

CONSOLIDATED FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

Banner Health and Subsidiaries
Years Ended December 31, 2018 and 2017
With Report of Independent Auditors

Ernst & Young LLP



Banner Health and Subsidiaries
Consolidated Financial Statements and
Supplementary Information
Years Ended December 31, 2018 and 2017

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Report of Independent Auditors

The Board of Directors
Banner Health

We have audited the accompanying consolidated financial statements of Banner Health and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor’s Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Banner Health and Subsidiaries at December 31, 2018 and 2017, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

March 22, 2019

Banner Health and Subsidiaries

Consolidated Balance Sheets

| | December 31 | |
|-------------------------------------------------------------------------------------|-----------------------|---------------|
| | 2018 | 2017 |
| | <i>(In Thousands)</i> | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 383,096 | \$ 292,911 |
| Short-term investments | 112,196 | 59,114 |
| Collateral held under securities lending program | 210,811 | 287,992 |
| Assets limited as to use | 144,170 | 120,567 |
| Patient receivables, net of allowance for doubtful accounts of \$214,189 in 2017 | 868,127 | 907,212 |
| Inventories | 206,055 | 192,877 |
| Other receivables | 350,731 | 264,295 |
| Other, primarily prepaid expenses | 86,211 | 64,590 |
| Total current assets | 2,361,397 | 2,189,558 |
| Assets limited as to use: | | |
| Funds designated by: | | |
| Board of Directors | 2,031,832 | 2,101,134 |
| Lease agreements | 1,931 | 1,901 |
| Funds held by trustees under: | | |
| Self-insurance funding arrangements | 103,564 | 119,952 |
| Project fund | - | 44,957 |
| Other funds | 138,238 | 222,155 |
| Total assets limited as to use, less current portion | 2,275,565 | 2,490,099 |
| Assets held for sale | - | 2,140 |
| Property and equipment, net | 3,685,196 | 3,493,785 |
| Leased hospital assets | 207,847 | 226,907 |
| Other assets: | | |
| Long-term investments | 2,114,408 | 2,374,808 |
| Other | 742,342 | 727,993 |
| Total other assets | 2,856,750 | 3,102,801 |
| Total assets | \$ 11,386,755 | \$ 11,505,290 |

| | December 31 | |
|---------------------------------------------------------------|-----------------------|---------------|
| | 2018 | 2017 |
| | <i>(In Thousands)</i> | |
| Liabilities and net assets | | |
| Current liabilities: | | |
| Trade accounts payable | \$ 208,932 | \$ 222,269 |
| Current portion of long-term debt | 58,994 | 187,970 |
| Debt subject to self liquidity | 200,000 | 200,000 |
| Current portion of hospital lease obligation | 22,188 | 22,907 |
| Payable under securities lending program | 210,811 | 287,992 |
| Estimated current portion of third-party payor settlements | 3,465 | 10,313 |
| Accrued expenses: | | |
| Salaries and benefits | 460,061 | 424,527 |
| Medical claims payable | 202,849 | 162,843 |
| Other | 238,164 | 268,004 |
| Total current liabilities | 1,605,464 | 1,786,825 |
| Long-term debt, less current portion | 3,064,972 | 3,004,176 |
| Hospital lease obligation | 211,515 | 223,061 |
| Estimated self-insurance liabilities, less current portion | 205,055 | 178,014 |
| Estimated third-party payor settlements, less current portion | 17,531 | 32,434 |
| Interest rate swaps | 258,762 | 311,004 |
| Other | 174,853 | 185,296 |
| Total liabilities | 5,538,152 | 5,720,810 |
| Net assets: | | |
| Net assets without donor restrictions | 5,613,878 | 5,569,307 |
| Non-controlling interests | 43,999 | 31,812 |
| Net assets without donor restrictions | 5,657,877 | 5,601,119 |
| Net assets with donor restrictions | 190,726 | 183,361 |
| Total net assets | 5,848,603 | 5,784,480 |
| Total liabilities and net assets | \$ 11,386,755 | \$ 11,505,290 |

See accompanying notes.

Banner Health and Subsidiaries
Consolidated Statements of Income

| | Year Ended December 31 | |
|--------------------------------------------------------------------------------------------------------|-------------------------------|-------------------|
| | 2018 | 2017 |
| | <i>(In Thousands)</i> | |
| Revenues: | | |
| Patient service revenue, net of contractals | \$ 6,553,649 | \$ 6,611,476 |
| Provision for doubtful accounts | – | 323,405 |
| Net patient service revenue | <u>6,553,649</u> | <u>6,288,071</u> |
| Medical insurance premiums | 1,539,653 | 1,197,928 |
| Other revenue | 426,477 | 349,267 |
| Total other operating revenue | <u>1,966,130</u> | <u>1,547,195</u> |
| Total revenues | <u>8,519,779</u> | <u>7,835,266</u> |
| Expenses: | | |
| Salaries and benefits | 4,025,037 | 3,797,182 |
| Supplies | 1,377,496 | 1,278,375 |
| Physician and professional fees | 209,522 | 180,616 |
| Medical claims cost, net of Banner claims of \$366,861 and \$409,541 in 2018 and 2017, respectively | 1,137,340 | 838,840 |
| Depreciation and amortization | 414,841 | 412,428 |
| Interest | 126,438 | 112,328 |
| Other | 1,042,768 | 944,841 |
| Total expenses | <u>8,333,442</u> | <u>7,564,610</u> |
| Operating income | <u>186,337</u> | <u>270,656</u> |
| Other income (loss): | | |
| Investment income – realized | 195,642 | 130,649 |
| Investment (loss) gain – unrealized | (341,150) | 238,277 |
| (Loss) income from alternative investments | (16,720) | 85,484 |
| (Loss) income, net | <u>(162,228)</u> | <u>454,410</u> |
| Unrealized gain on interest rate swaps | 52,015 | 21,607 |
| Other | (5,712) | (11,557) |
| | <u>(115,925)</u> | <u>464,460</u> |
| Excess of revenues over expenses | 70,412 | 735,116 |
| Less excess of revenues over expenses attributable to non-controlling interests | <u>26,449</u> | <u>25,720</u> |
| Excess of revenues over expenses attributable to Banner Health | <u>\$ 43,963</u> | <u>\$ 709,396</u> |

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Changes in Net Assets

| | Year Ended December 31 | |
|---------------------------------------------------------------------------------|-------------------------------|----------------------------|
| | 2018 | 2017 |
| | <i>(In Thousands)</i> | |
| Net assets without donor restrictions: | | |
| Excess of revenues over expenses attributable to Banner Health | \$ 43,963 | \$ 709,396 |
| Amortization of cumulative loss on interest rate swaps | 227 | 227 |
| Decrease in unfunded pension liability | 1,180 | 3,307 |
| Cumulative effect of change in accounting principle | (7,323) | - |
| Contributions for property and equipment acquisitions | 6,524 | 8,925 |
| Increase in net assets without donor restrictions | <u>44,571</u> | <u>721,855</u> |
| Non-controlling interests: | | |
| Excess of revenue over expenses attributable to non-controlling interests | 26,449 | 25,720 |
| Other changes, primarily distributions of earnings to non-controlling interests | (14,262) | (24,492) |
| Increase in non-controlling interests | <u>12,187</u> | <u>1,228</u> |
| Net assets with donor restrictions: | | |
| Contributions | 27,157 | 27,015 |
| Net unrealized (loss) gain on investments | (1,998) | 1,898 |
| Net assets released from restrictions for property and equipment additions | (2,990) | (6,311) |
| Net assets released from restrictions for operations | (14,804) | (17,685) |
| Increase in net assets with donor restrictions | <u>7,365</u> | <u>4,917</u> |
| Increase in net assets | 64,123 | 728,000 |
| Net assets, beginning of year | <u>5,784,480</u> | <u>5,056,480</u> |
| Net assets, end of year | <u><u>\$ 5,848,603</u></u> | <u><u>\$ 5,784,480</u></u> |

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Cash Flows

| | Year Ended December 31 | |
|-----------------------------------------------------------------------------------------------|------------------------|-------------------|
| | 2018 | 2017 |
| | <i>(In Thousands)</i> | |
| Operating activities | | |
| Increase in net assets | \$ 64,123 | \$ 728,000 |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | 414,841 | 412,428 |
| Decrease (increase) in investments designated as trading | 353,292 | (524,363) |
| Net unrealized gain on interest rate swaps | (52,242) | (21,834) |
| Decrease in unfunded pension liability | (1,180) | (3,307) |
| Cumulative effect of change in accounting principle | 7,323 | – |
| Gain on sale of business venture | (50,443) | – |
| (Gain) loss on sale of assets, net | (1,525) | 162 |
| Contributions for purchase of property and equipment and other | (6,524) | (8,925) |
| Restricted contributions | (27,157) | (27,015) |
| Cash distributions to non-controlling interests | 26,215 | 25,970 |
| Changes in operating elements, net of acquisitions and dispositions: | | |
| Patient receivables | 31,762 | (154,460) |
| Inventories and other current assets | (121,235) | (5,761) |
| Accounts payable and accrued expenses | 32,363 | 72,815 |
| Estimated third-party payor settlements | (21,751) | 11,890 |
| Estimated self-insurance liabilities | 27,041 | 8,113 |
| Other liabilities | (7,453) | (23,480) |
| Net cash provided by operating activities | <u>667,450</u> | <u>490,233</u> |
| Investing activities | | |
| Net purchases of property and equipment | (561,323) | (639,331) |
| Decrease (increase) in project fund | 44,957 | (44,957) |
| Proceeds from sale of business venture | 95,200 | – |
| Increase in other assets | (65,583) | (107,975) |
| Net cash used in investing activities | <u>(486,749)</u> | <u>(792,263)</u> |
| Financing activities | | |
| Proceeds from restricted contributions | 27,157 | 27,015 |
| Proceeds from issuance of debt | 298 | 505,305 |
| Payments of hospital lease obligations | (23,278) | (24,482) |
| Payments of long-term debt | (68,478) | (62,725) |
| Cash distributions to non-controlling interests | (26,215) | (25,970) |
| Net cash (used in) provided by financing activities | <u>(90,516)</u> | <u>419,143</u> |
| Net increase in cash and cash equivalents | 90,185 | 117,113 |
| Cash and cash equivalents at beginning of year | 292,911 | 175,798 |
| Cash and cash equivalents at end of year | <u>\$ 383,096</u> | <u>\$ 292,911</u> |
| Supplemental disclosure of cash flow information | | |
| Interest paid, including amounts capitalized | <u>\$ 139,405</u> | <u>\$ 108,573</u> |
| Taxes paid | <u>\$ 6,141</u> | <u>\$ 9,239</u> |
| Non-cash activities | | |
| Decrease in receivable from Sun Health and related obligation for retirement plan | <u>\$ (2,627)</u> | <u>\$ (3,289)</u> |
| Capital lease obligation | <u>\$ 11,023</u> | <u>\$ 22,609</u> |

See accompanying notes.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018

1. Description of Business

Banner Health is a nonprofit corporation exempt from income taxes under Internal Revenue Code Section 501(c)(3) and applicable state income tax codes. Banner Health and its Subsidiaries (collectively, Banner) own, control, or lease hospitals, clinics, nursing homes, clinical laboratories, ambulatory surgery centers, urgent care centers, home health agencies, a captive insurance company, a foundation, an accountable health care organization (see Note 6), a Medicaid managed care health plan and related Medicare Advantage health plan, and other health care-related organizations in six western states. Banner also holds controlling interests in several health care-related business ventures (see Note 2) and non-controlling interests in several other entities that are accounted for under the equity method of accounting (see Note 7).

2. Significant Accounting Policies

Basis of Consolidation

The accompanying consolidated financial statements reflect the consolidated operations of all owned and leased operating units of Banner and its wholly owned subsidiaries. Banner also holds controlling interests in the following business ventures. The business venture financial results are included within Banner's consolidated financial statements. Banner records the unrelated investor's ownership share of these business ventures as non-controlling interest.

Sonora Quest Laboratories, LLC

The Sonora Quest Laboratories, LLC (SQL) business venture was formed in 1997. Banner holds a 51% controlling interest and Quest Diagnostics of Arizona, Inc. (Quest) holds a 49% non-controlling interest. SQL provides a broad range of laboratory services to Arizona physicians, hospitals and other health care providers. The non-controlling interest balance as of December 31, 2018 and 2017 primarily relates to Quest's investment in SQL.

BHSM Rehabilitation, LLC

In December 2017, Banner Health and Select Medical (Select) entered into a business venture that will own and operate Banner's and Select's Arizona inpatient and outpatient rehabilitation services. The business venture, BHSM Rehabilitation, LLC (BHSM), began operations on May 1, 2018. Banner holds a 51% controlling interest in BHSM and Select holds a 49% non-controlling interest.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

The business venture agreement provides for the construction of three new inpatient rehabilitation hospitals. As these hospitals are completed, Banner will contribute its inpatient rehabilitation assets to BHSM. Banner expects to make additional working capital contributions of approximately \$61,395,000 to facilitate the construction of the three new inpatient rehabilitation hospitals and growth of the outpatient rehabilitation business.

Banner Atlas JV, LLC

Banner entered into a new business venture with Atlas Healthcare Partners, LLC (Atlas), effective September 1, 2018, that will own and operate Banner's ambulatory surgery centers. The business venture is named Banner Atlas JV, LLC, with Banner holding a 75% controlling interest and Atlas holding a 25% non-controlling interest. Atlas will manage the ambulatory surgery centers via a management service agreement and will work with Banner to develop additional ambulatory surgical facilities in Banner's primary markets. Banner Atlas JV, LLC will always maintain a controlling interest in each surgery center.

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

Subsequent Events

Subsequent events have been evaluated through March 22, 2019, the date the consolidated financial statements were issued. There were no subsequent events requiring recognition in the consolidated financial statements.

Fair Values

The carrying values of financial instruments classified as current assets and current liabilities approximate fair value. The fair values of other financial instruments are disclosed in their respective notes.

Cash and Cash Equivalents

Cash and cash equivalents consist primarily of cash and highly liquid marketable securities with an original maturity of three months or less when purchased by Banner.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Short-Term Investments

Short-term investments include debt securities with maturity dates of one year or less from the balance sheet date and actively traded equity securities that are expected to be used on a short-term basis for working capital needs. These investments are stated at fair value, based on quoted market prices in active markets.

Investments

Investment income, including interest and dividends, realized gains and losses on investments, unrealized gains and losses on investments, and income on alternative investments, is included in excess of revenues over expenses, unless the income or loss is restricted by donor or law.

Banner invests in various investment securities that are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the consolidated financial statements.

Banner invests in alternative investments, mainly hedge funds, through limited partnerships. Banner accounts for its ownership interests in these alternative investments under the equity method of accounting, based on the net asset value per share of the fund held by Banner. The hedge fund net asset value is provided to Banner by each of the hedge fund managers. The net asset value is determined based on the estimated fair value of each of the underlying investments held in the hedge fund. However, the hedge fund investment holdings may include investments in private investment funds whose values have been estimated by the hedge fund managers in the absence of readily ascertainable fair values. Due to the inherent uncertainty of these estimates, these values may differ from the values that would have been used had a ready market for these investments existed. The investment income recorded is based on Banner's proportionate share of the hedge fund portfolio net asset value.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Certain of Banner's alternative investments are subject to redemption lockup periods or have capital call commitments. As of December 31, 2018, approximately \$124,300,000 of Banner's alternative investments were subject to a two-year redemption lockup period. In addition, certain of Banner's alternative investment agreements follow a capital call structure, of which Banner has committed up to approximately \$300,500,000. Of that total, Banner has made capital contributions of \$119,251,000 as of December 31, 2018, resulting in up to approximately \$181,249,000 in uncalled commitments.

Banner uses derivative financial instruments in its investment portfolio to moderate changes in value due to fluctuations in the financial markets. Banner has not designated its derivatives related to marketable securities as hedged financial instruments. Accordingly, the change in the fair value of derivatives is recognized as a component of investment income. Banner's fixed-income manager has executed a master netting arrangement for each of the derivative instruments held by the same counterparty, which are legally offset as the instrument is settled. Banner's derivative contracts in a net loss position were reported on a net basis on the accompanying consolidated balance sheets as of December 31, 2018 and 2017. As of December 31, 2018, approximately \$1,429,581,000 of gross derivative assets and approximately \$1,425,776,000 of gross derivative liabilities were netted together within investments. As of December 31, 2017, approximately \$1,380,750,000 of gross derivative assets and \$1,374,913,000 of gross derivative liabilities were netted together within investments (see Note 4).

Banner has entered into a repurchase agreement for approximately \$174,410,000 and \$163,931,000 as of December 31, 2018 and 2017, respectively. In connection with the repurchase agreement, Banner has loaned cash to certain financial institutions in exchange for purchased securities that serve as collateral. Collateral provided by these financial institutions was approximately \$177,973,000 and \$164,777,000 as of December 31, 2018 and 2017, respectively. The collateral is stated at fair value, based on quoted market prices in active markets. The repurchase agreement has been recorded as a collateralized borrowing. The collateral has not been sold or pledged to an external party as of December 31, 2018 and 2017 and, accordingly, is not recorded on the consolidated balance sheets. The executed repurchase agreements as of December 31, 2018 will mature during 2019.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Assets Limited as to Use

Assets limited as to use include marketable securities that have been designated for use as determined by the Banner Board of Directors, such as for property and equipment replacement and expansion, payments under lease and loan agreements, assets held by trustees under self-insurance funding and indenture agreements, and assets held as collateral by counterparties under interest rate swap agreements.

Securities Lending Program

Banner participates in securities lending transactions through its custodian whereby Banner lends a portion of its investments to various brokers in exchange for collateral for the securities loaned, usually on a short-term basis. Collateral provided by the brokers consists of cash and securities and is maintained at levels approximating 103% of the fair value of the securities on loan, adjusted for market fluctuations. Banner maintains effective control of the loaned securities through its custodian during the term of the arrangement in that the securities may be recalled at any time. Under the terms of the agreement, the borrower must return the same, or substantially the same, investments that were borrowed. The value of collateral held for loaned securities is reported in current assets as collateral held under securities lending program, and a corresponding obligation is reported in current liabilities as a payable under securities lending program in the accompanying consolidated balance sheets. At December 31, 2018 and 2017, the fair value of the collateral provided on behalf of Banner was approximately \$210,811,000 and \$287,992,000, respectively. At December 31, 2018 and 2017, the fair value of securities on loan was approximately \$203,175,000 and \$279,360,000, respectively. The securities loaned under the securities lending program as of December 31, 2018 will mature during 2019.

Net Patient Accounts Receivable

Net patient accounts receivable and net patient service revenues have been adjusted to the estimated amounts expected to be received based on contractual rates for services rendered, inclusive of the estimated price concession. These estimated amounts are subject to further adjustments upon review by third-party payors.

Inventories

Inventories, consisting principally of supplies, are stated at the lower of cost or market, determined on a first-in, first-out basis.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Property and Equipment

Property and equipment are stated at cost, if purchased, or at fair value on the date received, if donated, less accumulated depreciation and amortization.

Amortization is provided on a straight-line basis over the shorter of the lease period or the estimated useful lives for leasehold improvements. Depreciation is provided on a straight-line basis over the estimated useful lives of the property and equipment, which range from 2 to 20 years for major moveable equipment and from 5 to 40 years for buildings and fixed equipment.

Long-Lived Asset Impairment

Banner reviews long-lived assets, other than goodwill, for impairment when events or changes in business conditions indicate that their carrying values may not be recoverable. Banner considers assets to be impaired and writes them down to fair value if expected undiscounted cash flows are less than the carrying amounts. Fair value is the present value of the associated discounted cash flows.

Goodwill

Purchases of acquired businesses are allocated to the assets and liabilities assumed based on the estimated fair values on the respective acquisition dates. Based on these values, the excess purchase price over the fair value of the net assets acquired is allocated to goodwill.

Banner evaluates goodwill for impairment at least annually and more frequently if certain indicators are encountered. Goodwill is tested at the reporting unit level, defined as an operating segment or one level below an operating segment, with the fair value of the reporting unit being compared to its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered to be impaired.

Banner completes its annual impairment test during the fourth quarter to determine whether there are events or circumstances that indicate it is more likely than not that the reporting units' fair values are less than their carrying amounts. Banner determined that there was no goodwill impairment for 2018 or 2017.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Costs of Borrowing

Debt issuance costs are deferred and amortized over the terms of Banner's bonds using the straight-line method, which approximates the effective interest method.

Interest incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Self-Insurance Programs

In connection with self-insurance programs, accounts have been established for the purpose of accumulating assets based on actuarial determinations. These assets can be used only for the payment of professional liability, general liability, workers' compensation, employment liability, employee group life insurance claims, health plan stop-loss coverage, and related expenses. It is Banner's policy to record the expense and related liability for professional liability, general liability, workers' compensation, employment liability, and employee group life insurance losses based upon undiscounted actuarial estimates.

Net Assets

Net assets, revenues, gains, and losses are classified based on the existence or absence of donor or grantor imposed restrictions. Net assets and changes therein are classified and reported as follows:

Net Assets Without Donor Restrictions – Net assets available for use in general operations and not subject to donor restrictions.

Net Assets With Donor Restrictions – Net assets subject to donor imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both. Net assets with donor restrictions are primarily restricted for capital projects, Alzheimer's research, oncology, and pediatric programs.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Contributions

Banner records contributions upon receipt of an unconditional promise to give. Gifts, bequests, and other promises or receipts restricted by donors as to use or time period are recorded as net assets with donor restriction until used in the manner designated or upon expiration of the time period restriction. Donated property and equipment are recorded at fair value at the date received. Unrestricted contributions received are recorded as other income.

Performance Indicator

Banner's performance indicator is the excess of revenues over expenses, which includes all changes in net assets without donor restrictions other than changes in the amortization of cumulative loss on interest rate swaps, contributions for property and equipment acquisitions, decrease in unfunded pension liability, and the cumulative effect of changes in accounting principle.

Net Patient Service Revenue

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

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

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

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

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

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Banner has determined that the nature, amount, timing and uncertainty of revenue and cash flows are affected by the payors, the lines of business that render services to patients and the timing of when revenue is recognized and billed. Net patient service revenue for the year ended December 31, 2018, by payor, under the new revenue standard effective January 1, 2018, and net patient service revenue for the years ended December 31, 2018 and 2017, under the accounting revenue standards prior to January 1, 2018 in which the net patient service revenue is presented net of the provision for doubtful accounts, is as follows (in thousands):

| | December 31, 2018 | | December 31, 2017 |
|-------------------|----------------------|---------------------|----------------------|
| | New Standard | Prior Standard | Prior Standard |
| Medicare | \$ 1,510,209 | \$ 1,502,818 | \$ 1,504,342 |
| Medicaid | 975,520 | 989,319 | 913,805 |
| Commercial payors | 493,803 | 492,389 | 461,230 |
| Contracted payors | 3,478,559 | 3,465,339 | 3,347,044 |
| Self-pay | 95,558 | 97,425 | 61,650 |
| | \$ 6,553,649 | \$ 6,547,290 | \$ 6,288,071 |

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

Net patient service revenue for the year ended December 31, 2018, by line of business, is as follows (in thousands):

| | |
|----------------------|---------------------|
| Hospital | \$ 5,562,094 |
| Physician services | 518,527 |
| Laboratory | 281,202 |
| Ambulatory and other | 191,826 |
| | \$ 6,553,649 |

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

State Supplemental Programs

Banner's academic medical centers are eligible to receive supplemental payments from the Arizona Health Care Cost Containment System (AHCCCS), Arizona's Medicaid program, by qualifying as sponsoring institutions of Graduate Medical Education (GME) programs. Supplemental payments are paid annually after the completion of the state's fiscal year and are based on each hospital's inpatient Medicaid days, number of residents and actual costs to maintain the program. Banner accrues the estimated supplemental payments over the fiscal year, as they are earned based on Medicaid utilization. The revenue is recorded as part of net patient service, as it is considered additional reimbursement for care provided to AHCCCS patients. The total revenue recognized for the years ended December 31, 2018 and 2017 was approximately \$103,004,000 and \$112,304,000, respectively.

Medical Insurance Premiums and Medical Claim Costs

Banner Health Network (BHN) has entered into risk contracts with insurance companies, whereby BHN receives a monthly capitation fee, and is responsible for the payment of the enrolled members' claims. For the years ended December 31, 2018 and 2017, BHN recorded premium revenue from insurance companies of approximately \$516,891,000 and \$558,309,000, respectively. BHN paid health care claims for services rendered to enrolled members of approximately \$553,066,000 and \$663,026,000 for the years ended December 31, 2018 and 2017, respectively. BHN has recorded a medical claim liability, associated with claims incurred but not yet paid, of approximately \$43,885,000 and \$66,171,000 as of December 31, 2018 and 2017, respectively. BHN is also a participant in the Medicare Shared Savings Plan (MSSP), a shared risk program with the Centers for Medicare and Medicaid Services (CMS). BHN has not recorded any MSSP shared risk gains or losses for the 2018 or 2017 contract years.

The Banner-University Health Plans (BUHP) include University Care Advantage and University Family Care. BUHP has entered into contracts with AHCCCS and CMS to provide health insurance services for enrolled members. In October 2018, University Family Care was awarded a new five-year complete care contract, which is in addition to the long-term care contract that was awarded on October 1, 2017. For the years ended December 31, 2018 and 2017, BUHP recorded premium revenue from AHCCCS and CMS of approximately \$1,022,762,000 and \$639,619,000, respectively. BUHP paid health care claims for services rendered to enrolled members of approximately \$951,135,000 and \$585,355,000 for the years ended December 31, 2018 and 2017,

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

respectively. BUHP has recorded a medical claim liability, associated with claims incurred but not yet paid, of approximately \$163,556,000 and \$93,723,000 as of December 31, 2018 and 2017, respectively.

The medical claims costs of BHN, BUHP, and other plans owned by Banner Health reported on the consolidated statements of income are net of intercompany eliminations for services rendered at Banner facilities and providers.

Charity Care and Services That Benefit the Community

In furtherance of its charitable purpose, Banner provides a broad range of benefits to the communities it serves, including offering various community-based social service programs and several health-related educational programs. These services are designed and provided to improve the general standards of health for the communities.

Included in services to the communities are programs directed at the poor and persons who cannot afford health care due to inadequate resources and/or who are uninsured or underinsured. Non-elective, medically necessary care provided by Banner is rendered, regardless of the patient's ability to pay, and Banner's charity care policy offers various discounts from billed charges based on the patient's family's income.

In addition to providing traditional charity care, Banner: assumes the unpaid costs of Medicaid and other indigent public programs; provides services for the community through health promotion and education, health clinics, and screenings, all of which cannot be billed or can be operated only on a deficit basis; assumes the unpaid costs of training health professionals, such as medical residents, nursing students, and students in allied health professions; provides community health research; and provides cash and in-kind donations of equipment, supplies, or staff time made on behalf of the community.

Banner's cost accounting system is used to quantify the estimated charity care costs, which include both direct and indirect costs, for providing patient care at each facility. During 2018 and 2017, costs incurred by Banner in the provision of charity care, the unpaid costs of programs directed at the poor, the education of health professionals, research activities, and the costs of supporting other community programs were approximately \$649,292,000 and \$647,585,000, respectively. Charity care is recorded based on the cost of services provided for which charges are written off in accordance with Banner's charity care policy, but does not include the amount, if any, for which the patient remains responsible.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

The following summary of Banner's net community benefit for the years ended December 31 represents services to both the poor and broader community:

| | 2018 | % of Total Expense | 2017 | % of Total Expense |
|----------------------------------------------------------------------------------|-----------------------|-------------------------------|-----------------------|-------------------------------|
| | <i>(In Thousands)</i> | | <i>(In Thousands)</i> | |
| Traditional charity care, at cost | \$ 83,904 | 1.0% | \$ 73,436 | 1.0% |
| Unpaid cost of public programs, Medicaid, and other indigent care programs | 456,999 | 5.5 | 482,319 | 6.4 |
| Health professional education | 59,992 | 0.7 | 45,151 | 0.6 |
| Community health services | 8,037 | 0.1 | 8,373 | 0.1 |
| Research activities | 7,406 | 0.1 | 11,008 | 0.1 |
| Community-building activities | 364 | – | 298 | – |
| Subsidized health services | 29,164 | 0.3 | 23,481 | 0.3 |
| Contributions and in-kind donations | 3,394 | 0.1 | 3,479 | 0.1 |
| Community benefit operations | 32 | – | 40 | – |
| Total cost of community benefit | 649,292 | 7.8 | 647,585 | 8.6 |
| Unpaid cost of Medicare | 83,627 | 1.0 | 63,798 | 0.8 |
| Total cost of community benefit and unpaid cost of Medicare | \$ 732,919 | 8.8% | \$ 711,383 | 9.4% |

Traditional Charity Care is the cost of services for which reimbursement is not pursued, in accordance with Banner's policy to provide health care services free of charge or on a discounted fee schedule to those who cannot afford health care due to inadequate resources and/or who are uninsured or underinsured.

Unpaid Cost of Public Programs is the shortfall created when Banner receives payments below the cost for patients enrolled in publicly supported programs, such as Medicaid.

Health Professional Education includes the unpaid costs of training health professionals, such as medical residents, nursing students, and students in allied health professions.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Community Health Services include costs for health education and related activities designed to improve the health of the community. Community health education programs, community-based clinical services, and health care support services are included. No patient bills are generated for these services.

Research Activities include clinical and community health research, as well as studies on health care delivery.

Community-Building Activities include the costs of programs that develop the community through physical improvements, economic development, support system enhancements, environmental improvements, leadership development, coalition building, community health improvement advocacy, and workforce enhancement.

Subsidized Health Services include costs for billed services that are subsidized by Banner. These include services offered despite a financial loss, because they are needed in the community and either other providers are unwilling to provide the services or the services would, otherwise, be unable to meet patient demand.

Contributions and In-Kind Donations include cash donations, grants, and in-kind donations to the community at large and other tax-exempt organizations.

Community Benefit Operations include costs of directly planning, evaluating, and managing community benefit activities.

Use of Estimates

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Net patient service revenue increased in 2018 and 2017 by approximately \$35,380,000 and \$13,694,000, respectively, for changes in estimates related to third-party payor settlements. Other revenue increased in 2018 and 2017 by approximately \$5,069,000 and \$22,288,000, respectively, for certain BHN contract settlements, and by approximately \$3,583,000 and \$15,005,000 in 2018 and 2017 relating to additional state supplemental program payments. Medical insurance premiums and claim costs increased by approximately \$3,223,000, net, for 2018 relating to the reversal of reserves for quality contributions due to recent CMS interpretation which did not require payment of these contributions and adjustments to the prior year claim liabilities for BHN and BUHP. Other expense increased by approximately \$11,000,000 and decreased by approximately \$17,000,000 in 2018 and 2017, respectively, related to professional and general liability claim experience changes and reduction to legal accruals.

New Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, a new financial statement accounting standard for not-for-profit entities. Banner has retrospectively adopted this accounting standard on January 1, 2018 and has presented two categories of net assets within the December 31, 2018 and 2017 consolidated financial statements, net assets with donor restrictions and nets assets without donor restrictions, and has also added additional liquidity and functional expense disclosures.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, a new lease accounting standard. This accounting standard requires companies that lease assets to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in their balance sheets. This accounting standard will also require additional disclosures about the amount, timing and uncertainty of cash flows arising from leases and is effective for fiscal years beginning after December 15, 2018. Banner adopted this accounting standard on January 1, 2019 and recorded right of use assets of approximately \$489,303,000, a lease obligation of approximately \$505,358,000, and a transition adjustment which increased net assets without donor restriction by approximately \$24,637,000.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

In March 2017, the FASB issued ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715)*, a new accounting standard relating to retirement benefit plan costs. This accounting standard provides guidance on the presentation of service cost and other components of net periodic benefit cost in the consolidated statement of income. Banner adopted this accounting standard on January 1, 2018 using a retrospective approach. This resulted in approximately \$1,462,000 and \$1,800,000 of non-service benefit costs moving from salaries and benefits to other expense in the consolidated statements of income for the years ended December 31, 2018 and 2017, respectively.

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*, a new accounting standard relating to accounting for contributions received and made. This accounting standard provides a more robust framework to determine when a transaction should be accounted for as a contribution or as an exchange transaction and provides additional guidance about how to determine whether a contribution is conditional. The accounting standard will be adopted by Banner on January 1, 2019 using a modified prospective basis. Banner is currently assessing the impact of this accounting standard on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, *Intangibles – Goodwill and Other*, a new intangibles-goodwill accounting standard. The accounting standard simplified the test used to evaluate goodwill and other intangibles for impairment. Under the new accounting standard, a company will perform its annual goodwill impairment test by comparing the fair value of the reporting unit with its carrying amount. An impairment charge will be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the impairment loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. A company will still have the option to perform the qualitative assessment for a reporting unit. This accounting standard is effective for fiscal years beginning after December 15, 2020. Management is currently evaluating the impact of adopting this accounting standard.

Reclassifications

Certain reclassifications have been made to the 2017 consolidated financial statements to conform with classifications used in 2018. Approximately \$1,800,000 of pension costs were reclassified from salaries and benefits expense to other expenditures due to the adoption of the new retirement benefit accounting standard. In addition, approximately \$164,777,000 of repurchase agreement collateral was reversed from collateral assets and collateral payable on the consolidated balance sheets, as it was determined that the collateral was not sold or repledged as of December 31, 2017.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Concentrations of Credit Risk

Banner grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors as of December 31 was as follows:

| | <u>2018</u> | <u>2017</u> |
|---------------------------------------------------|---------------|---------------|
| Commercial, HMO, PPO and other third-party payors | 44.1% | 39.7% |
| Medicare | 30.1 | 34.6 |
| Medicaid and AHCCCS | 19.2 | 19.2 |
| Self-pay | 6.6 | 6.5 |
| | <u>100.0%</u> | <u>100.0%</u> |

4. Fair Value Measurements

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

- *Level 1* – Pricing inputs into the determination of fair value are generally observable inputs, such as quoted prices for identical instruments in active markets. Financial assets in Level 1 primarily include listed equities and mutual funds.
- *Level 2* – Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Financial assets and liabilities in Level 2 include asset-backed securities, mortgage-backed securities, collateralized mortgage obligations, U.S. Treasury securities, corporate bonds and loans, forward contracts, interest and credit swap agreements, options, and interest rate swap obligations.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements (continued)

- *Level 3* – Pricing inputs are generally unobservable and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using factors that involve considerable judgment and interpretation including, but not limited to, private and public comparables, third-party appraisals, discounted cash flow models, and fund manager estimates.

Assets and liabilities measured at fair value are based on one or more of the three valuation techniques identified in the tables below. The valuation techniques are as follows:

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

Banner's investment in alternative investments of approximately \$1,069,224,000 and \$1,015,320,000 as of December 31, 2018 and 2017, respectively, is accounted for using the equity method of accounting. Accordingly, the alternative investments are omitted from the following schedule of financial instruments measured at fair value. There have not been any changes in any of the investments' fair value level classification between Level 1 and Level 2 in 2018 or 2017. Banner has no Level 3 investments.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements (continued)

| | December 31, 2018 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Valuation Technique (a, b, c) |
|-------------------------------------------------------------------------------|----------------------|----------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|-------------------------------------|
| Cash and cash equivalents | \$ 415,868 | \$ 384,365 | \$ 31,503 | \$ – | a |
| Collateral held under securities lending (primarily cash and debt securities) | 210,811 | 190,062 | 20,749 | | a |
| Mutual funds: | | | | | |
| Mutual funds – U.S. funds | 1,541,010 | 1,541,010 | – | – | a |
| Mutual funds – International | 522,942 | 522,942 | – | – | a |
| Total mutual funds | <u>2,063,952</u> | <u>2,063,952</u> | – | – | |
| Debt securities: | | | | | |
| U.S. Treasury/government obligations | 179,202 | – | 179,202 | – | a |
| Corporate bonds/non-U.S. government bonds | 181,970 | – | 181,970 | – | a |
| Asset-backed securities | 69,195 | – | 69,195 | – | a |
| Commercial mortgage-backed securities | 8,238 | – | 8,238 | – | a |
| Non-government-backed collateralized mortgages | 6,155 | – | 6,155 | – | a |
| Government mortgage-backed securities | 158,367 | – | 158,367 | – | a |
| Government commercial-backed securities | 5,027 | – | 5,027 | – | a |
| Total debt securities | <u>608,154</u> | – | <u>608,154</u> | – | |
| Repurchase agreements | <u>174,410</u> | – | <u>174,410</u> | – | a |
| Equity securities: | | | | | |
| U.S. equity securities | 78,969 | 78,969 | – | – | a |
| International equity securities | 174,006 | 174,006 | – | – | a |
| Total equity securities | <u>252,975</u> | <u>252,975</u> | – | – | |
| Derivative securities: | | | | | |
| Future contracts | 842,371 | 842,371 | – | – | a |
| Forward contracts | 583,000 | – | 583,000 | – | a |
| Interest rate swap agreements | 3,489 | – | 3,489 | – | a |
| Net credit swaps | 721 | – | 721 | – | a |
| Subtotal derivative assets | <u>1,429,581</u> | <u>842,371</u> | <u>587,210</u> | – | |
| Future contracts | (842,371) | (842,371) | – | – | a |
| Forward contracts | (582,752) | – | (582,752) | – | a |
| Interest rate swap agreements | (381) | – | (381) | – | a |
| Option agreements | (92) | – | (92) | – | a |
| Net credit swaps | (180) | – | (180) | – | a |
| Subtotal derivative liabilities | <u>(1,425,776)</u> | <u>(842,371)</u> | <u>(583,405)</u> | – | |
| Total investments in the fair value hierarchy | <u>\$ 3,729,975</u> | <u>\$ 2,591,354</u> | <u>\$ 838,621</u> | <u>\$ –</u> | |
| Investment measured at net asset value: private commingled fund | <u>142,383</u> | | | | |
| Total fair value investments | <u>\$ 3,872,358</u> | | | | |
| Short-term investments | \$ 112,196 | | | | |
| Collateral held under securities lending agreements | 210,811 | | | | |
| Assets limited as to use | 2,419,735 | | | | |
| Long-term investments | 2,114,408 | | | | |
| Other assets – Banner Foundation restricted funds | 87,778 | | | | |
| Less alternative investments | 1,069,224 | | | | |
| Less split-dollar life insurance | 3,346 | | | | |
| Total fair value investments | <u>\$ 3,872,358</u> | | | | |
| Interest rate swaps included in other long-term liabilities | <u>\$ (258,762)</u> | <u>\$ –</u> | <u>\$ (258,762)</u> | <u>\$ –</u> | c |

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements (continued)

| | December 31, 2017 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Valuation Technique (a, b, c) |
|-------------------------------------------------------------------------------|----------------------|----------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|-------------------------------------|
| Cash and cash equivalents | \$ 445,490 | \$ 396,314 | \$ 49,176 | \$ – | a |
| Collateral held under securities lending (primarily cash and debt securities) | 287,992 | 119,882 | 168,110 | – | a |
| Mutual funds: | | | | | |
| Mutual funds – U.S. funds | 1,337,830 | 1,337,830 | – | – | a |
| Mutual funds – International | 641,160 | 641,160 | – | – | a |
| Total mutual funds | <u>1,978,990</u> | <u>1,978,990</u> | <u>–</u> | <u>–</u> | |
| Debt securities: | | | | | |
| U.S. Treasury/government obligations | 293,005 | – | 293,005 | – | a |
| Corporate bonds/non-U.S. government bonds | 288,847 | – | 288,847 | – | a |
| Asset-backed securities | 160,792 | – | 160,792 | – | a |
| Commercial mortgage-backed securities | 13,888 | – | 13,888 | – | a |
| Non-government-backed collateralized mortgages | 21,567 | – | 21,567 | – | a |
| Government mortgage-backed securities | 392,670 | – | 392,670 | – | a |
| Government commercial-backed securities | 11,598 | – | 11,598 | – | a |
| Total debt securities | <u>1,182,367</u> | <u>–</u> | <u>1,182,367</u> | <u>–</u> | |
| Repurchase agreements | <u>163,931</u> | <u>–</u> | <u>163,931</u> | <u>–</u> | a |
| Equity securities: | | | | | |
| U.S. equity securities | 113,611 | 113,611 | – | – | a |
| International equity securities | 219,698 | 219,698 | – | – | a |
| Total equity securities | <u>333,309</u> | <u>333,309</u> | <u>–</u> | <u>–</u> | |
| Derivative securities: | | | | | |
| Future contracts | 344,681 | 344,681 | – | – | a |
| Forward contracts | 996,920 | – | 996,920 | – | a |
| Interest rate swap agreements | 18,183 | – | 18,183 | – | a |
| Option agreements | 19 | – | 19 | – | a |
| Net credit swaps | 20,947 | – | 20,947 | – | a |
| Subtotal derivative assets | <u>1,380,750</u> | <u>344,681</u> | <u>1,036,069</u> | <u>–</u> | |
| Future contracts | (344,681) | (344,681) | – | – | a |
| Forward contracts | (999,429) | – | (999,429) | – | a |
| Interest rate swap agreements | (15,044) | – | (15,044) | – | a |
| Option agreements | (151) | – | (151) | – | a |
| Net credit swaps | (15,608) | – | (15,608) | – | a |
| Subtotal derivative liabilities | <u>(1,374,913)</u> | <u>(344,681)</u> | <u>(1,030,232)</u> | <u>–</u> | |
| Total fair value investments | <u>\$ 4,397,916</u> | <u>\$ 2,828,495</u> | <u>\$ 1,569,421</u> | <u>\$ –</u> | |
| Short-term investments | \$ 59,114 | | | | |
| Collateral held under securities lending agreements | 287,992 | | | | |
| Assets limited as to use | 2,610,666 | | | | |
| Long-term investments | 2,374,808 | | | | |
| Other assets – Banner Foundation restricted funds | 86,770 | | | | |
| Less alternative investments | 1,015,320 | | | | |
| Less split-dollar life insurance | 6,114 | | | | |
| Total fair value investments | <u>\$ 4,397,916</u> | | | | |
| Interest rate swaps included in other long-term liabilities | <u>\$ (311,004)</u> | <u>\$ –</u> | <u>\$ (311,004)</u> | <u>\$ –</u> | c |

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements (continued)

Banner received restricted pledges and contributions of approximately \$27,157,000 and \$27,015,000 for the years ended December 31, 2018 and 2017, respectively, which were subject to fair value measurement on a non-recurring basis. The restricted contributions were measured based on the actual cash received or for pledges receivable, using discounted cash flow projections. Approximately \$9,268,000 and \$8,853,000 of these restricted contributions were recorded as pledges receivable as of December 31, 2018 and 2017, respectively.

Investment (loss) income consisted of the following for the years ended December 31:

| | 2018 | 2017 |
|----------------------------------------------------------------------------------------------------------------------------------|-----------------------|-------------|
| | <i>(In Thousands)</i> | |
| Interest and dividend income | \$ 70,517 | \$ 55,679 |
| Net realized gain on sales of marketable securities | 127,152 | 82,013 |
| Realized and unrealized (loss) gain from alternative investments, including amount recorded in net assets with donor restriction | (16,475) | 86,706 |
| Net realized gain (loss) on derivative instruments | 1,644 | (3,043) |
| Net unrealized (loss) gain on marketable securities | (346,702) | 234,380 |
| Net unrealized gain on derivative instruments | 3,579 | 5,422 |
| | (160,285) | 461,157 |
| Less investment loss credited to other revenue, restricted equity, and capitalized bond project funds | 1,943 | 6,747 |
| Investment (loss) income, net | \$ (162,228) | \$ 454,410 |

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Liquidity

Financial assets available for general expenditure within one year of the balance sheet date, consist of the following as of December 31 (in thousands):

| | |
|-------------------------------------------------------------|---------------------|
| Cash and cash equivalents | \$ 383,096 |
| Patient receivables, net | 868,127 |
| Short-term investments | 112,196 |
| Funds designated by Board of Directors and lease agreements | 2,033,763 |
| Long-term investments | 2,114,408 |
| | \$ 5,511,590 |

Banner has the ability to structure its financial assets to be available, as its general expenditures and other obligations come due. Cash in excess of daily requirements are invested in short-term investments. Banner also maintains a \$75,000,000 line of credit as discussed in Note 8. As of December 31, 2018, \$75,000,000 remained available on the line of credit.

6. Property and Equipment

Property and equipment consisted of the following as of December 31:

| | 2018 | 2017 |
|------------------------------------------------|-----------------------|--------------|
| | <i>(In Thousands)</i> | |
| Land and land improvements | \$ 341,021 | \$ 333,210 |
| Buildings and fixed equipment | 4,145,859 | 3,808,905 |
| Major movable equipment | 2,960,428 | 2,789,044 |
| Construction-in-progress | 509,156 | 522,671 |
| | 7,956,464 | 7,453,830 |
| Less accumulated depreciation and amortization | 4,271,268 | 3,960,045 |
| Property and equipment, net | \$ 3,685,196 | \$ 3,493,785 |

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Other Non-Current Assets

Non-current assets consisted of the following as of December 31:

| | 2018 | 2017 |
|--------------------------------------------------------------------------------------------------------|-----------------------|-------------------|
| | <i>(In Thousands)</i> | |
| Restricted assets | \$ 191,430 | \$ 186,676 |
| Goodwill | 262,536 | 251,979 |
| Investments in unconsolidated affiliates | 200,731 | 210,119 |
| Due from Sun Health Services | 27,973 | 30,601 |
| Intangible assets, net of accumulated amortization of \$14,622,000 in 2018 and \$10,794,000 in 2017 | 8,427 | 11,919 |
| Other | 51,245 | 36,699 |
| Total other noncurrent assets | <u>\$ 742,342</u> | <u>\$ 727,993</u> |

Investments in Unconsolidated Affiliates

Investments in unconsolidated affiliates are primarily comprised of the following investments that are accounted for under the equity method or cost method of accounting, as described herein:

Veritage

Effective December 31, 2018, Banner sold its 50% membership interest in Veritage, LLC (Veritage) to Blue Cross and Blue Shield of Arizona, Inc. Veritage owns MediSun, a Medicare Advantage plan. The gain on sale is reported within other operating revenue.

Banner Health and Aetna Health Insurance Holding Company LLC

In October 2016, Banner entered into an agreement with Aetna ACO Holdings, Inc. (Aetna), a subsidiary of Aetna, Inc., pursuant to which Banner and Aetna agreed to form an insurance holding company, Banner Health and Aetna Health Insurance Holding Company LLC (HoldCo), to be owned 49% by Banner and 51% by Aetna and to be the parent of two Arizona insurance companies (collectively, NewCo). HoldCo was formed in 2017. NewCo became licensed as an Arizona insurance company in 2017 and began issuing insurance policies in 2018. In addition, commencing

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Other Non-Current Assets (continued)

upon the licensure of NewCo as an insurance company in 2017, NewCo assumed risk prospectively through reinsurance arrangements, and shared in profits and losses retroactively to January 1, 2017, through a contractual arrangement, for certain insurance arrangements, and self-insurance administrator activities conducted by Aetna or its affiliates in the Phoenix metropolitan area. Banner, through its subsidiary, Banner Plan Administration, Inc., and Aetna, through certain affiliates, provide various administrative services to NewCo.

Under the agreement, Banner may be required to make additional capital contributions in part based upon the successful renewal or migration of existing Aetna business with the scope of the business venture. During 2017, Banner funded \$60,384,000 to NewCo. During 2018, Banner funded an additional \$10,343,000, along with a \$16,033,000 intangible contribution of the membership of Banner's employee medical plans. Additional capital contributions may be necessary in order to fund adequate working capital for NewCo and HoldCo, in order to maintain statutory capital requirements. Banner accounts for its 49% investment in HoldCo using the equity method of accounting. Banner's investment in HoldCo was approximately \$94,345,000 and \$70,788,000 as of December 31, 2018 and 2017, respectively, and Banner's share of HoldCo's (losses) earnings was \$(2,819,000) and \$10,404,000 for the years ended December 31, 2018 and 2017, respectively. Total unaudited assets, liabilities and net (loss) income of HoldCo were approximately \$178,520,000, \$99,401,000 and \$(5,711,000) in 2018, respectively, and \$218,490,000, \$54,133,000 and \$20,808,000 in 2017, respectively.

Premier Inc.

Banner is a member of the group purchasing organization of Premier Inc. (Premier) and, in connection with this membership, Banner holds a non-controlling interest in Premier that is accounted for under the equity method of accounting. Banner's investment in Premier was approximately \$93,300,000 and \$72,670,000 as of December 31, 2018 and 2017, respectively. Banner's share of Premier's net income recorded under the equity method of accounting and Class B units vendor incentive was approximately \$20,671,000 and \$14,803,000 in 2018 and 2017, respectively, and is recorded as a reduction to supplies expense.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Other Non-Current Assets (continued)

Due From Sun Health Services

As part of the acquisition of Sun Health Corporation in 2008, Sun Health Services; Sun Health Foundation; Sun Health Properties, Inc., and their controlled affiliates (collectively, Sun Health Services) entered into a Support and Maintenance Agreement to provide an annual contribution, calculated under the terms of the agreement and, subject to certain contractual limitations and conditions, to support projects at the facilities acquired from Sun Health Corporation (the predecessor of Sun Health Services) , or at other future Banner projects in the northwestern section of the Phoenix metropolitan area. Capital project commitments from Sun Health Services as of December 31, 2018 and 2017 were approximately \$59,726,000 and \$57,600,000, respectively, and are recorded as restricted assets within other non-current assets.

In addition to the capital project commitment, Sun Health Services also funds the Sun Health defined pension plan obligation (see Note 11) in accordance with the terms outlined in the acquisition agreement. Banner has recorded a receivable from Sun Health Services of approximately \$27,973,000 and \$30,601,000 as of December 31, 2018 and 2017, respectively, representing the unfunded plan obligation.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt

Long-term debt consisted of the following as of December 31:

| | <u>2018</u> | <u>2017</u> |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|---------------------|
| | <i>(In Thousands)</i> | |
| Revenue Bonds, Series 2017A, interest 4.00% to 5.00%, due through 2041 | \$ 188,985 | \$ 188,985 |
| Revenue Bonds, Series 2017B, interest 5.00%, due through 2048 | 85,945 | 85,945 |
| Revenue Bonds, Series 2017C, interest 5.00%, due through 2048 | 85,945 | 85,945 |
| Weekly Rate Securities Revenue Bonds, Series 2017D, interest determined weekly, average interest 1.42% in 2018 and 1.07% on 2017, due through 2048 | 100,000 | 100,000 |
| Revenue Bonds, Series 2016A, interest 3.13% to 5.00%, due through 2038 | 803,500 | 803,500 |
| Revenue Bonds, Series 2015A, interest 5.00%, due through 2025 | 83,890 | 94,100 |
| Daily Rate Securities Revenue Bonds, Series 2015B, interest determined daily, average interest 1.36% in 2018 and 0.86% in 2017, due through 2046 | 100,630 | 100,630 |
| Daily Rate Securities Revenue Bonds, Series 2015C, interest determined daily, average interest 1.36% in 2018 and 0.86% in 2017, due through 2046 | 100,630 | 100,630 |
| Direct Purchase Rate Securities Revenue Bonds, Series 2015D, interest determined monthly, average interest 2.32% in 2018 and 1.30% in 2017, due through 2025 | 100,290 | 100,290 |
| Taxable loan, interest determined monthly, average interest 2.53% in 2018 and 1.63% in 2017, due through 2022 | 100,556 | 100,556 |
| Commercial paper, interest determined by dealer, average interest 2.06% in 2018 and 1.11% in 2017. | 100,000 | 100,000 |
| Revenue Bonds, Series 2014A, interest 4.00% to 5.00%, due through 2044 | 200,600 | 200,600 |
| Revenue Bonds, Series 2012A, interest 3.75% to 5.00%, due through 2043 | 179,090 | 179,090 |
| Taxable Revenue Bonds, Series 2012B, interest 4.16%, due 2030 | 67,840 | 67,840 |
| Series 2012 Bank of America obligation, interest 1.91%, due through 2019 | 810 | 5,345 |
| Revenue Bonds, Series 2008A, interest 5.00%, due 2018 | - | 2,800 |
| Direct Purchase Rate Securities Revenue Bonds, Series 2008B, interest determined monthly, average interest 2.87% in 2018 and 1.65% in 2017, due through 2035 | 80,475 | 82,500 |
| Direct Purchase Rate Securities Revenue Bonds, Series 2008C, interest determined monthly, average interest 2.36% in 2018 and 1.69% in 2017, due through 2035 | 80,475 | 82,500 |
| Revenue Bonds, Series 2008D, interest 5.00% to 5.25%, due through 2018 | - | 16,930 |
| Weekly Rate Securities Revenue Bonds, Series 2008E, interest determined weekly, average interest 1.42% in 2018 and 0.85% in 2017, due through 2029 | 95,740 | 101,120 |
| Weekly Rate Securities Revenue Bonds, Series 2008F, interest determined weekly, average interest 1.43% in 2018 and 0.85% in 2017, due through 2029 | 78,570 | 82,970 |
| Weekly Rate Securities Revenue Bonds, Series 2008G, interest determined weekly, average interest 1.43% in 2018 and 0.85% in 2017, due through 2029 | 74,140 | 78,295 |
| Weekly Rate Securities Revenue Bonds, Series 2008H, interest determined weekly, average interest 1.42% in 2018 and 0.85% in 2017, due through 2029 | 57,940 | 61,185 |
| Index Rate Bonds, Series 2007B, interest determined quarterly, average interest 2.27% in 2018 and 1.61% in 2017, due through 2037 | 400,000 | 400,000 |
| Other, primarily net bond premium | 157,915 | 170,390 |
| | 3,323,966 | 3,392,146 |
| Less current portion, including debt subject to self-liquidity | 258,994 | 387,970 |
| Total long-term debt, less current portion, including debt subject to self-liquidity | \$ 3,064,972 | \$ 3,004,176 |

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt (continued)

Scheduled maturities of debt for the years ending December 31 and thereafter are as follows (in thousands):

| | |
|------------|---------------------|
| 2019 | \$ 258,994 |
| 2020 | 73,709 |
| 2021 | 76,779 |
| 2022 | 79,107 |
| 2023 | 80,277 |
| Thereafter | <u>2,755,100</u> |
| | <u>\$ 3,323,966</u> |

Total interest incurred was approximately \$143,914,000 and \$127,212,000 in 2018 and 2017, respectively, of which \$17,476,000 and \$14,884,000 was capitalized in 2018 and 2017, respectively. Included within interest costs is approximately \$12,929,000 and \$13,578,000 of interest expense related to the NCMC, Inc. lease obligation in 2018 and 2017, respectively (see Note 14).

Master Indenture and Bond Indentures

Substantially all of Banner's indebtedness, including its obligations on interest rate swaps, is secured by obligations issued under a master indenture, as supplemented from time to time (the Master Indenture). The Master Indenture provides that all indebtedness secured by obligations issued thereunder is on equal parity with all other such indebtedness. The Master Indenture contains covenants that, among other matters, restrict the transfer of assets and require the maintenance of specified levels of cash on hand and compliance with certain other financial ratios. Pursuant to the Master Indenture, as supplemented, Banner has pledged its gross revenues, including all accounts receivable, to secure all indebtedness and other obligations governed by the Master Indenture. Banner was in compliance with these covenants as of December 31, 2018. Banner Health and its two wholly owned subsidiaries, Banner – University Medical Center Tucson Campus, LLC and Banner – University Medical Center South Campus, LLC, are the only members of the Obligated Group responsible for payment of obligations issued under the Master Indenture.

Under the terms of the bond indentures, periodic deposits are made to a trustee held fund to meet interest and principal payments. Trustee held funds are included as assets limited as to use on the accompanying consolidated balance sheets.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt (continued)

Certain of Banner's bonds are subject to a remarketing agreement, whereby bond holders have the right to tender their bonds to Banner for repurchase at the end of the interest rate period if the bonds are not resold to a new purchaser. Banner has entered into several direct pay letter of credit agreements with third-party banks which will pay for any tendered bonds if they are not resold to a new purchaser. As of December 31, 2018, Banner has entered into direct pay letter of credit agreements associated with the Revenue Bonds Series 2015B-D, Revenue Bonds Series 2008B-C, and Revenue Bonds Series 2008E-H. There were no advances outstanding on the direct pay letter of credit agreements as of December 31, 2018. The direct pay letter of credit agreements support the debt's long-term debt classification.

Interest Rate Swap Agreements

Banner has multiple interest rate swap contracts that effectively convert the variable rate of certain bonds into fixed rates. Banner's obligations under the swap agreements are secured by the Master Indenture.

The interest rate swaps did not qualify for hedge accounting treatment under accounting standards for derivative instruments and hedging activities. The derivative mark-to-market adjustments resulted in unrealized gains of approximately \$52,015,000 and \$21,607,000 for the years ended December 31, 2018 and 2017, respectively, recorded in excess of revenues over expenses. The net realized portion of the interest rate swaps for the years ended December 31, 2018 and 2017, recorded as an increase to interest expense, was approximately \$28,940,000 and \$37,284,000, respectively.

Each of the interest rate swap agreements has collateral posting thresholds based on the counterparties' bond ratings. At the AA- rating level, Banner and its counterparty must post collateral when the mark-to-market exceeds between \$35,000,000 and infinity, depending on the counterparty. At December 31, 2018 and 2017, Banner had approximately \$43,740,000 and approximately \$120,045,000, respectively, of collateral outstanding with its counterparties. The fair value of the collateral is reported as assets limited as to use – other funds on the accompanying consolidated balance sheets.

As of December 31, 2018 and 2017, the estimated fair value of the interest rate swaps resulted in an imputed obligation of \$258,762,000 and \$311,004,000, respectively, which is recorded in interest rate swaps on the accompanying consolidated balance sheets. The fair value of the swaps is based on the forward LIBOR curve, with a blended average duration of 7 to 21 years.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt (continued)

Hospital Lease Obligation

Banner has subleased North Colorado Medical Center (NCMC) and other real and personal property, comprising substantially all of the NCMC, Inc. assets located in Weld County, Colorado and used by Banner for health care operations, from NCMC, Inc. since 1995. The NCMC, Inc. lease extends through December 31, 2027.

Lease payments are based on NCMC depreciation and a return on the net book value of those assets. If the cumulative operating income from Banner's health care operations in Weld County exceeds 5% of the cumulative net operating revenue during the preceding five-year period, Banner will pay to NCMC, Inc. 50% of such excess. Banner paid approximately \$12,553,000 of additional lease payments based on the 2013-2017 cumulative operating income for NCMC. To compensate for indigent care provided by Banner, NCMC, Inc. is required to pay Banner \$5,000,000 annually, which has been recorded as other operating revenue.

Banner has recorded the NCMC lease as a capital lease obligation on the accompanying consolidated balance sheets. The property leased from NCMC, Inc. is being depreciated over the lease term, and total depreciation expense recorded by Banner for the years ended December 31, 2018 and 2017 was approximately \$28,199,000 and \$28,508,000, respectively. Interest expense recorded by Banner on the lease obligation with NCMC, Inc. was approximately \$12,929,000 and \$13,578,000 for the years ended December 31, 2018 and 2017, respectively.

Total lease payments made to NCMC, Inc. were approximately \$38,541,000 and \$39,894,000 for the years ended December 31, 2018 and 2017, respectively.

Banner has guaranteed payment of the principal and interest on various debt offerings of NCMC, Inc. pursuant to the limited guaranty agreements entered into with the bond trustee. The aggregate amount payable under the limited guaranty agreements is limited to the rent otherwise payable under the lease agreement. Banner's annual lease payment is in excess of the NCMC, Inc. maximum annual debt service and, in the event of default by NCMC, Inc., Banner will pay the trustee the portion of the rent equal to NCMC, Inc.'s debt service obligation. Such payments are to be credited against rent and all other payment obligations to NCMC, Inc. Banner did not record a liability for the limited guaranty agreements as of December 31, 2018 or 2017.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt (continued)

Revolving Line of Credit

On September 1, 2009, Banner entered into a \$75,000,000 revolving line of credit with JPMorgan Chase, N.A. The line of credit expires on September 30, 2019. As of December 31, 2018, there were no draws on the line of credit.

Banner's obligations with respect to this revolving line of credit are secured by the Master Indenture.

Fair Value of Debt

As of December 31, 2018 and 2017, the estimated fair value of Banner's debt, excluding unamortized net premiums, was \$3,288,626,000 and \$3,397,436,000, respectively. The estimated fair value is based on quoted market prices for these issues or, where such prices are not available, on current interest rates for debt with similar remaining maturities.

9. Estimated Self-Insurance Liabilities

Banner has obtained insurance through a combination of purchased and self-insurance programs for professional and general liability claims, workers' compensation claims, and several other insurance programs to address claims incurred as part of Banner's ongoing business operations, including directors and officers, auto, environmental, aviation, cybersecurity, property, employee life insurance, and certain physicians' prior acts coverage. Banner is self-insured for several of its insurance programs through its wholly owned captive, Banner Indemnity, Ltd. (BIL).

Banner's professional and general liability is self-insured through BIL to which Banner contributes actuarially determined amounts to fund estimated ultimate losses. Since July 1, 2015, Banner is self-insured, on a claims-made basis, for the first \$15,000,000 of each professional liability claim and the first \$10,000,000 in aggregate of general liability claims. BIL also provides an integrated excess liability policy with a single limit of \$200,000,000 per occurrence and \$200,000,000 aggregate for a two-year term expiring July 1, 2020. This policy is fully reinsured by A.M. Best reinsurance carriers with a minimum rating of A-VII or better.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Estimated Self-Insurance Liabilities (continued)

Under its self-insured professional and general liability program, Banner contributes actuarially determined amounts to BIL to fund estimated ultimate losses. Banner has accrued estimates for asserted and incurred but not reported claims. The actuarially determined claim liabilities amounted to approximately \$196,883,000 and \$172,204,000, of which \$40,511,000 and \$39,405,000 has been recorded as current liabilities on the accompanying consolidated balance sheets as of December 31, 2018 and 2017, respectively. Self-insurance liabilities are undiscounted at December 31, 2018 and 2017.

10. Non-current Liabilities

Other non-current liabilities consisted of the following as of December 31:

| | <u>2018</u> | <u>2017</u> |
|------------------------------------------|-----------------------|-------------------|
| | <i>(In Thousands)</i> | |
| Non-current employee benefit liabilities | \$ 92,032 | \$ 96,640 |
| Banner Health retirement income plan | 14,792 | 17,159 |
| Sun Health Services pension plan | 27,973 | 30,601 |
| Asset retirement obligation | 15,625 | 15,008 |
| Other | 24,431 | 25,888 |
| Total other non-current liabilities | <u>\$ 174,853</u> | <u>\$ 185,296</u> |

11. Retirement Plans

Defined Contribution Plan

Substantially all of Banner's eligible employees may elect to participate in Banner's defined contribution plan. Employees may contribute up to 21% of eligible compensation, subject to plan restrictions. Banner may provide a matching contribution equal to the first 4% of eligible compensation contributed for each participant, as defined under the defined contribution plan. Contribution expense was approximately \$79,166,000 and \$71,414,000 for the years ended December 31, 2018 and 2017, respectively.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Retirement Plans (continued)

Defined Benefit Plans

Banner has two defined benefit plans; Banner Retirement Income Plan and the Sun Health Pension Plan. Banner's Pension and Retirement Committee oversee the investment policy and strategy associated with both of these defined benefit plans. The expected long-term rate of return on plan assets for both pension plans is based on historical and projected rates of return for current and planned asset categories in the Plan's investment portfolio. Assumed projected rates of return for each asset category were selected after analyzing historical experience and future expectations of the returns and volatility for assets of that category using benchmark rates. Based on the target asset allocation among the asset categories, the overall expected rate of return for the portfolio was developed and adjusted for historical and expected experience of active portfolio management results compared to benchmark returns and for the effect of expenses paid from plan assets.

Banner's overall investment strategy is to achieve a mix of approximately 60% of investments for long-term growth and 40% for near-term benefit payments with a wide diversification of asset types, fund strategies, and fund managers. The target allocations for plan assets are 55% equity securities, 35% fixed-income securities, and 10% alternative investments. Equity securities include U.S. and international investments and range from large-cap to small-cap companies. Fixed-income securities include corporate bonds of companies from diversified industries, mortgage-backed securities, and U.S. Treasuries. Alternative investments include mainly hedge funds that invest in several different strategies.

Banner Retirement Income Plan

Banner has a non-contributory defined benefit plan (the Plan) that provides certain eligible employees with retirement and death benefits. Banner annually contributes amounts to the Plan as necessary to meet the Employee Retirement Income Security Act of 1974 (ERISA) minimum funding requirements. Benefits are based on years of service and the employee's compensation during the last five years of employment. Benefit accruals under the Plan have been frozen since 2002.

Banner's Board of Directors resolved to terminate the Plan via an amendment effective December 31, 2018. The termination process is expected to take 12 to 24 months to complete.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Retirement Plans (continued)

In order to terminate the Plan, Banner must fully fund participant benefits and purchase annuities through an insurance company. At plan termination, Banner will recognize the accumulated plan losses as pension expense, within non-operating expense. The Plan's accumulated losses recorded in net assets without donor restrictions were approximately \$47,803,000 as of December 31, 2018.

The following tables set forth the benefit obligation and assets of the Plan at December 31 (using measurement dates as of December 31, 2018 and 2017, respectively) and components of net periodic benefit costs for the years then ended:

| | 2018 | 2017 |
|---------------------------------------------------|-----------------------|-------------|
| | <i>(In Thousands)</i> | |
| Change in projected benefit obligation | | |
| Projected benefit obligation at beginning of year | \$ 70,700 | \$ 72,178 |
| Interest cost | 2,462 | 2,805 |
| Actuarial (gain) loss | (3,926) | 1,412 |
| Benefits paid | (5,564) | (5,695) |
| Projected benefit obligation at end of year | 63,672 | 70,700 |
| Change in plan assets | | |
| Fair value of plan assets at beginning of year | 53,541 | 51,642 |
| Actual return on plan assets | (1,747) | 5,724 |
| Employer contributions | 2,650 | 1,870 |
| Benefits paid | (5,564) | (5,695) |
| Fair value of plan assets at end of year | 48,880 | 53,541 |
| Funded status – accrued benefit recorded | \$ (14,792) | \$ (17,159) |
| Unrecognized net loss recorded in net assets | \$ 47,803 | \$ 48,983 |

The assumptions used to determine the projected benefit obligation include the weighted average discount rate of 4.25% and 3.63% as of December 31, 2018 and 2017, respectively, and weighted average expected long-term rate of return on plan assets of 7.00% as of December 31, 2018 and 2017.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Retirement Plans (continued)

The funded status of the Plan of approximately \$(14,792,000) and \$(17,159,000) at December 31, 2018 and 2017, respectively, is included in other non-current liabilities in the accompanying consolidated balance sheets. No plan assets are expected to be returned to Banner during the year ending December 31, 2019.

| | 2018 | 2017 |
|------------------------------------------------|-----------------------|-------------|
| | <i>(In Thousands)</i> | |
| Components of net periodic benefit cost | | |
| Interest cost | \$ 2,462 | \$ 2,805 |
| Expected return on plan assets | (3,848) | (3,939) |
| Amortization of actuarial loss | 2,300 | 2,238 |
| Recognized settlement loss | 549 | 696 |
| Net periodic benefit cost | \$ 1,463 | \$ 1,800 |

The assumptions used to determine the net periodic benefit cost include the weighted average discount rate of 3.63% and 4.04% as of December 31, 2018 and 2017, respectively, and weighted average expected long-term rate of return on plan assets of 7.00% as of December 31, 2018 and 2017.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Retirement Plans (continued)

The fair value of the Plan's assets at December 31, 2018, by asset category, is as follows:

| Asset category | December 31, 2018 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Valuation Technique (a, b, c) |
|------------------------------------------|------------------------------|---------------------------------------------------------------------------------------|----------------------------------------------------------------------|--------------------------------------------------------------|----------------------------------------------|
| <i>(In Thousands)</i> | | | | | |
| Registered investment company funds: | | | | | |
| U.S. funds | \$ 28,687 | \$ 28,687 | \$ - | \$ - | a |
| International funds | 8,904 | 8,904 | - | - | a |
| Common/collective trust funds | 5,655 | - | 5,655 | - | a |
| Total assets in the fair value hierarchy | <u>43,246</u> | <u>\$ 37,591</u> | <u>\$ 5,655</u> | <u>\$ -</u> | |
| Investments measured at net asset value: | | | | | |
| Alternative investments | 5,634 | | | | |
| | <u>\$ 48,880</u> | | | | |

The fair value of the Plan's assets at December 31, 2017, by asset category, is as follows:

| Asset category | December 31, 2017 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Valuation Technique (a, b, c) |
|------------------------------------------|------------------------------|---------------------------------------------------------------------------------------|----------------------------------------------------------------------|--------------------------------------------------------------|----------------------------------------------|
| <i>(In Thousands)</i> | | | | | |
| Registered investment company funds: | | | | | |
| U.S. funds | \$ 18,657 | \$ 18,657 | \$ - | \$ - | a |
| International funds | 18,993 | 18,993 | - | - | a |
| Common/collective trust funds | 10,469 | - | 10,469 | - | a |
| Total assets in the fair value hierarchy | <u>48,119</u> | <u>\$ 37,650</u> | <u>\$ 10,469</u> | <u>\$ -</u> | |
| Investments measured at net asset value: | | | | | |
| Alternative investments | 5,422 | | | | |
| | <u>\$ 53,541</u> | | | | |

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Retirement Plans (continued)

Information about the expected cash flows for the Plan, assuming the Plan is not terminated, are as follows (in thousands):

| | | |
|-----------------------------------------|----|--------|
| Expected employer contributions in 2019 | \$ | 2,037 |
| Expected benefit payments: | | |
| 2019 | | 5,482 |
| 2020 | | 5,374 |
| 2021 | | 5,279 |
| 2022 | | 5,185 |
| 2023 | | 5,099 |
| 2024-2028 | | 23,125 |

Sun Health Pension Plan

Under the terms of the agreement for the purchase of Sun Health Corporation, Banner assumed sponsorship of the Sun Health Pension Plan, a defined benefit plan, and the Sun Health Pension Plan Trust (the Trust). Sun Health Services retained the obligation to fund any required contributions to the Trust to meet the ERISA minimum funding requirements, and Sun Health Services retains the right to any excess assets that may exist upon termination of the Sun Health Pension Plan. Benefit accruals under the Sun Health Pension Plan have been frozen since May 2007, except for certain employees whose salary benefits were not frozen until 2014. At December 31, 2018 and 2017, Banner recorded a non-current liability of approximately \$27,973,000 and \$30,601,000, respectively, representing the unfunded liability under the Sun Health Pension Plan, and a long-term receivable from Sun Health Services in the same amount on the accompanying consolidated balance sheets (see Note 7).

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Retirement Plans (continued)

The following table sets forth the benefit obligation and assets of the Sun Health Pension Plan at December 31 (using measurement dates as of December 31, 2018 and 2017, respectively):

| | 2018 | 2017 |
|---------------------------------------------------|-----------------------|-------------|
| | <i>(In Thousands)</i> | |
| Change in projected benefit obligation | | |
| Projected benefit obligation at beginning of year | \$ 107,556 | \$ 103,087 |
| Service cost | – | 25 |
| Interest cost | 3,943 | 4,277 |
| Actuarial (gain) loss | (7,377) | 5,112 |
| Benefits paid | (5,203) | (4,945) |
| Projected benefit obligation at end of year | 98,919 | 107,556 |
| Change in plan assets | | |
| Fair value of plan assets at beginning of year | 76,955 | 69,197 |
| Actual return on plan assets | (3,946) | 8,154 |
| Employer contributions | 3,140 | 4,549 |
| Benefits paid | (5,203) | (4,945) |
| Fair value of plan assets at end of year | 70,946 | 76,955 |
| Funded status – accrued benefit recorded | \$ (27,973) | \$ (30,601) |

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Retirement Plans (continued)

The assumptions used to determine the projected benefit obligation include the weighted average discount rate of 4.37% and 3.77% as of December 31, 2018 and 2017, respectively, and weighted average expected long-term rate of return on plan assets of 7.00% as of December 31, 2018 and 2017.

The fair value of Sun Health Pension Plan assets at December 31, by asset category, is as follows:

| December 31, 2018 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Valuation Technique (a, b, c) |
|---------------------------------------------|-------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|-------------------------------------|
| <i>(In Thousands)</i> | | | | |
| Asset category | | | | |
| Registered investment company funds: | | | | |
| U.S. funds | \$ 28,177 | \$ 28,177 | \$ - | a |
| International funds | 22,938 | 22,938 | - | a |
| Common/collective trust funds | 11,912 | - | 11,912 | a |
| Total assets in the fair value hierarchy | 63,027 | \$ 51,115 | \$ 11,912 | \$ - |
| Investments measured at net asset value: | | | | |
| Alternative investments | 7,919 | | | |
| | \$ 70,946 | | | |

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Retirement Plans (continued)

| Asset category | December 31, 2017 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Valuation Technique (a, b, c) |
|---------------------------------------------|----------------------|-------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|-------------------------------------|
| <i>(In Thousands)</i> | | | | | |
| Registered investment company funds: | | | | | |
| U.S. funds | \$ 26,147 | \$ 26,147 | \$ – | \$ – | a |
| International funds | 28,480 | 28,480 | – | – | a |
| Common/collective trust funds | 14,660 | – | 14,660 | – | a |
| Total assets in the fair value hierarchy | 69,287 | <u>\$ 54,627</u> | <u>\$ 14,660</u> | <u>\$ –</u> | |
| Investments measured at net asset value: | | | | | |
| Alternative investments | 7,668 | | | | |
| | <u>\$ 76,955</u> | | | | |

Information about the expected cash flows for the Sun Health Pension Plan follows (in thousands):

| | |
|-----------------------------------------|----------|
| Expected employer contributions in 2019 | \$ 1,819 |
| Expected benefit payments: | |
| 2019 | 5,672 |
| 2020 | 5,889 |
| 2021 | 6,057 |
| 2022 | 6,170 |
| 2023 | 6,332 |
| 2024–2028 | 32,316 |

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Income Taxes

Banner's deferred tax assets and liabilities primarily relate to BHN. Deferred tax assets and liabilities consist of the following as of December 31:

| | 2018 | 2017 |
|---------------------------------------------------|-----------------------|-------------|
| | <i>(In Thousands)</i> | |
| Deferred tax assets: | | |
| Net loss carryforwards | \$ 94,726 | \$ 77,175 |
| Accrued expenses | 688 | 559 |
| Total deferred tax assets | 95,414 | 77,734 |
| Deferred tax liabilities: | | |
| Depreciation | (1) | (265) |
| Total deferred tax liabilities | (1) | (265) |
| Valuation allowance | (95,413) | (77,469) |
| Net deferred tax assets after valuation allowance | \$ — | \$ — |

As of December 31, 2018, Banner had estimated federal net operating loss carryforwards of approximately \$380,869,000 that begin to expire in the year 2033 and estimated state net operating loss carryforwards of approximately \$380,869,000 that begin to expire in 2033.

On December 22, 2017, the Tax Cuts and Jobs Act (Enactment) was enacted, which reduced the corporate statutory income tax rate from 35% to 21%, beginning January 1, 2018. This reduction in the corporate statutory income tax rate required Banner to re-evaluate certain of its deferred tax assets and liabilities, as of the date of Enactment, to reflect the revised income tax rates applicable to future periods. For tax-exempt entities, the Enactment also requires organizations to categorize certain fringe benefit expenses as a source of unrelated business income, pay an excise tax on remuneration above certain thresholds that is paid to executives by the organization, and report income or loss from unrelated business activities on an activity-by-activity basis, among other provisions.

At December 31, 2017, Banner made a reasonable estimate of the income tax effects of the Enactment on its consolidated financial position. Under regulatory guidance, Banner had a measurement period of up to one year, during which time the accounting for the effects of the Enactment could be completed. As of December 31, 2018, Banner concluded that, at the end of the one-year measurement period, no adjustments to its initial estimates would be necessary.

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

13. Statement of Functional Expenses

The following statement of functional expenses reports Banner's operating expenses, as presented on the consolidated statements of income, by each of Banner's major operating function for the years ended December 31, 2018 and 2017. Operating expenses that are attributable to more than one operating function have been allocated using a basis representative of the operating expenditure such as patient volume, full-time equivalent or facility size.

| | Operating Expenses at December 31, 2018 | | | | |
|---------------------------------|------------------------------------------------|---------------------------------|-------------------------------|--------------------------------|---------------------------------------|
| | Delivery | Insurance Operations | Corporate Services | Other/ Eliminations | Banner Health Consolidated |
| | <i>(In Thousands)</i> | | | | |
| Expenses: | | | | | |
| Salaries and benefits | \$ 3,461,372 | \$ 79,308 | \$ 592,567 | \$ (108,210) | \$ 4,025,037 |
| Supplies | 1,399,023 | 417 | (14,622) | (7,322) | 1,377,496 |
| Physician and professional fees | 204,132 | 13,101 | 27,613 | (35,324) | 209,522 |
| Medical claims costs | - | 1,504,201 | - | (366,861) | 1,137,340 |
| Depreciation and amortization | 338,801 | 1,375 | 74,665 | - | 414,841 |
| Interest expense | 122,166 | 2,302 | 2,018 | (48) | 126,438 |
| Other | 1,128,528 | 53,939 | 23,566 | (163,265) | 1,042,768 |
| Total expenses | \$ 6,654,022 | \$ 1,654,643 | \$ 705,807 | \$ (681,030) | \$ 8,333,442 |

| | Operating Expenses at December 31, 2017 | | | | |
|---------------------------------|------------------------------------------------|---------------------------------|-------------------------------|--------------------------------|---------------------------------------|
| | Delivery | Insurance Operations | Corporate Services | Other/ Eliminations | Banner Health Consolidated |
| | <i>(In Thousands)</i> | | | | |
| Expenses: | | | | | |
| Salaries and benefits | \$ 3,324,832 | \$ 66,532 | \$ 551,959 | \$ (146,141) | \$ 3,797,182 |
| Supplies | 1,293,229 | 287 | (10,711) | (4,430) | 1,278,375 |
| Physician and professional fees | 261,153 | 14,322 | 26,943 | (121,802) | 180,616 |
| Medical claims costs | - | 1,248,381 | - | (409,541) | 838,840 |
| Depreciation and amortization | 324,268 | 2,160 | 86,000 | - | 412,428 |
| Interest expense | 114,506 | 1,179 | (3,345) | (12) | 112,328 |
| Other | 1,056,289 | 47,422 | (5,316) | (153,554) | 944,841 |
| Total expenses | \$ 6,374,277 | \$ 1,380,283 | \$ 645,530 | \$ (835,480) | \$ 7,564,610 |

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

14. Commitments and Contingencies

Leases

Future minimum lease payments (excluding operating agreements), by year and in the aggregate, under non-cancelable operating lease arrangements with initial or remaining terms of one year or more consist of the following at December 31, 2018 (in thousands):

| | | |
|------------|----|----------------|
| 2019 | \$ | 34,245 |
| 2020 | | 32,259 |
| 2021 | | 27,387 |
| 2022 | | 23,931 |
| 2023 | | 16,656 |
| Thereafter | | 24,445 |
| | \$ | <u>158,923</u> |

Amounts charged to expense for all operating leases totaled approximately \$76,662,000 and \$76,529,000 in 2018 and 2017, respectively.

Facility Construction

Banner is undertaking significant renovation and expansion projects at several of its facilities. The committed cost to complete these construction projects is estimated to be approximately \$217,000,000.

Academic Affiliation Agreement

On February 28, 2015, the University of Arizona Health Network (UAHN) and its wholly owned subsidiary, University Medical Center Corporation, were acquired by Banner. As part of the transaction, Banner and the University of Arizona (UA) entered into a 30-year academic affiliation agreement (the AAA), providing for ongoing support of the UA Colleges of Medicine in Tucson and Phoenix, and for Banner – University Medical Center Phoenix (B-UMCP) to become the primary teaching affiliate of the UA College of Medicine – Phoenix. Under the terms of the transaction, Banner and UA contributed \$300,000,000 to an Academic Enhancement Fund to provide \$20,000,000 of annual support for academic enhancements, faculty recruitment, and

Banner Health and Subsidiaries

Notes to Consolidated Financial Statements (continued)

14. Commitments and Contingencies (continued)

program development at the UA College of Medicine – Tucson and College of Medicine – Phoenix. In addition, Banner agreed to fund such additional amounts as may be needed to meet the \$20,000,000 annual commitment during the 30-year term of the AAA to the extent that the Academic Enhancement Fund and earnings thereon, is insufficient to do so. Banner must fund a minimum amount of \$151,300,000 for funds flow and mission support. The annual funds flow commitment is subject to adjustment based upon fluctuations in governmental funding for graduate medical education. Banner funded approximately \$267,242,000 and \$241,813,000 relating to the AAA funds flow and mission support for the years ended December 31, 2018 and 2017, respectively.

Compliance with Laws and Regulations

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

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

Supplementary Information



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Report of Independent Auditors on Supplementary Information

The Board of Directors
Banner Health

Our audit was conducted for the purpose of forming an opinion on the accompanying consolidated financial statements as a whole. The accompanying separate financial information of the Arizona acute care hospitals and other Arizona licensed operating units of Banner Health are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Ernst & Young LLP

April 30, 2019

Banner Health

Balance Sheets – Arizona Acute Care Hospitals

December 31, 2018
(In Thousands)

| | Banner- University Medical Center Phoenix | Banner Desert Medical Center | Banner- University Medical Center Tucson | Banner Thunderbird Medical Center | Banner Gateway Medical Center | Banner Boswell Medical Center | Banner Del E. Webb Medical Center | Banner Estrella Medical Hospital | Banner Baywood Medical Center | Banner Heart Hospital | Banner – University Medical Center South | Banner Casa Grande Medical Center | Banner Ironwood Medical Center | Page Hospital | Banner Goldfield Medical Center | Banner Payson Medical Center |
|---------------------------------------------|-------------------------------------------------------|---------------------------------------|------------------------------------------------------|--------------------------------------------|----------------------------------------|----------------------------------------|--------------------------------------------|-------------------------------------------|----------------------------------------|-----------------------------|------------------------------------------------------|-----------------------------------------------|-----------------------------------------|------------------|------------------------------------------|---------------------------------------|
| Assets | | | | | | | | | | | | | | | | |
| Current assets: | | | | | | | | | | | | | | | | |
| Cash | \$ 79 | \$ 8 | \$ 32 | \$ 12 | \$ 10 | \$ 5 | \$ 5 | \$ 5 | \$ 6 | \$ – | \$ 6 | \$ 2 | \$ 2 | \$ 12 | \$ 1 | \$ 2 |
| Short-term investments | – | – | 143 | – | – | – | – | – | – | – | – | – | – | – | – | – |
| Assets limited as to use | 15,927 | 17,621 | 5,360 | 14,328 | 1,010 | 5,200 | 5,986 | 9,091 | 5,275 | 955 | – | 1,556 | 4,596 | – | – | 37 |
| Net patient receivables | 122,376 | 114,000 | 113,134 | 70,886 | 57,981 | 37,436 | 38,006 | 40,622 | 32,954 | 17,618 | 21,595 | 13,398 | 9,967 | 2,455 | 2,088 | 7,302 |
| Inventories | 25,304 | 15,362 | 22,241 | 13,862 | 9,498 | 9,953 | 10,974 | 7,245 | 5,344 | 4,178 | 3,454 | 2,687 | 2,787 | 597 | 513 | 1,841 |
| Due from Banner affiliates | – | – | – | – | – | – | – | – | – | – | – | – | – | – | – | – |
| Estimated third-party payor settlements | 2,100 | – | 2,230 | 456 | – | 100 | – | – | – | – | 1,343 | 58 | – | 88 | – | 260 |
| Other | 67,941 | 1,632 | 77,345 | 1,062 | 4,376 | 301 | 625 | 1,058 | 280 | 112 | 36,754 | 305 | 781 | 760 | 94 | 350 |
| Total current assets | 233,727 | 148,623 | 220,485 | 100,606 | 72,875 | 52,995 | 55,596 | 58,021 | 43,859 | 22,863 | 63,152 | 18,006 | 18,133 | 3,912 | 2,696 | 9,792 |
| Assets limited to use, less current portion | – | – | – | – | – | – | – | – | – | – | – | – | – | – | – | – |
| Property and equipment, net | 619,690 | 283,657 | 600,530 | 221,627 | 168,657 | 134,762 | 155,849 | 190,652 | 109,931 | 34,988 | 20,043 | 88,996 | 85,470 | 785 | 12,464 | 39,724 |
| Other assets | 16,561 | 26,324 | 16,195 | 3,804 | 13,978 | 51,808 | 941 | 1,402 | 2,198 | 5,224 | 358 | 140 | 628 | 55 | 320 | 126 |
| | \$ 869,978 | \$ 458,604 | \$ 837,210 | \$ 326,037 | \$ 255,510 | \$ 239,565 | \$ 212,386 | \$ 250,075 | \$ 155,988 | \$ 63,075 | \$ 83,553 | \$ 107,142 | \$ 104,231 | \$ 4,752 | \$ 15,480 | \$ 49,642 |

Banner Health

Balance Sheets – Arizona Acute Care Hospitals (continued)

December 31, 2018
(In Thousands)

| | Banner- University Medical Center Phoenix | Banner Desert Medical Center | Banner- University Medical Center Tucson | Banner Thunderbird Medical Center | Banner Gateway Medical Center | Banner Boswell Medical Center | Banner Del E. Webb Medical Center | Banner Estrella Medical Hospital | Banner Baywood Medical Center | Banner Heart Hospital | Banner- University Medical Center South | Banner Casa Grande Medical Center | Banner Ironwood Medical Center | Page Hospital | Banner Goldfield Medical Center | Banner Payson Medical Center |
|---------------------------------------------------------------|-------------------------------------------------------|---------------------------------------|------------------------------------------------------|--------------------------------------------|----------------------------------------|----------------------------------------|--------------------------------------------|-------------------------------------------|----------------------------------------|-----------------------------|-----------------------------------------------------|--------------------------------------------|-----------------------------------------|------------------|------------------------------------------|---------------------------------------|
| Liabilities and net assets (deficit) | | | | | | | | | | | | | | | | |
| Current liabilities: | | | | | | | | | | | | | | | | |
| Trade accounts payable | \$ 12,726 | \$ 8,157 | \$ 10,514 | \$ 4,755 | \$ 3,091 | \$ 5,745 | \$ 5,369 | \$ 2,487 | \$ 6,676 | \$ 79 | \$ 889 | \$ 1,085 | \$ 678 | \$ 98 | \$ 117 | \$ 218 |
| Current portion of long-term debt | 66,377 | 13,995 | 144,000 | 11,941 | – | 2,611 | 3,006 | 2,987 | 3,353 | 480 | – | – | 2,308 | – | – | – |
| Estimated current portion of third-party payor settlements | – | 1,638 | – | – | 221 | – | 28 | 331 | 390 | 9 | – | – | 388 | – | 26 | – |
| Accrued salaries and benefits | 21,460 | 18,005 | 17,411 | 14,309 | 8,673 | 8,028 | 7,570 | 8,271 | 6,972 | 2,196 | 4,212 | 3,814 | 2,067 | 604 | 480 | 1,147 |
| Other accrued expenses | 17,966 | 4,177 | 9,875 | 2,681 | 349 | 3,251 | 1,451 | 1,820 | 1,804 | 712 | 400 | 1,326 | 604 | 281 | 510 | 580 |
| Total current liabilities | 118,529 | 45,972 | 181,800 | 33,686 | 12,334 | 19,635 | 17,424 | 15,896 | 19,195 | 3,476 | 5,501 | 6,225 | 6,045 | 983 | 1,133 | 1,945 |
| Long-term debt, less current portion | 417,342 | 358,043 | 526,890 | 309,667 | 200,190 | 121,501 | 139,878 | 297,935 | 128,680 | 22,315 | – | 66,913 | 107,384 | – | – | 35,316 |
| Estimated third-party payor settlements, less current portion | 1,797 | 94 | – | 198 | 423 | – | 203 | 161 | 737 | 63 | 328 | 457 | – | 20 | 9 | 277 |
| Other | 7,749 | 834 | 33 | 509 | 77 | 3,686 | 631 | – | 650 | – | 9 | 230 | – | – | – | – |
| Total liabilities | 545,417 | 404,943 | 708,723 | 344,060 | 213,024 | 144,822 | 158,136 | 313,992 | 149,262 | 25,854 | 5,838 | 73,825 | 113,429 | 1,003 | 1,142 | 37,538 |
| Net assets (deficit): | | | | | | | | | | | | | | | | |
| Without donor restrictions | 308,130 | 45,868 | 112,158 | (20,134) | 27,878 | 59,353 | 53,310 | (65,024) | 4,591 | 36,591 | 77,349 | 33,177 | (9,782) | 3,695 | 14,016 | 11,964 |
| With donor restrictions | 16,431 | 7,793 | 16,329 | 2,111 | 14,608 | 35,390 | 940 | 1,107 | 2,135 | 630 | 366 | 140 | 584 | 54 | 322 | 140 |
| Total net assets (deficit) | 324,561 | 53,661 | 128,487 | (18,023) | 42,486 | 94,743 | 54,250 | (63,917) | 6,726 | 37,221 | 77,715 | 33,317 | (9,198) | 3,749 | 14,338 | 12,104 |
| | \$ 869,978 | \$ 458,604 | \$ 837,210 | \$ 326,037 | \$ 255,510 | \$ 239,565 | \$ 212,386 | \$ 250,075 | \$ 155,988 | \$ 63,075 | \$ 83,553 | \$ 107,142 | \$ 104,231 | \$ 4,752 | \$ 15,480 | \$ 49,642 |

Banner Health

Statements of Income – Arizona Acute Care Hospitals

Year Ended December 31, 2018
(In Thousands)

| | Banner- University Medical Center Phoenix | Banner Desert Medical Center | Banner- University Medical Center Tucson | Banner Thunderbird Medical Center | Banner Gateway Medical Center | Banner Boswell Medical Center | Banner Del E. Webb Medical Center | Banner Estrella Medical Hospital | Banner Baywood Medical Center | Banner Heart Hospital | Banner- University Medical Center South | Banner Casa Grande Medical Center | Banner Ironwood Medical Center | Page Hospital | Banner Goldfield Medical Center | Banner Payson Medical Center |
|-----------------------------------------------|-------------------------------------------------------|---------------------------------------|------------------------------------------------------|--------------------------------------------|----------------------------------------|----------------------------------------|--------------------------------------------|-------------------------------------------|----------------------------------------|-----------------------------|-----------------------------------------------------|--------------------------------------------|-----------------------------------------|------------------|------------------------------------------|---------------------------------------|
| Revenues: | | | | | | | | | | | | | | | | |
| Patient service revenue, net of contractals | \$ 856,651 | \$ 729,756 | \$ 691,934 | \$ 534,624 | \$ 412,862 | \$ 315,679 | \$ 305,027 | \$ 319,800 | \$ 277,177 | \$ 149,165 | \$ 154,861 | \$ 107,565 | \$ 78,711 | \$ 19,682 | \$ 17,944 | \$ 40,669 |
| Other | 19,746 | 6,997 | 32,509 | 6,558 | 19,164 | 2,370 | 3,111 | 3,733 | 2,546 | 952 | 19,277 | 1,160 | 1,040 | 725 | 16 | 361 |
| Total revenues | 876,397 | 736,753 | 724,443 | 541,182 | 432,026 | 318,049 | 308,138 | 323,533 | 279,723 | 150,117 | 174,138 | 108,725 | 79,751 | 20,407 | 17,960 | 41,030 |
| Expenses: | | | | | | | | | | | | | | | | |
| Salaries and benefits | 312,829 | 252,782 | 242,678 | 207,871 | 122,751 | 117,619 | 118,046 | 120,697 | 110,034 | 35,266 | 64,918 | 50,898 | 29,397 | 8,622 | 8,661 | 16,049 |
| Supplies | 193,324 | 115,710 | 192,836 | 76,038 | 97,081 | 74,870 | 47,719 | 34,767 | 42,375 | 46,140 | 23,650 | 13,121 | 7,234 | 676 | 1,071 | 5,055 |
| Physician and professional fees | 22,439 | 20,596 | 9,040 | 11,983 | 2,058 | 2,495 | 3,149 | 4,921 | 5,765 | 2,209 | 1,113 | 4,647 | 2,447 | 689 | 1,143 | 2,250 |
| Depreciation and amortization | 45,079 | 38,363 | 25,521 | 28,647 | 20,784 | 14,467 | 16,254 | 19,146 | 14,415 | 5,044 | 3,882 | 8,422 | 7,635 | 104 | 1,731 | 3,126 |
| Interest | 16,394 | 11,553 | 15,756 | 9,141 | 7,743 | 5,315 | 5,764 | 7,500 | 3,941 | 1,222 | – | 3,529 | 3,182 | – | 526 | 1,570 |
| Other | 285,841 | 171,418 | 269,202 | 146,656 | 123,883 | 97,629 | 89,048 | 91,736 | 80,410 | 28,902 | 66,195 | 38,545 | 20,404 | 5,205 | 6,971 | 12,915 |
| Total expenses | 875,906 | 610,422 | 755,033 | 480,336 | 374,300 | 312,395 | 279,980 | 278,767 | 256,940 | 118,783 | 159,758 | 119,162 | 70,299 | 15,296 | 20,103 | 40,965 |
| Operating income (loss) | 491 | 126,331 | (30,590) | 60,846 | 57,726 | 5,654 | 28,158 | 44,766 | 22,783 | 31,334 | 14,380 | (10,437) | 9,452 | 5,111 | (2,143) | 65 |
| Disposal of assets | 80 | 193 | 10 | – | 45 | (6) | 20 | 4 | 23 | – | 1 | 1 | – | – | – | 32 |
| Excess (deficiency) of revenues over expenses | \$ 571 | \$ 126,524 | \$ (30,580) | \$ 60,846 | \$ 57,771 | \$ 5,648 | \$ 28,178 | \$ 44,770 | \$ 22,806 | \$ 31,334 | \$ 14,381 | \$ (10,436) | \$ 9,452 | \$ 5,111 | \$ (2,143) | \$ 97 |

Banner Health

Statements of Changes in Net Assets – Arizona Acute Care Hospitals

Year Ended December 31, 2018

(In Thousands)

| | Banner- University Medical Center Phoenix | Banner Desert Medical Center | Banner- University Medical Center Tucson | Banner Thunderbird Medical Center | Banner Gateway Medical Center | Banner Boswell Medical Center | Banner Del E. Webb Medical Center | Banner Estrella Medical Hospital | Banner Baywood Medical Center | Banner Heart Hospital | Banner- University Medical Center South | Banner Casa Grande Medical Center | Banner Ironwood Medical Center | Page Hospital | Banner Goldfield Medical Center | Banner Payson Medical Center |
|--------------------------------------------------------------|-------------------------------------------------------|---------------------------------------|------------------------------------------------------|--------------------------------------------|----------------------------------------|----------------------------------------|--------------------------------------------|-------------------------------------------|----------------------------------------|-----------------------------|-----------------------------------------------------|--------------------------------------------|-----------------------------------------|------------------|------------------------------------------|---------------------------------------|
| Net assets without donor restrictions: | | | | | | | | | | | | | | | | |
| Excess (deficiency) of revenues over expenses | \$ 571 | \$ 126,524 | \$ (30,580) | \$ 60,846 | \$ 57,771 | \$ 5,648 | \$ 28,178 | \$ 44,770 | \$ 22,806 | \$ 31,334 | \$ 14,381 | \$ (10,436) | \$ 9,452 | \$ 5,111 | \$ (2,143) | \$ 97 |
| Cumulative effect of change in accounting principle | (988) | (2,150) | 6,413 | (1,745) | (864) | (1,390) | (638) | (1,401) | (168) | (236) | (771) | (1,035) | (555) | (134) | (175) | (576) |
| Contributions for property and equipment acquisitions | 210 | 740 | 141 | 114 | 357 | 38 | 1,907 | 22 | 363 | 80 | 29 | 338 | 13 | – | – | 150 |
| Equity transfers from (to) Banner Health | 90,432 | (123,761) | 69,741 | (67,039) | (61,221) | 1,872 | (33,480) | (44,715) | (22,647) | (28,126) | (25,286) | 6,627 | (10,730) | (4,228) | 1,638 | 5,028 |
| Increase (decrease) in net assets without donor restrictions | 90,225 | 1,353 | 45,715 | (7,824) | (3,957) | 6,168 | (4,033) | (1,324) | 354 | 3,052 | (11,647) | (4,506) | (1,820) | 749 | (680) | 4,699 |
| Net assets with donor restrictions: | | | | | | | | | | | | | | | | |
| Contributions | 2,121 | 633 | 819 | 302 | 1,391 | 1,265 | 305 | 339 | 296 | 180 | 96 | 119 | 89 | 2 | 87 | 178 |
| Net assets released from restriction | (207) | (136) | (166) | (942) | (3,627) | (318) | (295) | (88) | (212) | (237) | (122) | (174) | (101) | – | (36) | (99) |
| Increase (decrease) in net assets with donor restrictions | 1,914 | 497 | 653 | (640) | (2,236) | 947 | 10 | 251 | 84 | (57) | (26) | (55) | (12) | 2 | 51 | 79 |
| Increase (decrease) in net assets | 92,139 | 1,850 | 46,368 | (8,464) | (6,193) | 7,115 | (4,023) | (1,073) | 438 | 2,995 | (11,673) | (4,561) | (1,832) | 751 | (629) | 4,778 |
| Net assets (deficit), beginning of year | 232,422 | 51,811 | 82,119 | (9,559) | 48,679 | 87,628 | 58,273 | (62,844) | 6,288 | 34,226 | 89,388 | 37,878 | (7,366) | 2,998 | 14,967 | 7,326 |
| Net assets (deficit), end of year | \$ 324,561 | \$ 53,661 | \$ 128,487 | \$ (18,023) | \$ 42,486 | \$ 94,743 | \$ 54,250 | \$ (63,917) | \$ 6,726 | \$ 37,221 | \$ 77,715 | \$ 33,317 | \$ (9,198) | \$ 3,749 | \$ 14,338 | \$ 12,104 |

Banner Health

Statements of Cash Flows – Arizona Acute Care Hospitals

Year Ended December 31, 2018

(In Thousands)

| | Banner- University Medical Center Phoenix | Banner Desert Medical Center | Banner- University Medical Center Tucson | Banner Thunderbird Medical Center | Banner Gateway Medical Center | Banner Boswell Medical Center | Banner Del E. Webb Medical Center | Banner Estrella Medical Hospital | Banner Baywood Medical Center | Banner Heart Hospital | Banner- University Medical Center South | Banner Casa Grande Medical Center | Banner Ironwood Medical Center | Page Hospital | Banner Goldfield Medical Center | Banner Payson Medical Center |
|--------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------|---------------------------------------|------------------------------------------------------|--------------------------------------------|----------------------------------------|----------------------------------------|--------------------------------------------|-------------------------------------------|----------------------------------------|-----------------------------|-----------------------------------------------------|--------------------------------------------|-----------------------------------------|------------------|------------------------------------------|---------------------------------------|
| Operating activities | | | | | | | | | | | | | | | | |
| Increase (decrease) in net assets | \$ 92,139 | \$ 1,850 | \$ 46,368 | \$ (8,464) | \$ (6,193) | \$ 7,115 | \$ (4,023) | \$ (1,073) | \$ 438 | \$ 2,995 | \$ (11,673) | \$ (4,561) | \$ (1,832) | \$ 751 | \$ (629) | \$ 4,778 |
| Adjustments to reconcile increase (decrease) in net assets to net cash provided by (used in) operating activities: | | | | | | | | | | | | | | | | |
| Equity transfers (from) to Banner | (90,432) | 123,761 | (69,741) | 67,039 | 61,221 | (1,872) | 33,480 | 44,715 | 22,647 | 28,126 | 25,286 | (6,627) | 10,730 | 4,228 | (1,638) | (5,028) |
| Depreciation and amortization | 45,079 | 38,363 | 25,521 | 28,647 | 20,784 | 14,467 | 16,254 | 19,146 | 14,415 | 5,044 | 3,882 | 8,422 | 7,635 | 104 | 1,731 | 3,126 |
| (Increase) decrease in investments designated as trading | (4,543) | (3,662) | (2,935) | (2,819) | – | 174 | 200 | 144 | (688) | 31 | – | – | 154 | – | – | (10) |
| Contributions for property and equipment acquisitions | (210) | (740) | (141) | (114) | (357) | (38) | (1,907) | (22) | (363) | (80) | (29) | (338) | (13) | – | – | (150) |
| (Gain) loss on disposal of assets | (80) | (193) | (10) | – | (45) | 6 | (20) | (4) | (23) | – | (1) | (1) | – | – | – | (32) |
| Restricted contributions | (2,121) | (633) | (819) | (302) | (1,391) | (1,265) | (305) | (339) | (296) | (180) | (96) | (119) | (89) | (2) | (87) | (178) |
| Changes in operating elements: | | | | | | | | | | | | | | | | |
| Patient receivable | (916) | (2,679) | 12,029 | 4,877 | (3,895) | 5,501 | 3,542 | (335) | 4,806 | 795 | 3,225 | 2,951 | (5) | 53 | 391 | (1,834) |
| Inventories and other current assets | (6,449) | 1,104 | (4,576) | (1,279) | (1,620) | (945) | (598) | (2,179) | 378 | (504) | 8,104 | (209) | (468) | (355) | (14) | (190) |
| Accounts payable and accrued expenses | 2,121 | (3,257) | (3,435) | (958) | 222 | 861 | 742 | 591 | (1,134) | 309 | (3,435) | (829) | 93 | 143 | 152 | (1,518) |
| Estimated third-party payor settlements | (5,531) | (439) | (4,697) | (81) | (736) | (827) | (480) | 898 | (1,558) | (198) | (398) | (286) | (621) | (143) | (121) | (275) |
| Other liabilities | (152) | – | 32 | – | – | (50) | – | – | – | – | 9 | – | – | – | – | – |
| Net cash provided by (used in) operating activities | 28,905 | 153,475 | (2,404) | 86,546 | 67,990 | 23,127 | 46,885 | 61,542 | 38,622 | 36,338 | 24,874 | (1,597) | 15,584 | 4,779 | (215) | (1,311) |
| Investing activities | | | | | | | | | | | | | | | | |
| Purchases of property and equipment | (127,453) | (19,782) | (93,251) | (10,040) | (7,207) | (21,896) | (9,760) | (12,957) | (10,252) | (7,717) | (3,229) | (5,109) | (1,884) | (570) | (1,460) | (3,838) |
| Decrease in project fund | 18,795 | – | 26,162 | – | – | – | – | – | – | – | – | – | – | – | – | – |
| (Increase) decrease in other assets | (1,585) | 1,037 | (706) | 466 | 2,865 | (946) | (11) | (404) | (35) | (48) | 32 | 57 | (34) | (4) | (50) | (65) |
| Net cash used in investing activities | (110,243) | (18,745) | (67,795) | (9,574) | (4,342) | (22,842) | (9,771) | (13,361) | (10,287) | (7,765) | (3,197) | (5,052) | (1,918) | (574) | (1,510) | (3,903) |
| Financing activities | | | | | | | | | | | | | | | | |
| Restricted contributions | 2,121 | 633 | 819 | 302 | 1,391 | 1,265 | 305 | 339 | 296 | 180 | 96 | 119 | 89 | 2 | 87 | 178 |
| Equity transfers from (to) Banner | 90,432 | (123,761) | 69,741 | (67,039) | (61,221) | 1,872 | (33,480) | (44,715) | (22,647) | (28,126) | (25,286) | 6,627 | (10,730) | (4,228) | 1,638 | 5,028 |
| Payments of long-term debt | (11,214) | (11,603) | (2,212) | (10,235) | (3,818) | (3,422) | (3,939) | (3,805) | (5,984) | (628) | – | (97) | (3,025) | – | – | 8 |
| Net cash provided by (used in) financing activities | 81,339 | (134,731) | 68,348 | (76,972) | (63,648) | (285) | (37,114) | (48,181) | (28,335) | (28,574) | (25,190) | 6,649 | (13,666) | (4,226) | 1,725 | 5,214 |
| Net increase (decrease) in cash | 1 | (1) | (1,851) | – | – | – | – | – | – | (1) | (3,513) | – | – | (21) | – | – |
| Cash at beginning of year | 78 | 9 | 1,883 | 12 | 10 | 5 | 5 | 5 | 6 | 1 | 3,519 | 2 | 2 | 33 | 1 | 2 |
| Cash at end of year | \$ 79 | \$ 8 | \$ 32 | \$ 12 | \$ 10 | \$ 5 | \$ 5 | \$ 5 | \$ 6 | \$ – | \$ 6 | \$ 2 | \$ 2 | \$ 12 | \$ 1 | \$ 2 |

Banner Health

Balance Sheets – Other Arizona Licensed Operating Units

December 31, 2018

(In Thousands)

| | Banner Behavioral Health Hospital | Banner University Crisis Response Center | Banner Rehabilitation Center | Banner Hospice |
|---------------------------------------------------------------|------------------------------------------------------|-------------------------------------------------------------|---------------------------------------------|---------------------------|
| Assets | | | | |
| Current assets: | | | | |
| Cash | \$ – | \$ 5,229 | \$ – | \$ 1 |
| Assets limited as to use | – | – | 87 | – |
| Patient accounts receivable | 6,906 | – | 959 | 1,678 |
| Inventories | 106 | – | 167 | 63 |
| Estimated current portion of third-party payor settlements | – | – | 2 | – |
| Other | 196 | 15 | 5 | 729 |
| Total current assets | 7,208 | 5,244 | 1,220 | 2,471 |
| Property and equipment, net | 45,462 | – | 5,067 | 31 |
| Other assets | 3,863 | – | 3 | 10 |
| | \$ 56,533 | \$ 5,244 | \$ 6,290 | \$ 2,512 |

Banner Health

Balance Sheets – Other Arizona Licensed Operating Units (continued)

December 31, 2018

(In Thousands)

| | Banner Behavioral Health Hospital | Banner University Crisis Response Center | Banner Rehabilitation Center | Banner Hospice |
|---------------------------------------------|------------------------------------------------------|-------------------------------------------------------------|---------------------------------------------|---------------------------|
| Liabilities and net assets (deficit) | | | | |
| Current liabilities: | | | | |
| Trade accounts payable | \$ 105 | \$ 819 | \$ 96 | \$ 256 |
| Current portion of long-term debt | – | – | 44 | – |
| Accrued salaries and benefits | 1,687 | 3 | 273 | 1,361 |
| Due to Banner affiliates | – | – | – | 11,247 |
| Other accrued expenses | 170 | – | 54 | 1,888 |
| Total current liabilities | 1,962 | 822 | 467 | 14,752 |
| Long-term debt, less current portion | – | – | 2,034 | – |
| Other | 12 | – | 63 | 1 |
| Total liabilities | 1,974 | 822 | 2,564 | 14,753 |
| Net assets (deficit): | | | | |
| Without donor restrictions | 50,696 | 4,422 | 3,726 | (12,251) |
| With donor restrictions | 3,863 | – | – | 10 |
| Total net assets (deficit) | 54,559 | 4,422 | 3,726 | (12,241) |
| | \$ 56,533 | \$ 5,244 | \$ 6,290 | \$ 2,512 |

Banner Health

Statements of Income – Other Arizona Licensed Operating Units

Year Ended December 31, 2018

(In Thousands)

| | Banner Behavioral Health Hospital | Banner University Crisis Response Center | Banner Rehabilitation Center | Banner Hospice |
|--------------------------------------------------------------------|------------------------------------------------------|-------------------------------------------------------------|---------------------------------------------|---------------------------|
| Revenues: | | | | |
| Net patient service revenue | \$ 41,936 | \$ 23,786 | \$ 7,647 | \$ 18,585 |
| Other | 1,597 | – | 116 | 269 |
| Total revenues | <u>43,533</u> | <u>23,786</u> | <u>7,763</u> | <u>18,854</u> |
| Expenses: | | | | |
| Salaries and benefits | 24,872 | 77 | 8,232 | 9,972 |
| Supplies | 377 | – | 1,322 | 2,026 |
| Physician and professional fees | 118 | – | 6 | 198 |
| Depreciation | 3,839 | – | 694 | 59 |
| Interest | 1,847 | – | – | – |
| Other | 13,733 | 24,135 | 2,247 | 3,721 |
| Total expenses | <u>44,786</u> | <u>24,212</u> | <u>12,501</u> | <u>15,976</u> |
| Operating (loss) income | (1,253) | (426) | (4,738) | 2,878 |
| Loss on disposal of assets | 1 | – | – | – |
| (Deficiency) excess of revenues over expenses | (1,252) | (426) | (4,738) | 2,878 |
| Contributions for property and equipment equipment acquisitions | 120 | – | – | – |
| Equity transfers from Banner Health | 498 | 7,293 | 4,796 | – |
| Cumulative effect of change in accounting principle | (46) | – | – | – |
| (Decrease) increase in net assets without donor restrictions | <u>\$ (680)</u> | <u>\$ 6,867</u> | <u>\$ 58</u> | <u>\$ 2,878</u> |

Banner Health

Statements of Changes in Net Assets – Other Arizona Licensed Operating Units

Year Ended December 31, 2018

(In Thousands)

| | Banner Behavioral Health Hospital | Banner University Crisis Response Center | Banner Rehabilitation Center | Banner Hospice |
|--------------------------------------------------------------|------------------------------------------------------|-------------------------------------------------------------|---------------------------------------------|---------------------------|
| Net assets without donor restrictions: | | | | |
| (Deficiency) excess of revenues over expenses | \$ (1,252) | \$ (426) | \$ (4,738) | \$ 2,878 |
| Contributions for property and equipment acquisitions | 120 | – | – | – |
| Equity transfers from (to) Banner Health | 498 | 7,293 | 4,796 | – |
| Cumulative effect of change in accounting principle | (46) | – | – | – |
| (Decrease) increase in net assets without donor restrictions | (680) | 6,867 | 58 | 2,878 |
| Net assets with donor restrictions: | | | | |
| Contributions | 19 | – | – | – |
| Net assets released from restriction | (18) | – | – | – |
| Increase in net assets with donor restrictions | 1 | – | – | – |
| Increase (decrease) in net assets | (679) | 6,867 | 58 | 2,878 |
| Net assets (deficit), beginning of year | 55,238 | (2,445) | 3,668 | (15,119) |
| Net assets (deficit), end of year | <u>\$ 54,559</u> | <u>\$ 4,422</u> | <u>\$ 3,726</u> | <u>\$ (12,241)</u> |

Banner Health

Statements of Cash Flows – Other Arizona Licensed Operating Units

Year Ended December 31, 2018

(In Thousands)

| | Banner Behavioral Health Hospital | Banner University Crisis Response Center | Banner Rehabilitation Center | Banner Hospice |
|--------------------------------------------------------------------------------------------------------------|------------------------------------------------------|-------------------------------------------------------------|---------------------------------------------|---------------------------|
| Operating activities | | | | |
| (Decrease) increase in net assets | \$ (679) | \$ 6,867 | \$ 58 | \$ 2,878 |
| Adjustments to reconcile (decrease) increase in net assets to net cash (used in) operating activities: | | | | |
| Equity transfers (from) to Banner | (498) | (7,293) | (4,796) | – |
| Depreciation | 3,839 | – | 694 | 59 |
| Increase in investments designated as trading | – | – | 3 | – |
| Contributions for property and equipment acquisitions | (120) | – | – | – |
| Loss on disposal of assets | 1 | – | – | – |
| Restricted contributions | (19) | – | – | – |
| Changes in operating assets and liabilities: | | | | |
| Patient receivable | (2,113) | – | 141 | (13) |
| Inventories and other current assets | (26) | – | (16) | 41 |
| Accounts payable and accrued expenses | 267 | (1,643) | 153 | 397 |
| Estimated third-party payor settlements | (67) | – | (102) | – |
| Other liabilities | – | – | – | – |
| Net cash provided by (used in) operating activities | <u>585</u> | <u>(2,069)</u> | <u>(3,865)</u> | <u>3,362</u> |
| Investing activities | | | | |
| Net purchases of property and equipment | (1,104) | – | (873) | – |
| Increase in other assets | – | – | (1) | – |
| Net cash used in investing activities | <u>(1,104)</u> | <u>–</u> | <u>(874)</u> | <u>–</u> |
| Financing activities | | | | |
| Restricted contributions | 19 | – | – | – |
| Equity transfers from Banner | 498 | 7,293 | 4,796 | (3,362) |
| Payments of long-term debt | – | – | (57) | – |
| Net cash provided by (used in) financing activities | <u>517</u> | <u>7,293</u> | <u>4,739</u> | <u>(3,362)</u> |
| Net (decrease) increase in cash | (2) | 5,224 | – | – |
| Cash at beginning of year | 2 | 5 | – | 1 |
| Cash at end of year | <u>\$ –</u> | <u>\$ 5,229</u> | <u>\$ –</u> | <u>\$ 1</u> |

Banner Health

Note to Supplementary Information

December 31, 2018

1. Equity Transfers from (to) Banner Health

The acute care hospitals and operating units (collectively, the Facilities) reflected in the accompanying supplementary information, participate in Banner Health's (Banner) centralized cash management function whereby the Facilities transfer available cash to Banner, which in turn is used for expenditures paid by Banner on behalf of the Facilities. The net cash transfer activity is recorded as an intercompany transaction with Banner. Intercompany transactions with Banner are recorded as an equity transfer on the statements of changes in net assets.