OVERLAKE HOSPITAL ASSOCIATION

Consolidated Financial Statements
and Consolidating Information

June 30, 2018 and 2017

(With Independent Auditors' Report Thereon)

KPMG LLP
Suite 2900
1918 Eighth Avenue
Seattle, WA 98101

Independent Auditors' Report

The Board of Directors
Overlake Hospital Association:

We have audited the accompanying consolidated financial statements of Overlake Hospital Association and subsidiaries, which comprise the consolidated balance sheets as of June 30, 2018 and 2017, 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 Overlake Hospital Association and subsidiaries as of June 30, 2018 and 2017, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG

Other Matters

Our audit was performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information in Schedules 1 and 2 is presented for the purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

October 15, 2018

OVERLAKE HOSPITAL ASSOCIATION

Consolidated Balance Sheets

June 30, 2018 and 2017

(In thousands)

Assets		**2018**	**2017**
Current assets:			
Cash and cash equivalents	$	29,730	18,404
Receivables, net of allowance for uncollectible accounts of $9,465 in 2018 and $9,009 in 2017		60,787	54,983
Current portion of pledges receivable		2,158	706
Current portion of assets whose use is limited		6,946	8,488
Supplies inventory		9,744	9,029
Prepaid expenses		10,722	8,154
Other current assets		5,519	5,798
Total current assets		125,606	105,562
Assets whose use is limited:			
Restricted by donors		10,657	16,023
Management designated		4,041	3,536
Funds held under bond indenture and collateral agreements		118,939	8,488
Less current portion		(6,946)	(8,488)
Total assets whose use is limited, net of current portion		126,691	19,559
Investments		466,515	408,061
Long-term portion of pledges receivable, net		4,743	3,252
Other long-term receivables, net		3,043	3,398
Land, buildings, and equipment, net		253,178	240,068
Other assets:			
Investments in joint ventures		2,740	3,091
Prepaid pension		—	1,946
Other assets		1,917	2,175
Total other assets		4,657	7,212
Total assets	$	984,433	787,112

(Continued)

OVERLAKE HOSPITAL ASSOCIATION

Consolidated Balance Sheets

June 30, 2018 and 2017

(In thousands)

Liabilities and Net Assets	**2018**	**2017**
Current liabilities:		
Current portion of long-term debt	$ 5,245	8,640
Accounts payable	21,576	16,928
Accrued liabilities	56,168	49,192
Deferred revenues	—	14,029
Accrued interest payable	5,699	3,729
Payable to third-party agencies	7,229	5,600
Total current liabilities	95,917	98,118
Long-term debt, net of current portion	307,653	155,816
Pension liability	5,438	—
Other long-term liabilities	11,454	10,842
Total liabilities	420,462	264,776
Net assets:		
Unrestricted net assets	546,792	502,732
Temporarily restricted net assets	11,334	13,874
Permanently restricted net assets	5,845	5,730
Total net assets	563,971	522,336
Total liabilities and net assets	$ 984,433	787,112

See accompanying notes to consolidated financial statements.

OVERLAKE HOSPITAL ASSOCIATION

Consolidated Statements of Operations and Changes in Net Assets

Years ended June 30, 2018 and 2017

(In thousands)

		2018	2017
Operating revenue:			
Patient service revenue	$	540,109	504,924
Provision for uncollectible accounts		(11,013)	(8,720)
Net patient service revenue		529,096	496,204
Other operating revenue		27,997	15,145
Contribution revenue		2,190	1,878
Net operating revenue		559,283	513,227
Operating expenses:			
Salaries		231,374	219,178
Registry		10,337	10,195
Employee benefits		54,191	54,226
Supplies		90,910	87,979
Purchased services		49,818	51,431
Interest and amortization		8,794	7,989
Depreciation and amortization		33,742	33,282
Rent, leases, and utilities		12,080	11,665
Hospital taxes and assessments		17,655	19,586
Marketing, insurance, and other		18,359	16,818
Total operating expenses		527,260	512,349
Excess of revenue over expenses from operations		32,023	878
Nonoperating revenue, net:			
Investment income		13,552	22,901
Loss on refinancing		(8,627)	—
Nonoperating expenses		(2,219)	—
Total nonoperating revenue, net		2,706	22,901
Excess of revenue over expenses		34,729	23,779
Other changes in unrestricted net assets:			
Net assets released for capital acquisitions		6,924	2,088
Change in prepaid pension and pension liability		(4,746)	4,138
Change in net unrealized gains on investments		6,810	20,082
Other		343	292
Increase in unrestricted net assets		44,060	50,379
Changes in temporarily restricted net assets:			
Contributions		5,446	10,431
Investment income		616	280
Change in net unrealized gains on investments		24	677
Net assets released from restrictions		(8,626)	(3,699)
(Decrease) increase in temporarily restricted net assets		(2,540)	7,689
Changes in permanently restricted net assets:			
Contributions		115	154
Increase in permanently restricted net assets		115	154
Increase in net assets		41,635	58,222
Net assets, beginning of year		522,336	464,114
Net assets, end of year	$	563,971	522,336

See accompanying notes to consolidated financial statements.

OVERLAKE HOSPITAL ASSOCIATION

Consolidated Statements of Cash Flows

Years ended June 30, 2018 and 2017

(In thousands)

	2018	2017
Cash flows from operating activities:		
Change in net assets	$ 41,635	58,222
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	32,768	33,166
Provision for uncollectible accounts	11,013	8,720
Loss (gain) on disposal of assets	3	(6)
Loss on refinancing	8,627	—
Restricted contributions received for capital and permanently restricted purposes	(1,054)	(8,273)
Net realized and unrealized gains on investments	(6,600)	(33,656)
Equity earnings in joint ventures	(2,213)	(3,025)
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Receivables, net	(16,817)	(9,567)
Pledges receivable	(2,943)	(544)
Supplies inventory	(715)	(466)
Prepaid expenses	(2,568)	1,446
Other current assets	279	2,316
Other long-term receivables	355	945
Prepaid pension	1,946	(1,946)
(Decrease) increase in:		
Accounts payable	3,308	(189)
Accrued liabilities	6,976	(4,994)
Deferred revenues	(14,029)	—
Accrued interest payable	1,970	(115)
Payable to third-party agencies	1,629	(1,566)
Pension liability	5,438	(2,435)
Other long-term liabilities	612	102
Net cash provided by operating activities	69,620	38,135
Cash flows from investing activities:		
Purchase of land, buildings, and equipment	(45,262)	(37,412)
Proceeds from disposal of assets	5	6
Proceeds from sale of investments and assets whose use is limited	81,701	143,855
Sale of interest in joint venture	—	14,339
Purchase of investments and assets whose use is limited	(239,145)	(172,576)
Distributions from joint ventures	2,564	2,648
Purchase of other assets	—	(442)
Net cash used in investing activities	(200,137)	(49,582)
Cash flows from financing activities:		
Restricted contributions received for capital and permanently restricted purposes	1,054	8,273
Principal payments on long-term debt	(8,640)	(8,204)
Proceeds from issuance of new debt	249,215	—
Refunding of old debt from new debt	(98,153)	—
Financing fees paid	(1,633)	(21)
Net cash provided by financing activities	141,843	48
Net increase (decrease) in cash and cash equivalents	11,326	(11,399)
Cash and cash equivalents, beginning of year	18,404	29,803
Cash and cash equivalents, end of year	$ 29,730	18,404
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 6,824	8,104
Purchase of land, buildings, and equipment included in accounts payable	3,942	2,602

See accompanying notes to consolidated financial statements.

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

(a) Organization

Overlake Hospital Association (the Association) is a 501(c)(3) not-for-profit corporation located in Bellevue, Washington. The purpose of the Association is to promote and conduct health-related activities through its affiliation with other health-related organizations. The Association owns buildings adjacent to the Overlake Hospital Medical Center campus and currently leases space for mixed office use.

Overlake Hospital Medical Center (the Hospital) is a 501(c)(3) not-for-profit corporation located in Bellevue, Washington. The Hospital's primary service area is from Bothell to Black Diamond and from the Cascade Mountains to Lake Washington, including Mercer Island. The Hospital provides inpatient, outpatient, and emergency care services. The Hospital is controlled by the Association.

The Hospital is affiliated with other healthcare related organizations including the following:

Overlake Medical Clinics, LLC (the Clinics) was formed to establish, own, and operate primary care clinics and other outpatient healthcare entities. The Hospital is the sole member of the Clinics.

Overlake Hospital Foundation (the Foundation) is a 501(c)(3) not-for-profit corporation. The purpose of the Foundation is to: (a) receive grants, bequests, donations, and contributions on behalf of; (b) provide fund-raising and other support to; and (c) make contributions to Overlake Hospital and its related tax-exempt corporations. The Foundation is controlled by the Hospital.

Overlake Hospital Auxiliaries (the Auxiliaries) is a 501(c)(3) not-for-profit corporation. The purpose of the Auxiliaries is to promote, support, and advance the well-being of the Hospital through a variety of ways including serving as goodwill ambassadors to the community, conducting fund-raising activities, maintaining membership strength, and providing services to the Hospital for the benefit of its patients and their families. The Auxiliaries are controlled by the Hospital.

Overlake Provider Network, LLC (the Provider Network) was formed to develop a clinically integrated network among health care providers. The Hospital is the sole member of the Provider Network. The Provider Network was inactivated in 2017.

Overlake Medical Tower LLC (the Medical Tower) was formed to acquire, own, develop, and operate a medical office building and garage complex on the Hospital's campus. The Association is the sole member of the Medical Tower.

The consolidated financial statements of the Association include the accounts of the Association and all of the above listed affiliates.

(b) Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles 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 revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates include the provision for contractual allowances and uncollectible accounts, fair value of financial instruments, reserves for employee benefit obligations, and self-insurance reserves for professional liability and workers' compensation.

(c) Basis of Presentation

The consolidated financial statements include the accounts of the Association and its affiliates. All significant intercompany transactions between the Association and its affiliates have been eliminated in consolidation.

(d) Cash and Cash Equivalents

The Association maintains cash on deposit at financial institutions, which at times exceed the limits insured by the Federal Deposit Insurance Corporation. This exposes the Association to potential risk of loss in the event the financial institution becomes insolvent.

(e) Provision for Uncollectible Accounts

The Hospital and the Clinics provide an allowance for potential uncollectible patient accounts receivable whereby such receivables are reduced to their estimated net realizable value. The Hospital estimates this allowance based on the aging of accounts receivable, historical collection experience, and other relevant factors. The Clinics estimate this allowance based on the historical collection experience by the clinic and other relevant factors. There are various factors that can impact the collection trends, such as changes in the economy, which in turn have an impact on unemployment rates and the number of uninsured and underinsured patients, the increased burden of co-insurance, and deductibles to be made by patients with insurance and business practices related to collection efforts. These factors continuously change and can have an impact on collection trends and the estimation process.

(f) Pledges Receivable

Pledges of financial support are recorded at fair value by the Association when a donor's unconditional promise to give has sufficient definition with respect to the amount and planned timing of the donation. Conditional promises to give and intentions to give are reported at fair value at the earlier of when the contingency is met or the date the gift is received. An allowance for uncollectible pledges is recorded based on an estimated percentage of pledges that may not be collectible based on historical experience. The Association anticipates collection of net pledges receivable over the next one to ten years. Pledges over $250 not scheduled to be collected within one year are discounted.

(g) Assets Whose Use is Limited

Certain assets of the Hospital and the Foundation are held in trust under indenture agreements, are restricted by donor stipulations, or are management designated. Assets that have been management designated are subject to change in the future. These assets consist primarily of cash, accrued interest, money market funds, bond mutual funds, and equity mutual funds, and are recorded at fair value.

(h) Investments

Investments consist primarily of cash, accrued interest, money market funds, bond mutual funds, and equity mutual funds, and are recorded at fair value. Investments are classified as other-than-trading with unrealized gains and losses included in changes in net assets unless the losses are considered other-than-temporary.

(i) Other-Than-Temporary Impairment

The Association reviews investments each period and assesses whether an other-than-temporary impairment has occurred. Each investment within the portfolio is evaluated individually. Major factors that are considered are: 1) fair value of the investment is below cost, 2) loss has been sustained over an extended period of time, and 3) whether the Association intends to sell or could be required to sell the investment security, or, if not, whether it has the ability to hold an investment for a reasonable period of time sufficient for a forecasted recovery of fair value up to or beyond the cost of the investment. Additional factors that might be considered include, but are not limited to: 1) credit risk of the investment, 2) decline attributable to adverse conditions specifically related to the investment, its industry, or geography, 3) investment has been downgraded by a rating agency, 4) dividends have been reduced or eliminated or scheduled interest has not been paid, 5) changes in the value of the investment after the close of the period, 6) trading in the investment has been suspended, and 7) discussion with investment advisor.

A decline in the market value of any other-than-trading security below cost that is deemed to be other-than-temporary results in an impairment to reduce the carrying amount to market value. The impairment is charged against nonoperating revenue and a new cost basis for the security is established.

(j) Land, Buildings, and Equipment

Land, buildings, and equipment acquisitions over $3 with a useful life of at least two years are recorded at cost. Improvements and replacements of buildings and equipment are capitalized; maintenance and repairs are expensed. The cost of land, buildings, and equipment sold or retired and the related accumulated depreciation are removed from the records and any resulting gain or loss is recorded. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets or lease term if shorter.

The fair value of a long-lived asset may change due to a number of factors such as a significant decrease in the market price of a long-lived asset, a significant adverse change in the manner in which the asset is used, a significant adverse change in legal factors or the business climate that could affect the value of the asset, or a change in expected useful life due to changes regarding obsolescence, planned replacement, or disposal. When management becomes aware of a situation that causes the fair value of a long-lived asset to be lower than the book value, management records an impairment and revises the estimated useful life as needed.

(k) Deferred Financing Costs

The Association defers the costs of obtaining financing and amortizes these costs over the term of the related debt using the effective-interest method. Deferred financing costs are included in long-term debt.

(l) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are assets that have been limited by donors to a specific time period or purpose. Permanently restricted net assets are assets that have been restricted by donors to be maintained by the Association in perpetuity.

(m) Net Patient Service Revenue

The Association is paid for services to Medicare inpatients under the Prospective Payment System, which provides for reimbursement based on diagnosis-related groupings (DRGs). Such DRG payments are prospectively established and may be greater or less than the Association’s actual charges for its services. The majority of Medicare outpatient services are reimbursed based on ambulatory payment classifications (APCs). APC payments are prospectively established and may be greater or less than the Association’s actual charges for its services. Payments for Medicare outpatient laboratory services and certain therapeutic services are based on a fee schedule.

The Association is paid for services provided to Medicaid inpatients under a DRG-based system. Payments for Medicaid outpatient services are reimbursed on a percentage of actual charges or a fee schedule.

The Association has agreements with third-party payors that provide for payments at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, per diem payments, and risk sharing agreements. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors.

For services that are paid under cost-reimbursed contractual arrangements with Medicare, the Association is paid at an interim rate during the year. The difference between the interim rate and the actual reimbursement based on defined allowable costs results in a receivable from or a payable to third-party agencies.

The Medicare program’s administrative procedures preclude final determination of amounts receivable from or payable to the Medicare program until after the Association’s annual cost reports have been audited or otherwise reviewed and settled by Medicare. The estimated settlement receivable/payable for unsettled cost reports is included in the accompanying consolidated financial statements.

Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The Association's net patient service revenue increased by $1,799 and $2,725 as a result of retroactive adjustments under reimbursement agreements with third-party payors during 2018 and 2017, respectively.

(n) Charity Care

The Association provides service to eligible patients at reduced or no cost based upon the individual patient's financial resources. The Association's policy provides for 100% charity to patients with income up to 200% of the federal poverty guidelines and from 65% to 98% charity to patients with income from 201% to 400% of the federal poverty guidelines. Records are kept to identify, approve, and monitor those costs that are incurred under the charity care policy. Because the Association does not expect payment, estimated charges for charity care are not included in revenue. In addition to the approved charity care described above, the Association believes that other uncollected accounts would be approved under its charity care policy if information about the patient's financial resources were shared with the Association. Such amounts are not considered charity care.

(o) Private Pay Discounts

The Association offers patients with no insurance prompt pay discounts for medically necessary services. A 30% prompt pay discount is granted for full payment within 30 days of the first billing statement. Prompt pay discounts are recorded as an adjustment to patient service charges.

(p) Donor-Restricted Gifts

Gifts received from or pledged by donors are reported as either temporarily or permanently restricted contributions if they are received with donor stipulations that limit the use of the donated assets or contain a time restriction. When a donor restriction expires, that is, when a stipulated time restriction ends or restricted purpose is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets.

(q) Excess of Revenue over Expenses

The consolidated statements of operations and changes in net assets include excess of revenue over expenses. Changes in net assets that are excluded from excess of revenue over expenses include net assets released for capital acquisitions, certain changes in prepaid pension and pension liability, change in net unrealized gains on investments that are other-than-trading, contributions to temporarily and permanently restricted net assets, investment income from donor-designated endowments and net assets released from restrictions.

(r) Federal Income Taxes

The Association is an organization exempt from taxation under Section 501(c)(3) of the Internal Revenue Code (IRC) and is generally not subject to federal income taxes. However, the Association is subject to income taxes on any net income that is derived from a trade or business, regularly carried on, and not in furtherance of the purposes for which it was granted exemption.

(s) Recently Issued Accounting Standards

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard as issued was to be effective for the Association on July 1, 2017. In July 2015, the FASB issued ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of Effective Date*. This guidance approves a one-year deferral of the effective date of ASU 2014-09. The final ASU now requires the Association to adopt this standard on July 1, 2018. The standard permits the use of either the retrospective or cumulative effect transition method. Adoption of this standard is not expected to have a material impact on the Association's consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements of Not-for Profit Entities*, which, among other things requires a not for profit to: 1) present on the face of the balance sheet amounts for two classes of net assets at the end of the period, rather than for the currently required three classes. The two classes are net assets with donor restrictions and net assets without donor restrictions; 2) present on the face of the statement of operations the amount of the change in each of the two classes of net assets; 3) continue to present on the face of the statement of cash flows the net amount for operating cash flows using either the direct or indirect method; 4) provide various enhanced disclosures; 5) report investment return net of external and direct internal investment expenses and no longer require disclosure of those netted expenses; and 6) use, in the absence of explicit donor stipulations, the placed-in-service approach for reporting expirations of restrictions on gifts of cash or other assets to be used to acquire or construct a long-lived asset and reclassify any amounts from net assets with donor restrictions to net assets without donor restrictions for such long-lived assets that have been placed in service as of the beginning of the period of adoption. ASU 2016-14 is effective for the Association on July 1, 2018. ASU 2016-02 should be applied on a retrospective basis in the year that the Update is first applied. The guidance will not have a material impact on the Association's consolidated financial position, results of operations, equity or cash flows.

In November 2016, the FASB issued ASU 2016-18, *Restricted Cash*, which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. ASU 2016-18 is effective for the Association for annual and interim periods on July 1, 2018. Adoption of this standard is not expected to have a material impact on the Association's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which, among other things, requires lessees to recognize most leases on-balance sheet. This will increase their reported assets and liabilities – in some cases very significantly. Lessor accounting remains substantially similar to current U.S. GAAP. ASU 2016-02 supersedes Topic 840, *Leases*. ASU 2016-02 is effective for the Association on July 1, 2019. Early adoption is permitted. ASU 2016-02 mandates a modified retrospective transition method for all entities. Management is finalizing the inventory of leases. The Association is currently evaluating the impact on the Association's consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. The ASU, among other things, requires equity securities classified as other than trading to be measured at fair value with changes in fair value recognized in excess of revenues over expenses and updates certain disclosure requirements related to financial instruments. ASU 2016-01 is effective for the Association for annual and interim periods on July 1, 2019; however, the Association early adopted the option to remove the fair value of debt disclosure as of June 30, 2018 and 2017 as permitted under the provisions of the ASU. When the remaining provisions of this ASU are adopted, a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption is required. The Association is currently evaluating the effects this standard will have on the Association's consolidated financial statements and accompanying disclosures.

(Dollars in thousands)

(2) Net Patient Service Revenue

The following is the mix of patient charges by payor for the years ended June 30, 2018 and 2017:

	2018	2017
Medicare	26 %	26 %
Medicaid	1	1
Kaiser Permanente/Group Health	19	20
Premera	14	14
Regence	13	13
Other third-party payors	25	24
Private pay	2	2
Total	100 %	100 %

(3) Hospital Safety Net Program

Under the Hospital Safety Net program, Washington State nongovernmental hospitals are assessed a fee on all non-Medicare patient days, up to a maximum of fifty-four thousand days per year. This fee is collected by the state and the state uses these funds to obtain federal Medicaid matching funds. Each state fiscal year, the state uses the assessment and Medicaid matching funds to make supplemental payments to Washington hospitals. The law sunsets on July 1, 2021.

Safety net revenue recognized under the program in the consolidated statements of operations was $14,091 and $16,205 for the years ended June 30, 2018 and 2017, respectively and was classified in net patient service revenue. Safety net expenses recognized under the program in the consolidated statements of operations were $12,977 and $15,185 for the years ended June 30, 2018 and 2017, respectively and were classified in hospital taxes and assessments.

Safety net revenue recognized and not yet received as of June 30, 2018 and 2017 totaled $3,253 and $3,241, respectively. Safety net expenses recognized and not yet paid as of June 30, 2018 and 2017 totaled $3,244 and $3,796, respectively.

(4) Charity Care and Community Benefit

The Association provides care without charge or at reduced rates to patients who qualify for charity care according to the Association’s policy. The Association determines the cost of charity care using a cost to

(Continued)

charge ratio following the regulatory guidelines. Total expenses are reduced by bad debt, other operating revenue, the hospital safety net assessment, and community benefit expense and patient charges are reduced by community benefit revenue in determining the cost to charge ratio. The ratio is then applied to the charges that were written off for charity to determine the cost of charity. For the years ended June 30, 2018 and 2017, the cost of providing charity was estimated at approximately $7,057 and $5,202, respectively.

The Association provides care to Medicaid patients at rates below the cost of providing services. For the years ended June 30, 2018 and 2017, payments were less than estimated cost by approximately $15,971 and $13,685, respectively.

The Association is also involved in an array of activities that benefit the broader community. Community education classes are offered in a wide range of health-related topics including preparing for childbirth, positive parenting, infant and child safety, adult first aid, CPR, women’s health, smoking cessation, weight loss, diabetes, balance, dementia, living wills, long-term care insurance, cholesterol, caregiver support, dealing with cancer, and depression. In addition to classes, the Association has a cancer resource center that coordinates support groups, counseling, and provides access to the latest information on cancer at no cost. The Association provides cholesterol, diabetes, and bone density screenings at various community events. The Association assists patients that need help enrolling in Medicaid. Education is part of the Association’s mission and is evidenced by the Association’s participation in several residency programs or by providing a clinical setting for college-based programs including nursing, pharmacy technicians, medical imaging technicians, respiratory therapists, lab assistants, and cancer counselors. The Association operates a senior care clinic at a loss for the benefit of the community. The Association participates in clinical research projects. As a community member, the Association participates and helps sponsor many community events in the area it serves. The estimated net unreimbursed expenditures on community benefit programs were $5,701 and $6,136 in 2018 and 2017, respectively.

The Association works in partnership with a number of community agencies and provides volunteer support for programs and events that benefit the community. It is the Association’s belief that giving back to the community is an integral part of its mission.

(Dollars in thousands)

(5) Concentrations of Credit Risk

The Association grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30 is as follows:

	2018	2017
Medicare	18 %	20 %
Medicaid	3	2
Kaiser Permanente	16	16
Premera	13	12
Regence	9	11
Other third-party payors	31	29
Private pay	10	10
Total	100 %	100 %

(6) Provision for Uncollectible Accounts

The Association records a provision for bad debts in the period of services on the basis of past experience, which has historically indicated that many patients are unresponsive or are otherwise unwilling to pay the portion of their bill for which they are financially responsible. The estimates made and changes affecting those estimates for the years ended June 30, 2018 and 2017 are summarized below:

	2018	2017
Changes in allowance for doubtful accounts:		
Allowance for doubtful accounts at beginning of year	$ 9,009	8,049
Write-off of uncollectible accounts, net of recoveries	(10,557)	(7,760)
Provision for uncollectible accounts	11,013	8,720
Allowance for doubtful accounts at end of year	$ 9,465	9,009

(Dollars in thousands)

(7) Assets Whose Use is Limited and Investments

Assets whose use is limited and investments, which are stated at fair value based primarily on quoted market prices, consisting of the following as of June 30, 2018 and 2017:

		2018	2017
Assets whose use is limited:			
Cash and accrued interest receivable	$	5,921	7,135
Money market funds		114,407	8,488
Bond mutual funds		5,237	4,546
Equity mutual funds		8,072	7,878
Assets whose use is limited	$	133,637	28,047
Investments:			
Cash and accrued interest receivable	$	2,080	1,578
Money market funds		12	17
Bond mutual funds		228,335	195,187
Equity mutual funds		236,088	211,279
Total investments	$	466,515	408,061

Components of unrestricted investment income (which is included in other nonoperating revenue, net) for the years ended June 30, 2018 and 2017 are as follows:

		2018	2017
Interest and dividends	$	14,041	9,224
Net realized (losses) gains on investments		(489)	13,677
Total investment income	$	13,552	22,901

Components of temporarily restricted investment income for the years ended June 30, 2018 and 2017 are as follows:

		2018	2017
Interest and dividends	$	361	265
Net realized gains on investments		255	15
Total investment income	$	616	280

(Dollars in thousands)

The following tables summarize the composition of the Association's assets whose use is limited and investments with unrealized losses as of June 30, 2018 and 2017:

	2018					
	Unrealized losses existing					
	Less than 12 months		12 Months or longer		Total	
Description of securities	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
Bond mutual funds	$ 132,645	(3,578)	49,494	(2,908)	182,139	(6,486)
Equity mutual funds	13,998	(430)	—	—	13,998	(430)
	$ 146,643	(4,008)	49,494	(2,908)	196,137	(6,916)

	2017					
	Unrealized losses existing					
	Less than 12 months		12 Months or longer		Total	
Description of securities	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
Bond mutual funds	$ 110,675	(1,610)	8,812	(826)	119,487	(2,436)
Equity mutual funds	1,969	(11)	14	(1)	1,983	(12)
	$ 112,644	(1,621)	8,826	(827)	121,470	(2,448)

The Association recognized $607 and $796 of other-than-temporary impairment on assets whose use is limited and investments during the years ended June 30, 2018 and 2017, respectively.

The majority of the Association's investments and assets whose use is limited are in bond and equity mutual funds. Unrealized losses on these investments and assets whose use is limited are due to the economic environment.

(8) Disclosure about Fair Value of Financial Instruments

Generally Accepted Accounting Principles established a framework for measuring fair value that provides 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 identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under Accounting Standards Codification (ASC) 820-10-50, *Fair Value Measurement – Overall,* are described below:

- Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets. At June 30, 2018 and 2017, Level 1 securities include primarily money market funds and mutual funds.
- Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model based valuation techniques for which all significant assumptions are observable in the market. At June 30, 2018 and 2017, Level 2 securities include an unregistered mutual fund.

- Level 3 – Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Association's estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of discounted cash flow models and similar techniques. At June 30, 2018 and 2017, there were no Level 3 securities.

Fair value is based on 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. The Association maximizes the use of observable inputs and minimizes the use of unobservable inputs when developing fair value measurements. Fair value measurements for assets and liabilities where there is limited or no observable market data and, therefore, are based primarily upon estimates calculated by the Association, are based on the economic and competitive environment, the characteristics of the asset or liability, and other factors. Therefore, the results cannot be determined with precision and may not be realized upon an actual settlement of the asset or liability. There may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, that could significantly affect the results of the current or future values.

Following is a description of valuation methods and assumptions used for assets recorded at fair value and for estimating fair value for financial instruments not recorded at fair value but required to be disclosed:

(a) Cash

The carrying amounts, at cost, equal fair value.

(Dollars in thousands)

(b) Marketable Securities

The tables below present the balances of assets measured at fair value on a recurring basis as of June 30, 2018 and 2017:

	2018				
	Investments at estimated fair value				
		Quoted prices in active markets for identical assets (Level 1)	Valuation techniques based on observable market data (Level 2)	Valuation techniques incorporating information other than observable market data (Level 3)	Total
Cash and accrued interest	$	5,921	—	—	5,921
Money market funds		114,407	—	—	114,407
Bond mutual funds		5,237	—	—	5,237
Equity mutual funds		8,072	—	—	8,072
Total assets whose use is limited	$	133,637	—	—	133,637
Cash and accrued interest	$	2,080	—	—	2,080
Money market funds		12	—	—	12
Bond mutual funds		228,335	—	—	228,335
Equity mutual funds		213,313	22,775	—	236,088
Total investments	$	443,740	22,775	—	466,515

	2017				
	Investments at estimated fair value				
		Quoted prices in active markets for identical assets (Level 1)	Valuation techniques based on observable market data (Level 2)	Valuation techniques incorporating information other than observable market data (Level 3)	Total
Cash and accrued interest	$	7,135	—	—	7,135
Money market funds		8,488	—	—	8,488
Bond mutual funds		4,546	—	—	4,546
Equity mutual funds		7,878	—	—	7,878
Total assets whose use is limited	$	28,047	—	—	28,047

(Dollars in thousands)

	2017			
	Investments at estimated fair value			
	Quoted prices in active markets for identical assets (Level 1)	Valuation techniques based on observable market data (Level 2)	Valuation techniques incorporating information other than observable market data (Level 3)	Total
Cash and accrued interest	$ 1,578	—	—	1,578
Money market funds	17	—	—	17
Bond mutual funds	195,187	—	—	195,187
Equity mutual funds	191,002	20,277	—	211,279
Total investments	$ 387,784	20,277	—	408,061

(9) Land, Buildings, and Equipment

The Association's land, buildings, and equipment accounts, and related accumulated depreciation accounts, as of June 30, 2018 and 2017 are set forth below:

	2018	2017
Assets:		
Land	$ 7,601	7,601
Land improvements	4,957	4,957
Buildings and improvements	285,236	274,718
Equipment:		
Fixed	46,474	43,506
Movable	220,763	212,086
Construction in progress	37,482	18,570
Total land, buildings, and equipment	602,513	561,438
Accumulated depreciation:		
Land improvements	4,261	4,168
Buildings and improvements	144,217	136,101
Equipment:		
Fixed	32,823	30,147
Movable	168,034	150,954
Total accumulated depreciation	349,335	321,370
Total land, buildings, and equipment, net	$ 253,178	240,068

(Dollars in thousands)

The Association recorded $33,484 and $32,263 of depreciation expense in 2018 and 2017, respectively. The following is a summary of asset lives used for calculating depreciation:

	Asset lives
Land improvements	8–40 years
Buildings and improvements	2–40 years
Fixed equipment	3–30 years
Movable equipment	2–20 years

(10) Sale of Interest in PacLab, LLC

In May 2017, the Association entered into an agreement to sell its interest in PacLab, LLC to a third party. The Association was paid $14,339 for its interest in PacLab upon entering the agreement. This amount less the value of the interest was recorded as deferred revenue until the sale closed on April 6, 2018 at which time it was recorded as other operating revenues.

(11) Financing

(a) Long-Term Debt

Long-term debt, as of June 30, 2018 and 2017, is as follows:

		2018	2017
Revenue bonds, Series 2014, 4.00% to 5.00%, due in annual principal installments ranging from $1,290 to $3,370, until 2038, including a premium of $3,397 and $3,690, and net of deferred financing cost of $607 and $659 as of June 30, 2018 and 2017, respectively, callable on or after July 2024.	$	48,800	50,266
Revenue bonds, Series 2017A/B, 4.00% to 5.00%, due in annual principal installments ranging from $2,625 to $16,215, from 2023 until 2043, including a premium of $21,554 and net of deferred financing cost of $1,441 and $21 as of June 30, 2018 and 2017, respectively, callable on or after January 2028.		196,897	(21)
Revenue bonds, Series 2017C, variable rate, due in annual principal installments ranging from $14,180 to $18,185, from 2043 until 2045, net of deferred financing cost of $142 as of June 30, 2018. Principal may be prepaid in whole or in part at each Rate Reset Date and is subject to a mandatory tender date of December 21, 2022 unless the Bank (or other owner) elects the right to retain the bonds.		49,858	—

(Dollars in thousands)

		2018	2017
Revenue bonds, Series 2010, net of discount of $113 and deferred financing cost of $1,011 as of June 30, 2017. The bonds were legally defeased on December 21, 2017.	$	—	93,072
Note payable to a financial institution, 3.34%, secured by a deed of trust on land, building, and rental income due in monthly payments including interest of $373 until August 2022, net of deferred financing cost of $42 and $70 as of June 30, 2018 and 2017, respectively.		17,343	21,139
Total long-term debt		312,898	164,456
Less current portion		(5,245)	(8,640)
Long-term debt, net of current portion	$	307,653	155,816

In fiscal year 2018, the Hospital received proceeds from the Washington Health Care Facilities Financing Authority, Revenue Bonds, Series A, B and C with total proceeds of approximately $249,215. The 2017 Series C bonds, in the amount of approximately $49,858 as of June 30, 2018, are variable rate revenue bonds which were all purchased in a private placement by a financial institution. They will be held by that financial institution until December 2022 unless an election is made by the financial institution to retain the 2017 Series C Revenue Bonds for a longer period. If the financial institution does not elect to retain the 2017 Series C bonds, the bonds will be remarketed and it is possible that if the remarketing is not successful they will become due and payable in December 2022. The debt maturity table includes the expected principal payments for the 2017 Series C Revenue Bonds according to the original contractual maturity schedule at the time of issuance.

(Dollars in thousands)

The principal amounts due by year are as follows:

Fiscal year:		
2019	$	5,245
2020		5,449
2021		5,652
2022		5,866
2023		6,503
Thereafter		261,464
		290,179
Add net unamortized bond premiums		24,951
Less unamortized deferred financing costs		(2,232)
	$	312,898

The obligated group for the revenue bonds (the bonds) consists of the Hospital and the Association. As security for the payment of the bonds, the Hospital has granted the Trustee a security interest in the Hospital's gross revenue and the moneys in the trust funds as described below. Trust funds have been established for the regular deposit of interest and principal payments of the bonds and is reflected within assets whose use is limited on the accompanying consolidated balance sheet.

Under the terms of the loan agreements, the Hospital has agreed to maintain certain financial ratios and comply with certain other covenants.

(12) Retirement Program

The Hospital's retirement program consists of a Cash Account Plan (the Plan), a Voluntary Employee Tax Deferred Plan 403(b) (the Voluntary Plan), and a Contribution Plan 401(a) (the Contribution Plan).

(a) The Plan

The Plan is a defined benefit, noncontributory plan with a defined contribution feature. The Plan covers all qualified employees hired prior to September 1, 2008, including employees of the Hospital's controlled affiliates, complies with the Employee Retirement Income Security Act of 1974 and is accounted for in accordance with ASC 715-20-50, *Compensation – Retirement Benefits – Defined Benefit Plans – General*. The measurement date of the Plan is June 30.

Effective January 1, 2009, the Plan is frozen to new participants. Employees of the Hospital hired on or after September 1, 2008 or under the age of 41 as of December 31, 2008 participate in a retirement program (Service Plus Program) and effective January 1, 2009 do not accrue additional benefits under the Plan. Any existing benefits for such participants are frozen as of December 31, 2008 except for interest.

(Dollars in thousands)

Employees hired prior to September 1, 2008 and who had reached the age of 41 or older as of December 31, 2008 were given the choice to continue to accrue benefits under the Plan or participate in the Service Plus Program. Eligible participants must be credited with 1,000 hours during the year to receive an employer contribution. Employees become vested in the Plan according to a step schedule with full vesting at three years.

In 2018, participants that currently receive benefits in the Plan and that met certain combined age and service criteria received a voluntary early retirement offer. Participants that elected the offer were required to accept the offer between May 8, 2018 and June 30, 2018, retire from the Hospital or Clinics by December 9, 2018, and start their Plan benefit no later than January 1, 2019 by either taking a lump sum distribution or starting monthly benefits. Participants that elected the offer had the value of their Plan balance increased by 20% as of June 30, 2018. The cost of this benefit was recorded as special termination benefits.

On April 25, 2018, the Finance Committee of the Board of Trustees of the Hospital approved a plan to terminate the Plan on July 15, 2018 pursuant to the criteria outlined in the plan document. The Plan termination is pending certain regulatory approvals necessary to begin distribution of assets to participants and other wind down procedures. If Plan assets are not sufficient to fund the distribution of accumulated benefits, the Hospital plans to fund the shortfall between assets and liabilities.

A summary of the change in benefit obligation and change in plan assets for the years ended June 30, 2018 and 2017 is as follows:

		2018	2017
Benefit obligation at beginning of year	$	58,787	59,772
Service cost		2,803	3,113
Interest cost		1,971	1,852
Benefits paid		(4,591)	(4,162)
Expenses paid		(326)	(374)
Actuarial loss (gain)		3,346	(523)
Plan amendments		757	(891)
Special termination benefits		2,219	—
Benefit obligation at end of year		64,966	58,787

(Continued)

(Dollars in thousands)

		2018	2017
Fair value of plan assets at beginning of year	$	60,733	57,337
Actual return on plan assets		2,168	4,737
Employer contribution		1,544	3,195
Benefits paid		(4,591)	(4,162)
Expenses paid		(326)	(374)
Fair value of plan assets at end of year		59,528	60,733
Funded status		(5,438)	1,946
Net amount recognized in the consolidated balance sheets	$	(5,438)	1,946
Amounts recognized in unrestricted net assets consist of:			
Prior service credit	$	—	891
Accumulated loss		(14,902)	(11,047)
Net actuarial loss	$	(14,902)	(10,156)

A summary of the components of net periodic benefit cost for the years ended June 30, 2018 and 2017 is as follows:

		2018	2017
Service cost	$	2,803	3,113
Interest cost		1,971	1,852
Expected return on plan assets		(3,285)	(3,008)
Amortization of loss		608	996
Amortization of prior service cost		(109)	—
Curtailment gain recognized		(25)	—
Special termination benefit recognized		2,219	—
Net periodic benefit cost	$	4,182	2,953

The estimated prior service credit and net loss that will be amortized into net periodic benefit cost over the next fiscal year is $258 and $499, respectively.

(Dollars in thousands)

Weighted average assumptions used to determine benefit obligations at June 30, 2018 and 2017 were as follows:

	2018	2017
Discount rate	4.08 %	3.54 %
Rate of compensation increase	5.75	5.75
Measurement date	June 30, 2018	June 30, 2017

Weighted average assumptions used to determine net benefit cost for the years ended June 30, 2018 and 2017 were as follows:

	2018	2017
Discount rate	3.54 %	3.26 %
Long-term rate of return on assets	5.61	5.35
Rate of compensation increase	5.75	5.75

To develop the expected long-term rate of return on assets assumption, the Hospital considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio. This resulted in the selection of 5.61% and the 5.35% long-term rate of return on assets assumption for the years ended June 30, 2018 and 2017, respectively, which reflects a lower return expectation than the Plan has experienced historically, in recognition that future returns may not be as strong as past returns.

The expected employer contribution for the year ending June 30, 2019 is $0.

Benefit payments expected to be paid over the next 10 years ending June 30 are as follows:

2019	$ 18,000
2020	15,700
2021	2,200
2022	2,300
2023	2,100
2024–2028	9,900
	$ 50,200

(Dollars in thousands)

The objectives of the Plan's investment policy are to protect the funded status of the Plan by reducing the investment risk to align with the reduced timeline to pay out plan assets, secondarily maximize returns within reasonable and prudent levels of risk, and maintain sufficient liquidity to meet benefit payment obligations on a timely basis. At June 30, 2018, The Plan's investment policy was to hold 100% of plan assets in money market funds due to the recent decision made to terminate the plan. The Plan's asset allocations as of the measurement date by asset category are as follows:

	2018	2017
Asset category:		
Money market funds	100 %	— %
Equity securities	—	36
Bond ETF securities	—	64
Total	100 %	100 %

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of June 30, 2018:

		Investments at estimated fair value			
		Investments at fair as value determined by quoted prices in active markets (Level 1)	Valuation techniques based on observable market data (Level 2)	Valuation techniques incorporating information other than observable market data (Level 3)	Total
Mutual funds:					
Money market funds	$	59,528	—	—	59,528
Total investments	$	59,528	—	—	59,528

(Dollars in thousands)

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of June 30, 2017:

		Investments at estimated fair value			
		Investments at fair as value determined by quoted prices in active markets (Level 1)	Valuation techniques based on observable market data (Level 2)	Valuation techniques incorporating information other than observable market data (Level 3)	Total
Mutual funds:					
Domestic equity funds	$	13,915	—	—	13,915
International equity funds		7,851	—	—	7,851
Money market funds		139	—	—	139
Closed end taxable funds:					
Bond ETF funds		38,828	—	—	38,828
Total investments	$	60,733	—	—	60,733

(b) The Voluntary Plan

The Voluntary Plan is a 403(b) plan. The Voluntary Plan is entirely employee funded. All employees may participate in the program and have a choice of investments with varying levels of risk and return. New employees are automatically enrolled in the Voluntary Plan.

(c) The Contribution Plan

Plan eligibility commences on the date of hire. Employees are divided into two groups. Group I employees include those hired prior to September 1, 2008, who had attained at least 41 years of age on December 31, 2008, and elected to continue to accrue benefits under the Overlake Hospital Medical Center Cash Account Plan. Group II employees include those hired after August 31, 2008 and employees hired prior to September 1, 2008 who did not attain at least 41 years of age on December 31, 2008 or otherwise elected to become a Group II employee. Employees who were eligible to elect between coverage as a Group I or a Group II employee but did not make an election were treated as a Group I employee under the Contribution Plan.

Participants must be credited with 1,000 hours of service during the calendar year in order to receive employer contributions. Each year the Hospital makes matching contributions to the Plan based on a percentage of employee contributions to the Voluntary Plan up to a specified maximum percent of the employee's eligible compensation. The Hospital's matching contributions are summarized as follows:

Group I employees receive 50% of employee contributions to the Voluntary Plan up to 3% of eligible compensation.

 (Continued)

(Dollars in thousands)

Group II Employees receive 100% of employee contributions to the Voluntary Plan, up to a maximum of 4% of the employee's eligible compensation for participants with less than five years of service or up to a maximum of 6% of the employee's eligible compensation for participants with five or more years of service at the start of the plan year, respectively.

In addition, the Hospital makes a nonelective service contribution equal to 2% of eligible compensation for each Group II employee subject to certain limitations imposed under the IRC. The Hospital contributed approximately $10,618 and $9,956 in matching and service contributions for the years ended June 30, 2018 and 2017, respectively, and is reflected in employee benefits in the consolidated statements of operations and changes in net assets.

(13) Commitments

The Association and its affiliates lease certain equipment and office space that are accounted for as operating leases. Total rental expense for all operating leases for the years ended June 30, 2018 and 2017 was approximately $7,377 and $7,000, respectively. The following is a schedule of future noncancelable operating lease payments as of June 30, 2018:

Fiscal year:		
2019	$	5,700
2020		5,646
2021		5,564
2022		4,905
2023		4,721
Thereafter		17,420
Operating lease obligations	$	43,956

The Association has outstanding construction contract commitments of $32,946 and $13,279 as of June 30, 2018 and 2017, respectively.

(14) Professional Liability Insurance, Workers' Compensation, and Health Benefits

The Association maintains claims-made professional liability insurance coverage through a commercial carrier. The policy for the years ended June 30, 2018 and 2017 has a $500 and $250 deductible per occurrence, respectively. The Association also carries excess coverage policies for its professional liability program.

Based upon actuarial valuations, the Association has recorded an estimated liability (undiscounted) for claims incurred but not reported as well as claims reported and not paid of $11,684 and $11,319 and a reinsurance receivable of $4,392 and $4,791 as of June 30, 2018 and 2017, respectively.

The Association is self-insured for workers' compensation. The accrued liabilities for the self-insured components of this plan include the unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. The Association also carries an excess coverage policy for its workers' compensation program. The Association has recorded an undiscounted liability for workers' compensation claims based on actuarial estimates of approximately $2,610 and $2,363 and a reinsurance receivable of $243 and $236 as of June 30, 2018 and 2017, respectively.

(Dollars in thousands)

The Association is self-insured for medical, dental, and prescription drugs. The accrued liabilities for the self-insured components of this plan include the unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. The Association also carries an excess coverage policy for its medical, dental, and prescription program. The Association has recorded an undiscounted liability for medical, dental, and prescription drugs claims based on actuarial estimates of approximately $1,383 and $1,320 as of June 30, 2018 and 2017, respectively.

(15) Litigation and Compliance with Laws and Regulations

The Association is involved in litigation and regulatory investigations arising in its normal course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Association’s future financial position or results from operations.

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

(16) Functional Expenses

The Association provides healthcare services to residents within its geographic service area. Expenses related to providing these services for the years ended June 30, 2018 and 2017 are as follows:

		2018	2017
Healthcare services	$	436,243	414,676
General and administrative		89,740	96,238
Fundraising		1,277	1,435
Total operating expenses	$	527,260	512,349

(Dollars in thousands)

(17) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes as of June 30, 2018 and 2017:

		2018	2017
Health care services	$	4,587	3,535
Purchase of building improvements and equipment		6,371	9,539
Health education		247	685
Indigent care		129	115
Total temporarily restricted net assets	$	11,334	13,874

Permanently restricted net assets as of June 30, 2018 and 2017 are assets that have been restricted by donors to be held in perpetuity, the income from which is expendable to support healthcare services, health education, and indigent care.

(18) Endowments

The Foundation's endowments consist of 19 individual funds established for a variety of purposes including both donor-restricted endowment funds and funds designated by management to function as endowments. Quasi endowment net assets associated with endowment funds, including funds designated by management, are classified and reported based on the existence or absence of donor-imposed restrictions.

(19) Subsequent Events

The Association has performed an evaluation of subsequent events through October 15, 2018, which is the date these consolidated financial statements were issued.

Schedule 1

OVERLAKE HOSPITAL ASSOCIATION

Consolidating Information – Balance Sheets

June 30, 2018 and 2017

(In thousands)

	Association	Hospital	Medical Tower	Eliminating entries	Total 2018	Total 2017
Current assets:						
Cash and cash equivalents	$ 360	28,110	1,260	—	29,730	18,404
Receivables, net	—	60,787	—	—	60,787	54,983
Current portion of pledges receivable	—	2,158	—	—	2,158	706
Current portion of assets whose use is limited	—	6,946	—	—	6,946	8,488
Supplies inventory	—	9,744	—	—	9,744	9,029
Prepaid expenses	55	10,470	197	—	10,722	8,154
Other current assets	61	5,458	—	—	5,519	5,798
Receivable from affiliates		1	—	(1)	—	—
Total current assets	476	123,674	1,457	(1)	125,606	105,562
Assets whose use is limited, net of current portion	—	126,691	—	—	126,691	19,559
Investments	—	464,436	2,079	—	466,515	408,061
Long-term portion of pledges receivables, net	—	4,743	—	—	4,743	3,252
Other long-term receivables, net	—	3,043	—	—	3,043	3,398
Land, buildings, and equipment, net	5,840	223,718	23,620	—	253,178	240,068
Other assets:						
Investments in joint ventures	—	2,740	—	—	2,740	3,091
Prepaid pension	—	—	—	—	—	1,946
Other assets	—	1,917	—	—	1,917	2,175
Interest in net assets of consolidated affiliates	557,766	—	—	(557,766)	—	—
Total other assets	557,766	4,657	—	(557,766)	4,657	7,212
Total assets	$ 564,082	950,962	27,156	(557,767)	984,433	787,112
Current liabilities:						
Current portion of long-term debt and capital leases	$ —	1,290	3,955	—	5,245	8,640
Payable to affiliates	—		1	(1)	—	—
Accounts payable	12	21,411	153	—	21,576	16,928
Accrued liabilities	66	56,044	58	—	56,168	49,192
Deferred liabilities	—	—	—	—	—	14,029
Accrued interest payable	—	5,650	49	—	5,699	3,729
Payable to third-party agencies	—	7,229	—	—	7,229	5,600
Total current liabilities	78	91,624	4,216	(1)	95,917	98,118
Long-term debt, net of current portion	—	294,265	13,388	—	307,653	155,816
Pension liability	—	5,438	—	—	5,438	—
Other long-term liabilities	33	11,421	—	—	11,454	10,842
Total liabilities	111	402,748	17,604	(1)	420,462	264,776
Net assets:						
Unrestricted net assets	563,971	531,035	9,552	(557,766)	546,792	502,732
Temporarily restricted net assets	—	11,334	—	—	11,334	13,874
Permanently restricted net assets	—	5,845	—	—	5,845	5,730
Total net assets	563,971	548,214	9,552	(557,766)	563,971	522,336
Total liabilities and net assets	$ 564,082	950,962	27,156	(557,767)	984,433	787,112

See accompanying independent auditors' report.

Schedule 2

OVERLAKE HOSPITAL ASSOCIATION

Consolidating Information – Operations and Changes in Net Assets

Years ended June 30, 2018 and 2017

(In thousands)

	Association	Hospital	Medical Tower	Eliminating entries	Total 2018	Total 2017
Operating revenue:						
Patient service revenue	$ —	540,109	—	—	540,109	504,924
Provision for uncollectible accounts	—	(11,013)	—	—	(11,013)	(8,720)
Net patient service revenue	—	529,096	—	—	529,096	496,204
Other operating revenue	1,652	24,112	9,442	(7,209)	27,997	15,145
Contribution revenue	—	2,190	—	—	2,190	1,878
Net operating revenue	1,652	555,398	9,442	(7,209)	559,283	513,227
Operating expenses:						
Salaries	—	231,374	—	—	231,374	219,178
Registry	—	10,337	—	—	10,337	10,195
Employee benefits	—	54,191	—	—	54,191	54,226
Supplies	5	90,822	83	—	90,910	87,979
Purchased services	142	48,372	1,304	—	49,818	51,431
Interest	—	8,126	668	—	8,794	7,989
Depreciation and amortization	316	31,949	1,477	—	33,742	33,282
Rent, leases, and utilities	706	18,055	528	(7,209)	12,080	11,665
Hospital taxes and assessments	—	17,655	—	—	17,655	19,586
Marketing, insurance, taxes, and other	67	17,741	551	—	18,359	16,818
Total operating expenses	1,236	528,622	4,611	(7,209)	527,260	512,349
Excess of revenue over expenses from operations	416	26,776	4,831	—	32,023	878
Nonoperation revenue, net:						
Investment income	—	13,550	2	—	13,552	22,901
Loss on refinancing	—	(8,627)	—	—	(8,627)	—
Nonoperating expenses	—	(2,219)	—	—	(2,219)	—
Total nonoperating revenue, net	—	2,704	2	—	2,706	22,901
Interest in net assets of consolidated affiliates	41,595	—	—	(41,595)	—	—
Excess of revenue over expenses	42,011	29,480	4,833	(41,595)	34,729	23,779
Other changes in unrestricted net assets:						
Net assets released for capital acquisitions	—	6,924	—	—	6,924	2,088
Change in pension liability	—	(4,746)	—	—	(4,746)	4,138
Change in net unrealized gains on investments	—	6,810	—	—	6,810	20,082
Appropriation of endowment assets for expenditure	—	343	—	—	343	292
Intercompany transfers	(376)	3,000	(2,624)	—	—	—
Increase in unrestricted net assets	41,635	41,811	2,209	(41,595)	44,060	50,379
Changes in temporarily restricted net assets:						
Contributions	—	5,446	—	—	5,446	10,431
Investment income	—	616	—	—	616	280
Change in net unrealized gains on investments	—	24	—	—	24	677
Net assets released from restrictions	—	(8,626)	—	—	(8,626)	(3,699)
(Decrease) increase in temporarily restricted net assets	—	(2,540)	—	—	(2,540)	7,689
Changes in permanently restricted net assets:						
Contributions	—	115	—	—	115	154
Increase in permanently restricted net assets	—	115	—	—	115	154
Increase in net assets	41,635	39,386	2,209	(41,595)	41,635	58,222
Net assets, beginning of year	522,336	508,828	7,343	(516,171)	522,336	464,114
Net assets, end of year	$ 563,971	548,214	9,552	(557,766)	563,971	522,336

See accompanying independent auditors' report.