

MULTICARE HEALTH SYSTEM
Consolidated Financial Statements
December 31, 2020 and 2019
(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 2900
1918 Eighth Avenue
Seattle, WA 98101

Independent Auditors' Report

The Board of Directors
MultiCare Health System:

We have audited the accompanying consolidated financial statements of MultiCare Health System (a Washington nonprofit corporation), which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of operations and 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 consolidated financial statements in accordance 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of MultiCare Health System as of December 31, 2020 and 2019, and the results of its operations and changes in net assets and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Seattle, Washington
March 24, 2021

MULTICARE HEALTH SYSTEM

Consolidated Balance Sheets

December 31, 2020 and 2019

(In thousands)

Assets	2020	2019
Current assets:		
Cash and cash equivalents	\$ 946,223	434,854
Accounts receivable	374,372	376,500
Supplies inventory	49,167	41,738
Other current assets, net	85,144	71,397
Total current assets	1,454,906	924,489
Donor restricted assets held for long-term purposes	88,900	70,783
Investments	1,970,458	1,797,483
Property, plant, and equipment, net	1,763,666	1,763,345
Right-of-use operating lease asset, net	137,763	144,140
Right-of-use financing lease asset, net	15,694	—
Other assets, net	502,459	384,004
Total assets	\$ 5,933,846	5,084,244
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 208,422	195,356
Accrued compensation and related liabilities	299,523	247,971
Accrued interest payable	18,649	15,168
Current portion of right-of-use operating lease liability	28,574	28,322
Current portion of right-of-use financing lease liability	2,836	—
Current portion of long-term debt	7,950	13,668
Total current liabilities	565,954	500,485
Interest rate swap liabilities	154,347	88,311
Right-of-use operating lease liability, net of current portion	114,288	120,345
Right-of-use financing lease liability, net of current portion	13,200	—
Long-term debt, net of current portion	1,618,849	1,276,973
Other liabilities, net	213,046	155,320
Total liabilities	2,679,684	2,141,434
Commitments and contingencies (note 15)		
Net assets:		
Without donor restrictions	3,111,401	2,819,420
With donor restrictions	142,761	123,390
Total net assets	3,254,162	2,942,810
Total liabilities and net assets	\$ 5,933,846	5,084,244

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2020 and 2019

(In thousands)

	2020	2019
Revenues, gains, and other support without donor restrictions:		
Patient service revenue	\$ 3,105,968	3,107,525
Other operating revenue	256,819	120,355
Net assets released from restrictions for operations	4,655	6,225
Total revenues, gains, and other support without donor restrictions	<u>3,367,442</u>	<u>3,234,105</u>
Expenses:		
Salaries and wages	1,616,021	1,548,101
Employee benefits	248,132	241,346
Supplies	520,378	501,688
Purchased services	298,256	271,114
Depreciation and amortization	168,188	165,670
Interest	45,970	46,585
Other	369,741	357,486
Total expenses	<u>3,266,686</u>	<u>3,131,990</u>
Excess of revenues over expenses from operations	<u>100,756</u>	<u>102,115</u>
Other income (loss):		
Investment income	272,266	255,460
Loss on interest rate swaps, net	(75,033)	(45,436)
Other (loss) income, net	(13,068)	869
Total other income, net	<u>184,165</u>	<u>210,893</u>
Excess of revenues over expenses	<u>284,921</u>	<u>313,008</u>
Other changes in net assets without donor restrictions:		
Changes in pension asset	2,513	13,276
Net assets released from restriction – capital acquisitions	4,327	9,689
Other	220	(7,550)
Increase in net assets without donor restrictions	<u>291,981</u>	<u>328,423</u>
Changes in net assets with donor restrictions:		
Contributions and other	21,425	20,032
Income on investments	2,482	1,116
Net assets released from restriction – capital acquisitions	(4,327)	(9,689)
Net assets released from restrictions for operations and other	(4,655)	(6,225)
Increase in assets held in trust by others	4,446	2,620
Increase in net assets with donor restrictions	<u>19,371</u>	<u>7,854</u>
Increase in net assets	<u>311,352</u>	<u>336,277</u>
Net assets, beginning of year	<u>2,942,810</u>	<u>2,606,533</u>
Net assets, end of year	<u>\$ 3,254,162</u>	<u>2,942,810</u>

See accompanying notes to consolidated financial statements.

MULTICARE HEALTH SYSTEM
Consolidated Statements of Cash Flows
Years ended December 31, 2020 and 2019
(In thousands)

	2020	2019
Cash flows from operating activities:		
Increase in net assets	\$ 311,352	336,277
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	168,188	165,670
Amortization of bond premiums, discounts, and issuance costs	(2,494)	(2,728)
Net realized and unrealized gains on investments	(251,078)	(216,859)
Change in fair value of interest rate swap	67,298	42,620
(Gain) loss on disposal of assets, net	(90)	824
Gain on bond refinancing	—	(869)
Losses on joint ventures, net	4,709	8,002
Restricted contributions for long-term purposes	(12,188)	(2,795)
Changes in operating assets and liabilities:		
Accounts receivable	2,128	(659)
Supplies inventory and other current assets	(21,176)	(12,298)
Right-of-use lease asset	35,391	29,282
Other assets, net	(104,363)	(16,374)
Accounts payable and accrued expenses and accrued interest payable	16,547	(7,144)
Accrued compensation and related liabilities	51,552	26,117
Right-of-use lease liability	(33,111)	(24,756)
Other liabilities, net	57,479	27,675
Net cash provided by operating activities	<u>290,144</u>	<u>351,985</u>
Cash flows from investing activities:		
Purchase of property, plant, and equipment	(169,168)	(195,206)
Proceeds from disposal of property, plant, and equipment	997	1,157
Investments in joint ventures, net	(26,199)	(15,084)
Purchases of investments	(4,397,377)	(2,342,719)
Sales of investments	4,472,955	2,263,097
Change in donor trusts	(9,457)	(5,571)
Net cash used in investing activities	<u>(128,249)</u>	<u>(294,326)</u>
Cash flows from financing activities:		
Repayment of long-term debt	(20,796)	(12,009)
Proceeds from bond issuance	300,000	—
Proceeds from debt issuance	61,794	—
Payment of debt issue expenses	(2,346)	—
Principal payments on finance lease obligations	(1,366)	—
Restricted contributions for long-term purposes	12,188	2,795
Net cash provided by (used in) financing activities	<u>349,474</u>	<u>(9,214)</u>
Net change in cash and cash equivalents	511,369	48,445
Cash and cash equivalents, beginning of year	434,854	386,409
Cash and cash equivalents, end of year	<u>\$ 946,223</u>	<u>434,854</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest, net of amount capitalized	\$ 42,967	47,781
Noncash activities:		
Increase in deferred compensation plans	13,726	16,198
Increase (decrease) in accounts payable for purchases of property, plant, and equipment	349	(3,716)

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

December 31, 2020 and 2019

(Dollars in thousands)

(1) Nature of Organization and Summary of Significant Accounting Policies

(a) Organization Description

MultiCare Health System (MHS), a Washington nonprofit corporation, is an integrated healthcare delivery system providing inpatient, outpatient, and other healthcare services primarily to the residents of Pierce, South King and Spokane Counties and, with respect to pediatric care, much of the southwest Washington area. As of December 31, 2020, MHS is licensed to operate 1,992 inpatient hospital beds, including 120 beds associated with Wellfound Behavioral Health Hospital (Wellfound), a 50% owned joint venture located in Tacoma, Washington, which opened in May 2019. MHS currently operates eight acute care facilities (Tacoma General Hospital, Good Samaritan Hospital, Allenmore Hospital, Mary Bridge Children's Hospital, Auburn Medical Center, Covington Medical Center, Deaconess Hospital and Valley Hospital) and one behavioral health hospital (Navos).

As of December 31, 2020, MHS also operates eight outpatient surgical sites, five free-standing emergency departments, home health, hospice, and a network of urgent care, primary care and multispecialty clinics located throughout the MHS service areas.

The consolidated financial statements include the operations of these facilities and services as well as those of three wholly owned subsidiaries (Greater Lakes Mental Healthcare, Medis, Inc. and MultiCare Rehabilitation Specialists, P.C.), a wholly owned professional services organization supporting cardiovascular services at MHS (CHVI Professional Corp), a wholly owned accountable care organization (MultiCare Connected Care), and two fundraising foundations (Mary Bridge Children's Foundation and MultiCare Foundations, which is doing business as MultiCare Health Foundation, Good Samaritan Foundation, MultiCare South King Health Foundation, MultiCare Behavioral Health Foundation and MultiCare Inland Northwest Foundation).

In December 2020, MHS announced that it reached an agreement with an affiliate of LifePoint Health to acquire a majority ownership interest in Capital Medical Center in Olympia. The acquisition is subject to regulatory approval but is anticipated to close on or about March 31, 2021.

(b) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of MHS after elimination of all significant intercompany accounts and transactions.

(c) Use of Estimates

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

(d) Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid instruments with maturities of three months or less at the date of purchase. Cash equivalents and investments that are held by

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outside investment managers or restricted per contractual or regulatory requirements are classified as investments on the consolidated balance sheets.

(e) Accounts Receivable

Accounts receivable are primarily comprised of amounts due for healthcare services from patients and third-party payors and are recorded net of amounts for contractual adjustments and implicit price concessions.

(f) Supplies Inventory

Supplies inventory consists of pharmaceutical, medical-surgical, and other supplies generally used in the operations of MHS. Supplies inventory is stated at lower of cost or net realizable value using the average cost method, except for pharmacy, which uses the first-in, first-out (FIFO) method. Obsolete and unusable items are expensed at the time such determination is made.

(g) Donor Restricted Assets

The majority of the donor restricted assets are invested in MHS' investments and are stated at fair value or estimated fair value. Donor restricted assets that are held separately from MHS' investments include perpetual trusts and charitable remainder unitrusts, where MHS is the beneficiary but not the trustee, that are invested in mutual funds, fixed income securities, and equity securities. Those with readily determinable fair values are stated at fair value. Those investments for which quoted market prices are not readily determinable are carried at values provided by the respective investment managers or trustees, which management believes approximates fair value.

Charitable gift annuities, which are included in donor restricted assets, totaled \$2,471 and \$2,410 at December 31, 2020 and 2019, respectively. MHS has recorded a corresponding payable of \$1,119 and \$1,222 at December 31, 2020 and 2019, respectively, to pay for estimated future obligations to beneficiaries. The current portion of these obligations is included in accounts payable and accrued expenses and the long-term portions are included in other liabilities, net in the accompanying consolidated balance sheets. According to Washington State law, MHS, as a distinct legal entity holding charitable gift annuities, is required to maintain unrestricted net assets of at least \$500, which MHS has done for each of the periods presented.

(h) Investments

MHS accounts for its investment portfolio as a trading portfolio, therefore, investments in fixed income securities, equity securities, and commingled trusts with a readily determinable fair value are recorded at fair value, which are determined based on quoted market prices or prices with observable inputs obtained from national securities exchanges or similar sources. Other investments, including limited partnerships, commingled real estate trust funds, limited liability partnerships, and hedge funds are carried at net asset value (NAV) provided by the respective investment managers, which management believes approximates fair value. Valuations provided by investment managers consider variables such as valuation and financial performance of underlying investments, quoted market prices for similar securities, recent sale prices of underlying investments, and other pertinent information. Management reviews the valuations provided by investment managers and believes that the carrying values of these financial instruments are reasonable estimates of fair value.

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Realized gains and losses are recorded using the average cost method. Investment income or loss (including realized gains and losses on investments, change in unrealized gains or losses, interest, and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law.

(i) Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost. Depreciation expense is computed using the straight-line method over the following estimated useful lives of the assets:

Buildings	25–50 years
Land improvements	8–20 years
Equipment	3–25 years

Maintenance and repairs are charged to operations as they occur. Expenditures that materially increase values, change capacities, or extend useful lives are capitalized. Gains upon sale or retirement of property, plant, and equipment are included in other operating revenue whereas losses are included in other expenses. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of constructing those assets.

MHS assesses potential impairments to its long-lived assets as well as its intangible assets, as described below, when there is evidence that events or changes in circumstances indicate that an impairment has been incurred. These changes can include a deterioration in operating performance, a reduction in reimbursement rates from government or third-party payors or a change in business strategy. An impairment charge is recognized when the sum of the expected future undiscounted net cash flows is less than the carrying amount of the asset. In 2020 and 2019, there were no impairment charges.

Gifts of long-lived assets such as land, buildings, or equipment are reported as support without donor restrictions, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as support with donor restrictions. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

(j) Leases

Management reviews contracts in order to identify leases and properly classify leases as either operating or financing. MHS is a lessee of various equipment and facilities under noncancelable operating and financing leases. Operating and financing right-of-use (ROU) liabilities are recognized based on the net present value of lease payments over the lease term at the commencement date of the lease, and are reduced by payments made on each lease on the straight-line basis. Since most of the leases do not provide an implicit rate of return, MHS uses its incremental borrowing rate based on information available at the commencement date of the lease in determining the present value of lease

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payments. Generally, MHS cannot determine the interest rate implicit in the lease because it does not have access to the lessor's estimated residual value or the amount of the lessor's deferred initial direct costs. Therefore, MHS generally uses its incremental borrowing rate as the discount rate for the lease. MHS' incremental borrowing rate for a lease is the rate of interest it would have to pay on a collateralized basis to borrow an amount equal to the lease payments using similar terms. Leases with an initial term of 12 months or less are not recorded on the balance sheet; rather, rent expense for these leases is recognized on a straight-line basis over the lease term, or when incurred if a month-to-month lease.

If a lease contains a renewal option at the commencement date and it is considered reasonably certain that the renewal option will be exercised by management to renew the lease, the renewal option payments are included in MHS' net minimum lease payments used to determine the right-of-use lease liabilities and related lease assets. All other renewal options are included in right-of-use lease liabilities and related lease assets when they are reasonably certain to be exercised.

All lease agreements generally require MHS to pay maintenance, repairs, property taxes and insurance costs, which are variable amounts based on actual costs incurred during each applicable period. Such costs are not included in the determination of the ROU lease liability or ROU lease asset. Variable lease cost also includes escalating rent payments that are not fixed at commencement but are based on an index that is determined in future periods over the lease term based on changes in the Consumer Price Index or other measure of cost inflation.

Variable lease payments associated with MHS' leases are recognized when the event, activity, or circumstance in the lease agreement on which those payments are assessed occurs. Variable lease payments are presented in other expenses in the consolidated statement of operations and changes in net assets.

MHS has elected the practical expedient to not separate lease components from nonlease components related to its real estate leases.

(k) Goodwill and Intangible Assets

Goodwill is an asset representing the future economic benefits arising from the difference in the fair value of the business acquired and the fair value of the identifiable and intangible net assets acquired in a business combination. Indefinite-lived intangible assets are assets that are not amortized because there is no foreseeable limit to cash flows generated from them. Goodwill and intangible assets is included in other assets, net in the accompanying consolidated balance sheets.

If it is more likely than not that goodwill is impaired, MHS records the amount that the carrying value exceeds the fair value as an impairment charge. Goodwill is not amortized and along with indefinite-lived intangible assets is evaluated at least annually for impairment. There were no impairment charges recognized during the years ended December 31, 2020 or 2019.

Amortizing intangible assets are comprised of certificates of need, license agreements, trade names and lease arrangements, which all have finite useful lives. Amortization expense is recorded on a

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straight-line basis over the estimated useful life of the assets, which ranges from three to thirty years, associated with the nature of the intangible asset.

(l) Investment in Joint Ventures

MHS maintains ownership in certain joint ventures related to imaging, office buildings, behavioral health and other healthcare focused activities and accounts for these joint ventures under the equity method of accounting. As of December 31, 2020 and 2019, MHS held ownership interests in 21 and 15 joint ventures, respectively. Investment in joint ventures is included in other assets, net in the accompanying consolidated balance sheets. Losses on joint ventures for the years ended December 31, 2020 and 2019 were \$4,709 and \$8,002, respectively, primarily associated with the startup costs at Wellfound and are included in other operating revenue on the consolidated statements of operations and changes in net assets.

(m) Estimated Third-Party Payor Settlements

Medicare cost reports are filed annually by MHS with the Medicare intermediary and are subject to audit and adjustment prior to settlement. Estimates of net settlements due to Medicare were \$3,456 and \$3,562 as of December 31, 2020 and 2019, respectively, and have been recorded within accounts payable and accrued expenses in the accompanying consolidated balance sheets. Third-party settlements are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, based upon the amount of the final settlements. Patient service revenue increased by \$106 and \$2,746 for 2020 and 2019, respectively, to reflect changes in the estimated Medicare settlements for prior years.

(n) Interest Rate Swaps

MHS maintains several interest rate swap agreements as a means of hedging its exposure to variable-based interest rates and fluctuations in cash flows as part of its overall interest rate risk management strategy. All MHS interest rate swaps are recorded at fair value. The accounting for changes in the fair value of these swaps depends on whether those had been designated as cash flow hedges. As of December 31, 2020 and 2019, none of MHS' interest rate swaps were designated as cash flow hedges and therefore, the changes in fair value are recognized and included in other income (loss) on the consolidated statements of operations and changes in net assets. These swaps have notional amounts totaling approximately \$709,000 and expire starting in August 2027 through August 2049. The majority of the swaps have the economic effect of fixing the LIBOR-based variable interest rate on an equivalent amount of MHS' outstanding floating rate principal debt.

Under master netting provisions of the International Swap Dealers Association (ISDA) agreement with each of the counterparties, MHS is permitted to settle with the counterparties on a net basis. Due to the right of offset under these master netting provisions, MHS offsets the fair value of certain interest rate swap assets with swap liabilities on the consolidated balance sheets.

(o) Net Assets with Donor Restrictions

Gifts are reported as support with donor restrictions if they are received with donor stipulations that restrict the use of the donated assets to a specific time or purpose or have been restricted by donors and are maintained by MHS in perpetuity. When restricted funds to be used for operations are

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expended for their restricted purposes or by the occurrence of the passage of time, these amounts are released from restrictions for operations and are classified as revenues, gains, and other support without donor restrictions. When restricted funds are expended for the acquisition of property, plant, and equipment, these amounts are recognized in net assets without donor restrictions as net assets released from restriction – capital acquisitions.

MHS applies the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurement*, related to using the present value technique to measure fair value of pledges receivable. In accordance with ASC Topic 820, MHS has applied the expected present value technique to pledges received after January 1, 2009 that adjusts for a risk premium to take into account the risks inherent in those expected cash flows. Pledges of financial support are recorded as pledges receivable when unconditional pledges are made and are stated at net realizable value. Pledges are reported net of an allowance for uncollectible pledges and pledges to be collected in future years are reflected at a discounted value using a weighted average discount rate. As of December 31, 2020, and 2019, MHS has recorded \$14,160 and \$8,024, respectively, of net pledge receivables, which are included in donor-restricted assets in the accompanying consolidated balance sheets. As of December 31, 2020, \$5,436 of pledges are due in one year or less and \$8,724 in two to seven years.

(p) Patient Service Revenue

Patient service revenue is reported at the amount that reflects the consideration to which MHS expects to receive in exchange for providing patient services. These amounts are due from patients, third-party payors, and others and include the variable consideration for retroactive adjustments to revenue due to final settlement of audits, reviews, and investigations. MHS bills the patient and third-party payors several days after the services are performed or when the patient is discharged from the facility, whichever is later.

(q) Hospital Safety Net Assessment

The State of Washington (the State) has a safety net assessment program involving Washington State hospitals to increase funding from other sources and obtain additional federal funds to support increased payments to providers for Medicaid services. In connection with this program, MHS recorded increases in patient service revenue of \$83,884 and \$84,831 for 2020 and 2019, respectively, and incurred assessments of \$61,112 and \$59,460 for 2020 and 2019, respectively, which were recorded in other operating expenses in the accompanying consolidated statements of operations and changes in net assets. MHS has outstanding receivables of \$14,649 and \$4,679 associated with this program as of December 31, 2020 and 2019, respectively, which are included with accounts receivable on the consolidated balance sheets.

(r) Uncompensated and Undercompensated Care

MHS provides a variety of uncompensated and undercompensated healthcare services to the communities it serves within the purview of its mission. Because MHS does not pursue collection of amounts determined to qualify as uncompensated care, MHS has determined that it has provided implicit price concessions to uninsured patients and patients with other uninsured balances. The implicit price concessions included in estimating the transaction price represent the difference between

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amounts billed to patients and the amount MHS expects to receive based on its historical collections from these patients. Patients who meet the criteria of MHS' uncompensated care policy are eligible to receive these services without charge or at an amount less than MHS' established rates. Such amounts determined to qualify as charity care are not reported as revenue. The State provides guidelines for charity care provided by hospitals in the state. Hospitals are recommended to provide full charity care to patients who meet 100% of the federal poverty guidelines and a lesser amount to patients who meet up to 200% of the federal poverty guidelines. MHS provides full charity care to patients who meet 300% of the federal poverty guidelines and also provides uncompensated care on a sliding scale for patients whose income is between 301% and 500% of the federal poverty guidelines for true self-pay patients and patients with deductibles and coinsurance amounts. The estimated cost of charity care provided was approximately \$51,000 and \$58,000 in 2020 and 2019, respectively. The estimated cost of uncompensated and undercompensated services provided to patients covered under Medicaid in excess of payments received was approximately \$218,443 and \$203,000 in 2020 and 2019, respectively. These cost estimates are calculated based on the overall ratio of costs to charges for MHS.

(s) Other Operating Revenue

Other operating revenue includes revenue from cafeteria sales, retail pharmacy, laboratory revenue from community providers, medical office rental income, contributions without donor restrictions, grant revenue, contracted behavioral healthcare revenue and other miscellaneous revenue.

(t) Excess of Revenues over Expenses

The consolidated statements of operations and changes in net assets include excess of revenues over expenses. Changes in net assets without donor restrictions, which are excluded from the excess of revenues over expenses, primarily include changes in accrued pension asset, net assets released from restrictions for capital expenditures, and capital assets received.

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(u) Federal Income Taxes

ASC Subtopic 740-10, *Income Taxes*, clarifies the accounting for uncertainty in income taxes recognized in MHS' consolidated financial statements. This topic also prescribes a recognition threshold and measurement standard for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. Only tax positions that meet the "more-likely-than-not" recognition threshold at the effective date may be recognized or continue to be recognized upon adoption. In addition, this topic provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Other than Medis, Inc., which is a taxable corporation, all of the other entities have obtained determination letters from the Internal Revenue Service that they are exempt from federal income taxes under Section 501(a) of the Internal Revenue Code as an organization described in 501(c)(3) of the Internal Revenue Code, except for tax on unrelated business income.

(v) Self-Insurance Reserves

MHS is self-insured with respect to professional and general liability, workers compensation and medical and other health benefits with excess insurance coverage over self-insured retention limits. MHS records insurance liabilities for these specific items by using third party actuarial calculations and certain assumptions and inputs such as MHS historical claims experience and the estimated amount of future claims that will be incurred.

(w) New and Pending Accounting Standards

In June 2016, FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The amendments in this update require that financial assets are measured at amortized cost basis and presented at the net amount expected to be collected. This eliminates the probable initial recognition threshold in current GAAP and, instead, reflects an entity's current estimate of all expected credit losses and broadens the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The provisions of this ASU are effective for MHS for the year beginning on January 1, 2021. MHS does not expect the adoption of this ASU to have a material effect on its consolidated financial statements.

In August 2018, FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. The amendments in this update modify the disclosure requirements on fair value measurements in Topic 820, *Fair Value Measurement*, based on the concepts in the Concepts Statement, including the consideration of costs and benefits. The changes in this ASU remove certain disclosure requirements, modify certain disclosure requirements, and add two new disclosure requirements, as applicable. Most of these changes relate to Level 3 fair value measurements. The provisions of this ASU are effective for MHS for the year beginning on January 1, 2020. MHS has adopted this ASU, and it did not have a material effect on its consolidated financial statements.

In August 2018, FASB issued ASU 2018-15, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. The amendments in this update align the requirements for

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capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The guidance in Subtopic 350-40 is used to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense and is also used to determine the amortization period of the capitalized costs. The provisions of this ASU are effective for MHS for the year beginning on January 1, 2021. MHS does not expect the adoption of this ASU to have a material effect on its consolidated financial statements.

In April 2019, FASB issued ASU 2019-04, *Codification Improvements to Topic 326, Financial Instruments – Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*. The amendments in this update are divided into four separate topics that discuss the details of the improvement areas and the amendments made to the Codification for these improvement areas. Topics 1, 2 and 5 in this ASU relate specifically to ASU 2016-13, which is effective for MHS for the year beginning January 1, 2023. Topics 3 and 4 in this ASU have been evaluated and are not applicable to MHS. MHS does not expect the adoption of this ASU to have a material effect on its consolidated financial statements.

In March 2020, FASB issued ASU 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the effects of Reference Rate Reform on Financial Reporting*. The amendments in this update provide practical expedients to contract modifications when it is being modified due to the replacement of a reference rate within the contract. The provisions of this ASU are effective immediately and will be available through December 31, 2022. Modifications completed after December 31, 2022 must use current guidance instead of the provisions in this ASU. MHS anticipates making contract modifications in 2021 and 2022 but does not expect the adoption of this ASU to have a material effect on its consolidated financial statements.

(2) Coronavirus (COVID-19) Impact

MHS, along with most other healthcare providers across the United States, has experienced operational challenges related to the outbreak of the COVID-19 pandemic. On February 29, 2020, the Governor of the State of Washington (the Governor) declared a state of emergency after the State of Washington reported its first known death from COVID-19. COVID-19 was declared a pandemic by the World Health Organization on March 11, 2020, and on March 13, 2020, the President of the United States declared a national emergency as a result of the pandemic. On March 23, 2020, the Governor implemented a stay at home order called “Stay Home, Stay Healthy.” On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law, which was aimed to direct economic assistance for American workers, families, and small businesses, and preserve jobs for American industries. The COVID-19 pandemic impacted all hospitals and physician offices throughout the health system.

On March 16, 2020, MHS canceled or postponed all nonemergent procedures as a precautionary measure to allow for the preservation of Personal Protective Equipment (PPE). Further, MHS set up temporary facilities and secured additional patient beds to accommodate the surge impacts that were projected in the early stages of the pandemic. On May 18, 2020, the Governor modified the restrictions on elective procedures for all medical and dental facilities. Based on this modification, MHS resumed all procedures within its facilities, while taking all appropriate social distancing precautions and usage of PPE for staff,

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patients and visitors in accordance with national, state and local guidance. MHS ensured that sufficient PPE was maintained for surge capacity of at least 20% within the hospital facilities.

The CARES Act requires the amount of funding received to be validated, which requires management to quantify lost revenues and increased expenses associated with the pandemic for Provider Relief Funds (PRF). MHS has recognized revenue associated with the PRF funding according to the terms and conditions of the CARES Act, and as contribution revenue under FASB ASC 958-605. Contribution revenue attributable to PRF funding totaled \$118,965 and is included within other operating revenue on the consolidated statements of operations and changes in net assets. Refunding of amounts received may be required by the CARES Act if a receiving entity is unable to quantify the financial losses intended to be covered by funding. MHS has determined that it is able to justify retaining all funding received in 2020 by the PRF and has not recorded any liabilities as of December 31, 2020 for potential repayment of PRF payments received.

In March 2020, MHS chose to support employees by protecting pay and benefits for those that were unable to work due to the cancellations/postponements of procedures. MHS protected the pay and benefits for those individuals through April 25, 2020. Approximately 50% of this cost has been recovered through the employee retention credits offered to employers as part of the CARES Act, which totaled \$2,409. The CARES Act also allowed MHS to defer payment of the employer portion of the FICA taxes due to the federal government through December 31, 2020. Payment of these deferred taxes will occur with 50% paid by the end of 2021 and the other 50% by the end of 2022. The total amount of FICA taxes deferred in 2020 was \$71,866, with the current portion of \$35,933 recorded within accrued compensation and related liabilities, and the long-term portion of \$35,933 recorded within other liabilities, net on the consolidated balance sheets. MHS considered whether to utilize the Medicare Advanced Payment Program (MAPP) when it was available to obtain additional cash flow but chose not to engage in this program.

MHS has filed applications and obtained reimbursement of additional expenses from the Federal Emergency Management Agency (FEMA) based on criteria due to the national emergency declaration made due to COVID-19. MHS submitted an expedited funding application with FEMA that covers the period from the start of the national disaster declaration to June 30, 2020. The expedited application allowed MHS to recover up to 50% of the total funding applied for on the application. However, based on FEMA guidelines for this expedited application, FEMA only reimbursed 75% of the recoverable amount. MHS continues to complete the final reconciliation of the expedited funding application to receive the remainder of the funding and will apply for additional funding pertaining to later periods until the national disaster declaration is no longer in effect.

The following table shows the funding that has been received to prepare and respond to COVID-19 and recognized as other operating revenue through December 31, 2020:

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Sources of external relief funding	Amount
CARES Act PRF funding	\$ 118,965
FEMA	4,214
Insurance Funds for Business Interruption	1,004
State of Washington Coronavirus Relief Fund	<u>2,922</u>
Total proceeds received and recognized in 2020	<u>\$ 127,105</u>

In January 2021, MHS received an additional \$160,032 in CARES Act PRF funding. MHS continues to reconcile and analyze its lost revenue and increased expenses based on known reporting guidance.

The impact of COVID-19 has increased the uncertainty associated with management's assumptions and estimates made on these financial statements. The actual impact of COVID-19 on MHS's consolidated financial statements may differ significantly from the assumptions and estimates made for the year ended December 31, 2020.

(3) Revenue from Contracts with Customers

Revenue is recognized as performance obligations are satisfied. Performance obligations are determined based on the nature of the services provided by MHS and are recognized either over time or at a point in time. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred through a point in time in relation to total actual charges incurred. MHS believes that this method provides a useful depiction of the provision of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the hospitals or clinics receiving inpatient or outpatient services. MHS measures an inpatient performance obligation from time of admission to time of discharge and an outpatient performance obligation from the start of the outpatient service to the completion of the outpatient service. Revenue for performance obligations satisfied at a point in time are recognized when goods or services are provided to patients and customers.

MHS has elected to apply the optional exemption in ASC 606-10-50-14a as all of MHS' performance obligations related to contracts with a duration of less than one year. Under this exemption, MHS was not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. Any unsatisfied or partially unsatisfied performance obligations are completed within days or weeks of the end of the year.

MHS determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with MHS policy, and implicit price concessions provided to uninsured patients. MHS determines its estimates of contractual adjustments and discounts based on contractual agreements, discount policies and historical experience. MHS determines its estimate of implicit price concessions based on its historical collection experience with each class of patients.

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Contractual agreements with third-party payors provide for payments at amounts less than MHS' established charges. A summary of the payment arrangements with major third-party payors is as follows:

- Medicare – Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge, which provides for reimbursement based on Medicare Severity Diagnosis-Related Groups (MS-DRGs). These rates vary according to a patient classification system that is based on clinical diagnosis, acuity, and expected use of hospital resources. The majority of Medicare outpatient services is reimbursed under a prospective payment methodology, the Ambulatory Payment Classification System (APCs), or fee schedules.
- Medicaid – Inpatient services rendered to Medicaid program beneficiaries are reimbursed under a prospective payment system similar to Medicare; however, Medicaid utilizes All Payor Refined Diagnosis-Related Groups (APR-DRGs) as opposed to Medicare's MS-DRGs. The majority of Medicaid outpatient services is reimbursed under a prospective payment methodology, the Enhanced Ambulatory Patient Groups (EAPG), or fee schedules.
- Other – MHS has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to MHS under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates and fee schedules.

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various healthcare organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements with the government. Compliance with such laws and regulations may also be subject to future government exclusion from the related programs. There can be no assurance that regulatory or governmental authorities will not challenge MHS' compliance with these laws and regulations, and it is not possible to determine the impact, if any, that such claims or penalties would have upon MHS. In addition, the contracts with commercial payors also provide for retroactive audit and review of claims that can reduce the amount of revenue ultimately received.

Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are considered variable consideration and are included in the determination of the current estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor, and historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known, or as years are settled and no longer subject to such audits, reviews and investigations. Adjustments arising from a change in the transaction price were not significant in 2020 or 2019.

Generally, patients who are covered by third-party payors are responsible for related deductibles and co-insurance, which vary in amount. MHS also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. MHS estimates the transaction price for patients with deductibles and co-insurance from those who are uninsured based on

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historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charges by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Additional revenue due to changes in estimates of implicit price concessions, discounts, and contractual adjustments for prior years were not significant for 2020 or 2019. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay and deemed uncollectable are recorded as bad debt expense.

Consistent with MHS' mission, care is provided to patients regardless of their ability to pay. MHS has determined that it has provided implicit price concessions to uninsured patients and patients with other uninsured balances. The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amount MHS expects to receive based on its collection experience with those patients. Patients who meet the criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as uncompensated care are not reported as revenue.

MHS has determined that the best depiction of its revenue is by its mix of payors as this shows the amount of revenue recognized from each portfolio. Patient service revenue disaggregated by payor for the years ended December 31, 2020 and 2019 are as follows:

	<u>2020</u>	<u>2019</u>
Payors:		
Medicare	\$ 847,084	833,070
Medicaid	497,785	479,340
Premera	445,238	458,091
Regence	306,588	326,247
Aetna	190,029	195,283
Kaiser Permanente	142,854	128,354
First Choice	112,142	116,867
Self-pay	16,246	15,963
Other	548,002	554,310
	<u>\$ 3,105,968</u>	<u>3,107,525</u>

MHS has elected to apply the practical expedient under ASC 340-40-25-4 and therefore, all incremental customer contract acquisition costs are expensed as incurred, as the amortization period of the asset that MHS would have otherwise recognized is one year or less in duration.

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(4) Concentration of Credit Risk

MHS grants credit without collateral to its patients, most of whom are residents of the communities it serves and are insured under third-party payor agreements. The mix of gross receivables from patients and third-party payors at December 31, 2020 and 2019 was as follows:

	<u>2020</u>	<u>2019</u>
Medicare	32 %	30 %
Medicaid	24	23
Premiera	10	9
Self-pay	9	8
Regence	5	6
First Choice	1	2
Health Care Exchange	1	1
Other commercial insurance	18	21
	<u>100 %</u>	<u>100 %</u>

(5) Fair Value Measurements**(a) Fair Value Hierarchy**

In accordance with ASC Topic 820, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for similar assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical or similar assets or liabilities that MHS could access at the measurement date. Level 1 securities generally include investments in equity securities, mutual funds and certain fixed income securities.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are based upon observable market inputs for the asset or liability, either directly or indirectly. Level 2 securities generally include investments in fixed income securities (composed primarily of government, agency and corporate bonds), and interest rate swaps.
- Level 3 inputs are unobservable market inputs for the asset or liability. Level 3 securities include donor trusts where MHS is not the trustee.

The level in the fair value hierarchy within which a fair value measurement, in its entirety, falls is based on the lowest level input that is significant to the fair value measurement.

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ASC Subtopic 820-10 allows for the use of a practical expedient for the estimation of the fair value of investments in investment companies for which the investment does not have a readily determinable fair value. The practical expedient used by MHS is the Net Asset Value (NAV) per share, or its equivalent. In some instances, the NAV may not equal the fair value that would be calculated under fair value accounting standards. Valuations provided by investment managers consider variables such as the financial performance of underlying investments, recent sales prices of underlying investments and other pertinent information. In addition, actual market exchanges at year-end provide additional observable market inputs of the redemption price. MHS reviews valuations and assumptions provided by investment managers for reasonableness and believes that the carrying amounts of these financial instruments approximate the estimated of fair value of the instrument. Where investments are not presented at fair value, NAV is used as a practical expedient to approximate fair value.

The following tables present the placement in the fair value hierarchy of investment assets and liabilities that are measured at fair value on a recurring basis and investments valued at NAV at December 31, 2020 and 2019:

Fair value measurements at reporting date using				
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	December 31, 2020			
Assets:				
Trading securities:				
Mutual funds	\$ 592,499	592,499	—	—
Equity securities	243,866	243,866	—	—
Fixed income bond funds	364,126	364,126	—	—
Fixed income governmental obligations	67,186	21,137	46,049	—
Fixed income other	95,268	—	95,268	—
Commingled trust fund – international equity	169,362	—	169,362	—
Donor trusts	30,807	—	—	30,807
Total assets at fair value	1,563,114	\$ 1,221,628	310,679	30,807
Investment assets valued at NAV	456,274			
Total assets at fair value or NAV	\$ 2,019,388			
Liabilities:				
Interest rate swaps	\$ 154,347	—	154,347	—

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Fair value measurements at reporting date using				
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	December 31, 2019			
Assets:				
Trading securities:				
Mutual funds	\$ 649,528	649,528	—	—
Equity securities	122,103	122,103	—	—
Fixed income bond funds	343,709	343,709	—	—
Fixed income governmental obligations	65,137	26,912	38,225	—
Fixed income other	84,106	—	84,106	—
Commingled trust fund – international equity	144,659	—	144,659	—
Interest rate swaps	1,263	—	1,263	—
Donor trusts	25,904	—	—	25,904
Total assets at fair value	1,436,409	1,142,252	268,253	25,904
Investment assets valued at NAV	403,840			
Total assets at fair value or NAV	\$ 1,840,249			
Liabilities:				
Interest rate swaps	\$ 88,311	—	88,311	—

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The following table presents information for investments where the NAV was used as a practical expedient to measure fair value at December 31, 2020 and 2019:

	NAV December 31, 2020	NAV December 31, 2019	Unfunded commitments	Redemption frequency	Redemption notice period
Hedge funds	\$ 239,797	213,291	60	Quarterly	60 or 95 business days prior to valuation date
Common trust funds	205,844	175,882	N/A	Daily	1 business day prior to valuation date
Limited partnerships	10,633	14,667	1,800	N/A	N/A
Total investments valued at NAV	\$ <u>456,274</u>	<u>403,840</u>	<u>1,860</u>		

Hedge funds include investments in hedge fund-of-funds products with certain investment managers. The fair values of the investments in this category have been estimated using the NAV per share of the investment.

Common trust funds include investments in a collective or common trust account that invests funds in an underlying fund or set of funds. The trust account seeks an investment return that approximates the performance of an index as defined by each common trust fund. The fair value of the investments in this category are estimated using the NAV per share of the fund that is derived from the underlying investments in the trust fund.

Limited partnerships include investments in private equity and venture capital funds in both developed and emerging markets with approximately 35% invested in private equity in developed markets, 20% in venture capital in developed markets, and 45% in private equity and venture capital in emerging markets. The fair values of the investments in this category have been estimated using the NAV of MHS' ownership interest in partners' capital. These assets can never be redeemed with the partnerships. Instead, the nature of the investment in this category is that distributions are received through the liquidation of the underlying assets of the partnership.

(b) Interest Rate Swaps

The interest rate swaps are recorded at estimated fair value by using certain observable market inputs that participants would use from closing prices for similar assets. In addition, other valuation techniques and market inputs are used that help determine the fair values of these swaps, which include certain valuation models, current interest rates, forward yield curves, implied volatility and credit default swap pricing.

At December 31, 2020 and 2019, these interest rate swaps did not qualify as cash flow hedges and therefore, any changes in the fair value of these swaps are recorded as a gain or loss in the consolidated statements of operations and changes in net assets.

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The fair value of the interest rate swaps liability is included in interest rate swap liabilities on the consolidated balance sheets, and the fair value of the interest rate swap asset is included in other assets, net on the consolidated balance sheets. The fair value losses of these interest rate swaps for the years ended December 31, 2020 and 2019 were \$67,298 and \$42,620, respectively, and are included in loss on interest rate swaps in other (loss) income, net in the consolidated statements of operations and changes in net assets. Also included in the loss on interest rate swaps is the loss on net cash settlement amounts associated with the swaps of \$7,735 and \$2,816, respectively, for the years ended December 31, 2020 and 2019, respectively.

The following table represents both the fair value and settlement value for the interest rate swap assets and liabilities as of December 31, 2020 and 2019 as follows:

		Asset derivatives					
		2020			2019		
		Balance Sheet Location	Fair value	Settlement value	Balance Sheet Location	Fair value	Settlement value
Derivative instruments:							
Interest rate swaps		Other assets	—	—	Other assets	1,263	1,438
		Liability derivatives					
		2020			2019		
		Balance Sheet Location	Fair value	Settlement value	Balance Sheet Location	Fair value	Settlement value
Derivative instruments:							
Interest rate swaps		Interest rates swap liabilities	154,347	159,666	Interest rates swap liabilities	88,311	94,899

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(6) Donor Restricted Assets and Investments

A summary of donor restricted assets and investments at 2020 and 2019 is as follows:

December 31, 2020			
	Donor restricted assets	Investments	Total
Mutual funds	\$ 5,400	587,099	592,499
Equity securities	2,222	241,644	243,866
Fixed income securities	4,799	521,781	526,580
Commingled trust fund – international equity	1,543	167,819	169,362
Hedge funds	2,185	237,612	239,797
Common trust funds	1,876	203,968	205,844
Limited partnerships	98	10,535	10,633
Donor trusts	30,807	—	30,807
Pledge receivables, net and other	39,970	—	39,970
Total	<u>\$ 88,900</u>	<u>1,970,458</u>	<u>2,059,358</u>
December 31, 2019			
	Donor restricted assets	Investments	Total
Mutual funds	\$ 5,588	643,940	649,528
Equity securities	1,050	121,053	122,103
Fixed income securities	4,241	488,711	492,952
Commingled trust fund – international equity	1,245	143,414	144,659
Hedge funds	1,836	211,455	213,291
Common trust funds	1,513	174,369	175,882
Limited partnerships	126	14,541	14,667
Donor trusts	25,904	—	25,904
Pledge receivables, net and other	29,280	—	29,280
Total	<u>\$ 70,783</u>	<u>1,797,483</u>	<u>1,868,266</u>

Fixed income securities include mutual funds, corporate bonds, mortgage-backed securities, asset-backed securities, U.S. government obligations, and state government obligations.

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(7) Liquidity and Availability of Financial Assets

MHS actively monitors the availability of resources required to meet its operating obligations and other contractual commitments, while also striving to maximize investment returns of its available funds. To help meet its general obligations, MHS can also access the credit markets as a means of producing liquidity, if needed. MHS draws income, appreciation and distributions from its endowment fund up to 5% of the endowment average account value annually, as applicable donor restrictions are met, as another way of providing liquidity. For purposes of analyzing resources available to meet general expenditures over a twelve-month period, MHS considers all expenditures related to its ongoing activities to provide integrated healthcare delivery as well as the conduct of services undertaken to support these activities to be general expenditures.

At December 31, 2020 and 2019, MHS' financial resources are as follows:

	<u>2020</u>	<u>2019</u>
Cash and cash equivalents	\$ 946,223	434,854
Accounts receivable	374,372	376,500
Other current assets, net	85,144	71,397
Donor restricted assets	88,900	70,783
Investments	<u>1,970,458</u>	<u>1,797,483</u>
	3,465,097	2,751,017
Less prepaid assets included in other current assets, net	(37,612)	(35,222)
Less donor restricted assets	(88,900)	(70,783)
Less investments with redemption limitations of greater than one year	<u>(10,633)</u>	<u>(14,667)</u>
Total financial assets available for general expenditures	\$ <u><u>3,327,952</u></u>	<u><u>2,630,345</u></u>

In addition to financial assets available to meet general expenditures over the next twelve months, MHS operates mostly using revenues, gains and other support without donor restrictions and anticipates collecting sufficient revenues to cover general expenditures.

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(8) Property, Plant, and Equipment, Net

A summary of property, plant, and equipment at December 31, 2020 and 2019 is as follows:

	<u>2020</u>	<u>2019</u>
Land and land improvements	\$ 131,993	131,635
Buildings	2,202,449	2,094,270
Equipment	<u>1,115,316</u>	<u>1,020,402</u>
	3,449,758	3,246,307
Less accumulated depreciation	<u>(1,751,452)</u>	<u>(1,585,761)</u>
	1,698,306	1,660,546
Construction in progress	<u>65,360</u>	<u>102,799</u>
Property, plant, and equipment, net	<u>\$ 1,763,666</u>	<u>1,763,345</u>

Depreciation expense charged to operations for the years ended December 31, 2020 and 2019 amounted to \$166,517 and \$163,826, respectively. Depreciation and amortization expense for the years ended December 31, 2020 and 2019 was \$168,188 and \$165,670, respectively.

(9) Other Assets, Net

Other assets are as follows at December 31, 2020 and 2019:

	<u>2020</u>	<u>2019</u>
Investment in joint ventures	\$ 64,534	45,575
Deferred compensation plan assets held in trust (note 11)	85,320	71,594
Accrued pension asset (note 11)	45,590	45,420
Self-insured retention receivables, net of current portion (notes 12 and 13)	23,435	22,383
Interest rate swaps (note 5(b))	—	1,263
Goodwill and other intangibles	167,083	168,284
Net investment in lease (note 16(b))	23,200	25,798
Loans receivable	75,606	1,160
Other	<u>17,691</u>	<u>2,527</u>
Other assets, net	<u>\$ 502,459</u>	<u>384,004</u>

Deferred compensation plan assets held in trust are participant-managed investments consisting of equity and fixed income mutual funds with prices quoted in active markets.

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In December 2020, MHS funded \$75,000 into an escrow account as part of a loan based on a credit agreement executed with Astria Health. The loan bears a fixed interest rate of 9.5% with payments due at June 30 and December 31 of each year. In January 2021, the final promissory note documents were executed and funds were disbursed at that time. The loan matures in January 2024.

(10) Other Liabilities, Net

Other liabilities are as follows at December 31, 2020 and 2019:

	<u>2020</u>	<u>2019</u>
Professional liability, net of current portion (note 12)	\$ 73,822	67,204
Deferred compensation liability (note 11)	85,320	71,594
Workers' compensation liability, net of current portion (note 13)	14,166	12,943
Deferred FICA liability (note 2)	35,933	—
Other	<u>3,805</u>	<u>3,579</u>
Other liabilities, net	<u>\$ 213,046</u>	<u>155,320</u>

(11) Retirement Plans

(a) Defined Benefit Pension Plan

MHS operates one qualified defined benefit pension plan (the Plan) covering eligible employees. The Plan was closed to new employees effective after July 31, 2002. The benefits are based on years of service and the employee's highest five consecutive years of compensation. MHS contributions to the Plan vary from year to year, but the minimum contribution required by law has been provided in each year. Effective December 31, 2016, participants no longer accrue pension benefits under the Plan.

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The following tables set forth the changes in projected benefit obligations, changes in fair value of plan assets, and components of net periodic benefit costs for the Plan, which has measurement dates of December 31, 2020 and 2019:

	<u>2020</u>	<u>2019</u>
Change in projected benefit obligation:		
Projected benefit obligations at beginning of year	\$ 639,993	576,605
Service cost	670	1,230
Interest cost	22,963	25,779
Actuarial loss	85,184	71,704
Expected administrative expenses	(670)	—
Benefits paid	<u>(32,854)</u>	<u>(35,325)</u>
Projected benefit obligations at end of year	<u>\$ 715,286</u>	<u>639,993</u>
Change in fair value of plan assets:		
Fair value of plan assets at beginning of year	\$ 685,413	604,690
Actual gain on plan assets	108,966	116,048
Actual administrative expenses	(649)	—
Benefits paid	<u>(32,854)</u>	<u>(35,325)</u>
Fair value of plan assets at end of year	<u>\$ 760,876</u>	<u>685,413</u>
Funded status recognized in consolidated balance sheets consist of:		
Asset for pension benefits	\$ 45,590	45,420
Amount recognized in net assets without donor restrictions:		
Net loss	115,669	118,182
	<u>2020</u>	<u>2019</u>
Weighted average assumptions used to determine benefit obligations as of December 31:		
Discount rate	2.70 %	3.70 %
Expected return on plan assets	4.50	5.00

The expected return on plan assets assumption is based upon an analysis of historical long-term returns for various investment categories as measured by appropriate indices. These indices are weighted based upon the extent to which plan assets are invested in the particular categories in arriving at MHS' determination of a composite expected return. An actuary reviews the assumptions annually for reasonableness.

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The components of net periodic benefit cost are as follows during the years ended December 31, 2020 and 2019:

	<u>2020</u>	<u>2019</u>
Components of net periodic benefit cost:		
Service cost	\$ 670	1,230
Interest cost	22,963	25,779
Expected return on plan assets	(31,730)	(36,593)
Amortization of net actuarial loss	10,441	5,524
	<u>\$ 2,344</u>	<u>(4,060)</u>

The accumulated benefit obligation for the Plan was \$715,286 and \$639,993 at December 31, 2020 and 2019, respectively.

(i) *Cash Flows – Contributions*

MHS expects to make contributions to the Plan totaling approximately \$650 in 2021.

(ii) *Estimated Future Benefit Payments*

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

	<u>Pension benefits</u>
2021	\$ 38,071
2022	40,010
2023	40,044
2024	39,850
2025	40,770
2026–2030	195,246

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(iii) *Plan Assets*

The following tables set forth by level, within the fair value hierarchy, the Plans' investments at fair value:

Fair value measurements at reporting date using				
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	December 31, 2020			
Assets:				
Cash and cash equivalents	\$ 12,053	12,053	—	—
Trading securities:				
Mutual funds	106,439	106,439	—	—
Fixed income bond funds	105,998	105,998	—	—
Fixed income governmental obligations	312,189	270,336	41,853	—
Fixed income other	211,950	—	211,950	—
Commingled trust fund – international equity	22,485	—	22,485	—
	771,114	\$ 494,826	276,288	—
Broker receivables	40,662			
Broker payables	(164,621)			
Total assets at fair value	647,155			
Investments valued at NAV	113,721			
Total assets at fair value or NAV	\$ 760,876			

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Fair value measurements at reporting date using				
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	December 31, 2019			
Assets:				
Cash and cash equivalents	\$ 15,320	15,320	—	—
Trading securities:				
Mutual funds	89,996	89,996	—	—
Equity securities	267	267	—	—
Fixed income bond funds	115,559	115,559	—	—
Fixed income governmental obligations	267,627	211,270	56,357	—
Fixed income other	184,525	—	184,525	—
Commingled trust fund – international equity	22,286	—	22,286	—
	695,580	\$ 432,412	263,168	—
Broker receivables	56,641			
Broker payables	(171,268)			
Total assets at fair value	580,953			
Investments valued at NAV	104,460			
Total assets at fair value or NAV	\$ 685,413			

There were no significant transfers into or out of Level 1 or Level 2 financial instruments during the years ended December 31, 2020 and 2019.

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The following table presents information for investments where the NAV was used as a practical expedient to measure fair value at December 31, 2020 and 2019:

	<u>Fair value at December 31, 2020</u>	<u>Fair value at December 31, 2019</u>	<u>Unfunded commitments</u>	<u>Redemption frequency (if currently eligible)</u>	<u>Redemption notice period</u>
Commingled trust funds:					
Real estate	\$ 22,426	22,333	N/A	Quarterly	45 days
Absolute return funds	85,603	74,741	N/A	Monthly	5 business days prior to valuation date
Limited partnerships	<u>5,692</u>	<u>7,386</u>	<u>850</u>	N/A	N/A
Total investments valued at NAV	<u>\$ 113,721</u>	<u>104,460</u>	<u>850</u>		

Real estate is a real estate commingled trust that invests in U.S. commercial real estate. The fund owns real estate assets in the U.S. office, industrial, residential, and retail sectors.

Absolute return fund investments consist primarily of listed equity, equity-related and debt securities, including exchange-traded funds, other securities and other pooled investment vehicles. These investments use derivatives or other instruments for both investment and hedging purposes and may take long and/or short positions, and the derivative investments may include but are not restricted to futures, options, swaps, and forward currency contracts.

Limited partnerships include investments in private equity and venture capital in both developed and emerging markets with approximately 35% invested in private equity in developed markets, 20% in venture capital in developed markets, and 45% in private equity and venture capital in emerging markets. The fair values of the investments in this category have been estimated using the NAV of MHS' ownership interest in partners' capital. These assets can never be redeemed with the partnerships. Instead, the nature of the investment in this category is that distributions are received through the liquidation of the underlying assets of the partnership.

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The defined benefit plan weighted average asset allocations at December 31, 2020 and 2019 by asset category are as follows:

	<u>2020</u>	<u>2019</u>
Asset category:		
Domestic equities	10 %	7 %
International equities	7	7
Emerging markets	1	1
Fixed income securities	78	79
Alternative investments	1	1
Real estate	3	3
Global asset allocation	—	2
	<u>100 %</u>	<u>100 %</u>

(iv) *Investment Objectives*

The target asset allocations for each asset class are set based on the achieved funding levels for the Plan and are summarized below:

	<u>2020</u>	<u>2019</u>
Asset category:		
Domestic equities	9 %	8 %
International equities	8	6
Emerging markets	—	1
Fixed income securities	80	80
Real estate	3	3
Global asset allocation	—	2
	<u>100 %</u>	<u>100 %</u>

(v) *Investment Categories*

Equities

The strategic role of domestic equities is to provide higher expected market returns (along with international equities) of the major asset classes; maintain a diversified exposure within the U.S. stock market using multimanager portfolio strategies; and achieve returns in excess of passive indices using active investment managers and strategies.

The strategic role of international equities is to provide higher expected market return premiums (along with domestic equities) of the major asset classes and diversify the Plans' overall equity exposure by investing in non-U.S. stocks that are less than fully correlated to domestic equities with similar return expectations; to maintain a diversified exposure within the international stock

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market through the use of multimanager portfolio strategies; and achieve returns in excess of passive indices through the use of active investment managers and strategies.

The strategic role of emerging markets is to diversify the portfolio relative to domestic equities and fixed income investments and to specifically include equity investment in selected global markets and may also include currency hedging for defensive purposes.

Fixed Income

The strategic role of fixed income securities is to diversify the Plan's equity exposure by investing in fixed income securities that exhibit a low correlation to equities and lower volatility; maintain a diversified exposure within the U.S. fixed income market using multimanager portfolio strategies; and achieve returns in excess of passive indices through the use of active investment managers and strategies. It also provides effective diversification against equities and a stable level of cash flow.

Alternative Investments

The strategic role of alternative investments is for diversification relative to equities and fixed income investments, to add absolute return using hedging strategies, and to achieve significant expected return premiums over longer holding periods. Alternative investments include investments in hedge funds and private equities and are under the supervision and control of investment managers. Hedge funds include investments in a variety of instruments including stocks, bonds, commodities, and a variety of derivative instruments. Private equities consist primarily of equity investments made in companies that are not quoted on a public stock market, which can include U.S. and non-U.S. venture capital, leveraged buyouts, and mezzanine financing.

Real Estate

The strategic role of real estate is to diversify the Plan's portfolio relative to equities and fixed income investments to include a component of real property investment through a commingled fund structure and providing higher returns than benchmark investments of a similar class. Real estate investments may also include publicly and privately traded real estate investment trusts as well as direct investment through properties and mortgages.

Global Asset Allocation

The strategic role of global asset allocation is to add value through broad diversification among traditional asset classes and tactical allocation shifts. Global asset allocation includes investments in diversified multi-asset funds to achieve returns above other broad diversified benchmarks.

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(b) Defined Contribution Plans

MHS currently maintains three defined contribution plans including the MHS 401(a) Retirement Account Plan (RAP), the MHS 403(b) Employee Savings Plan, and the MHS 401(k) Plan. Most employees assigned to work at Deaconess Hospital, Valley Hospital and Rockwood Clinic are eligible for participation in the MHS 401(k) Plan, which is funded by both MHS and employee contributions. The MHS 403(b) Employee Savings Plan is 100% funded by employee contributions and the RAP is 100% funded by MHS contributions.

MHS' funding for the defined contribution plans is based on certain percentages of the employees' base pay and/or a percentage of their deferred contributions. Employer contributions to the defined-contribution plans for 2020 and 2019 were approximately \$49,550 and \$47,200, respectively, which were included with employee benefits in the accompanying consolidated statements of operations and changes in net assets.

(c) Other

In addition to the defined benefit and defined contribution plans as described above, MHS also maintains several deferred compensation arrangements for the benefit of eligible employees. Substantially all amounts that are deferred under these arrangements are held in trust until such time as these funds become payable to the participating employees.

(12) Professional Liability

MHS maintains a self-insurance program for professional liability with excess coverage over self-insured retention limits provided by commercial insurance carriers. MHS has recorded a liability as of December 31, 2020 and 2019, which comprises estimated deductibles and retentions for known claims at year-end and a liability for incurred but not reported claims based on an actuarially determined estimate.

At December 31, 2020 and 2019, the estimated gross professional liability (including current and long-term portions) was \$97,997 and \$85,634, respectively. The current portion is included in accounts payable and accrued expenses and the remainder is included in other liabilities, net. MHS has recorded a receivable for amounts to be received from the excess insurance carriers for their portion of the claims (including current and long-term portions) of \$32,450 and \$30,026 as of December 31, 2020 and 2019, respectively. The current amount is included in other current assets, net and the remainder is included in other assets, net in the accompanying consolidated balance sheets.

(13) Workers' Compensation and Employee Health Benefit Programs

MHS maintains a self-insurance program for workers' compensation with excess coverage over self-insured retention limits provided by commercial insurance carriers. MHS has recorded a liability based on an actuarial estimate of future claims payments. At December 31, 2020 and 2019, the estimated net liability based on future claims cost totaled \$17,726 and \$16,127, respectively. The gross liabilities (including both current and long-term portions) total \$21,083 and \$19,135 as of December 31, 2020 and 2019, respectively. The long-term amounts are included in other liabilities, net and the current portions are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets. These liabilities are secured by a letter of credit with the State of Washington. MHS has recorded a receivable for amounts to be received from excess insurance carriers of \$3,357 and \$3,008 as of

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December 31, 2020 and 2019, respectively, which is included with other current assets, net and other assets, net for the respective estimated current and long-term portions.

MHS maintains a self-insurance program for employee medical and dental insurance. Employees can elect to be included in the self-insurance plan as a part of their fringe benefit package. Premiums deducted from employees' wages are used in paying a portion of members' medical claims. The estimated liability for claims in 2020 and 2019 was \$10,129 and \$12,083, respectively. These amounts are included in accrued compensation and related liabilities in the accompanying consolidated balance sheets.

(14) Long-Term Debt

Long-term debt consists of the following at December 31, 2020 and 2019:

	2020	2019
2020 Taxable bonds	\$ 300,000	—
2020 OCED financing	60,889	—
2019 Term loan	35,255	35,255
WHCFA Revenue bonds, 2017 Series A and B	321,705	325,020
WHCFA Revenue bonds, 2017 Series C, D, and E	191,010	191,010
2017 Term loans	130,170	130,170
WHCFA Revenue bonds, 2015 Series A and B	352,315	356,365
WHCFA Revenue bonds, 2012 Series A	60,000	60,000
WHCFA Revenue bonds, 2009 Series A and B	98,130	98,130
Other	22,313	34,839
	<u>1,571,787</u>	<u>1,230,789</u>
Adjusted for:		
Current portion	(7,950)	(13,668)
Bond premiums, discounts, and debt issuance costs	55,012	59,852
Long-term debt, net of current portion	<u>\$ 1,618,849</u>	<u>1,276,973</u>

(a) 2020 Taxable Bonds

In July 2020, MHS issued \$300,000 of taxable 2020 series bonds. These bonds were issued as fixed rate bonds that bear interest of 2.803%. The principal of \$300,000 is due in 2051, with interest only payments made semiannually in February and August of each year.

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(b) 2020 OCED Financing

In June 2020, MHS finalized a sale-leaseback transaction for three completed off-campus emergency departments (OCED) and one OCED still in progress of being constructed with total cash proceeds received of \$61,794. Due to the specific terms of the agreement, the lease qualified as a financing type lease. The agreement did not meet the criteria for sale-leaseback accounting treatment and instead, is considered a financing liability. The agreement bears an implicit interest rate of 4.64%. Annual principal payments range from \$1,803 in 2021 to \$4,461 in 2039 with a final principal payment of \$96 in 2041.

(c) 2019 Term Loan

In August 2019, MHS entered into a fixed rate term loan agreement with JPMorgan Chase Bank, N.A., with an interest rate of 1.89%. The principal balance of \$35,255 is due in 2022.

(d) Washington Health Care Facility Authority (WHCFA) Revenue Bonds 2017 Series A and B

In November 2017, MHS issued \$333,970 of 2017 Series A and B bonds. These bonds were issued as fixed rate bonds that bear interest ranging from 3.0% to 5.0%. Annual principal payments range from \$3,315 in 2020 to \$62,410 in 2047.

(e) WHCFA Revenue Bonds 2017 Series C, D, and E

In November 2017, MHS entered into a \$111,010 variable rate private placement agreement (Series C and D) with JPMorgan Chase Bank, National Association and an \$80,000 variable rate private placement agreement (Series E) with Wells Fargo Municipal Capital Strategies, LLC. Annual principal payments range from \$390 in 2043 to \$55,505 in 2049. The interest rates, which were between 0.56% and 1.98% at December 31, 2020, reset monthly and are based on 70% of the one-month U.S. LIBOR plus a spread.

(f) 2017 Term Loans

In November 2017, MHS entered into two \$65,085 variable rate term loan agreements with Wells Fargo Bank, N.A. The principal balance of \$130,170 is due in 2047. The interest rates, which were between 0.84% and 2.55% at December 31, 2020, reset monthly and are based on the one-month U.S. LIBOR plus a spread.

(g) WHCFA Revenue Bonds 2015 Series A and B

In April 2015, MHS issued \$373,390 of 2015 Series A and B bonds. Series A and B bonds were issued as fixed rate bonds that bear interest ranging from 2.0% to 5.0%. Annual principal payments range from \$4,050 in 2020 to \$24,085 in 2034 with a final payment of \$8,860 due in 2045.

(h) WHCFA Revenue Bonds 2012 Series A

In November 2012, MHS issued \$60,000 of 2012 Series A bonds. 2012 Series A bonds were issued as fixed rate bonds that bear interest ranging from 3.8% to 4.1%. Annual principal payments range from \$5,190 in 2040 to \$22,085 in 2045 with a final payment of \$19,715 due in 2046.

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(i) WHCFA Revenue Bonds 2010 Series A

In January 2010, MHS issued \$100,150 of 2010 Series A bonds. In August 2019, the 2010 bonds were refinanced with the proceeds from the 2019 Term Loan as described below. This refinancing resulted in a gain of \$869 that is recognized in other (loss) income, net in the consolidated statements of operations and changes in net assets.

(j) WHCFA Revenue Bonds 2009 Series A and B

In May 2009, MHS issued the 2009 Series A and B bonds as variable rate demand bonds for \$50,000 each. The bonds were backed by an irrecoverable letter of credit equal to the aggregate principal and interest of the bonds. In July 2012, the 2009 Series A and B bonds were converted to \$98,130 of fixed rate bonds that bear interest ranging from 4.4% to 5.0%. Annual principal payments range from \$3,690 in 2040 to \$38,890 in 2044.

(k) Other

The other debt listed is primarily made up of debt held by Navos. In April 2020, MHS paid \$11,488 of Navos' debt outstanding to third-party creditors. Of the outstanding debt at December 31, 2020, \$16,092 is associated with certain buildings and other capital assets operated by Navos and is subject to provisions whereby the debt will be forgiven upon compliance with those provisions. These provisions state that Navos maintains the assets that were built or purchased with these notes and maintains their usage when the promissory note was signed for the length specified. If these provisions are not met, the note must be repaid based on the terms of the agreement. The forgivable debt is subject to a forgiveness provision in years 2028 through 2068.

(l) 2020 Line of Credit

In April 2020, MHS secured a \$200,000 line of credit through JPMorgan Chase Bank, N.A. The term of the line of credit is for 12 months and bears interest at a variable rate based upon the Central Bank Floating Rate. No draws have occurred as of December 31, 2020.

Revenue bonds issued by MHS through WHCFA are subject to applicable bond indenture agreements, which require that MHS satisfy certain measures of financial performance as long as the bonds are outstanding. These measures include a minimum debt service coverage ratio and a condition that the bonds are secured by a gross receivables pledge. Based on management's assessment of these requirements, MHS is in compliance with these covenants at December 31, 2020 and 2019.

Each fixed-rate revenue bond requires semiannual interest payments on February 15 and August 15 of each year until maturity. These bonds are subject to early redemption by MHS on or after certain specific dates and at certain specific redemption prices as outlined in each bond agreement.

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Principal maturities on long-term debt are as follows:

Year ending December 31:	
2021	\$ 7,950
2022	45,390
2023	20,616
2024	21,641
2025	22,716
Thereafter	<u>1,453,474</u>
	<u>\$ 1,571,787</u>

A summary of interest costs is as follows during the years ended December 31, 2020 and 2019:

	<u>2020</u>	<u>2019</u>
Interest cost:		
Charged to operations	\$ 48,464	49,313
Amortization of bond premiums, discounts, and issuance costs	(2,494)	(2,728)
Capitalized	<u>478</u>	<u>1,231</u>
	<u>\$ 46,448</u>	<u>47,816</u>

(15) Commitments and Contingencies

Approximately 48% of MHS employees were covered under collective bargaining agreements as of December 31, 2020. These employees provide nursing, nursing support, pharmacy, imaging, lab, inpatient and outpatient therapies, housekeeping, food, laundry, maintenance, and inventory/distribution services to MHS. Collective bargaining agreements have various expiration dates extending through March 2023.

(16) Leases

(a) Lessee

MHS leases various equipment and facilities under noncancelable operating and finance leases. Lease terms for noncancelable operating leases range from 1 to 18 years, and existing leases have expiration dates through 2036. Lease terms for finance leases range from 3 to 21 years, and existing leases have expiration dates through 2040.

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The components of lease cost for the years ended December 31, 2020 and 2019 were as follows:

	2020	2019
Operating lease cost	\$ 37,232	36,532
Finance lease cost:		
Amortization of right-of-use assets	1,550	—
Interest on lease liabilities	388	—
Total finance lease cost	1,938	—
Short term lease cost	1,644	344
Variable lease cost	7,242	7,141
Sublease income	(1,049)	(4,518)
Total lease cost	\$ 47,007	39,499

Other information related to leases as of December 31, 2020 and 2019 was as follows:

	2020	2019
Weighted average remaining lease term (years)		
Operating leases	6.7	6.8
Finance leases	7.7	N/A
Weighted average discount rate		
Operating leases	4.0 %	4.0 %
Finance leases	4.4	N/A
Operating cash flows from operating leases	(36,707)	(35,619)
Operating cash flows from finance leases	(388)	—
Financing cash flows from finance leases	(1,366)	—
Right-of-use assets obtained in exchange for new operating lease liabilities	19,850	40,717
Right-of-use assets obtained in exchange for new finance lease liabilities	16,739	—

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Maturities of lease liabilities under noncancelable leases as of December 31, 2020 are as follows:

	Operating Leases	Finance Leases	Total
For year ended December 31:			
2021	\$ 33,673	3,482	37,155
2022	26,333	3,482	29,815
2023	22,904	3,321	26,225
2024	18,102	3,096	21,198
2025	16,258	1,719	17,977
Thereafter	45,847	3,840	49,687
Total undiscounted lease payments	163,117	18,940	182,057
Less present value discount	(20,255)	(2,904)	(23,159)
Total lease liabilities	\$ 142,862	16,036	158,898

(b) Lessor

MHS leases a building to the Alliance for South Sound Health, which does business under the name Wellfound Behavioral Health Hospital (Wellfound). Wellfound is a related party owned 50 percent by MHS. The leased building is owned solely by MHS, and is the only asset that MHS leases out as a lessor. The lease has a 20 year initial lease term, with four 5 year extension options. Due to the related party nature of the lease, MHS considers it reasonably certain that Wellfound will exercise its four lease renewal options, and as such, treats the lease as a 40 year lease. There is no purchase option stated in the lease contract. MHS has determined that the lease is a sales-type financing lease, since the expected lease term spans a major portion of the useful life of the building. At December 31, 2020, MHS' other assets, net include a net investment in lease of \$23,200.

Revenue from leases for the years ended December 31, 2020 and 2019 is as follows:

	2020	2019
Interest income on net investment in finance leases	\$ 1,136	812
Variable lease income	28	25
Total lease income	\$ 1,164	837

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Future lease payments receivable as of December 31, 2020 are as follows:

Year ended December 31:		
2021	\$	1,246
2022		1,246
2023		1,246
2024		1,246
2025		1,246
Thereafter		<u>43,495</u>
Total lease payments to be received		49,725
Less: unearned interest income		<u>(26,525)</u>
Net investment in lease	\$	<u><u>23,200</u></u>

(17) Net Assets with Donor Restrictions

Net assets with donor restrictions are available for the following specified purposes at December 31, 2020 and 2019:

	<u>2020</u>	<u>2019</u>
Healthcare services	\$ 52,151	49,866
Endowment funds, perpetual trusts and related receivables	71,651	64,273
Purchase of property, plant and equipment	16,234	6,377
Indigent care	1,533	1,634
Health education	<u>1,192</u>	<u>1,240</u>
Total net assets with donor restrictions	\$ <u><u>142,761</u></u>	<u><u>123,390</u></u>

(18) Endowment Funds

MHS' endowments consist of over 100 individual funds established for a variety of purposes. They include both endowment funds with donor restrictions and funds designated without donor restrictions by the board of directors of its foundations to function as endowments (board-designated endowments). Net assets associated with endowment funds, including board-designated endowment funds, are classified and reported based on the existence or absence of donor-imposed restrictions and nature of restrictions, if any.

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The following tables present MHS' endowment net asset composition as well as associated changes therein:

	Board designated without donor restrictions	Funds with donor restrictions	Total
Endowment net assets, December 31, 2019	\$ 2,673	39,700	42,373
Investment return:			
Investment income	39	493	532
Net appreciation – realized and unrealized	153	1,989	2,142
Total investment return	192	2,482	2,674
Contributions	—	443	443
Appropriation of endowment assets for expenditure	(40)	(201)	(241)
Endowment net assets, December 31, 2020	\$ 2,825	42,424	45,249

	Board designated without donor restrictions	Funds with donor restrictions	Total
Endowment net assets, December 31, 2018	\$ 2,923	38,140	41,063
Investment return:			
Investment income	62	782	844
Net appreciation – realized and unrealized	27	334	361
Total investment return	89	1,116	1,205
Contributions	—	1,990	1,990
Appropriation of endowment assets for expenditure	(339)	(1,546)	(1,885)
Endowment net assets, December 31, 2019	\$ 2,673	39,700	42,373

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Perpetual trusts that are held and managed by third party trustees are recorded as net assets with donor restrictions on the consolidated balance sheets; however, they are not included as endowment net assets with donor restrictions in the above presentation. Those perpetual trusts totaled \$28,290 and \$23,445, respectively, as of December 31, 2020 and 2019. Also excluded from the presentation of endowment net assets with donor restrictions above are pledge receivables and other totaling \$937 and \$1,128, respectively, as of December 31, 2020 and 2019.

(a) Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level of the original gifts and the amounts of subsequent donations accumulated at the funds. In accordance with generally accepted accounting principles, deficiencies of this nature are reported in net assets with donor restrictions. There were no funds with deficiencies in 2020 or 2019.

(b) Investment Policy – Including Return Objectives and Strategies to Achieve Objectives

The endowment assets are invested in an investment portfolio, which include those assets of donor restricted funds that MHS must hold in perpetuity as well as all other foundation-related investment assets. MHS has adopted an investment policy for the foundation investments that intends to provide income to support the spending policy while seeking to maintain the purchasing power of the endowment assets. To satisfy its long-term rate of return objectives, MHS relies on a total return strategy in which investment returns are achieved through both capital appreciation and interest and dividend income. MHS uses a diversified asset allocation to achieve its long-term return objectives within prudent risk constraints. There are some donor restricted funds that are held separately from MHS' pooled investments. These endowments are invested by donors in manners to provide funding for specific purposes as determined by donors.

(c) Spending Policy

In order to provide a stable and consistent level of funding for programs and services supported by the endowments, the foundations have determined that an annual spending rate of 5% of the endowment's average account value is prudent. In establishing the spending policies, the MHS foundations considered among other things, the expected total return on its endowments, effect of inflation, duration of the endowments to achieve its objective of maintaining the purchasing power of the endowment assets held in perpetuity, as well as to provide additional growth through new gifts and investment returns.

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(Dollars in thousands)

(19) Functional Expenses

MHS provides inpatient and outpatient services, physician services, home health services, and fund-raising activities. Certain categories of expenses are attributable to programs and support services. These included salaries and wages, depreciation and amortization and other expenses. Costs are allocated based on cost allocation methods depending on the allocable expense, including square footage, time utilization and percentage of gross charges. Expenses related to providing these services are as follows for the years ended December 31, 2020 and 2019:

2020					
	Program services			Support services	Total
	Hospitals and related services	Clinics and urgent care centers	Retail and other services	Corporate and support services	
Salaries and wages	\$ 969,456	392,470	51,225	202,870	1,616,021
Employee benefits	119,926	66,759	11,931	49,516	248,132
Supplies	416,964	34,712	54,952	13,750	520,378
Purchased services	98,027	25,874	18,409	155,946	298,256
Depreciation and amortization	110,868	17,914	1,921	37,485	168,188
Interest	41,004	3,936	—	1,030	45,970
Other	226,092	49,321	25,724	68,604	369,741
	<u>\$ 1,982,337</u>	<u>590,986</u>	<u>164,162</u>	<u>529,201</u>	<u>3,266,686</u>
2019					
	Program services			Support services	Total
	Hospitals and related services	Clinics and urgent care centers	Retail and other services	Corporate and support services	
Salaries and wages	\$ 918,459	407,097	47,490	175,055	1,548,101
Employee benefits	120,308	69,120	11,259	40,659	241,346
Supplies	424,852	35,609	36,278	4,949	501,688
Purchased services	109,060	34,682	12,763	114,609	271,114
Depreciation and amortization	106,384	20,090	1,425	37,771	165,670
Interest	46,226	2,859	—	(2,500)	46,585
Other	217,900	44,851	16,565	78,170	357,486
	<u>\$ 1,943,189</u>	<u>614,308</u>	<u>125,780</u>	<u>448,713</u>	<u>3,131,990</u>

MULTICARE HEALTH SYSTEM

Notes to Consolidated Financial Statements

December 31, 2020 and 2019

(Dollars in thousands)

(20) Litigation and Regulatory Environment

The healthcare industry is subject to numerous laws and regulations from federal, state, and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government healthcare program participating requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government agencies are actively conducting investigations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in the imposition of significant fines and penalties, significant repayments for patient services previously billed, and/or expulsion from government healthcare programs. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

MHS is also involved in litigation arising in the normal course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect to MHS' financial position.

(21) Subsequent Events

MHS has evaluated the subsequent events through March 24, 2021, the date at which the consolidated financial statements were issued and has included all necessary adjustments and disclosures.