378	37,246
Total net assets without donor restrictions	**$ 1,663,342**	**$ 1,410,590**

Net Assets With Donor Restrictions
Net assets with donor restrictions include those whose use is limited by donor-imposed stipulations, including some that either expire with the passage of time or can be fulfilled and removed by actions of the Health Network pursuant to those stipulations. Additionally, net assets with donor restrictions include those whose use is limited by donor-imposed stipulations that neither expire with the passage of time nor can be fulfilled or otherwise removed by the actions of the Health Network. Investment earnings from net assets with donor restrictions may be donor-restricted for capital or operating needs depending upon the original intent of the donor.

Net assets are released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors. Net assets released from restrictions and used for operations are recorded in net assets released from restriction. Net assets released from restriction and used for acquisition of equipment are recorded as change in net assets without donor restrictions in the consolidated statements of changes in net assets.

Net assets with donor restrictions are restricted for the following purposes at December 31:

	2021	2020
Subject to expenditure for specified purpose:		
Capital improvements	$ 1,721	$ 1,471
Education and scholarships	2,182	1,860
Research	5,166	4,688
Healthcare services	35,449	30,463
Total	44,518	38,482
Subject to the Health Network's policy and appropriation:		
Investment in perpetuity, the income of which is expendable to healthcare services	364,024	329,475
Total net assets with donor restrictions	**$ 408,542**	**$ 367,957**

Donor-Restricted Contributions
Net assets with donor restrictions for donor-restricted endowment funds of perpetual durations are comprised of (a) the original value of the contributions made to the endowment, (b) the original value of the subsequent contributions made to the endowment, and (c) accumulations to the endowment made in accordance with applicable donor gift instruments. Any donor-restricted endowments that are not perpetual in nature are appropriated in accordance with donor intent.

(in thousands of dollars)

The Health Network considers the following factors in determining if donor-restricted endowment funds are accumulated or appropriated:

(1) The duration and preservation of the fund
(2) The purposes of the organization 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 appreciation of investments
(6) Other resources of the organization
(7) The investment policies of the organization

The Health Network's net assets with donor restrictions consist of endowments managed by donor-selected trustees and endowments managed by the Health Network. Unless otherwise directed by the donor, gifts received for endowments are invested in accordance with the Health Network's investment policy. In order to preserve the real value of a donor's gift and to sustain funding consistent with donor intent, the annual appropriation rate is set to strike a reasonable balance between long-term objectives of preserving and growing each endowment fund for the future of providing stable, annual appropriations.

Return Objectives and Risk Parameters
The Health Network has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. Under this policy, the return objective for the endowment assets, measured over a full market cycle, shall be to maximize the return with a balanced growth emphasis based on the endowment's target allocation applied to the appropriate individual benchmarks.

Strategies Employed for Achieving Investment Objectives
To achieve its long-term rate of return objectives, the Health Network elected a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends). The investment income percentage distribution is recorded as a transfer out of trusts in net assets with donor restrictions. The Health Network targets diversified asset allocation that places a greater emphasis on fixed income based investments to achieve its long-term objectives within prudent risk constraints.

Uncompensated Care and Community Services Benefit
The Health Network offers medical care to all patients, including those who may have difficulty paying for services due to limited income. Consistent with its mission to deliver compassionate, high quality, affordable healthcare services and to advocate for those who are poor and disenfranchised, the Health Network strives to ensure that the financial capacity of people who need healthcare services does not prevent them from seeking or receiving care. The Health Network provides, without discrimination, care for emergency medical conditions or other medically necessary care to individuals regardless of their eligibility for financial or government assistance. These individuals are not to be charged more than the amounts generally billed to individuals covered by insurance.

The Health Network's financial assistance policy defines the income eligibility criteria, the type of financial assistance, and the services that are included and excluded under its policy. The policy sets forth the procedure by which a patient shall apply for financial assistance, sometimes referred to as charity care. If the patient and/or guarantor's income is at or under 200% of the Federal Poverty Guidelines, all patient liability balances will be forgiven at 100%, whereas discounted care for uninsured but not meeting charity thresholds ranges between 69% and 85% of gross charges based upon the look-back method at each facility. The Health Network does not pursue collection of amounts determined to qualify for charity care; therefore, charity care amounts are not recorded as net patient service revenue.

(in thousands of dollars)

Of the Health Network's total expenses reported, an estimated $10,800 and $13,200 arose from providing services to charity patients in 2021 and 2020, respectively. The Health Network estimated these costs by applying the cost of the total direct and indirect costs of each procedure to the individual charity care cases. Patients are required to apply for the charity care discount, but often do not complete the necessary paperwork to determine if they qualify.

In addition to uncompensated care, the Health Network provides free and below cost services and programs for the benefit of the community. The cost of these programs is included in the accompanying consolidated statements of operations.

Services are also provided to beneficiaries of government-sponsored programs, including state Medical Assistance and indigent care programs. Reimbursement from these programs is often less than the cost of providing these services.

Income Taxes
AHN and some of the entities within the Health Network are tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code ("IRC") and are exempt from federal income taxes on exempt purpose income. These tax-exempt organizations are subject to federal taxes on unrelated business income under section 511 of the IRC. Certain for-profit entities within the Health Network are subject to federal and state income taxes. Provisions for the applicable tax liabilities have been made in the consolidated financial statements.

Deferred tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities and are measured using tax rates and laws that are expected to be in effect when the difference is reversed. The Health Network records a valuation allowance against its deferred tax assets when it determines that it is more likely than not that some portion or all of the deferred tax asset will not be realized.

Deficit of Revenue over Expenses
The consolidated statements of operations include a deficit of revenue over expenses. Changes in net assets without donor restrictions which are excluded from the deficit of revenue over expenses, consistent with industry practice, include unrealized gains and losses on available-for-sale debt securities, benefit plan asset and liability changes, contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), equity transfers from affiliates and changes in non-controlling interests.

Subsequent Events
In connection with the preparation of the consolidated financial statements, the Health Network evaluated events subsequent to the balance sheet date of December 31, 2021 through March 23, 2022, which is also the date the financial statements were issued, and has determined that all material transactions have been recorded and disclosed properly.

4. Revenue Recognition

In accordance with ASC 606, the Health Network records its net patient service revenue at the transaction price estimated to reflect the total consideration due from patients and third-party payors in exchange for providing healthcare services. Retroactive settlements with third-party payors are a result of cost report filings, audits, and other investigations and are realized through net patient service revenue in the period they are identified. Healthcare services are considered to be a single performance obligation and have a duration of less than one year. Revenues are recognized as these performance obligations are fulfilled. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected charges. The Health Network believes this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. AHN measures inpatient care, the performance obligation, from admission into the hospital

(in thousands of dollars)

to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Outpatient performance obligations are measured from patient registration to the point where care is no longer required to be provided. Revenue for performance obligations satisfied at a point in time is generally recognized when goods and services are provided to our patients, and the Health Network does not believe it has additional obligations to the patient.

The transaction price, which involves significant estimates, is determined based on our standard charges for the goods and services provided, with a reduction recorded for price concessions related to third-party contractual arrangements as well as patient discounts and patient price concessions. Any revision in estimates is recognized in the period in which the estimates are revised. Amounts are billed to patients and third-party payors after the performance obligation is satisfied, and payment is expected within a reasonable period of time, though settlement may occur well after the healthcare service is provided. The Health Network would provide refunds to patients and third-party payors once it is identified that overpayments have occurred.

Since all performance obligations relate to contracts with a duration of less than one year, the Health Network has elected to apply the optional exemption in ASC 606 and is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations primarily relate to inpatient services at the end of the reporting period. The performance obligations for these contracts will be satisfied when the patient is discharged from the hospital, which generally occurs within days or weeks of the end of the reporting period.

Revenues consist primarily of patient service revenues that are recorded based upon established billing rates less contractual adjustments and discounts. Revenues are recorded during the period the healthcare services are provided, based upon the estimated amounts due from the patients and third-party payors. Third-party payors include federal and state agencies (under the Medicare and Medicaid programs), managed care health plans and commercial insurance companies (including plans offered through the health insurance exchanges), and employers. Estimates of contractual adjustments are based upon the payment terms specified in the related contractual agreements. Contractual payment terms are generally based upon predetermined rates per diagnosis, per diem rates or discounted fee-for-service rates. Revenues related to uninsured patients and uninsured copayment and deductible amounts for patients who have health care coverage may have discounts applied (uninsured discounts and contractual discounts). Explicit price concessions are recorded as contractual adjustments. These concessions are calculated based upon established payor contract rates or by historical collection rates and are considered a reduction to arrive at net patient service revenue.

As described above, the transaction price for the Health Network's healthcare services is variable due to the existence of price concessions due to various agreements with insurance, governmental payors, and self-pay patients.

The Health Network considered amendments to the ASC Subtopic 606-10-10-4, meeting the objective in identifying the portfolio approach practical expedient and determined that the portfolios share similar characteristics and the accounting result would not be materially different than the result of applying the guidance to individual contracts.

The transaction price reflects the expectations about the consideration that the Health Network is entitled to receive from the patient or third-party. The transaction price is determined by using portfolios of accounts that have similar payment methodologies and performance experience.

(in thousands of dollars)

The Health Network's patient service revenues, by major payor, are as follows for the years ended December 31:

	2021	2020
Medicare*	$ 1,537,242	$ 1,291,656
Medical assistance	328,362	292,004
Blue Cross Blue Shield payors	1,146,162	1,149,881
Other third-party payors	694,524	592,557
Self-pay patients	29,871	22,539
Total net patient service revenue	$ 3,736,161	$ 3,348,637

* Includes Medicare Fee for Service as well as Medicare Advantage from commercial payors

In 2021, revenue from Medicare and Blue Cross Blue Shield accounted for 41% and 31%, respectively, of total patient service revenue, net of contractual allowances and discounts. In 2020, revenue from Medicare and Blue Cross Blue Shield accounted for 39% and 34%, respectively, of total patient service revenue, net of contractual allowances and discounts. 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 recorded estimates will change by a material amount. Estimated reimbursement amounts are adjusted in subsequent periods as cost reports are prepared and filed and as final settlements are determined (in relation to certain government programs, primarily Medicare, this is generally referred to as the "cost report" filing and settlement process).

Patient Accounts Receivable
Patient accounts receivable are recorded at net realizable value based on certain assumptions determined by each payor. For third-party payors including Medicare, Medicaid, and Managed Care, the net realizable value is based on the estimated contractual reimbursement percentage, which is based on current contract prices or historical paid claims data by payor. For self-pay accounts receivable, which includes patients who are uninsured and the patient responsibility portion for patients with insurance, the net realizable value is determined using estimates of historical collection experience without regard to aging category. The Health Network accounts for adjustments to previous reimbursement estimates as contractual allowance adjustments and records them in the year that such adjustments become known.
The mix of gross receivables from patients and payors was as follows at December 31:

	2021	2020
Medicare*	40.3%	39.1%
Medical assistance	12.3%	12.3%
Blue Cross Blue Shield payors	23.9%	25.1%
Other third-party payors	20.0%	20.3%
Self-pay patients	3.5%	3.2%
	100.0%	100.0%

* Includes Medicare Fee for Service as well as Medicare Advantage from commercial payors

Other Operating Revenue
Other operating revenue includes among other things, grants (including CARES Act funding), contracted physician services and other ancillary hospital services revenue such as parking, cafeteria, tuition and rent. Other operating revenue also includes the Health Network's proportionate share of affiliate earnings. All other operating revenue is composed of exchange transactions subject to ASC 606, with the exception of certain state and federal grants, which are non-exchange transactions and considered contributions for accounting purposes.

(in thousands of dollars)

The composition of other operating revenue is as follows for the years ended December 31:

	2021	2020
Pharmacy revenue	$ 71,727	$ 45,095
Ancillary services	34,586	31,771
Grant revenue	57,809	59,393
Physician services	24,008	27,593
Supply chain revenue	8,853	8,193
CARES Act grants	3,623	68,453
Other miscellaneous revenue	79,029	50,422
Total other operating revenue	$ 279,635	$ 290,920

5. Investments

The cost or amortized cost, gross unrealized gains and losses and fair value of investments in debt securities classified as available-for-sale at December 31, 2021 were as follows:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities				
U.S. Treasury and agency obligations	$ 38,808	$ 760	$ (218)	$ 39,350
Agency mortgage-backed securities	9,385	56	(182)	9,259
Asset-backed and other loan-backed securities	8,410	11	(36)	8,385
Corporate and other debt securities	41,528	676	(319)	41,885
Total debt securities	$ 98,131	$ 1,503	$ (755)	$ 98,879

The cost or amortized cost, gross unrealized gains and losses and fair value of investments in debt securities classified as available-for-sale at December 31, 2020 were as follows:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities				
U.S. Treasury and agency obligations	$ 35,664	$ 2,332	$ -	$ 37,996
Agency mortgage-backed securities	7,446	161	(5)	7,602
Asset-backed and other loan-backed securities	3,890	58	-	3,948
Corporate and other debt securities	32,446	1,684	-	34,130
Total debt securities	$ 79,446	$ 4,235	$ (5)	$ 83,676

(in thousands of dollars)

The gross unrealized losses and fair value of debt securities classified as available-for-sale by investment category and length of time an individual security was in a continuous unrealized loss position at December 31, 2021 were as follows:

	Less than 12 months		12 months or greater		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Debt securities						
U.S. Treasury and agency obligations	$ 14,208	$ (202)	$ 383	$ (16)	$ 14,591	$ (218)
Agency mortgage-backed securities	7,135	(182)	-	-	7,135	(182)
Asset-backed and other loan-backed securities	7,079	(36)	-	-	7,079	(36)
Corporate and other debt securities	19,883	(319)	-	-	19,883	(319)
Total debt securities	$ 48,305	$ (739)	$ 383	$ (16)	$ 48,688	$ (755)

The gross unrealized losses and fair value of debt securities classified as available-for-sale by investment category and length of time an individual security was in a continuous unrealized loss position at December 31, 2020 were as follows:

	Less than 12 months		12 months or greater		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Debt securities						
U.S. Treasury and agency obligations	$ 399	$ -	$ -	$ -	$ 399	$ -
Corporate and other debt securities	811	(5)	-	-	811	(5)
Total debt securities	$ 1,210	$ (5)	$ -	$ -	$ 1,210	$ (5)

At December 31, 2021 and 2020, the Health Network held available-for-sale debt securities with gross unrealized losses of $755 and $5, respectively. Management evaluated the unrealized losses and determined that they were due primarily to volatility in the interest rate environment and market conditions. The Health Network does not intend to sell the related debt securities, and it is not likely that the Health Network will be required to sell the debt securities before recovery of their amortized cost basis, which may be maturity. Therefore, management does not consider the available-for-sale debt securities to be other-than-temporarily impaired as of December 31, 2021 and 2020.

The realized gains on the available-for-sale debt securities were $311 and $356 for the years ended December 31, 2021 and 2020 and no other-than-temporary impairments were recognized.

The amortized cost and fair value of available-for-sale debt securities at December 31, 2021 and 2020 are shown below by contractual maturity. Expected maturities could differ from contractual maturities as borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	2021		2020	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year or less	$ 5,006	$ 5,059	$ 3,245	$ 3,282
Due after one year and within five years	48,736	49,440	40,108	42,031
Due five years through ten years	21,035	21,283	24,258	26,304
Due after ten years	5,559	5,454	499	509
Asset-backed and other loan-backed securities	17,795	17,643	11,336	11,550
Total	$ 98,131	$ 98,879	$ 79,446	$ 83,676

(in thousands of dollars)

Board designated, restricted and other investments consist of the following investments at December 31:

	2021	2020
Cash and cash equivalents	$ 69,578	$ 56,961
Debt securities		
U.S. Treasury and agency obligations	115,970	119,021
Agency mortgage-backed securities	2,510	2,368
Asset-backed and other loan-backed securities	7,317	2,703
Corporate and other debt securities	79,287	93,675
Total debt securities	205,084	217,767
Equity securities		
Domestic	286,506	169,361
Foreign	137,969	119,991
Total equity securities	424,475	289,352
Common collective trust interests	9,358	8,936
Total board designated, restricted and other investments	$ 708,495	$ 573,016

Board designated, restricted and other investments consist of the following components at December 31:

	2021	2020
Assets without donor restrictions		
Other investments	$ 548,865	$ 436,722
Board designated		
Foundation	39,378	37,246
Other	7,529	-
Self-insurance	3,140	2,552
Grant funds and other	35,086	31,135
Total assets without donor restrictions	633,998	507,655
Assets with donor restrictions	74,497	65,361
Total board designated, restricted and other investments	$ 708,495	$ 573,016

The following is a summary of net investment income for the year ended December 31, 2021:

	Without Donor Restrictions	With Donor Restrictions
Interest and dividends	$ 28,975	$ 8,253
Net realized gains on investments	9,309	20,379
Net unrealized gains on board designated, restricted and other investments	3,783	19,484
Total net investment income	$ 42,067	$ 48,116

(in thousands of dollars)

The following is a summary of net investment income for the year ended December 31, 2020:

	Without Donor Restrictions	With Donor Restrictions
Interest and dividends	$ 25,627	$ 5,983
Net realized gains on investments	9,233	8,903
Net unrealized gains on board designated, restricted and other investments	15,199	29,430
Total net investment income	$ 50,059	$ 44,316

The recognition of unrealized gains and losses on investments that are restricted as to use are recorded directly to net assets with donor restrictions as required by donor or regulation. These investments consist primarily of equity securities, agency mortgage-backed securities, corporate debt securities and U.S. Treasury obligations. All unrealized gains and losses on marketable board designated and other investments are recognized in net investment income on the consolidated statements of operations.

6. Fair Value of Financial Instruments

Input levels, as defined by Fair Value Measurement guidance, are as follows:

Level 1: Pricing inputs are based on unadjusted quoted market prices for identical financial assets or liabilities in active markets. Active markets are those in which transactions occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2: Pricing inputs include observable inputs other than Level 1 pricing inputs, such as quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Pricing inputs include unobservable inputs that are supported by little or no market activity and that reflect management’s best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The following methods and assumptions were used to determine the fair value of each class of the following assets and liabilities recorded at fair value in the consolidated balance sheets:

Cash equivalents: Cash equivalents consist of highly liquid investments with maturities of three months or less and are designated as Level 1.

Debt securities, available-for-sale: Fair values of available-for-sale debt securities are based on quoted market prices, where available. These fair values are obtained primarily from a third party pricing service, which generally use Level 1 or Level 2 inputs, for the determination of fair value to facilitate fair value measurements and disclosures.

Equity securities: Fair values of equity securities are generally designated as Level 1 and are based on quoted market prices for identical assets in active markets. For certain equity securities, quoted market prices for identical securities are not always available, and the fair value is estimated by reference to similar or underlying securities for which quoted prices are available. These securities are designated as Level 2. The Health Network also has certain private equity securities that do not have readily determinable fair values and are excluded from the fair value hierarchy. In prior years, these private equity securities were designated as Level 3, and the fair value was estimated through a private valuation.

(in thousands of dollars)

Board designated, restricted and other investments: Board designated, restricted and other investments include cash equivalents, debt securities and equity securities that follow the same methods and assumptions and fair value designations described above.

Beneficial interest in participating trusts: Donor-restricted net assets consist of amounts held in perpetuity as designated by donors, including the Health Network's portion of beneficial interests in several endowments managed by donor-selected trustees. The fair value for endowments managed by donor-selected trustees are designated as Level 3 securities with the interest in these trusts based on the fair value of the underlying trust investments.

The Health Network uses a third party pricing service to obtain quoted prices for each security. The third party service provides pricing based on recent trades of the specific security or like securities, as well as a variety of valuation methodologies for those securities where an observable market price may not exist. The third party service may derive pricing for Level 2 securities from market-corroborated pricing, matrix pricing, discounted cash flow analyses and inputs such as yield curves and indices. Pricing for Level 3 securities may be obtained from investment managers for private placements.

Certain invested assets are valued at NAV as a practical expedient to fair value. The holdings of the underlying investments are measured at fair value as of the reporting date. These investments, if sold, are probable of being sold at amounts equal to net asset value per share.

The Health Network performs an analysis of reasonableness of the prices received for fair value by monitoring month-to-month fluctuations and determining reasons for significant differences, selectively testing fair values against prices obtained from other sources, and comparing the consolidated fair value of a class of assets against an appropriate index benchmark. The Health Network did not make material adjustments to the quoted market prices obtained from third party pricing services.

(in thousands of dollars)

The following table summarizes fair value measurements by level at December 31, 2021 for financial assets measured at fair value on a recurring basis:

		Fair Value Measurement			Net Asset
	Total	**Level 1**	**Level 2**	**Level 3**	**Value**
Assets					
Cash and cash equivalents	$ 259,127	$ 259,127	$ -	$ -	$ -
Investments					
Debt securities, available-for-sale					
U.S. Treasury and agency obligations	39,350	37,783	1,567	-	-
Agency mortgage-backed securities	9,259	-	9,259	-	-
Asset-backed and other loan-backed securities	8,385	-	8,385	-	-
Corporate and other debt securities	41,885	-	41,885	-	-
Total debt securities	98,879	37,783	61,096	-	-
Equity securities					
Domestic	7,934	7,934	-	-	-
Foreign	11,604	11,604	-	-	-
Total equity securities	19,538	19,538	-	-	-
Board designated, restricted and other investments					
Cash and cash equivalents	69,578	69,578	-	-	-
Debt securities					
U.S. Treasury and agency obligations	115,970	112,435	3,535	-	-
Agency mortgage-backed securities	2,510	-	2,510	-	-
Asset-backed and other loan-backed securities	7,317	-	7,317	-	-
Corporate and other debt securities	79,287	-	79,287	-	-
Equity securities					
Domestic	284,767	284,767	-	-	-
Foreign	137,969	137,969	-	-	-
Common collective trust interests	9,358	-	-	-	9,358
Total board designated, restricted and other investments	706,756	604,749	92,649	-	9,358
Beneficial interest in perpetual trusts	325,806	-	-	325,806	-
457(b) plan assets	56,599	56,599	-	-	-
Total	**$ 1,466,705**	**$ 977,796**	**$ 153,745**	**$ 325,806**	**$ 9,358**

The table above excludes privately held equities of $1,739 included with board designated, restricted and other investments on the consolidated balance sheets.

(in thousands of dollars)

The following table summarizes fair value measurements by level at December 31, 2020 for financial assets measured at fair value on a recurring basis:

		Fair Value Measurement			Net Asset
	Total	**Level 1**	**Level 2**	**Level 3**	**Value**
Assets					
Cash and cash equivalents	$ 260,438	$260,438	$ -	$ -	$ -
Investments					
Debt securities, available-for-sale					
U.S. Treasury and agency obligations	37,996	35,596	2,400	-	-
Agency mortgage-backed securities	7,602	-	7,602	-	-
Asset-backed and other loan-backed securities	3,948	-	3,948	-	-
Corporate and other debt securities	34,130	-	34,130	-	-
Total debt securities	83,676	35,596	48,080	-	-
Equity securities					
Domestic	6,310	6,310	-	-	-
Foreign	8,885	8,885	-	-	-
Total equity securities	15,195	15,195	-	-	-
Board designated, restricted and other investments					
Cash and cash equivalents	56,961	56,961	-	-	-
Debt securities					
U.S. Treasury and agency obligations	119,021	116,588	2,433	-	-
Agency mortgage-backed securities	2,368	-	2,368	-	-
Asset-backed and other loan-backed securities	2,703	-	2,703	-	-
Corporate and other debt securities	93,675	-	93,675	-	-
Equity securities					
Domestic	167,622	167,622	-	-	-
Foreign	119,991	119,991	-	-	-
Common collective trust interests	8,936	-	-	-	8,936
Total board designated, restricted and other investments	571,277	461,162	101,179	-	8,936
Beneficial interest in perpetual trusts	292,248	-	-	292,248	-
457(b) plan assets	47,936	47,936	-	-	-
Total	**$1,270,770**	**$820,327**	**$149,259**	**$ 292,248**	**$ 8,936**

The table above excludes privately held equities of $1,739 included with board designated, restricted and other investments on the consolidated balance sheets.

Transfers between levels, if any, are recorded annually as of the end of the reporting period unless, with respect to a particular issue, a significant event occurred that necessitated the transfer be reported at the date of the event. There were no material transfers from Level 3 during the years ended December 31, 2021 and 2020.

(in thousands of dollars)

The changes in fair value for assets measured using significant unobservable inputs (Level 3) were as follows for the years ended December 31:

	Beneficial Interest in Perpetual Trusts	
	2021	**2020**
Balance at January 1	$ 292,248	$ 263,002
Net unrealized gains	17,165	26,424
Net realized gains	26,358	12,777
Purchases	26	-
Transfers out of trusts	(9,991)	(9,955)
Balance at December 31	**$ 325,806**	**$ 292,248**

Beginning in 2019, certain private equity securities were no longer carried at fair value under ASU 2016-01, Financial Instruments. The carrying value of these securities was $1,739 at December 31, 2021 and 2020, respectively. An impairment of $5,760 was recorded for observable price changes on these securities in 2020.

The following table summarizes the nature of the funds valued based on net asset value as a practical expedient for fair value as of December 31, 2021:

	Fair Value	**Unfunded Commitments**	**Redemption Frequency**	**Redemption Notice Period**
Common collective trust interests	$ 9,358	$ -	Quarterly	60 Days

The following table summarizes the nature of the funds valued based on net asset value as a practical expedient for fair value as of December 31, 2020:

	Fair Value	**Unfunded Commitments**	**Redemption Frequency**	**Redemption Notice Period**
Common collective trust interests	$ 8,936	$ -	Quarterly	60 Days

Fair Value Option
The Health Network elected the fair value option for its investments, with the exception of the available-for-sale debt securities held by Palladium. At December 31, 2021 and 2020, the Health Network reported investments of $633,998 and $507,655, respectively under the fair value option within board designated, restricted and other investments at fair value on the consolidated balance sheets. The Health Network has recorded unrealized gains of $3,783 and $15,199 (included in net investment income on the consolidated statements of operations) for the years ended December 31, 2021 and 2020, respectively.

(in thousands of dollars)

7. Equity Method Investments

The Health Network has ownership interests in various health-related ventures which were formed to reduce the costs and increase effectiveness in providing community service benefits. These include ventures which provide laboratory, ambulance, oncology and other services and are accounted for under the equity method of accounting. The accompanying consolidated balance sheets reflect equity investments as follows for December 31:

	2021		2020	
	Ownership Interest	Investment Balance	Ownership Interest	Investment Balance
Vantage Holding Company	52.3%	$ 9,283	52.3%	$ 8,565
Associated Clinical Labs	12.3%	9,258	12.3%	10,242
AHN-LECOM JV, LLC	50.0%	8,690	50.0%	7,058
EmergyCare, Inc.	50.0%	4,588	50.0%	3,203
AHN Emergency Medicine Management, LLC	50.0%	2,550	50.0%	2,280
Community Blood Bank of Erie County	40.0%	1,718	40.0%	1,366
Regional Cancer Center	50.0%	-	50.0%	351
Other (a)	various	6,563	various	6,436
		$ 42,650		$ 39,501

(a) Consists of various individually immaterial investments of varying ownership interests (ranging from <2% to 50%).

Total assets, liabilities, and net assets of the equity investees were approximately $453,969, $214,360, and $239,609, respectively, at December 31, 2021 and $458,730, $222,747, and $235,983, respectively, at December 31, 2020. Total revenues, expenses and net income of the equity investees was approximately $206,348, $158,922, and $47,426, respectively, for the year ended December 31, 2021 and $244,345, $205,023, and $39,322, respectively, for the year ended December 31, 2020.

Differences, if any, between the carrying amount of the investment and the amount of underlying equity in net assets of the investment are, in the opinion of management, deemed to be immaterial in the aggregate.

8. Property and Equipment, Net

Property and equipment was comprised of the following at December 31:

	2021	2020
Land, buildings and leasehold improvements	$ 1,760,748	$ 1,371,556
Equipment	1,147,824	989,117
Capitalized software	84,242	83,182
Total depreciable assets	2,992,814	2,443,855
Less: accumulated depreciation	(1,226,371)	(1,038,116)
Net depreciable assets	1,766,443	1,405,739
Construction in progress	95,623	355,279
Property and equipment, net	$ 1,862,066	$ 1,761,018

Depreciation expense amounted to $199,700 and $179,004 for 2021 and 2020, respectively.

(in thousands of dollars)

The Health Network capitalizes interest on certain assets that require a period of time to prepare for their intended use. The amount capitalized is based on the weighted average outstanding borrowing rate. For the years ended December 31, 2021 and 2020, the Health Network capitalized $19,803 and $17,318, respectively.

The Health Network made reclassifications of prior year construction in progress amounts to properly classify the underlying asset.

9. Employee Benefit Plans

Defined Benefit Plans

The Health Network covers certain employees meeting the age and service requirements through multiple non-contributory defined benefit pension plans (the "pension plans"): Retirement Plan for Eligible Employees of West Penn Allegheny Health System (the "WPAHS pension plan"), Jefferson Retirement Plan (the "JRMC pension plan"), and Saint Vincent Health System Pension Plan (the "SVHS pension plan"). The JRMC pension plan, SVHS pension plan and a portion of the WPAHS pension plan are frozen. Effective July 1, 2019, the JRMC and SVHS pension plans merged. Effective December 31, 2019, the Highmark pension plan, WPAHS, and newly merged JRMC and SVHS pension plans were merged into a single multiple employer plan, sponsored by the Highmark Health.

The Health Network funds its pension plans according to minimum funding requirements of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended. During 2021, the Health Network does not expect to contribute to the pension plans related to the 2021 or 2022 plan year.

A special one-time expense of $11,281 was required under settlement accounting rules as of December 31, 2020. This adjustment was triggered as a result of the lump sum payments made during the year from the plan.

(in thousands of dollars)

The amounts recognized in the consolidated balance sheets at December 31, are as follows:

	2021	2020
Accumulated benefit obligation	$ 1,301,919	$ 1,387,161
Change in benefit obligations		
Benefit obligations at beginning of year	$ 1,394,238	$ 1,357,090
Service cost	8,869	9,076
Interest cost	20,228	34,326
Participant contributions	-	8
Benefit payments	(81,418)	(111,759)
Actuarial gain	(33,896)	105,497
Benefit obligations at end of year	$ 1,308,021	$ 1,394,238
Change in plan assets		
Net plan assets at beginning of year	$ 1,155,288	$ 1,068,510
Actual return on plan assets	81,411	152,529
Participant contributions	-	8
Employer contributions	-	46,000
Benefit payments	(81,418)	(111,759)
Net plan assets at end of year	$ 1,155,281	$ 1,155,288
Amounts recognized in the consolidated balance sheets		
Benefit plan liabilities	$ (152,740)	$ (238,950)
Amounts included in unrestricted net assets		
Actuarial loss	(134,982)	(195,818)
Net amounts recognized	$ (134,982)	$ (195,818)

The estimated actuarial loss for the pension plans that will be amortized from net assets in 2022 is $3,300.

The following table provides the components of net periodic benefit credit for the years ended December 31:

	2021	2020
Service cost	$ 8,869	$ 9,076
Interest cost	20,228	34,326
Expected return on plan assets	(59,979)	(70,220)
Amortization of actuarial loss	5,508	3,039
Settlement loss	-	11,281
Net periodic benefit credit	$ (25,374)	$ (12,498)

(in thousands of dollars)

The Health Network's weighted-average assumptions related to the calculation of the pension benefit obligations and net periodic benefit cost for the pension and other post-retirement plans are presented in the table below:

	2021	2020
Weighted-average assumptions		
Discount rate - benefit obligations	2.62%	2.20%
Discount rate - net periodic costs	2.20%	3.05%
Expected return on plan assets	6.00%	7.00%
Rate of compensation increase	2.64 - 7.15%	2.45 - 7.25%

The expected return on pension plan assets is developed using inflation expectations, risk factors and input from actuaries to arrive at a long-term nominal expected return for each asset class. The nominal expected return for each asset class is then weighted based on the target asset allocation to develop the expected long-term rate of return on plan assets.

Estimated benefit payments are expected as follows:

2022	$	140,000
2023	$	94,000
2024	$	93,000
2025	$	90,000
2026	$	86,000
2027-2031	$	388,000

The pension plans' overall investment strategies are determined by the plans' investment committees, investment advisors and plan administrators. Overall, the goals of the Health Network are to achieve sufficient diversification of asset types, fund strategies and fund managers in order to minimize volatility and maximize returns over the long term, while still having sufficient funds to pay those benefits due in the near term.

The pension plan investment strategy includes dynamic target allocations that change as the funded status changes, with the goals of reducing risk as funded status improves, with an overall investment strategy to achieve a mix of 70% of long-duration fixed income securities meant to hedge the benefit obligations, 28% of investments for long-term growth and 2% for near-term benefit payments with a diversification of asset types, fund strategies and fund managers. The target allocations for the Health Network's plan assets are approximately 44% fixed income securities, 45% equity securities, 9% alternative investments and 2% cash equivalents. Equity securities primarily include stock investments in U.S. developed and emerging market corporations. Fixed income securities primarily include bonds of domestic and foreign companies from diversified industries, domestic mortgage-backed securities and bonds of U.S. and foreign governments and agencies. Alternative investments include investments in real estate and private equity funds that follow several different strategies.

(in thousands of dollars)

The following table summarizes the fair value measurements by level at December 31, 2021:

		Fair Value Measurement			Net Asset
	Total	**Level 1**	**Level 2**	**Level 3**	**Value**
Pension plan assets					
Cash and cash equivalents	$ -	$ -	$ -	$ -	$ -
Debt securities					
U.S. Treasury and agency obligations	204,308	204,308	-	-	-
Agency mortgage-backed securities	56,704	-	56,704	-	-
State and political obligations	7,536	-	7,536	-	-
Commercial mortgage-backed securities	1,364	-	1,364	-	-
Asset-backed securities	11,572	-	11,572	-	-
Corporate and other debt securities	207,573	-	207,429	144	-
Total debt securities	489,057	204,308	284,605	144	-
Equity securities					
Domestic	99,891	99,891	-	-	-
Foreign	11,885	11,885	-	-	-
Total equity securities	111,776	111,776	-	-	-
Registered investment company shares	468,649	468,649	-	-	-
Private limited partnerships	84,491	-	-	-	84,491
Total	$ 1,153,973	$ 784,733	$ 284,605	$ 144	$ 84,491

At December 31, 2021, the fair value of pension plan assets excluded accrued interest and other receivables of $1,308.

The following table summarizes the fair value measurements by level at December 31, 2020:

		Fair Value Measurement			Net Asset
	Total	**Level 1**	**Level 2**	**Level 3**	**Value**
Pension plan assets					
Cash and cash equivalents	$ -	$ -	$ -	$ -	$ -
Debt securities					
U.S. Treasury and agency obligations	148,163	148,163	-	-	-
Agency mortgage-backed securities	5,447	-	5,447	-	-
State and political obligations	7,437	-	7,437	-	-
Commercial mortgage-backed securities	3,265	-	3,165	100	-
Residential mortgage-backed securities	165	-	165	-	-
Asset-backed securities	10,869	-	10,019	850	-
Corporate and other debt securities	140,175	-	140,124	51	-
Total debt securities	315,521	148,163	166,357	1,001	-
Equity securities					
Domestic	102,421	102,386	-	35	-
Foreign	13,220	13,220	-	-	-
Total equity securities	115,641	115,606	-	35	-
Registered investment company shares	656,648	656,648	-	-	-
Private limited partnerships	66,432	-	-	-	66,432
Total	$ 1,154,242	$ 920,417	$ 166,357	$ 1,036	$ 66,432

At December 31, 2020, the fair value of pension plan assets excluded accrued interest and other receivables of $1,046.

(in thousands of dollars)

The following table summarizes the nature of the funds valued based on net asset value as a practical expedient for fair value as of December 31, 2021:

	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Private limited partnerships	$ 84,491	$ 9,000	Quarterly	30 Days

The following table summarizes the nature of the funds valued based on net asset value as a practical expedient for fair value as of December 31, 2020:

	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Private limited partnerships	$ 66,432	$ 14,000	Quarterly	30 Days

Defined Contribution Plans

The Health Network sponsors several forms of defined contribution savings plans including: 403(b), 401(a), and 401(k) plans under the Internal Revenue Code. While a number of the plans are frozen, certain plans continue to provide employer matching at various levels. Effective January 1, 2018, a new defined contribution plan was established for the benefit of substantially all Health Network employees, except for those governed by a collective bargaining agreement that permits continued participation in a legacy defined contribution plan. The Health Network's expense associated with contributions to these savings plans was $67,750 and $62,994 for the years ended December 31, 2021 and 2020, respectively.

Deferred Compensation Plans

The Health Network sponsors multiple deferred compensation plans, for a select group of management and highly compensated employees, which are governed by Internal Revenue Code Section 457(b). Salary deferrals are subject to Code 457(b) limits. The Health Network makes no employer contributions to the plan. The related plan assets, while held in a separate trust, are recorded on the accompanying consolidated balance sheets within the caption of other assets, and the offsetting liabilities are included within other liabilities. At December 31, 2021 and 2020 these assets were $56,599 and $47,936, respectively. The Health Network is not at risk for any negative changes to the market value of these assets.

(in thousands of dollars)

10. Debt

The Health Network's total debt consisted of the following at December 31:

	2021	2020
AHN Series 2018 revenue bonds	$ 975,437	$ 980,648
Mortgage loan, due March 15, 2032, interest at 6.00%	-	20,538
Mortgage loan, due March 1, 2029, interest at 4.626%	4,082	4,551
Equipment loan, due March 19, 2026, interest at 4.99%	3,910	-
Mortgage and other loans due through 2026 at varying interest rates	2,984	6,242
Total debt	$ 986,413	$ 1,011,979
Less: current portion	(25,911)	(9,546)
Total debt, net of current portion	$ 960,502	$ 1,002,433

A summary of aggregate maturities on debt is as follows:

Years ending December 31,	
2022	25,911
2023	26,454
2024	26,550
2025	26,976
2026	26,854
Thereafter	853,668
Total	$ 986,413

Series 2018 Revenue Bonds
In August 2018, the Health Network issued tax exempt revenue bonds with a par value of $943,365 (Series 2018A) through the Allegheny County Hospital Development Authority ("ACHDA") at a premium of $56,639 for total proceeds of $1,000,004. The Series 2018 Revenue Bonds consist of both serial and term bonds scheduled to mature at various dates through April 2047. Interest rates are fixed and range from 4.00% to 5.00%. The Health Network is required to pay interest only through 2021, with level debt service thereafter consisting of principal and interest. The unamortized premium was $38,471 and $43,921 at December 31, 2021 and 2020, respectively. The bonds are collateralized by the gross receivables and other property of the Health Network.

Revolving Credit Facilities
In July 2020, the Health Network entered into a one-year and three-year line of credit facility for $50,000 each, with options to extend the terms. Amounts borrowed under these facilities bear interest at variable interest rates. On July 28, 2021 the one-year facility expired with no plans of renewal. $20,000 of the $50,000 three-year facility has been set aside for letters of credit, of which $12,750 has been utilized, but not drawn upon. The three-year facility is collateralized by the gross receivables and other property of the Health Network.

Other Debt
The consolidated joint venture, Erie Medical Complex, LLC ("EMC") held an outstanding mortgage loan of $20,538 at December 31, 2020, related to a medical office building. The related medical office building was pledged as collateral on the loan and had a carrying value of $17,614 at December 31, 2020. In December 2021, EMC was merged into and with a third party real estate investment trust. As a result of the merger, SVHS' interest in EMC was cancelled in exchange for cash consideration, and EMC was removed from the consolidated financial statements.

(in thousands of dollars)

On September 30, 2020, JRMC purchased an additional 45.9% of the ownership in its joint venture, Jefferson Medical Associates ("JMA"), bringing total ownership to 89.7%. With this purchase, JRMC assumed JMA's outstanding mortgage loan. The outstanding mortgage loan balance was $4,082 and $4,551 at December 31, 2021 and 2020. The mortgage note matures on March 1, 2029 and requires monthly principal and interest payments.

Several of the debt agreements referred to above contain covenants, including covenants relating to debt service coverage and financial reporting. At December 31, 2021 and 2020, the Health Network was in compliance with all debt covenants that could affect the financial position or results from operations.

11. Income Taxes

The components of the income tax (benefit) expense were as follows for the years ended December 31:

	2021	2020
Federal		
Current	$ 312	$ 123
Deferred	1,120	(4,567)
Total federal	1,432	(4,444)
State		
Current	988	1,322
Deferred	(284)	216
Total state	704	1,538
Total income tax expense (benefit)	$ 2,136	$ (2,906)

There were no foreign current or deferred provisions for the years ended December 31, 2021 and 2020.

The components of deferred income taxes were as follows at December 31:

	2021	2020
Deferred tax assets		
Other payables and accrued expenses	$ 3,109	$ 2,800
Net operating loss carryforwards	65,635	83,112
Investment in partnerships	2,696	1,727
Total deferred tax assets	71,440	87,639
Less: valuation allowance	(58,885)	(72,872)
Total deferred tax assets, net of valuation allowance	12,555	14,767
Deferred tax liabilities		
Goodwill and other intangibles	1,383	1,518
Property and equipment	2,766	4,159
Net unrealized gains on available-for-sale securities	635	1,084
Operating lease right to use liabilities	631	-
Total deferred tax liabilities	5,415	6,761
Net deferred tax asset	$ 7,140	$ 8,006

The realization of net deferred tax assets is dependent on the Health Network's ability to generate sufficient taxable income in future periods. The amount of deferred tax assets considered realizable, however, could change if estimates of future taxable income change.

(in thousands of dollars)

While the majority of entities within the Health Network are not-for-profit, there are a limited number of entities organized as for-profit companies. These include Clinical Services, Inc., HMPG and its subsidiaries as well as several physician practices consolidated within WPAHS. On 1/1/2021 Clinical Services, Inc. became the parent of HMPG, Inc.

At December 31, 2021, various subsidiaries and affiliates of the Health Network had state net operating loss carryforwards totaling $231,359 that expire through 2041 and are available to offset future state taxable income of the subsidiary that generated the loss carryforward. The utilization of the state net operating loss carryforwards is subject to certain limitations; therefore, the Health Network recognized a valuation allowance for that portion of the federal net operating loss carryforward not expected to be utilized.

At December 31, 2021, the Health Network had federal net operating loss carryforwards, related to subsidiaries of $224,907, which expire in various amounts through 2041. The utilization of the federal net operating loss carryforwards is subject to certain limitations; therefore, the Health Network recognized a valuation allowance for that portion of the federal net operating loss carryforward not expected to be utilized.

A reconciliation of income tax expense (benefit) recorded in the consolidated statements of operations and amounts computed at the statutory federal rate were as follows for the years ended December 31:

	2021	2020
Income taxes at statutory rate	$ (15,173)	$ (26,186)
Tax exempt income	16,865	25,992
Valuation allowance adjustments	1,869	(4,662)
State taxes, net of federal tax benefit	756	1,261
Nondeductible compensation	287	855
Equity adjustment - partnership	(165)	(132)
Return to provision adjustments	(1,803)	-
Other	(500)	(34)
Total income tax expense (benefit)	$ 2,136	$ (2,906)

The Health Network has no uncertain tax positions for 2021 or 2020 and does not anticipate any uncertain tax positions in 2022.

12. Leases

The Health Network enters into lease arrangements for real estate and equipment. The Health Network leases a significant number of physician offices, outpatient facilities and administrative offices. Additionally, the Health Network leases medical equipment and vehicles.

It is determined if an arrangement is or contains a lease at inception of the contract. Right-of-use assets represent the right to use the underlying assets for the lease term and lease liabilities represent the obligation to make lease payments arising from the leases. Right-of-use assets and lease liabilities are recognized at commencement date based on the present value of lease payments over the lease term. The Health Network uses its estimated incremental borrowing rate, which is derived using a collateralized borrowing rate for the same currency and term as the associated lease. A right-of-use asset and lease liability is not recognized for leases with an initial term of 12 months or less and the Health Network recognizes lease expense for these leases over the lease term within other operating expenses.

Real estate leases include multiple optional renewal periods. The Health Network will evaluate extension periods within one year of expiration of the lease term.

(in thousands of dollars)

Real estate leases include fixed rental payments. Most leases include lease payment increases at pre-determined dates. There are a number of leases that require separate payments to the lessor based on the lessor's property and casualty insurance costs and the property taxes assessed on the property, as well as a portion of the common area maintenance associated with the property.

Rent expense associated with leases was as follows for the years ended December 31:

	2021	2020
Finance lease cost:		
Amortization of right of use assets	$ 5,105	$ 3,565
Interest on lease liabilities	3,233	1,441
Operating lease cost	53,790	54,519
Short-term/variable lease cost	4,698	5,325
Total lease cost	$ 66,826	$ 64,850

Cash and non-cash activities associated with leases were as follows for the years ended December 31:

	2021	2020
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	$ 52,217	$ 54,564
Non-cash investing and financing activities:		
Additions to ROU assets obtained from:		
New operating lease liabilities	$ 3,233	$ 19,094
New finance lease liabilities	2,758	19,656

As of December 31, 2021, the weighted-average remaining lease term and discount rate on finance and operating leases was as follows:

Weighted-average remaining lease term - finance leases	15 years
Weighted-average remaining lease term - operating leases	9 years
Weighted-average discount rate - finance leases	4.7%
Weighted-average discount rate - operating leases	4.4%

(in thousands of dollars)

The future payments due under operating and finance leases as of December 31, 2021 is as follows:

	Operating Leases	Finance Leases
Years ending December 31,		
2022	$ 43,840	$ 6,367
2023	38,856	6,970
2024	34,482	7,046
2025	31,472	7,123
2026	26,875	7,202
Thereafter	128,860	69,918
Total	304,385	104,626
Less: effects of discounting	(55,993)	(30,977)
Lease liabilities recognized	$ 248,392	$ 73,649

13. Insurance Coverage

Professional Liability

Palladium provides medical professional liability coverage on a claims-made basis to the Health Network and its employed physicians and also on a claims-made or occurrence basis to its affiliated physicians and groups. Palladium provides general liability coverage on an occurrence basis. Defense costs with respect to medical professional liability and general liability are outside the limits and are unlimited. Overall coverage for professional liability extends to $62,000 and general liability extends to $58,000.

With respect to the primary layer of medical professional liability coverage, Palladium provides limits of $500 per occurrence, $2,500 aggregate per hospital and $500 per occurrence, $1,500 aggregate per physician to providers participating in the Pennsylvania Medical Care Availability and Reduction of Error (“MCARE”) Fund, and limits of $1,000 per occurrence, $3,000 aggregate to providers and entities not participating in the MCARE Fund. The primary layer of general liability coverage affords limits of $1,000 per occurrence, $3,000 aggregate.

The excess policies written afford the following shared limits corresponding to the first through eighth excess layers respectively:

- First Excess: $2,000 per occurrence, $10,000 aggregate (the aggregate was increased from $8,000 to $10,000 in 2021) with respect to medical professional liability;
- Second Excess: $4,000 per occurrence, $4,000 aggregate for WPAHS and $4,000 per occurrence, $4,000 aggregate all other insureds with respect to medical professional liability.
- Third Excess: $5,000 per occurrence, $10,000 aggregate with respect to medical professional liability and $5,000 per occurrence, $10,000 aggregate with respect to excess follow-form liability (which includes general liability, auto liability, employers’ liability, helipad liability and non-owned aircraft liability and private police liability);
- Fourth Excess: $5,000 per occurrence, $5,000 aggregate with respect to medical professional liability and $5,000 per occurrence, $5,000 aggregate with respect to excess follow-form liability;
- Fifth Excess: $10,000 per occurrence, $10,000 aggregate with respect to medical professional liability and $10,000 per occurrence, $10,000 aggregate with respect to excess follow-form liability;
- Sixth Excess: $15,000 each occurrence, $15,000 aggregate with respect to excess health care liability. The excess medical professional liability coverage is claims-made and the excess follow-form liability coverage is occurrence-based;
- Seventh Excess: $10,000 per occurrence, $10,000 aggregate. The coverage is occurrence-based.
- Eighth Excess: $10,000 per occurrence, $10,000 aggregate. The coverage is occurrence-based.

(in thousands of dollars)

Palladium ceded 100% of the underlying risk for the third through eighth excess layers to third-party, highly-rated reinsurers. Reinsurance contracts do not relieve Palladium from its obligations to participants. Additionally, failure of the reinsurers to honor their obligations could result in significant losses to Palladium. Accordingly, Palladium continually evaluates the reinsurers' financial condition. The financial condition of third-party reinsurers is assessed by review of the reinsurers' A.M. Best rating. Palladium records an allowance for credit losses when it's believed that it will be unable to collect amounts due.

As discussed briefly above, additional coverage is also provided for the Health Network by the MCARE Fund created by Pennsylvania Act No. 113 of 2002. Most of the Health Network's entities providing services in Pennsylvania are required to participate in the MCARE Fund. The MCARE Fund, an agency fund of the Commonwealth of Pennsylvania, provides coverage in excess of the required primary layer. The MCARE Fund exposure was capped at $500 per incident and $1,500 in aggregate for 2021 and 2021, respectively. The Health Network's annual surcharge premium for participation in the MCARE Fund was approximately $7,798 and $7,517 for 2021 and 2020, respectively which are included in the amounts charged to malpractice expense. No provision has been made for any future MCARE Fund assessments in the accompanying consolidated financial statements as the Health Network's portion of the MCARE Fund's unfunded liability could not be reasonably estimated.

14. Functional Expenses

The Health Network provides general health care services to residents within its geographic region. Expenses related to providing these services are as follows for the year ended December 31, 2021:

	Program Services		Supporting Activities		
	Healthcare Services	Research	Management & General	Fundraising	Total Expenses
Salaries, wages and fringe benefits	$ 1,849,478	$ 22,912	$ 339,821	$ 2,459	$ 2,214,670
Patient care supplies	837,363	24,104	45,392	-	906,859
Professional fees and purchased services	427,298	7,029	47,667	1,885	483,879
Depreciation and amortization	181,422	1,220	20,157	-	202,799
Other operating expenses	285,461	4,199	42,341	81	332,082
Interest expense	21,469	-	2,385	-	23,854
	$ 3,602,491	$ 59,464	$ 497,763	$ 4,425	$ 4,164,143

The Health Network provides general health care services to residents within its geographic region. Expenses related to providing these services are as follows for the year ended December 31, 2020:

	Program Services		Supporting Activities		
	Healthcare Services	Research	Management & General	Fundraising	Total Expenses
Salaries, wages and fringe benefits	$ 1,733,002	$ 21,645	$ 326,740	$ 4,952	$ 2,086,339
Patient care supplies	768,780	23,219	-	-	791,999
Professional fees and purchased services	387,766	6,750	43,085	1,862	439,463
Depreciation and amortization	162,722	775	18,081	-	181,578
Other operating expenses	271,821	5,044	37,310	290	314,465
Interest expense	21,969	-	2,442	-	24,411
	$ 3,346,060	$ 57,433	$ 427,658	$ 7,104	$ 3,838,255

(in thousands of dollars)

15. Related Party Transaction

In the normal course of business, the Health Network has transactions with Highmark Health and its subsidiaries and affiliates.

Total net patient service revenue from insurance claims, quality incentive programs and Community Health Reinvestment grants were $1,531,067 and $1,417,117 for the years ended December 31, 2021 and 2020, respectively. Included within net patient receivable balances are related party receivables of $253,092 and $224,344 as of December 31, 2021 and 2020, respectively. Additionally, total payor advances amounted to $30,609 as of December 31, 2021 and 2020, respectively, and are reported in deferred revenue.

In the normal course of business, the Health Network purchases certain services and receives shared service charges and allocations. Total purchased services and shared service charges were $147,900 and $119,357 for the year ended December 31, 2021 and 2020, respectively. At December 31, 2021 and 2020, $28,403 and $30,597, respectively, were outstanding and are included in accounts payable.

The Health Network has routinely received net asset transfers from Highmark Inc. in support of strategic capital improvements, service-line expansions and technology enhancements. For the year ended December 31, 2021, the Health Network recognized $266,191 in transfers recorded as additions to net assets without donor restrictions. The majority of these transfers were specific to an intercompany funding agreement to finance necessary capital expenditure projects with the purpose of expanding services and healthcare capabilities that will serve to benefit Highmark Inc. policyholders in the western Pennsylvania region. For the year ended December 31, 2020, the Health Network recognized $264,125 in transfers recorded as additions to net assets without donor restrictions. During 2020, Highmark funded $46,270 of these equity transfers, with $217,855 remaining unpaid and reported in other receivables on the consolidated balance sheet.

Effective January 1, 2018, the Health Network entered into a five year Clinical Affiliation Agreement (CAA) with Highmark Inc. in order for Highmark Inc.'s members to have access to high quality medical and healthcare services in western Pennsylvania and the surrounding community. Under the terms of the CAA, Highmark Inc. agreed to fund certain initiatives and objectives in furtherance of the integrated delivery and financing system objective of delivering high quality, lower cost health care in the community. In addition to the equity funding noted above, Highmark funded $15,137 and $16,883 in 2021 and 2020, respectively, under the CAA, which is included in the consolidated statement of operations.

16. Contingencies

Participation in government-sponsored healthcare programs subjects the Health Network to a variety of federal and state laws and regulations and risks associated with audits conducted under these programs. These audits may occur in years subsequent to the Health Network providing the relevant services under audit. Audit risks include repayment of claims and/or the payment of fines and penalties. The Health Network believes, based on consultation with legal counsel, adequate provision has been made in the financial statements for any potential liability related to these matters, and the amount of ultimate liability is not expected to materially affect the financial position or results from operations.

The Health Network is subject to various other contingencies, including legal and compliance actions and proceedings that arise in the ordinary course of its business. Due to the complex nature of these actions and proceedings, the timing of the ultimate resolution of these matters is uncertain. In the opinion of management, based on consultation with legal counsel, adequate provision has been made in the financial statements for any potential liability related to these matters, and the amount of ultimate liability is not expected to materially affect the financial position or results from operations.