Exhibit 6-A

Audited Financial Statements of PHS for the Five Fiscal Years ended December 31, 2017 Through 2021

Combined Financial Statements and Supplementary Information

Presbyterian Healthcare Services and Affiliates
Years Ended December 31, 2018 and 2017
With Reports of Independent Auditors

Ernst & Young LLP

Building a better
working world

Presbyterian Healthcare Services and Affiliates

Combined Financial Statements
and Supplementary Information

Years Ended December 31, 2018 and 2017

Contents

Report of Independent Auditors....1

Combined Financial Statements

Combined Balance Sheets....3
Combined Statements of Operations....4
Combined Statements of Changes in Net Assets....5
Combined Statements of Cash Flows....6
Notes to Combined Financial Statements....7

Supplementary Information

Report of Independent Auditors on Supplementary Information....52
Combining Balance Sheet....53
Combining Statement of Operations....55

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Report of Independent Auditors

The Board of Directors
Presbyterian Healthcare Services

We have audited the accompanying combined financial statements of Presbyterian Healthcare Services and Affiliates, which comprise the combined balance sheets as of December 31, 2018 and 2017, and the related combined statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

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Opinion

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

Ernst & Young LLP

April 12, 2019

Presbyterian Healthcare Services and Affiliates

Combined Balance Sheets

	December 31	
	2018	**2017**
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 284,331**	$ 256,172
Accounts receivable, less allowance for doubtful accounts of $29,638 as of December 31, 2017	**138,523**	132,820
Other receivables	**180,259**	111,147
Inventories, prepaid expenses, and other current assets	**56,412**	53,799
Total current assets	**659,525**	553,938
Assets limited as to use or restricted:		
Designated for long-term purposes	**1,908,842**	2,025,699
Designated for self-insurance funds	**137,847**	146,774
Restricted by donors	**45,265**	45,160
Held by trustee	**31,250**	94,350
Restricted for statutory requirements	**114,141**	101,350
	2,237,345	2,413,333
Property and equipment, net	**1,029,299**	932,121
Goodwill	**52,701**	52,701
Other assets	**161,636**	109,849
Total assets	**$ 4,140,506**	$ 4,061,942
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 99,155**	$ 76,062
Due under Medicaid contract	**38,505**	57,726
Accrued liabilities	**205,878**	144,132
Medical claims payable	**189,409**	120,752
Estimated third-party payor settlements	**6,221**	3,073
Current portion of long-term debt	**16,161**	15,580
Total current liabilities	**555,329**	417,325
Long-term debt, net of current portion	**830,662**	847,665
Employee benefit plans	**208,939**	226,912
Self-insurance plans	**171,809**	152,354
Other liabilities	**100,062**	97,990
Total liabilities	**1,866,801**	1,742,246
Net assets:		
Net assets without donor restrictions	**2,226,896**	2,274,535
Net assets with donor restrictions	**46,809**	45,161
Total net assets	**2,273,705**	2,319,696
Total liabilities and net assets	**$ 4,140,506**	$ 4,061,942

See accompanying notes.

Presbyterian Healthcare Services and Affiliates

Combined Statements of Operations

	Year Ended December 31	
	2018	**2017**
	(In Thousands)	
Operating revenues:		
Net premiums	**$ 2,297,979**	$ 1,988,757
Patient service revenue, net of contractual adjustments	**1,147,405**	1,101,684
Less provision for doubtful accounts	**–**	(30,070)
Net patient service revenue	**1,147,405**	1,071,614
Other operating revenues	**65,731**	63,671
Total operating revenues	**3,511,115**	3,124,042
Expenses:		
Medical claims	**1,404,083**	1,205,694
Salaries, wages and employee benefits	**1,036,237**	948,249
Purchased services and other	**520,088**	464,009
Supplies	**298,349**	284,758
Professional fees	**50,152**	48,070
Depreciation and amortization	**97,796**	95,700
Interest	**30,046**	28,965
Total expenses	**3,436,751**	3,075,445
Operating income	**74,364**	48,597
Other (loss) income:		
Investment income	**100,968**	168,036
Change in net unrealized gains and losses on investments	**(204,298)**	104,488
Loss on bond defeasance	**–**	(14,254)
Pension settlement loss	**(19,867)**	–
Change in fair value of interest rate swaps	**5,462**	2,779
Total other (loss) income	**(117,735)**	261,049
(Deficiency) excess of revenues over expenses before income tax	**(43,371)**	309,646
Provision for income taxes	**10,252**	8,987
(Deficiency) excess of revenues over expenses	**$ (53,623)**	$ 300,659

See accompanying notes.

Presbyterian Healthcare Services and Affiliates

Combined Statements of Changes in Net Assets

	Year Ended December 31 2018	2017
	(In Thousands)	
Net assets without donor restrictions		
(Deficiency) excess of revenues over expenses	**$ (53,623)**	$ 300,659
Change in pension obligation	**14,578**	(25,995)
Other changes in net assets	**(8,594)**	485
(Decrease) increase in net assets without donor restrictions	**(47,639)**	275,149
Net assets with donor restrictions		
Donor-restricted contributions	**5,336**	3,729
Investment (loss) income and other	**(1,567)**	4,409
Net assets released from restrictions	**(2,121)**	(2,234)
Changes in donor designation	**–**	(89)
Increase in net assets with donor restrictions	**1,648**	5,815
Change in net assets	**(45,991)**	280,964
Net assets, beginning of year	**2,319,696**	2,038,732
Net assets, end of year	**$ 2,273,705**	$ 2,319,696

See accompanying notes.

Presbyterian Healthcare Services and Affiliates

Combined Statements of Cash Flows

	Year Ended December 31 2018	2017
	(In Thousands)	
Operating activities		
Change in net assets	**$ (45,991)**	$ 280,964
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Change in net unrealized gains and losses on investments	**204,298**	(104,488)
Change in fair value of interest rate swaps	**(5,462)**	(2,779)
Loss on bond defeasance	**–**	14,254
Loss on pension settlement	**19,867**	–
Depreciation and amortization	**97,796**	95,700
Goodwill impairment	**–**	2,925
Changes in operating assets and liabilities:		
Accounts receivable	**(5,703)**	(12,619)
Other receivables	**(69,112)**	9,577
Inventories, prepaid expenses, and other current assets	**(2,613)**	(5,837)
Trading securities, net	**(78,619)**	(111,656)
Other assets	**(51,787)**	(22,402)
Accounts payable	**23,093**	16,132
Due under Medicaid contract	**(19,221)**	(128,664)
Accrued liabilities	**61,746**	(32,659)
Medical claims payable	**68,657**	(15,690)
Estimated third-party payor receivable/settlements	**3,148**	4,284
Other liabilities	**(10,851)**	49,532
Net cash provided by operating activities	**189,246**	36,574
Investing activities		
Sales of assets held by trustee and statutory deposits	**80,321**	219,773
Purchases of assets held by trustee and statutory deposits	**(30,012)**	(274,754)
Purchases of property and equipment	**(194,974)**	(177,058)
Net cash used in investing activities	**(144,665)**	(232,039)
Financing activities		
Proceeds from issuance of long-term debt	**–**	313,250
Payments on long-term debt	**(16,422)**	(163,643)
Net cash (used in) provided by financing activities	**(16,422)**	149,607
Change in cash and cash equivalents	**28,159**	(45,858)
Cash and cash equivalents, beginning of year	**256,172**	302,030
Cash and cash equivalents, end of year	**$ 284,331**	$ 256,172
Supplemental disclosures of cash flow information		
Cash paid for interest, net of amounts capitalized	**$ 31,543**	$ 26,251
Cash paid for income taxes	**$ 1,734**	$ 24,800

See accompanying notes.

1. Organization

Presbyterian Healthcare Services (PHS) is a New Mexico nonprofit corporation exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code (the Code). PHS is a diversified health care organization that owns, leases, controls, operates, or manages a variety of health care-related organizations, including seven hospitals in New Mexico, a for-profit health maintenance organization (HMO), and several other affiliated organizations. PHS provides a broad range of health care services, including inpatient, outpatient, subacute, home health care and physician services.

PHS consists of the following divisions and affiliates:

Presbyterian Healthcare Services Divisions

Presbyterian Hospital,* including the following, which are designated as remote locations of Presbyterian Hospital:
- Presbyterian Kaseman Hospital*
- Presbyterian Northside*
- Presbyterian Rust Medical Center*

Santa Fe Medical Center *
Plains Regional Medical Center*
Presbyterian Española Hospital*
Socorro General Hospital*
Lincoln County Medical Center (leased facility)
Dr. Dan C. Trigg Memorial Hospital (leased facility)

Presbyterian Healthcare Services Affiliates

Southwest Health Foundation
Presbyterian Network, Inc.:
- Presbyterian Insurance Company, Inc.
- Presbyterian Health Plan, Inc.
- Fluent Health, LLC
- Albuquerque Imaging Associates
- Southwest Magnetic Imaging Associates

Presbyterian Properties, Inc.
Presbyterian Healthcare Foundation*
Bernalillo County Health Care Corporation d.b.a. Albuquerque Ambulance Service*

* Denotes Obligated Group members.

PHS accesses the capital markets through an Obligated Group. Obligated Group members include PHS and certain divisions and affiliates as noted above, which are jointly and severally liable for the long-term debt outstanding under a Master Trust Indenture. None of the other PHS affiliates have any obligation related to requirements of the Master Trust Indenture. The Obligated Group's net assets represent approximately 76% and 77% of PHS and affiliates' combined net assets at December 31, 2018 and 2017, respectively.

1. Organization (continued)

Presbyterian Network, Inc. (PNI) is a wholly owned subsidiary of Southwest Health Foundation. PNI is the parent organization of two wholly owned subsidiaries: Presbyterian Health Plan, Inc. (PHP) and Presbyterian Insurance Company, Inc. (PIC). PHP is a state-licensed Health Maintenance Organization (HMO) in New Mexico and is also a federally qualified HMO under Title XIII of the Public Health Service Act. PHP provides comprehensive health care services in New Mexico to individuals primarily through health maintenance contracts with employer groups and individuals. PHP has a five-year contract with the State of New Mexico to provide physical health, behavioral health, and long-term care services to Medicaid eligible individuals under the Centennial Care program. The current five-year contract began January 1, 2014. At the beginning of 2018, PHP was awarded a new five-year contract beginning January 1, 2019. PHP also offers an HMO product to Medicare-eligible individuals (Medicare Advantage). The Medicare Advantage product provides managed care services that include all Medicare benefits and, in some cases, additional managed care services. PIC offers preferred provider and indemnity products to individuals through contracts with employer groups, as well as stop-loss coverage to PHP's level-funded and some self-funded groups.

On January 1, 2017, PNI, PHP and PIC, formed a management services organization, Fluent Health, LLC (Fluent), to facilitate potential health plan joint ventures outside of the state of New Mexico. The business purpose of Fluent is to provide claims processing, administrative, management, and consulting services to health plans. Fluent began providing these services to PHP and PIC on January 1, 2017.

Basis of Presentation

The accompanying combined financial statements include the accounts of PHS and its affiliates as described in Note 1 (collectively, Presbyterian Healthcare Services). All significant intercompany balances and transactions have been eliminated in combination.

2. Summary of Significant Accounting Policies

Pending Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires the rights and obligations arising from lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet. This accounting standard will also require additional disclosures about the amount, timing and uncertainty of cash flows arising from leases. The ASU is effective for PHS beginning January 1, 2019 and will be applied using a modified retrospective approach. The primary effect of the new standard will be to record right-of-use assets and obligations for current operating leases. The transition adjustment did not have a material impact on the combined financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, which applies to all entities that are required to present a statement of cash flows under Topic 230. ASU 2016-15 addresses the presentation and classification of cash flows related to certain matters pertaining to debt, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, distributions received from equity method investees, and certain other separately identifiable cash flows. The ASU is effective for PHS for the year ending December 31, 2019 and will be applied using a modified retrospective approach. PHS is currently evaluating the potential impact of this guidance.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which applies to all entities that have restricted cash and are required to present a statement of cash flows under Topic 230. ASU 2016-18 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. The ASU is effective for PHS for the year ending December 31, 2019 and will be applied using a modified retrospective approach. Management is currently evaluating the potential impact of this guidance.

In January 2017, the FASB issued ASU 2017-04*, Intangibles – Goodwill and Other (Topic 350)*. The accounting standard simplified the test used to evaluate goodwill and other intangibles for impairment. Under the new accounting standard, a company will perform its annual goodwill impairment test by comparing the fair value of the reporting unit with its carrying amount. An impairment charge will be recognized for the amount by which the carrying amount exceeds the

2. Summary of Significant Accounting Policies (continued)

reporting unit's fair value; however, the impairment loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. A company will still have the option to perform the qualitative assessment for a reporting unit. This accounting standard is effective for fiscal years beginning after December 15, 2020. Management is currently evaluating the impact of adopting this accounting standard, which will be effective January 2021.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*, a new fair value measurement accounting standard. This accounting standard changes the disclosure requirements for fair value measurement. The accounting standard is effective January 1, 2020 and will be applied using a retrospective approach. PHS is currently assessing the impact of this accounting standard on its combined financial statements.

Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, together with subsequent amendments, updates and an extension of the effective date (collectively, the New Revenue Standard), which supersedes most existing revenue recognition guidance, including industry-specific health care guidance. The New Revenue Standard provides for a single comprehensive principles-based standard for the recognition of revenue across all industries. PHS adopted this standard effective January 1, 2018 using a modified retrospective method. The modified retrospective method requires a company to record the transition adjustment for the New Revenue Standard, if any, as a cumulative effect adjustment to beginning net assets as of the date of adoption. PHS recorded a transition adjustment, which PHS considers immaterial to the combined financial statements, which decreased net assets as of January 1, 2018. The information in comparative periods has not been restated and continues to be reported under the accounting standards in effect in those periods. The adoption of ASU 2014-09 resulted in changes to the presentation of revenue primarily related to uninsured or underinsured patients. Prior to the adoption of ASU 2014-09, a significant portion of the provision for doubtful accounts related to self-pay patients, as well as co-pays, co-insurance and deductibles owed by patients with insurance. Under ASU 2014-09, the estimated uncollectible amounts due from these patients are generally considered implicit price concessions that are a direct reduction of net patient service revenue, with a corresponding reduction in the amounts presented separately as provisions for doubtful accounts.

2. Summary of Significant Accounting Policies (continued)

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. This accounting standard changes the presentation of net assets into two categories, net assets with donor restrictions and net assets without donor restrictions. This accounting standard also allows companies to elect to use either the direct or indirect cash flow method, and requires additional liquidity disclosures and presentation of expenses by both natural and functional classification. PHS adopted this standard for the year ended December 31, 2018, which primarily revised the presentation of PHS's net assets between net assets with and without donor restrictions. PHS elected to continue to use the indirect cash flow method.

Cash and Cash Equivalents

Cash and cash equivalents include bank deposits and highly liquid investments with original maturities at the time of purchase of three months or less. The carrying value of cash and cash equivalents approximates fair value.

Net Patient Accounts Receivable

Patient accounts receivable are recorded at net realizable value based on certain assumptions. In evaluating the collectability of accounts receivable, PHS analyzes its history and identifies trends for the appropriate allowances to reduce accounts receivable to net realizable value of its major payor sources of revenue, as well as self-pay patients, to estimate.

Management regularly reviews data about these major sources of revenue in evaluating the sufficiency of the allowances on accounts receivable. For receivables associated with services provided to patients who have third-party coverage, PHS analyzes historical collections as a basis for estimating future collections of accounts receivable. PHS has a policy of providing discounts to self-pay patients without insurance. Prior to the adoption of ASU 2014-09, a significant portion of the allowance for doubtful accounts was related to self-pay patients, as well as co-pays, co-insurance amounts and deductibles owed to PHS by patients with insurance. Under ASU 2014-09, the estimated uncollectable amounts due from these patients are generally considered implicit price concessions that are direct reductions of accounts receivable. The implicit price concessions are recognized immediately based on historical results.

2. Summary of Significant Accounting Policies (continued)

PHS's uninsured discount policies during 2018 and 2017 provided for a discount of 30% from standard rates for most services. These uninsured discounts are recorded with contractual adjustments as a deduction of patient service revenue.

Assets Limited as to Use or Restricted

Assets limited as to use or restricted include assets set aside by PHS for future long-term purposes, including capital improvements and self-insurance over which PHS retains control and may at its discretion subsequently use for other purposes, and investments held by PNI that are used to meet specified capital requirements for regulatory purposes. In addition, assets limited as to use or restricted include assets held by trustees under bond indenture agreements, contributions by donors with stipulated restrictions, and amounts on deposit to satisfy statutory requirements of the New Mexico Office of Superintendent of Insurance.

These assets consist primarily of cash, cash equivalents, government securities, other fixed-income securities, equity securities, and alternative investments. The carrying amounts of investments in marketable debt and equity securities are reported on the combined balance sheets at fair value. Alternative investments are reported at net asset value using the equity method of accounting, except for alternative investments held by Presbyterian Healthcare Foundation, which are reported at fair value, and alternative investments held as plan assets related to the defined benefit pension plan, which are also reported at fair value.

Income or loss related to the investment portfolio (including realized and unrealized gains and losses on investments, interest, and dividends) is included in the (deficiency) excess of revenues over expenses unless the income or loss is restricted by donor or law.

Income or loss restricted by donor or by law is classified as a change in net assets with donor restrictions consistent with the applicable restrictions.

As a condition of its Medicaid Centennial Care contract with the State of New Mexico Human Services Department (HSD), PHP is required to maintain an account with a balance equal to 90% of the average of the past three months capitation payments made to PHP from HSD. As of December 31, 2018 and 2017, $112,926 and $100,131, respectively, was held in bonds in a restricted managed asset account to satisfy this requirement.

2. Summary of Significant Accounting Policies (continued)

Fair Value Measurements

Accounting Standards Codification (ASC) 820, *Fair Value Measurement*, requires the categorization of financial assets and liabilities into a three-level hierarchy based on pricing inputs to the valuation technique. The fair value hierarchy gives the highest priority to the quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable inputs. The various levels of the fair value hierarchy are described as follows:

Level 1 – Pricing is based on observable inputs, such as quoted prices in active markets.

Level 2 – Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

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

Assets and liabilities measured at fair value are based on one or more of three valuation techniques noted in ASC 820. Where more than one technique is noted, individual assets or liabilities were valued using one or more of the noted techniques. The valuation techniques are as follows:

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

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

2. Summary of Significant Accounting Policies (continued)

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

When observable market data is available, it is required to be used in determining the fair value measurement. When inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level of input that is significant to the fair value measurement.

The majority of PHS's marketable debt and equity securities are measured based on observable market prices. PHS's interest rate swaps are measured using models based upon observable pricing inputs. Note 7 further describes the methods applied to determine fair value of PHS's financial assets and liabilities.

The carrying values of financial instruments classified as current assets and current liabilities approximate fair value due to their liquidity and short-term natures.

Inventories

Inventories, consisting of drugs and supplies, are stated at the lower of cost (first-in, first-out method) or net realizable value.

Property and Equipment, Net

Property and equipment purchases are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. The following useful lives are being used by PHS:

Land improvements	2–25 years
Buildings and improvements	5–40 years
Equipment and capitalized software	3–20 years

2. Summary of Significant Accounting Policies (continued)

Interest cost incurred on borrowed funds, net of interest earned on assets held by trustee during the period of construction of qualified capital projects, is capitalized as a component of the cost of acquiring those assets.

Goodwill

PHS follows the provisions of ASC 350, *Intangibles – Goodwill and Other*. Management assesses goodwill impairment using a qualitative evaluation, unless impairment triggers are identified. Goodwill impairment of $2,925 was recorded in 2017 which is recorded in depreciation and amortization expense. There was no goodwill impairment in 2018.

Impairment of Long-Lived Assets

PHS evaluates whether events and circumstances have occurred that indicate the remaining estimated useful lives of long-lived assets, other than goodwill, may not be recoverable. The assessment of possible impairment is based on the ability to recover the carrying amount of the asset based on undiscounted cash flows. Impairments are calculated as the total by which the carrying amount of the asset exceeds its estimated fair value. For the years ended December 31, 2018 and 2017, management determined that there was no impairment of its long-lived assets.

Investments in Unconsolidated Entities

Investments in unconsolidated entities are accounted for under the cost or equity method of accounting, as appropriate. PHS utilizes the equity method of accounting for its investment in entities over which it exercises significant influence. PHS's equity income or loss on these investments is recorded as other operating revenue.

(Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

Net Assets with Donor Restrictions

Unconditional pledges to give cash and other assets are reported at fair value at the date the pledge is received. The gifts are reported as net assets with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and recognized as a component of other operating revenue. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in other operating revenue.

Premium Revenues, Medical Claims Payable, and Health Care Expenses

Premium revenues are recognized in the month in which members are entitled to health care services. Premiums collected in advance are recorded as unearned premiums and are included in accrued liabilities on the accompanying combined balance sheets. During 2018 and 2017, premium revenue was as follows:

	Year Ended December 31	
	2018	**2017**
Premium revenue:		
Medicaid	**$ 1,470,272**	$ 1,168,475
Medicare	**417,074**	415,852
Commercial	**410,633**	404,430
Total	**$ 2,297,979**	$ 1,988,757

Coordination of benefits and subrogation are recognized in the period such amounts are determined to be recoverable from other insurers.

PHP is contracted with the state of New Mexico to serve the Medicaid population under the New Mexico Centennial Care program. All Medicaid services, including physical health, behavioral health, and long-term care, are provided as part of this program. PHP was one of four HMOs awarded five-year contracts by the state to administer the New Mexico Centennial Care program.

2. Summary of Significant Accounting Policies (continued)

Under this contract, PHP receives a fixed premium from the state to provide comprehensive health care services for enrollees, including those enrollees receiving services from PHS. PHS facilities and physicians are paid capitated or discounted fee-for-service rates from each of the MCOs. The medical claims costs of PHP on the combined statements of operations are net of intercompany eliminations for services rendered by PHS facilities totaling $784,960 and $753,629 for the years ended December 31, 2018 and 2017, respectively.

Under the Medicaid Centennial Care contract, PHP is permitted to retain 100% of the underwriting gain generated up to 3% annually. Underwriting gains above 3% are shared 50/50 between PHP and HSD. Additionally, for Hepatitis C drugs, PHP is subject to risk corridor adjustments. PHP and HSD share in excess gains or losses generated under the contract based on a tiered structure. Liabilities for the underwriting gain limitation and risk corridors of $20,752 and $41,347 as of December 31, 2018 and 2017, respectively, are recorded on the accompanying combined balance sheets in due under Medicaid contract.

HSD reviews claims for long-term care members to validate that they are receiving services within 90 days of becoming eligible, and also that there is no more than a 90 day break in such services. If HSD determines that services were not accessed, it has the right to recoup the original payment and repay for the member at an appropriate lower level premium. In 2017, in accordance with this Letter of Direction, PHP determined there is a liability as of December 31, 2018 and 2017 of $15,622 and $14,362, respectively. This is recorded on the accompanying combined balance sheets in due under Medicaid contract.

On September 1, 2018, PHP acquired approximately 83,000 Medicaid members previously served by another health plan. As a result of the purchase, PHP recorded an intangible asset equal to the cash paid of $42,011 and, in accordance with ASC 350, *Intangibles – Goodwill and Other*, determined a useful life of ten years. PHP has recorded $1,396 in amortization costs related to this intangible asset for the year ended December 31, 2018.

PHP and PIC serve as plan sponsors to offer Medicare Part D prescription drug insurance coverage under a contract with the Centers for Medicare & Medicaid Services (CMS). Premium revenue is recognized ratably over the period in which eligible individuals are entitled to receive prescription drug benefits. Premium revenues are subject to a comprehensive risk reconciliation under which CMS shares in a portion of direct surplus or deficit related to Medicare Part D premiums. In addition to premium revenues, PHP and PIC receive prepayments from CMS related to low income, cost sharing, and catastrophic reinsurance subsidies. PHP and PIC are fully reimbursed

2. Summary of Significant Accounting Policies (continued)

by CMS for costs incurred under these contract elements and, accordingly, there is no insurance risk to either company. Amounts received for these subsidies are not reflected as premium revenue, but rather are accounted for as deposits with the related liability recorded on the combined balance sheets. Pharmacy benefit costs not related to low income, cost sharing, or catastrophic reinsurance subsidies and administrative costs under the contract are expensed as incurred.

The estimated cost of all health services rendered to members through December 31 but not yet paid as of that date, is included in medical claims payable. This claims expense estimate is developed using actuarial assumptions based on historical experience with respect to the timing of payments in relation to the dates of service. Subsequent changes to prior period estimates are reflected in the current period. Losses on contracts are recognized in the period when health care costs are expected to exceed premium revenue.

Patient Service Revenue

Upon adoption of ASU 2014-09, PHS records patient service revenue at the transaction price estimated to reflect the total consideration due from patients and third-party payors in exchange for providing goods and services in patient care. These services are considered to be single performance obligations and have durations of less than one year. Revenues are recorded as these goods and services are provided. The transaction price, which involves significant estimates, is determined based on PHS's standard charges for the goods and services provided, with a reduction recorded for price concessions related to third-party contractual arrangements, as well as patient discounts and price concessions. This guidance specifies that the transaction price should be evaluated for individual contracts. However, as a practical expedient, entities may apply this guidance to a portfolio of contracts with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this guidance to the portfolio would not differ materially from applying this guidance to the individual contracts within that portfolio. PHS has chosen to use this portfolio approach and does not expect that it would be materially different from applying the guidance based on individual contracts. The impact of the transition adjustment that was recorded at January 1, 2018, was considered immatieral.

PHS has agreements with third-party payors that provide for payments at amounts different from established charges. The basis for payment under these agreements includes prospectively determined rates, cost reimbursement and negotiated discounts from established charges.

(Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

Patient service revenues are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments due to future audits, reviews and investigations. The differences between the estimated and actual adjustments are recorded as part of patient service revenue in future periods, as the amounts become known, or as years are no longer subject to such audits, reviews and investigations.

Currently, New Mexico utilizes supplemental reimbursement programs for the purpose of providing reimbursement to providers to offset a portion of the cost of providing care to Medicaid and uninsured patients. Under these programs, PHS recognizes revenue in the period in which amounts are estimable and collection is reasonably assured. Reimbursement under these programs is reflected in net patient service revenue.

For uninsured patients who do not qualify for charity care, PHS recognizes revenue on the basis of discounted rates, as provided by its policy. On the basis of historical experience, a significant portion of PHS's uninsured patients will be unable or unwilling to pay for the services provided. Prior to adoption of ASU 2014-09, PHS recorded a significant provision for doubtful accounts related to uninsured patients in the period the services are provided. Upon adoption of ASU 2014-09, the estimated uncollectable amounts due from these patients are generally considered implicit price concessions that are a direct reduction to net patient service revenue. Net patient service revenue, net of contractual allowances, discounts and implicit price concessions is recognized from the major payor sources as follows (after adoption of ASU 2014-09):

	Year Ended December 31, 2018
Patient service revenue, net of contractual allowances, discounts and implicit price concessions:	
Medicare	$ 346,791
Medicaid	206,730
Managed care and other third-party payors	562,885
Self pay	30,999
Total	$ 1,147,405

(Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

Net patient service revenue, net of contractual allowances and discounts but before the provision for doubtful accounts is recognized from the major payor sources as follows (prior to adoption of ASU 2014-09):

	Year Ended December 31 2018	2017
Patient service revenue (net of contractual allowances and discounts):		
Third-party payors	**$ 1,137,690**	$ 1,050,474
Self-pay	**47,759**	51,210
Total	**$ 1,185,449**	$ 1,101,684

Charity Care

As an integral part of its mission, PHS provides care to all patients, regardless of ability to pay for needed services. A patient is classified as a charity care patient in accordance with standards established across PHS and its affiliates. Charity care represents services rendered for which no, or only partial, payment is expected and, as such, is not included in revenues on the combined statements of operations.

(Deficiency) Excess of Revenues Over Expenses

The combined statements of operations include a measurement for (deficiency) excess of revenues over expenses. Changes in net assets without donor restrictions, which are excluded from (deficiency) excess of revenues over expenses, include contributions of long-lived assets (including assets acquired using contributions that, by donor restrictions, were to be used for the purpose of acquiring such assets) and changes in the pension liability.

Other Income and Loss

Activities that result in gains or losses and are unrelated to the primary mission of PHS are considered to be other income and losses. Accordingly, investment income, changes in unrealized gains and losses on investments, gain (loss) on debt extinguishment, gains (losses) on the settlement of pension obligations and unrealized changes in the fair value of interest rate swaps are reported as a component of other income (loss).

2. Summary of Significant Accounting Policies (continued)

Taxes

PHS and all of its affiliates, except for PNI and its subsidiaries, have been determined to be tax-exempt corporations by the Internal Revenue Service and generally are not subject to federal taxes on income.

The taxable affiliates utilize the liability method in accounting for income taxes. Under this method, deferred income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the currently enacted tax rates and laws. Valuation allowances are used to reduce deferred tax assets to their estimated net realizable values when management determines ultimate recovery is not probable.

PHP and PIC are required to pay premium taxes to the state based on a percentage of adjusted premiums received related to the Commercial and Medicaid product lines. As a result of paying premium taxes, PHP and PIC are exempt from paying state income taxes. PHP and PIC recorded net premium tax expense totaling $55,589 and $50,184 in 2018 and 2017, respectively. These amounts are included within purchased services and other expenses on the accompanying combined statements of operations.

ASC 740, *Income Taxes*, prescribes criteria for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. As of December 31, 2018 and 2017, there was no significant impact on the combined financial statements related to the tax positions taken. There were no significant tax positions taken by management that required accrual as of December 31, 2018 or 2017.

On December 22, 2017, the Tax Cuts and Jobs Act (Tax Legislation) was enacted. Among many changes resulting from Tax Legislation, the new law (i) reduces the federal statutory corporate tax rate to 21% effective January 1, 2018, (ii) eliminates the corporate alternative minimum tax for tax years beginning after December 31, 2017, (iii) allows businesses to immediately expense, for tax purposes, the cost of new investments in certain qualified depreciable assets, (iv) modifies the recognition of income rules by requiring the recognition of income for certain items no later than the tax year in which an item is taken into account as income on an applicable financial statement, and (v) limits the deduction by employers of expenses for entertainment and certain fringe benefits.

2. Summary of Significant Accounting Policies (continued)

At December 31, 2017, PHS was still analyzing certain aspects of Tax Legislation and refining its calculations. Thus, the accounting for the tax effect of Tax Legislation was not complete. PHS recorded provisional amounts which were included as a component of income tax expense for the year ended December 31, 2017. During the year ended December 31, 2018, PHS has completed its accounting for the tax effect of Tax Legislation to the extent guidance has been issued. As a result, PHS has recorded an immaterial measurement period adjustment, which is included as component of income tax expense. Tax Legislation has materially impacted the 2018 adjusted effective tax rate, primarily as a result of the reduced corporate statutory tax rate.

Derivative and Hedging Instruments

In accordance with ASC 815, *Derivatives and Hedging*, derivatives are recognized as either assets or liabilities at fair value on the combined balance sheets, regardless of the purpose or intent for holding them. For those derivatives not designated as hedges under such standards, the changes in fair value are recognized in excess of revenue over expenses. For those derivatives previously designated as hedges under such standards, the effective portion of the changes in fair value previously recognized in net assets is being amortized into the (deficiency) excess of revenues over expenses over the remaining lives of the derivative instruments.

Benefit Plans

PHS is the plan sponsor of a defined benefit pension plan (Plan I) and five other limited postretirement benefit plans. The funded status of Plan I is recognized on the combined balance sheets as the difference between the fair value of the investments and the actuarially determined pension obligation. Other required disclosures of ASC 715, *Compensation – Retirement Benefits*, include the accumulated benefit obligation and fair value of the plan's assets, assumptions used in the benefit obligation calculation, contributions, the asset allocation of the plan, and the expected benefits to be paid, which can be found in Note 11.

In addition to Plan I, PHS and PHP sponsor certain defined contribution plans. Contributions to these plans are expensed as earned by the employees.

2. Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of combined 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, liabilities, revenue and expenses in the combined financial statements. Actual results could differ from those estimates.

3. Patient Service Revenue

A summary of payment arrangements with major third-party payors follows:

Medicare – Inpatient acute care and certain outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge or procedure. These rates vary according to patient classification systems based on clinical, diagnostic and other factors.

Medicaid – The State Medicaid program consists of two primary plans. The larger plan is the New Mexico Centennial Care program. Medicaid services, including physical health, behavioral health, and long-term care, are provided as part of the New Mexico Centennial Care program. The smaller plan is a traditional Medicaid plan. PHS facilities and physicians are paid for inpatient acute care services on prospectively determined rates per discharge. Payments for outpatient services are made on a discounted fee-for-service basis.

Others – PHS has also entered into payment agreements with certain commercial insurance carriers, HMOs and preferred provider organizations. The basis for payment to PHS under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Amounts received from third-party payors in excess of expected reimbursement are reflected as estimated third-party payor settlements on the accompanying combined financial statements.

(Dollar Amounts in Thousands)

4. Other Operating Revenues

Other operating revenues consist of the following:

	Year Ended December 31	
	2018	**2017**
Health plan administrative fees	**$ 25,189**	$ 23,598
Contributions and other	**33,311**	30,280
Tax appropriation revenue	**7,231**	9,793
	$ 65,731	$ 63,671

5. Community Benefit

In support of its mission and philosophy, PHS voluntarily provides free care to patients who cannot afford health care due to inadequate resources and/or patients who are uninsured. Because PHS does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as patient service revenues. The estimated cost of this voluntary free care less the amount, if any, ultimately received was $40,987 and $37,947 in 2018 and 2017, respectively.

In addition, PHS provides services to other patients under certain government-reimbursed public aid programs, which pay providers amounts that are generally less than the cost of rendering the services provided to the patients. The estimated unreimbursed cost of this care was approximately $186,487 and $204,272 in 2018 and 2017, respectively. These unreimbursed costs and costs of voluntary free care do not include any governmental funds received for providing access to health care to all residents of the local community.

PHS uses information from its cost accounting system and certain cost-to-charge ratios, where applicable, to estimate the cost of financial assistance and other community benefits reported.

PHS, in furtherance of its mission, also commits significant time and resources to endeavors and critical services that meet otherwise unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable. Such programs include health screenings and assessments; cancer and other support groups; hospice programs; free transportation, lodging, meals and medications for transient patients when

(Dollar Amounts in Thousands)

5. Community Benefit (continued)

needed; funding for homeless health care programs; significant ongoing and temporary donations of office space and telephone systems for nonprofit health care organizations, including the Meals on Wheels program; free flu vaccine clinics; participation in regular blood drives; and the provision of educational opportunities for students interested in pursuing medical-related or pastoral careers.

6. Assets Limited as to Use or Restricted

PHS has designated the accumulation of certain funds for future replacement of property and equipment, other capital improvements, debt retirement, self-insurance reserves, and other long-term purposes. Under the terms of the Master Trust Indenture for the outstanding bond issues, funds held by the trustee have been established and legally designated for debt service and qualifying capital expenditures.

The following is a summary of assets limited as to use or restricted at fair value, except for certain alternative investments, which are recorded at net asset value using the equity method:

	December 31	
	2018	**2017**
Cash and cash equivalents	**$ 47,498**	$ 106,611
Fixed-income securities	**871,168**	905,359
Equity securities	**833,038**	972,554
Government securities	**138,986**	113,159
Public master limited partnerships	**64,879**	60,188
	1,955,569	2,157,871
Alternative investments	**281,776**	255,462
	$ 2,237,345	$ 2,413,333

Fixed-Income and Government Securities – These investment classes include investments in various fixed-income instruments that include investment-grade and high-yield domestic and international bonds, mortgage pools and bonds issued by U.S. government agencies. These investment classes also includes investments in common trust funds, mutual funds, exchange-traded funds and separately managed accounts that hold investments in fixed-income securities. The fixed-income investments are exposed to various kinds and levels of risk, including interest rate risk, credit risk, foreign exchange risk and liquidity risk.

6. Assets Limited as to Use or Restricted (continued)

Equity Securities – This investment class consists primarily of common equity securities of domestic and international companies. These securities trade through the major public domestic and international exchanges. This investment class also includes investments in common trust funds, mutual funds and exchange-traded funds that hold investments in equity securities. The equity securities investments are exposed to various risks, including market risk; individual security risk; foreign exchange risk; and, for common equity of companies with a small market capitalization, liquidity risk.

Public Master Limited Partnerships – This investment class consists of master limited partnerships that invest in various domestic infrastructure assets within the energy industry. The securities held within the limited partnership trade through the major public domestic exchanges and are exposed to various risks, including market risk, individual security risk, regulatory risk, interest rate risk and liquidity risk.

Alternative Investments – Funds in this class are invested with external investment managers who invest primarily in various alternative categories, including real estate, long- and short-equity positions, merger and event arbitrage, natural resources, distressed credit, managed futures, fixed-income arbitrage and foreign exchange. The managers employ various strategies, including long/short equity, event driven, relative value, and tactical trading. A long/short equity strategy will take both long- and short-equity positions in publicly traded stocks to provide maximum capital appreciation, while limiting downside risk. Event driven strategies deploy funds opportunistically across multiple asset categories seeking positive returns from companies involved in mergers, acquisitions, bankruptcy, litigation, regulatory uncertainty and other matters with the potential to unlock value. Relative value funds use a variety of different strategies across a broad array of equity and fixed income securities to take advantage of market inefficiencies between asset pairs, while maintaining a market neutral risk position. Tactical trading strategies invest primarily in liquid markets, such as fixed income and mortgage derivative securities, convertible debt, currencies, interest rate swaps, equity indices, and commodities and energy derivatives, while seeking to take advantage of changes in global economies and discrepancies among related sets of securities and derivatives resulting in asymmetrical outcomes. These investments are domestic and international in nature and have varying degrees of illiquidity. The risks associated with these investments are numerous and include liquidity risk, market risk, event risk, interest rate risk, foreign exchange risk and investment manager risk. In addition, the investment managers are not required to register with the Securities and Exchange Commission and are not subject to regulatory controls. As unregistered investment vehicles, these funds are not required to disclose the holdings in their portfolios to investors. Given the numerous risks involved, these funds have a greater likelihood of losing invested capital.

(Dollar Amounts in Thousands)

6. Assets Limited as to Use or Restricted (continued)

Investment (loss) income on assets limited as to use or restricted (excluding restricted by donor) consists of the following:

	Year Ended December 31	
	2018	**2017**
Interest and dividend income	**$ 54,184**	$ 39,426
Net realized gains on marketable securities	**46,784**	128,610
Total realized income	**100,968**	168,036
Net unrealized (loss) gains on marketable securities	**(204,131)**	118,169
Net unrealized loss on alternative investments	**(167)**	(13,681)
	$ (103,330)	$ 272,524

7. Fair Value Measurements

PHS's alternative investments, totaling $281,776 and $255,462 as of December 31, 2018 and 2017, respectively, are accounted for using the equity method of accounting. Accordingly, the alternative investments are omitted from the following tables of financial instruments measured at fair value.

7. Fair Value Measurements (continued)

The following table presents the fair value hierarchy for those financial assets and liabilities measured at fair value on a recurring basis at December 31, 2018:

	Level 1	Level 2*	Level 3	Fair Value	Carrying Value at December 31, 2018	Valuation Technique**
			(In Thousands)			
Designated for long-term purposes						
Money market	$ 8,839	$ –	$ –	$ 8,839	$ 8,839	a
Government and agencies	71,465	–	–	71,465	71,465	a
Bond funds	353,152	189,534	–	542,686	542,686	a/c
Corporate and municipal bonds	–	214,616	–	214,616	214,616	a
Equity funds	409,177	351,811	–	760,988	760,988	a
Other public equities	58,693	–	–	58,693	58,693	a
Total designated for long-term purposes	$ 901,326	$ 755,961	$ –	$ 1,657,287	$ 1,657,287	
Designated for self-insurance funds			–			
Money market	$ 3,499	$ –	$ –	$ 3,499	$ 3,499	a
Government and agencies	2,099	–	–	2,099	2,099	a
Bond funds	29,036	16,205	–	45,241	45,241	a/c
Corporate and municipal bonds	–	5,441	–	5,441	5,441	a
Equity funds	14,534	40,910	–	55,444	55,444	a
Other public equities	4,887	–	–	4,887	4,887	a
Total designated for self-insurance funds	$ 54,055	$ 62,556	$ –	$ 116,611	$ 116,611	
Restricted by donors						
Money market	$ 218	$ –	$ –	$ 218	$ 218	a
Government and agencies	1,552	–	–	1,552	1,552	a
Bond funds	7,829	4,116	–	11,945	11,945	a/c
Corporate and municipal bonds	–	4,660	–	4,660	4,660	a
Equity funds	8,967	7,639	–	16,606	16,606	a
Other public equities	1,299	–	–	1,299	1,299	a
Total restricted by donors	$ 19,865	$ 16,415	$ –	$ 36,280	$ 36,280	
Held by trustee						
Money market	$ 31,250	$ –	$ –	$ 31,250	$ 31,250	a
	$ 31,250	$ –	$ –	$ 31,250	$ 31,250	
Restricted for statutory requirements						
Money market	$ 3,692	$ –	$ –	$ 3,692	$ 3,692	a
Government and agencies	39,149	24,721	–	63,870	63,870	a
Corporate and municipal bonds	–	46,579	–	46,579	46,579	a
	$ 42,841	$ 71,300	$ –	$ 114,141	$ 114,141	
Financial liabilities						
Interest rate swaps	$ –	$ (15,642)	$ –	$ (15,642)	$ (15,642)	a

* Approximately 71% of Level 2 assets consist of commingled funds in which the underlying assets are primarily marketable debt and equity securities that trade on nationally recognized exchanges.

** Valuation techniques are described in Note 2.

7. Fair Value Measurements (continued)

The following table presents the fair value hierarchy for those financial assets and liabilities measured at fair value on a recurring basis at December 31, 2017:

	Level 1	Level 2*	Level 3	Fair Value	Carrying Value at December 31, 2017	Valuation Technique**
			(In Thousands)			
Designated for long-term purposes						
Money market	$ 5,949	$ –	$ –	$ 5,949	$ 5,949	a
Government and agencies	57,429	–	–	57,429	57,429	a
Bond funds	345,310	173,725	–	519,035	519,035	a/c
Corporate and municipal bonds	–	274,051	–	274,051	274,051	a
Equity funds	440,515	445,017	–	885,532	885,532	a
Other public equities	54,513	–	–	54,513	54,513	a
Total designated for long-term purposes	$ 903,716	$ 892,793	$ –	$ 1,796,509	$ 1,796,509	
Designated for self-insurance funds						
Money market	$ 2,997	$ –	$ –	$ 2,997	$ 2,997	a
Government and agencies	1,802	–	–	1,802	1,802	a
Bond funds	29,054	15,479	–	44,533	44,533	a/c
Corporate and municipal bonds	–	5,660	–	5,660	5,660	a
Equity funds	19,020	49,483	–	68,503	68,503	a
Other public equities	4,521	–	–	4,521	4,521	a
Total designated for self-insurance funds	$ 57,394	$ 70,622	$ –	$ 128,016	$ 128,016	
Restricted by donors						
Money market	$ 143	$ –	$ –	$ 143	$ 143	a
Government and agencies	1,191	–	–	1,191	1,191	a
Bond funds	7,353	3,603	–	10,956	10,956	a/c
Corporate and municipal bonds	–	5,683	–	5,683	5,683	a
Equity funds	9,290	9,229	–	18,519	18,519	a
Other public equities	1,154	–	–	1,154	1,154	a
Total restricted by donors	$ 19,131	$ 18,515	$ –	$ 37,646	$ 37,646	
Held by trustee						
Money market	$ 94,350	$ –	$ –	$ 94,350	$ 94,350	a
	$ 94,350	$ –	$ –	$ 94,350	$ 94,350	
Restricted for statutory requirements						
Money market	$ 3,172	$ –	$ –	$ 3,172	$ 3,172	a
Government and agencies	29,284	23,453	–	52,737	52,737	a
Corporate and municipal bonds	–	45,441	–	45,441	45,441	a
	$ 32,456	$ 68,894	$ –	$ 101,350	$ 101,350	
Financial liabilities						
Interest rate swaps	$ –	$ (19,954)	$ –	$ (19,954)	$ (19,954)	a

* Approximately 70% of Level 2 assets consist of commingled funds in which the underlying assets are primarily marketable debt and equity securities that trade on nationally recognized exchanges.

** Valuation techniques are described in Note 2.

(Dollar Amounts in Thousands)

7. Fair Value Measurements (continued)

There were no changes in the fair value level classification, between Level 1 and Level 2, for any investments in 2018 or 2017. PHS has no Level 3 investments.

As of December 31, 2018 and 2017, PHS had alternative investments representing various hedge funds and real asset investments that include limited liability companies and limited liability partnerships (as described in Note 6), as follows:

	December 31	
	2018	**2017**
Equity long/short	**$ 15,039**	$ 17,334
Event driven	**33,272**	33,191
Relative value	**44,720**	46,033
Tactical trading	**34,200**	37,200
Private equity	**5,089**	5,301
Real assets	**117,905**	84,419
Total cost basis	**250,225**	223,478
Unrealized gain, net	**31,551**	31,984
	$ 281,776	$ 255,462

Approximately 93% of these alternative investments represent investments with original lockup periods ranging from one month to five years. The remaining exposure represents investments with longer lockups and limited redemption rights. There were no material unfunded commitments at December 31, 2018.

Fair Value of Long-Term Debt

The fair value of long-term debt is estimated based upon published or quoted market prices for these issues or, where such prices not available, on similar issues and was $848,733 and $892,185 at December 31, 2018 and 2017, respectively.

(Dollar Amounts in Thousands)

8. Property and Equipment, Net

Property and equipment, net, consists of the following:

	December 31	
	2018	**2017**
Land and improvements	**$ 126,372**	$ 120,147
Buildings and improvements	**1,184,087**	1,010,721
Equipment	**625,245**	574,324
Software	**250,386**	234,231
	2,186,090	1,939,423
Less accumulated depreciation and amortization	**(1,235,767)**	(1,141,179)
	950,323	798,244
Construction-in-progress	**78,976**	133,877
	$ 1,029,299	$ 932,121

Unamortized software was $43,186 and $51,458 as of December 31, 2018 and 2017, respectively. Software amortization expense was $24,438 and $24,247 for the years ended December 31, 2018 and 2017, respectively, and is included in depreciation and amortization expense.

At December 31, 2018, PHS has future capital commitments of $6,583.

9. Medical Claims Expense

For the years ended December 31, 2018 and 2017, medical claims expense decreased $10,669 and $13,667 in 2018 and 2017, respectively, as a result of changes in estimates of unpaid claims and claims adjustment expenses. These changes generally are the result of ongoing analyses of recent loss development trends. Original estimates are increased or decreased as additional information becomes known regarding individual claims.

(Dollar Amounts in Thousands)

10. Long-Term Debt and Interest Rate Swaps

	December 31	
	2018	**2017**
2017 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates of 2.0% to 5.0% payable semiannually on the established interest payment dates, principal payments through 2046	**$ 238,730**	$ 239,115
2017 Series B Taxable Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates of 4.0% and 5.0% payable semiannually on the established interest payment dates, principal payments beginning in 2037 through 2046	**65,665**	65,665
2015 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates from 4.125% to 5.0% at December 31, 2018, payable semiannually on the established interest payment dates, principal payments through 2044	**218,195**	224,775
2012 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates from 4.0% to 5.0% at December 31, 2018, payable semiannually on the established interest payment dates, principal payments beginning in 2033 through 2042	**75,000**	75,000
2008 Series B, C, and D Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), variable-rate demand bonds with interest rate of 1.75% to 1.80% at December 31, 2018, payable monthly on the established interest payment date, principal payable in annual installments through 2034	**171,165**	178,695
2012 note payable to bank, variable rate, interest payable quarterly at one-month LIBOR plus .90% (3.36% at December 31, 2018) due October 2022	**50,000**	50,000
Other obligations	**4,790**	5,849
	823,545	839,099
Premiums on long-term debt, net	**30,148**	31,314
Less deferred financing fees	**(6,870)**	(7,168)
	846,823	863,245
Less current portion	**(16,161)**	(15,580)
	$ 830,662	$ 847,665

10. Long-Term Debt and Interest Rate Swaps (continued)

The 2017 Series A Revenue Bonds totaling $239,115 were issued through the New Mexico Hospital Equipment Loan Council in May 2017. Proceeds of the bonds were issued to defease the 2009 Series A Revenue Bonds and provide funding for the construction of a new hospital facility in Santa Fe, New Mexico, which opened in October 2018. The 2017 Series A bonds are fixed-rate bonds and have annual maturities that began in August 2018, and continue through 2046.

The 2017 Series B Taxable Revenue Bonds totaling $65,665 were issued through the New Mexico Hospital Equipment Loan Council in May 2017. Proceeds of the bonds are being used to fund the construction of a physician office building adjacent to the new hospital in Santa Fe, New Mexico, and expand PHS's administrative office in Albuquerque, New Mexico. The 2017 Series B bonds are fixed rate bonds and have annual maturities beginning in August 2037 and continuing through 2046.

The 2015 Series A Revenue Bonds were issued through the New Mexico Hospital Equipment Loan Council. Proceeds of the bonds were used to defease the 2008 Series A Bonds and fund various health care facilities throughout the PHS system. The 2015 bonds are fixed-rate serial and term bonds and have scheduled maturities and mandatory sinking fund deposits that began in August 2016, and continue through 2044.

The 2012 Series A Revenue Bonds were issued through the New Mexico Hospital Equipment Loan Council in August 2012. Proceeds of the bonds were used to fund various health care facilities throughout the PHS system, including a patient tower at the Española Hospital, a cancer center on the Rust Medical Center campus, a physician office building adjacent to Socorro General Hospital, and other general capital improvements. The 2012 bonds are fixed-rate term bonds and have scheduled mandatory sinking fund deposits starting in 2033 and continuing through 2042. In August 2012, PHS also obtained a $50,000 taxable bank direct loan (the 2012 Bank Loan), of which $50,000 was outstanding as of December 31, 2018 and 2017. Proceeds of the 2012 Bank Loan were used for a new system corporate office, which was completed in 2014.

10. Long-Term Debt and Interest Rate Swaps (continued)

The 2009 Series A Revenue Bonds totaling $134,610 of original issue discount bonds were issued through the New Mexico Hospital Equipment Loan Council. Proceeds of the bonds were used to fund a project for the construction of the Rust Medical Center and pay the costs of issuance. The 2009 bonds were defeased in 2017 and a loss of $14,254 was recognized.

The 2008 Revenue Bonds were issued through the New Mexico Hospital Equipment Loan Council in four series (Series A, Series B, Series C, and Series D) (the Series 2008 Bonds) in November 2008. The Series 2008 Bonds were designed to defease the 2005 Series A and B Revenue Bonds ($201,895); to pay off a Wells Fargo Credit Agreement, which defeased the 2004 Series A through D Bonds ($128,655) and the 1993A Bonds ($17,900) during March and April 2008; to reimburse PHS for prior capital expenditures; and to pay certain costs of issuing the Series 2008 Bonds. The Series 2008 A Bonds were refunded in their entirety in 2015 and have been legally defeased. The Series 2008 B through D Bonds are variable-rate demand obligations and bear interest on a daily (Series C and D) and weekly (Series B) rate period at amounts set by a remarketing agent. The interest rate mode can be modified under the terms of the legal documents. To secure the tender price of the Series 2008 B Bonds, PHS has entered into standby a bond purchase agreement with JPMorgan Chase Bank, N.A with expirations in November 2020. The Series 2008 C and D Bonds are supported by standby bond purchase agreements with Wells Fargo Bank, N.A. with expiration dates in November 2021 and 2019, respectively.

The Series 2008 B, C, and D Bonds are further subject to optional redemption at the discretion of PHS. In addition, the Series 2008 Bonds have a schedule of mandatory sinking fund deposits through 2034.

All of the outstanding bonds are collateralized by a pledge of unrestricted receivables of the Obligated Group, as defined under the Master Trust Indenture. The Master Trust Indenture of the Obligated Group requires, among other things, that certain funds be established and held by a trustee. The Master Trust Indenture also requires certain limitations on additional indebtedness, liens on property, and disposition or transfers of assets, as well as the maintenance of certain cash balances and other financial ratios. The Obligated Group was in compliance with all such covenants at December 31, 2018.

(Dollar Amounts in Thousands)

10. Long-Term Debt and Interest Rate Swaps (continued)

Scheduled principal payments and sinking fund requirements on long-term debt at December 31 are as follows:

	Long-Term Debt
2019	$ 16,161
2020	16,829
2021	17,548
2022	18,285
2023	19,060
Thereafter	765,810
	$ 853,693

Interest Rate Swaps

PHS has entered several interest rate swaps associated with bond issuances, some of which bonds are no longer outstanding. The 2005 Swaps provide that PHS receives a floating amount based on a percentage of one-month LIBOR (58.30% of LIBOR plus 0.36%) and PHS pays a fixed rate of 3.085% based on a notional amount of $146,420 and $153,950 at December 31, 2018 and 2017, respectively.

The 2006 Swaps provide that PHS receives a floating amount based on a percentage of one-month LIBOR (68%) and PHS pays a weighted average fixed rate of 3.564% based on a notional amount of $24,745 at both December 31, 2018 and 2017.

All derivatives that are being measured by PHS under ASC 820 are considered Level 2 assets (liabilities) because a quoted price can be obtained from a number of dealer counterparties and other market sources based on observable interest rates and yield curves for the full term of the asset or liability. In order to measure the fair value of municipal derivatives under ASC 820, PHS adjusted its mid-market periodic values of the swaps outstanding to incorporate non-performance risk by PHS (when the financial instrument is a liability) or the counterparty (when the financial instrument is an asset). In order to determine the risk of non-performance when the financial instrument is a liability, PHS has determined the change in the credit market for debt issues by

10. Long-Term Debt and Interest Rate Swaps (continued)

entities with the same credit characteristics as PHS. To determine non-performance risk when the instrument is an asset, PHS determines the change in the credit market for debt issues by the counterparty.

As of December 31, 2018 and 2017, the fair value of the 2005 and 2006 Swaps was a net liability of $15,642 and $19,954, respectively, and is included in other liabilities on the accompanying combined balance sheets.

If the liability related to the swaps were to exceed $40,000, PHS would be required to post a cash deposit for amounts in excess of the threshold as collateral with the counterparty. This collateral threshold would be reduced to $30,000 if PHS's current AA credit rating were to fall to A+, reduced to $20,000 at a rating of A, and further reduced to zero at a credit rating below A.

Interest expense included $2,958 and $4,066 in 2018 and 2017, respectively, related to net periodic payments to the counterparty.

11. Employee Benefit Plans

PHS has a defined benefit pension plan (Plan I) that previously covered substantially all of the employees of its related organizations, except employees of PNI. Effective January 1, 2006, Plan I was closed to new entrants, but it continued to accrue benefits for those employees in the plan as of December 31, 2005 until December 31, 2012, when Plan I was amended to cease future benefit accruals. Any benefits earned by participants under Plan I at December 31, 2012 will be preserved and will be payable based on Plan I's provisions.

PHS contributes such amounts as necessary on an actuarial basis to provide Plan I with assets sufficient to meet the benefits to be paid to Plan I participants. PHS contributed $31,739 and $13,041 in 2018 and 2017, respectively, to Plan I. In December 2018, certain participants in Plan I were removed from the plan through lump sum payments and annuities. Remaining participants in the plan were transferred to a new ongoing plan and the old plan was terminated. The termination of the plan resulted in a pension settlement charge of $19,867 which was recorded in 2018.

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

A summary of Plan I's benefit obligation, assets, and funded status is as follows:

	Year Ended December 31	
	2018	**2017**
Change in benefit obligation:		
Benefit obligation at beginning of year	**$ 553,711**	$ 492,240
Service cost	**4,300**	3,500
Interest cost	**21,346**	22,305
Plan settlements	**(54,527)**	–
Actuarial (gain) loss	**(33,704)**	58,687
Benefits paid and plan expenses	**(25,301)**	(23,021)
Benefit obligation at end of year	**$ 465,825**	$ 553,711
Change in assets:		
Fair value of assets at beginning of year	**$ 376,386**	$ 333,107
Actual return on assets	**(22,226)**	53,259
Employer contribution	**31,739**	13,041
Plan settlements	**(54,527)**	–
Benefits paid and plan expenses	**(25,301)**	(23,021)
Fair value of plan assets at end of year	**$ 306,071**	$ 376,386
Funded status at year-end	**$ (159,754)**	$ (177,325)
Amounts not yet reflected in net periodic benefit cost and included in net assets:		
Accumulated loss	**$ (176,253)**	$ (188,888)
Cumulative changes in unrestricted net assets	**(176,253)**	(188,888)
Cumulative employer contributions in excess of net periodic benefit cost	**16,499**	11,563
Net amount recognized in the combined balance sheets	**$ (159,754)**	$ (177,325)

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

The actuarial loss recorded in 2018 was primarily due to the change in discount rate from 3.93% to 4.48%. This change increased the benefit obligation by $39,000 in 2018.

In 2018, PHS recorded settlement and curtailment charges of $19,867 for the risk transfer activities that occurred in 2018. These charges are in addition to the regular periodic benefit cost of $6,936. These risk transfer activities are also the primary cause for the decrease on both pension obligation and assets during 2018.

A summary of the projected benefit obligation, accumulated benefit obligation, and fair value of plan assets is as follows:

	2018	2017
Projected benefit obligation	**$ 465,825**	$ 553,711
Accumulated benefit obligation	**465,825**	553,711
Fair value of plan assets	**306,071**	376,386

Net periodic pension benefit cost includes the following components:

	2018	2017
Service cost – benefits earned during the year	**$ 4,300**	$ 3,500
Interest cost on projected benefit obligation	**21,346**	22,305
Expected return on Plan I assets	**(24,589)**	(23,082)
Amortization of prior service credit	**1,561**	1,561
Recognized net actuarial loss	**4,318**	2,718
Net periodic pension benefit cost	**$ 6,936**	$ 7,002

Assumptions used to determine benefit obligation as of the measurement date are as follows:

	2018	2017
Discount rate at end of year	**4.48%**	3.93%
Rate of increase in compensation levels	**N/A**	N/A

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

Assumptions used to determine net periodic pension benefit cost are as follows:

	2018	2017
Discount rate at beginning of year	**3.93%**	4.62%
Rate of increase in compensation levels	**N/A**	N/A
Expected long-term rate of return on assets	**6.50%**	6.75%

Contributions to be made during 2019 have not been finalized, but are expected to be $25,714.

The expected return on Plan I assets has been developed using both historical and future expected returns for each asset class. Based on the target asset mix as of December 31, 2018, PHS has selected a long-term rate of return of 6.75% using this approach.

The asset allocation for Plan I, by asset class at the measurement date, was as follows:

	2018	2017
Cash and cash equivalents	**4%**	1%
Fixed-income securities	**44**	42
Common stock and equity	**35**	47
Absolute return, hedge funds, and other	**17**	10
	100%	100%

Plan I assets have historically been invested in a portfolio designed to preserve principal and obtain competitive investment returns and long-term investment growth, consistent with actuarial assumptions, while minimizing unnecessary investment risk. Diversification is achieved by retaining multiple investment managers with complementary philosophies, styles, and approaches.

11. Employee Benefit Plans (continued)

Plan I asset allocation targets at the measurement date were as follows:

	Target	Range
Cash and cash equivalents	1%	0%–6%
Fixed-income securities	44	39–49
Domestic equity securities	20	15–25
International equity securities	20	15–25
Other	15	7–25

PHS's Plan I assets are measured at fair value on a recurring basis and are made up of the following amounts as of December 31, 2018 and 2017 (excluding alternative investments of $39,614 and $35,153, respectively):

	Level 1	Level 2*	Total Fair Value	Valuation Technique* (a, b, c)
		(In Thousands)		
2018				
Money market	**$ 11,894**	**$ –**	**$ 11,894**	**a**
Bond funds	**24,573**	**109,116**	**133,689**	**a/c**
Common equities	**42,433**	**65,293**	**107,726**	**a**
Public Master Limited Partnerships	**13,148**	**–**	**13,148**	**a**
Total financial assets	**$ 92,048**	**$ 174,409**	**$ 266,457**	
2017				
Money market	$ 2,480	$ –	$ 2,480	a
Bond funds	33,449	122,850	156,299	a/c
Common equities	64,994	99,552	164,546	a
Public Master Limited Partnerships	17,908	–	17,908	a
Total financial assets	$ 118,831	$ 222,402	$ 341,233	

* Valuation techniques are described in Note 2.

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

Plan I's alternative investments are comprised of a hedge fund-of-funds and a private real estate investment trust (REIT). As described in Note 2, management has elected to use the net asset value per share, or its equivalent, as a practical expedient for fair value of Plan I's interest in alternative investments. The underlying funds have restrictions on the timing of withdrawals, which may reduce liquidity from three to six months.

Expected benefits to be paid to the Plan I participants and beneficiaries are as follows:

2019	$ 25,714
2020	21,341
2021	22,842
2022	24,238
2023–2028	167,029

In addition to Plan I, PHS also has five other limited postretirement benefit plans subject to the funded status recognition provisions of ASC 715. Plan I is funded, and the other postretirement plans are unfunded. During 2018, unrestricted net assets decreased by $14,578, and during 2017, unrestricted net assets increased by $25,995.

PHS has a defined contribution Plan (Plan II), which consists of a Section 403(b) plan and a Section 401(a) plan under the Code. Plan II requires PHS to pay a basic employer contribution, as well as match participant contributions up to a stated maximum percentage of the participant's salary. Contributions to Plan II are expensed as earned by employees and were $29,615 and $27,880 in 2018 and 2017, respectively.

PHP has a 401(k) defined contribution plan (Plan III) for PHP employees. Plan III requires PHP to match participant contributions up to a stated maximum percentage of the participant's salary. Plan III additionally provides an employer contribution for all employees regardless of whether the employee individually contributes to Plan III. PHP contributions to Plan III are expensed as earned by employees and were $3,692 and $3,279 in 2018 and 2017, respectively.

(Dollar Amounts in Thousands)

12. Net Assets with Donor Restrictions

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

	2018	2017
Subject to expenditure for specific purpose		
Program services and facility improvements	**$ 30,784**	$ 29,012
Education	**4,230**	4,589
	$ 35,014	$ 33,601
Subject to PHS's spending policy and appropriation		
Investment in perpetuity (including amounts above original gift amount) which once appropriated is expendable to support:		
Program services and facility improvements	**$ 9,959**	$ 9,764
Education	**1,836**	1,796
	$ 11,795	$ 11,560
Total net assets with donor restrictions	**$ 46,809**	$ 45,161

Net assets with donor restrictions are comprised of the following at December 31:

	2018	2017
Marketable securities	**$ 44,686**	$ 42,945
Pledges receivable	**1,543**	1,571
Other	**580**	645
	$ 46,809	$ 45,161

(Dollar Amounts in Thousands)

13. Concentration of Credit Risk

PHS provides health care services through its inpatient and outpatient care facilities throughout New Mexico. PHS grants credit to patients, most of whom are insured under third-party payor agreements, without requiring collateral or other security in extending credit to patients. However, PHS routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, HMOs and commercial insurance policies). The following table summarizes the percentage of net patient accounts receivable from all payors:

	December 31	
	2018	**2017**
Managed care and other third-party payors	**73%**	70%
Government	**20**	22
Self-pay	**7**	8
Total	**100%**	100%

Managed care and other third-party payors consist of receivables from various payors, including contracted third-party payors providing commercial and government programs. Management does not believe there is any significant concentration of credit risk associated with accounts receivable. Furthermore, management continually monitors and adjusts its allowances (contractual and implicit price concessions) associated with these receivables.

14. Commitments and Contingencies

Litigation and Other Contingent Liabilities

PHS is subject to pending and threatened legal actions arising during the ordinary course of business. Management and legal counsel periodically assess whether losses have been incurred related to pending or threatened litigation, claims, and assessments. Loss estimates are continually monitored and reviewed, and as estimates are adjusted, changes in estimated losses are reflected in current operations. Losses incurred due to the actual results of litigation could differ from estimates recorded. In management's opinion, upon consultation with legal counsel, these matters should not have a material adverse effect on PHS's combined financial condition, results of operations, or cash flows. However, PHS's evaluation of the likely effects of these actions

14. Commitments and Contingencies (continued)

could change in the future, and an unfavorable outcome, depending upon the amount and timing, could have a material effect on PHS's combined financial condition, results of operations or cash flows of a future period.

Health Insurer Fee

Section 9010 of the Patient Protection and Affordable Care Act (ACA) imposes a fee on each covered entity engaged in the business of providing health insurance for United States health risks. The guidance states that, in the data year (year in which the premiums used to allocate the assessment are written), the liability for the fee should be recorded in full when the entity provides qualifying health insurance in the fee year (the year in which the assessment is paid), with a corresponding entry to expense. The Consolidated Appropriations Act of 2016 placed a moratorium on the fee for 2017 only. In 2018, the fee was due for both PHP and PIC based on premiums written in 2017. As a result, fees paid and expensed in 2018 amounted to $34,900. This fee was again suspended for the 2019 fee year only.

Health Care Regulatory Environment

The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in exclusion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed and paid. Management believes that it has established adequate reserves to investigate, defend, and ultimately resolve any alleged instances of noncompliance. Compliance with such laws and regulations can be subject to future government review, as well as regulatory actions unknown or unasserted at this time.

14. Commitments and Contingencies (continued)

Self-Insurance Plans

PHS is self-insured for professional and general liability, workers' compensation, and employee health insurance. PHS purchases claims-made insurance to cover professional liability and workers' compensation claims in excess of the self-insured limits. There are known claims and incidents that may result in the assertion of additional claims, as well as claims for unknown incidents that may be asserted arising from services provided to patients. PHS has engaged independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued professional liability, general liability, and workers' compensation losses of $167,159 and $148,065 at December 31, 2018 and 2017, respectively, have been discounted at 3.47% and 2.75%, respectively, and in management's opinion, such amounts provide an adequate reserve for loss contingencies. The increase in the accrued liability can be attributed to adverse claim development. The accrued liability relating to professional and general liability and workers' compensation at December 31, 2018 and 2017 is reported on a gross basis and, therefore, has not been reduced by estimated insurance recoveries of $41,013 and $18,166, respectively, which are reported in other receivables. The accrued liability for estimated employee health claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported and totaled $4,650 and $4,289 at 2018 and 2017, respectively.

At December 31, 2018 and 2017, PHS had an available line of credit to collateralize the workers' compensation coverage of $10,400, of which none was outstanding.

Surety Bond

The Medicaid Centennial Care Contract requires PHP to provide a performance bond equal to 90% of the average of the past three months capitation payments made to PHP from HSD. As of December 31, 2018 and 2017, PHP held a surety bond issued by an unrelated insurance company in the amount of $111,100 and $94,000 respectively. At December 31, 2018, due to the increase in membership related to the United Healthcare purchase, PHP determined that the requirement was not met for 2018. In order to rectify the shortfall within 30 days, as mandated by HSD, PHP increased the surety bond to $148,000 as of January 1, 2019 in order to satisfy the requirement. As of December 31, 2017, PHP met the requirement.

(Dollar Amounts in Thousands)

14. Commitments and Contingencies (continued)

Operating Leases

Future minimum rental payments required for the next five years and thereafter for all operating leases that have initial or remaining noncancelable lease terms in excess of one year at December 31, 2018 are as follows:

2019	$ 2,489
2020	891
2021	191
2022	73
2023	20
Thereafter	580
	$ 4,244

Rent expense under operating leases for the years ended December 31, 2018 and 2017 totaled $5,049 and $5,609, respectively.

(Dollar Amounts in Thousands)

15. Functional Expenses

PHS provides general health care services to residents within its geographic region. PHS allocates expenses between functional categories through an analysis of each accounting unit within the organization. Accounting units with expenses that are attributable to more than one functional category, such as depreciation, information technology and insurance, are allocated ratably, based on directly assigned expenses, across all categories. Expenses related to providing these services are as follows:

	Patient Care	Insurance Operations	Other Programs	Supporting Services	Total
Year Ended December 31, 2018					
Medical claims	**$ –**	**$ 1,404,083**	**$ –**	**$ –**	**$ 1,404,083**
Salaries, wages and benefits	**663,081**	**114,535**	**102,748**	**155,873**	**1,036,237**
Purchased services and other	**191,143**	**227,875**	**64,277**	**36,793**	**520,088**
Supplies	**286,834**	**671**	**17,791**	**(6,947)**	**298,349**
Professional fees	**37,125**	**4**	**4,706**	**8,317**	**50,152**
Depreciation and amortization	**67,228**	**2,022**	**14,185**	**14,361**	**97,796**
Interest	**332**	**490**	**29,145**	**79**	**30,046**
	$ 1,245,743	**$ 1,749,680**	**$ 232,852**	**$ 208,476**	**$ 3,436,751**
Year Ended December 31, 2017					
Medical claims	$ –	$ 1,205,694	$ –	$ –	$ 1,205,694
Salaries, wages and benefits	617,148	94,023	103,361	133,717	948,249
Purchased services and other	182,251	179,386	62,255	40,117	464,009
Supplies	271,019	559	17,098	(3,918)	284,758
Professional fees	38,394	4	4,401	5,271	48,070
Depreciation and amortization	67,882	199	13,164	14,455	95,700
Interest	360	–	28,617	(12)	28,965
	$ 1,177,054	$ 1,479,865	$ 228,896	$ 189,630	$ 3,075,445

(Dollar Amounts in Thousands)

16. Liquidity

PHS's financial assets available within one year of the balance sheet date for general expenditure are as follows:

Cash and cash equivalents	$ 284,331
Patient accounts receivable	138,523
Other accounts receivable	139,246
Investments	1,891,180
	$ 2,453,280

PHS has a policy to structure its financial assets to be available as its general expenditures, liabilities and other obligations come due. In addition, PHS invests cash in excess of daily requirements in short-term investments.

17. Income Taxes

The components of the provision for income taxes for the years ended December 31 are as follows:

	2018	2017
Current	**$ 14,655**	$ 12,465
Deferred	**(4,403)**	(3,478)
Total provision for income taxes	**$ 10,252**	$ 8,987

On December 22, 2017, Tax Legislation was enacted. Beginning on January 1, 2018, separate company current tax expense is computed at a 21% rate. At December 31, 2017, PHS was still analyzing certain aspects of Tax Legislation and refining its calculations. Thus, the accounting for the tax effect of Tax Legislation was not complete. PHS recorded provisional amounts for the year ended December 31, 2017, as a component of income tax expense. During the year ended December 31, 2018, PHS completed the accounting for the tax effect of the Tax Legislation to the extent guidance has been issued. As a result, we have recorded an immaterial measurement period adjustment, which is included as a component of income tax expense.

(Dollar Amounts in Thousands)

17. Income Taxes (continued)

The differences between the actual and expected provision for income taxes or benefit computed by applying the federal corporate income tax rate of 21% in 2018 and 35% in 2017, plus a state rate of 4.8% for PNI operations only, to income before income taxes for the years ended December 31 are as follows:

	2018	2017
Computed tax expense at combined rate	**$ 3,938**	$ 15,030
Tax reform – tax rate differential	**(516)**	(5,548)
ACA health provider fee	**7,329**	–
Change in valuation allowance	**1,122**	(78)
Other permanent differences	**(172)**	(362)
Provision to return differences	**(345)**	66
State taxes and other	**(1,104)**	(121)
	$ 10,252	$ 8,987

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31 are presented below. Deferred tax assets and liabilities are valued at the rates at which they are expected to reverse in the future. As a result of Tax Legislation enacted on December 22, 2017, the deferred tax assets and liabilities below have been valued at 21%. The re-measurement of the deferred tax balance from 35% to 21% was included as a component of income tax expense for the year ended December 31, 2017. The measurement period adjustment recorded during the year ended December 31, 2018 is reflected in the deferred tax assets and deferred tax liabilities presented below.

(Dollar Amounts in Thousands)

17. Income Taxes (continued)

Deferred tax assets (liabilities) were comprised of the following at December 31:

	2018	2017
Deferred tax assets:		
Medical liabilities and other reserves	**$ 4,490**	$ 3,100
Medical claims payable (incurred but not reported)	**473**	191
Deferred compensation	**61**	313
Investments	**568**	317
Unrealized loss on investments	**1,774**	568
Net operating loss carryforwards	**1,813**	729
Deferred intercompany loss	**8,590**	–
Other	**265**	–
Total deferred tax assets	**18,034**	5,218
Deferred tax liabilities:		
Amortization of intangibles	**(14,052)**	(14,052)
Prepaid insurance	**(100)**	(95)
Partnership – book/tax difference	**(740)**	(208)
Gains on sale of securities	**(1)**	(259)
Unrealized gains on investments	**(240)**	(1,819)
Total deferred tax liabilities	**(15,133)**	(16,433)
Valuation allowance	**(10,441)**	(729)
Deferred tax liabilities, net	**$ (7,540)**	$ (11,944)

At December 31, 2018 and 2017, PNI had no federal net operating loss carryforwards. PNI is subject to state income tax and has state net operating loss carryforwards at December 31, 2018 and 2017 of $31,081 and $12,022, respectively, of which a portion is expiring each year.

At December 31, 2018 and 2017, a valuation allowance in the amount of $10,441 and $729, respectively, was established against the deferred tax asset related to the state net operating loss carryforwards, capital loss carryforwards, and deferred intercompany loss, as management currently believes that the benefit from some or all of these deferred tax assets may not be realized.

17. Income Taxes (continued)

In the normal course of business, PNI is subject to examination by taxing authorities, and PNI is no longer subject to U.S. federal, state, or local income tax examinations for years before 2015. PNI does not have any current federal tax disputes.

18. Subsequent Events

PHS has evaluated subsequent events occurring between the end of the most recent year end and April 12, 2019, the date the combined financial statements were issued.

Supplementary Information

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Report of Independent Auditors on Supplementary Information

The Board of Directors
Presbyterian Healthcare Services

Our audit was conducted for the purpose of forming an opinion on the combined financial statements as a whole. The combining balance sheet and statement of operations for the year ended December 31, 2018 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements, or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the combined financial statements as a whole.

Ernst & Young LLP

April 12, 2019

Presbyterian Healthcare Services and Affiliates

Combining Balance Sheet

December 31, 2018

	Obligated Group	Presbyterian Network, Inc.	Other Non-Obligated Group Members	Eliminations	Combined
			(In Thousands)		
Assets					
Current assets:					
Cash and cash equivalents	$ 84,107	$ 199,582	$ 642	$ –	$ 284,331
Accounts receivable	160,084	–	5,379	(26,940)	138,523
Other receivables	84,956	114,961	96	(19,754)	180,259
Inventories, prepaid expenses, and other current assets	48,737	6,517	1,158	–	56,412
Total current assets	377,884	321,060	7,275	(46,694)	659,525
Assets limited as to use or restricted:					
Designated for long-term purposes	1,625,758	282,459	625	–	1,908,842
Designated for self-insurance funds	137,847	–	–	–	137,847
Restricted by donors	45,265	–	–	–	45,265
Held by trustee	31,250	–	–	–	31,250
Restricted for statutory requirements	–	114,141	–	–	114,141
	1,840,120	396,600	625	–	2,237,345
Property and equipment, net	924,281	40,070	64,948	–	1,029,299
Goodwill	200	52,501	–	–	52,701
Other assets	93,849	55,445	127,251	(114,909)	161,636
Intercompany receivables (payables)	17,099	(52,780)	35,681	–	–
Total assets	$ 3,253,433	$ 812,896	$ 235,780	$ (161,603)	$ 4,140,506

Presbyterian Healthcare Services and Affiliates

Combining Balance Sheet (continued)

	Obligated Group	Presbyterian Network, Inc.	Other Non-Obligated Group Members	Eliminations	Combined
			(In Thousands)		
Liabilities and net assets (deficiency)					
Current liabilities:					
Accounts payable	$ 73,704	$ 23,238	$ 2,213	$ –	$ 99,155
Due under Medicaid contract	–	38,505	–	–	38,505
Accrued liabilities	151,228	87,820	3,368	(36,538)	205,878
Medical claims payable	–	199,565	–	(10,156)	189,409
Estimated third-party payor settlements	5,362	–	859	–	6,221
Current portion of long-term debt	16,161	–	–	–	16,161
Total current liabilities	246,455	349,128	6,440	(46,694)	555,329
Long-term debt, net of current portion	830,662	–	–	–	830,662
Employee benefit plans	208,939	–	–	–	208,939
Self-insurance plans	171,809	–	–	–	171,809
Other liabilities	71,162	27,290	1,610	–	100,062
Total liabilities	1,529,027	376,418	8,050	(46,694)	1,866,801
Net assets (deficiency):					
Net asset without donor restrictions	1,677,597	436,478	227,730	(114,909)	2,226,896
Net asset with donor restrictions	46,809	–	–	–	46,809
Total net assets (deficiency)	1,724,406	436,478	227,730	(114,909)	2,273,705
Total liabilities and net assets (deficiency)	$ 3,253,433	$ 812,896	$ 235,780	$ (161,603)	$ 4,140,506

Presbyterian Healthcare Services and Affiliates

Combining Statement of Operations

Year Ended December 31, 2018

	Obligated Group	Presbyterian Network, Inc.	Other Non-Obligated Group Members	Eliminations	Combined
			(In Thousands)		
Operating revenues:					
Net premiums	$ 440,964	$ 2,292,845	$ –	$ (435,830)	$ 2,297,979
Net patient service revenue	1,438,100	–	56,681	(347,376)	1,147,405
Other operating revenues	54,510	31,037	8,673	(28,489)	65,731
Total operating revenues	1,933,574	2,323,882	65,354	(811,695)	3,511,115
Expenses:					
Medical claims	226,522	1,962,521	–	(784,960)	1,404,083
Salaries, wages and employee benefits	895,993	114,535	30,793	(5,084)	1,036,237
Purchased services and other	293,938	227,874	19,927	(21,651)	520,088
Supplies	293,556	671	4,122	–	298,349
Professional fees	45,581	4	4,567	–	50,152
Depreciation and amortization	91,154	2,022	4,620	–	97,796
Interest	29,477	491	78	–	30,046
Total expenses	1,876,221	2,308,118	64,107	(811,695)	3,436,751
Operating income	57,353	15,764	1,247	–	74,364
Other income (loss):					
Investment income	82,903	17,043	1,022	–	100,968
Change in net unrealized gains (losses) on investments	(190,239)	(14,059)	–	–	(204,298)
Pension settlement loss	(19,867)	–	–	–	(19,867)
Change in fair value of interest rate swaps	5,462	–	–	–	5,462
Total other income (loss)	(121,741)	2,984	1,022	–	(117,735)
(Deficiency) of revenues over expenses before income taxes	(64,388)	18,748	2,269	–	(43,371)
Provision for income taxes	–	10,252	–	–	10,252
(Deficiency) of revenues over expenses	$ (64,388)	$ 8,496	$ 2,269	$ –	$ (53,623)

Combined Financial Statements and Supplementary Information

Presbyterian Healthcare Services and Affiliates
Years Ended December 31, 2019 and 2018
With Reports of Independent Auditors

Ernst & Young LLP

Building a better working world

Presbyterian Healthcare Services and Affiliates

Combined Financial Statements
and Supplementary Information

Years Ended December 31, 2019 and 2018

Contents

Report of Independent Auditors....1

Combined Financial Statements

Combined Balance Sheets....3
Combined Statements of Operations....4
Combined Statements of Changes in Net Assets....5
Combined Statements of Cash Flows....6
Notes to Combined Financial Statements....7

Supplementary Information

Report of Independent Auditors on Supplementary Information....52
Combining Balance Sheet – December 31, 2019....53
Combining Statement of Operations – Year Ended December 31, 2019....55

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Report of Independent Auditors

The Board of Directors
Presbyterian Healthcare Services

We have audited the accompanying combined financial statements of Presbyterian Healthcare Services and Affiliates, which comprise the combined balance sheets as of December 31, 2019 and 2018, and the related combined statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined financial position of Presbyterian Healthcare Services and Affiliates at December 31, 2019 and 2018, and the combined results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

April 16, 2020

Presbyterian Healthcare Services and Affiliates

Combined Balance Sheets

	December 31 2019	2018
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 245,160**	$ 284,331
Accounts receivable	**146,065**	138,523
Other receivables	**222,761**	180,259
Inventories, prepaid expenses, and other current assets	**63,335**	56,412
Total current assets	**677,321**	659,525
Assets limited as to use or restricted:		
Designated for long-term purposes	**2,175,445**	1,908,842
Designated for self-insurance funds	**148,136**	137,847
Restricted by donors	**50,007**	45,265
Held by trustee	**247,929**	31,250
Restricted for statutory requirements	**193,217**	114,141
	2,814,734	2,237,345
Property and equipment, net	**1,074,041**	1,029,299
Goodwill	**52,701**	52,701
Other assets	**224,623**	161,636
Total assets	**$ 4,843,420**	$ 4,140,506
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 95,024**	$ 99,155
Due under Medicaid contract	**30,276**	38,505
Accrued liabilities	**245,159**	205,878
Medical claims payable	**255,804**	189,409
Estimated third-party payor settlements	**9,131**	6,221
Current portion of long-term debt	**16,829**	16,161
Total current liabilities	**652,223**	555,329
Long-term debt, net of current portion	**1,068,591**	830,662
Employee benefit plans	**220,291**	208,939
Self-insurance plans	**207,345**	171,809
Other liabilities	**131,757**	100,062
Total liabilities	**2,280,207**	1,866,801
Net assets:		
Net assets without donor restrictions	**2,510,517**	2,226,896
Net assets with donor restrictions	**52,696**	46,809
Total net assets	**2,563,213**	2,273,705
Total liabilities and net assets	**$ 4,843,420**	$ 4,140,506

See accompanying notes.

Presbyterian Healthcare Services and Affiliates

Combined Statements of Operations

	Year Ended December 31	
	2019	2018
	(In Thousands)	
Operating revenues:		
Net premiums	**$ 3,189,815**	$ 2,297,979
Net patient service revenue	**1,119,138**	1,147,405
Other operating revenues	**83,991**	65,731
Total operating revenues	**4,392,944**	3,511,115
Expenses:		
Medical claims	**2,012,319**	1,404,083
Salaries, wages, and employee benefits	**1,212,400**	1,036,237
Purchased services and other	**603,382**	520,088
Supplies	**354,249**	298,349
Professional fees	**49,651**	50,152
Depreciation and amortization	**116,016**	97,796
Interest	**32,662**	30,046
Total expenses	**4,380,679**	3,436,751
Operating income	**12,265**	74,364
Other income (loss):		
Investment income	**55,691**	100,968
Change in net unrealized gains (losses) on investments	**271,753**	(204,298)
Loss on debt extinguishment	**(3,920)**	–
Pension settlement loss	**–**	(19,867)
Change in fair value of interest rate swaps	**(5,467)**	5,462
Total other income (loss)	**318,057**	(117,735)
Excess (deficiency) of revenues over expenses before income taxes	**330,322**	(43,371)
Provision for income taxes	**18,272**	10,252
Excess (deficiency) of revenues over expenses	**$ 312,050**	$ (53,623)

See accompanying notes.

Presbyterian Healthcare Services and Affiliates

Combined Statements of Changes in Net Assets

	Year Ended December 31	
	2019	**2018**
	(In Thousands)	
Net assets without donor restrictions		
Excess (deficiency) of revenues over expenses	**$ 312,050**	$ (53,623)
Change in pension obligation	**(28,422)**	14,578
Other changes in net assets	**(7)**	(8,594)
Increase (decrease) in net assets without donor restrictions	**283,621**	(47,639)
Net assets with donor restrictions		
Donor-restricted contributions	**4,560**	5,336
Investment income (loss) and other	**4,953**	(1,567)
Net assets released from restrictions	**(3,626)**	(2,121)
Increase in net assets with donor restrictions	**5,887**	1,648
Change in net assets	**289,508**	(45,991)
Net assets, beginning of year	**2,273,705**	2,319,696
Net assets, end of year	**$ 2,563,213**	$ 2,273,705

See accompanying notes.

Presbyterian Healthcare Services and Affiliates

Combined Statements of Cash Flows

	Year Ended December 31 2019	2018
	(In Thousands)	
Operating activities		
Change in net assets	**$ 289,508**	$ (45,991)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Change in net unrealized gains and losses on investments	**(271,753)**	204,298
Change in fair value of interest rate swaps	**5,467**	(5,462)
Loss on debt extinguishment	**3,920**	–
Loss on pension settlement	**–**	19,867
Depreciation and amortization	**116,016**	97,796
Changes in operating assets and liabilities:		
Accounts receivable	**(7,542)**	(5,703)
Other receivables	**(42,502)**	(69,112)
Inventories, prepaid expenses, and other current assets	**(6,923)**	(2,613)
Trading securities, net	**264,184**	(137,732)
Other assets	**(67,188)**	(51,787)
Accounts payable	**(4,131)**	23,093
Due under Medicaid contract	**(8,229)**	(19,221)
Accrued liabilities	**39,281**	61,746
Medical claims payable	**66,395**	68,657
Estimated third-party payor settlements	**2,910**	3,148
Other liabilities	**71,961**	(10,851)
Net cash provided by operating activities	**451,374**	130,133
Investing activities		
Sales of assets held by trustee and statutory deposits	**42,601**	80,321
Purchases of assets held by trustee and statutory deposits	**(338,356)**	(30,012)
Purchases of property and equipment	**(156,263)**	(194,974)
Net cash used in investing activities	**(452,018)**	(144,665)
Financing activities		
Proceeds from issuance of long-term debt	**334,932**	–
Payments on long-term debt	**(99,394)**	(16,422)
Net cash provided by (used in) financing activities	**235,538**	(16,422)
Change in cash, cash equivalents, and restricted cash	**234,894**	(30,954)
Cash, cash equivalents, and restricted cash, beginning of year	**331,829**	362,783
Cash, cash equivalents, and restricted cash, end of year	**$ 566,723**	$ 331,829
Supplemental disclosures of cash flow information		
Cash paid for interest, net of amounts capitalized	**$ 33,912**	$ 31,543
Cash paid for income taxes	**$ 15,462**	$ 1,734

1. Organization

Presbyterian Healthcare Services (PHS) is a New Mexico nonprofit corporation exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code (the Code). PHS is a diversified health care organization that owns, leases, controls, operates, or manages a variety of health care-related organizations, including seven hospitals in New Mexico, a for-profit health maintenance organization (HMO), and several other affiliated organizations. PHS provides a broad range of health care services, including inpatient, outpatient, subacute, home health care, and physician services.

PHS consists of the following divisions and affiliates:

Presbyterian Healthcare Services Divisions	Presbyterian Healthcare Services Affiliates
Presbyterian Hospital,* including the following, which are designated as remote locations of Presbyterian Hospital:	Southwest Health Foundation
Presbyterian Kaseman Hospital*	Presbyterian Network, Inc.:
Presbyterian Northside*	Presbyterian Insurance Company, Inc.
Presbyterian Rust Medical Center*	Presbyterian Health Plan, Inc.
Santa Fe Medical Center *	Fluent Health, LLC
Plains Regional Medical Center*	Albuquerque Imaging Associates
Presbyterian Española Hospital*	Southwest Magnetic Imaging Associates
Socorro General Hospital*	Presbyterian Properties, Inc.
Lincoln County Medical Center (leased facility)	Presbyterian Healthcare Foundation*
Dr. Dan C. Trigg Memorial Hospital (leased facility)	Bernalillo County Health Care Corporation d.b.a. Albuquerque Ambulance Service*

* Denotes Obligated Group members.

PHS accesses the capital markets through an Obligated Group. Obligated Group members include PHS and certain divisions and affiliates as noted above, which are jointly and severally liable for the long-term debt outstanding under a Master Trust Indenture. None of the other PHS affiliates have any obligation related to requirements of the Master Trust Indenture. The Obligated Group's net assets represent approximately 76% of PHS and affiliates' combined net assets at both December 31, 2019 and 2018.

1. Organization (continued)

Presbyterian Network, Inc. (PNI) is a wholly owned subsidiary of Southwest Health Foundation. PNI is the parent organization of two wholly owned subsidiaries: Presbyterian Health Plan, Inc. (PHP) and Presbyterian Insurance Company, Inc. (PIC). PHP is a state-licensed HMO in New Mexico and is also a federally qualified HMO under Title XIII of the Public Health Service Act. PHP provides comprehensive health care services in New Mexico to individuals primarily through health maintenance contracts with employer groups and individuals. PHP has a five-year contract with the state of New Mexico to provide physical health, behavioral health, and long-term care services to Medicaid eligible individuals under the Centennial Care program. The current five-year contract began January 1, 2019. PHP's previous Centennial Care contract was effective from January 1, 2014 through December 31, 2018. PHP also offers an HMO product to Medicare eligible individuals (Medicare Advantage). The Medicare Advantage product provides managed care services that include all Medicare benefits and, in some cases, additional managed care services. PIC offers preferred provider and indemnity products to individuals through contracts with employer groups, as well as stop-loss coverage to some of PHP's self-funded employer groups.

Fluent Health, LLC (Fluent) is a management services organization owned by PNI, PHP, and PIC. It was formed to facilitate potential health plan joint ventures outside of the state of New Mexico. The business purpose of Fluent is to provide claims processing, administrative, management, and consulting services to health plans. Currently, Fluent provides these services to PHP and PIC.

Basis of Presentation

The accompanying financial statements include the combined accounts of PHS and its affiliates as described in Note 1 (collectively, Presbyterian Healthcare Services), including Presbyterian Healthcare Foundation (the Foundation), which is not a controlled entity. However, the Foundation is organized for the benefit and support of PHS, and its financial position and results of operations are combined herein. All significant intercompany balances and transactions have been eliminated in combination.

2. Summary of Significant Accounting Policies

Pending Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2017-04*, Intangibles – Goodwill and Other (Topic 350)*. The accounting standard simplified the test used to evaluate goodwill and other intangibles for impairment. Under the new accounting standard, a company will perform its annual goodwill impairment test by comparing the fair value of the reporting unit with its carrying amount. An impairment charge will be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the impairment loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. A company will still have the option to perform the qualitative assessment for a reporting unit. This accounting standard is effective for fiscal years beginning after December 15, 2020. Management is currently evaluating the impact of adopting this accounting standard, which will be effective for the year ending December 31, 2021.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*, a new fair value measurement accounting standard. This accounting standard changes the disclosure requirements for fair value measurement. The accounting standard is effective for fiscal years beginning after December 15, 2019, and will be applied using a retrospective approach. Management is currently assessing the impact of this accounting standard, which will be effective January 1, 2020.

Adopted Accounting Pronouncements

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall Recognition and Measurement of Financial Assets and Financial Liabilities*, which amends the accounting and disclosures of financial instruments, including a provision that requires equity investments (except for investments accounted for under the equity method of accounting) to be measured at fair value and recognized in current earnings. Additionally, this ASU removed the disclosure requirement of fair value information for financial instruments measured at amortized cost. This ASU was adopted by PHS on January 1, 2019, using a modified retrospective approach and did not have a material effect on the combined financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires the rights and obligations arising from lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet. This accounting standard also requires additional disclosures about the amount, timing, and uncertainty of cash flows arising from leases.

2. Summary of Significant Accounting Policies (continued)

PHS adopted the ASU effective January 1, 2019, using a modified retrospective approach. The primary effect of the new standard was to record right-of-use assets of $6,018 and obligations for leases of $6,046 as of January 1, 2019.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, which applies to all entities that are required to present a statement of cash flows under Topic 230. ASU 2016-15 addresses the presentation and classification of cash flows related to certain matters pertaining to debt, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, distributions received from equity method investees, and certain other separately identifiable cash flows. The ASU was adopted by PHS for the year ended December 31, 2019, using a modified retrospective approach. This ASU did not have a material impact on the statement of cash flows.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which applies to all entities that have restricted cash and are required to present a statement of cash flows under Topic 230. ASU 2016-18 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. PHS adopted this ASU for the year ended December 31, 2019, using a modified retrospective approach. The effect of the new standard was to increase the amounts included in cash, cash equivalents, and restricted cash on the statements of cash flows by $321,563, $47,498, and $106,611 as of December 31, 2019, December 31, 2018, and January 1, 2018, respectively.

Cash and Cash Equivalents

Cash and cash equivalents include bank deposits and highly liquid investments with original maturities at the time of purchase of three months or less. The carrying value of cash and cash equivalents approximates fair value.

(Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

Cash, cash equivalents, and restricted cash as reported in the combined statements of cash flows are presented separately within the combined balance sheets in the following asset classes:

	Year Ended December 31	
	2019	**2018**
Cash and cash equivalents	**$ 245,160**	$ 284,331
Assets limited as to use or restricted	**321,563**	47,498
Total cash, cash equivalents, and restricted cash	**$ 566,723**	$ 331,829

Accounts Receivable

Accounts receivable consist of patient accounts that are recorded at net realizable value based on certain assumptions. In evaluating the collectability of accounts receivable, PHS analyzes its history and identifies trends for the appropriate allowances to reduce accounts receivable to net realizable value of its major payor sources of revenue, as well as self-pay patients.

Management regularly reviews data about these major sources of revenue in evaluating the sufficiency of the allowances on accounts receivable. For receivables associated with services provided to patients who have third-party coverage, PHS analyzes historical collections as a basis for estimating future collections of accounts receivable. PHS has a policy of providing discounts to self-pay patients without insurance. PHS's uninsured discount policies during 2019 and 2018 provided for a discount of 30% from standard rates for most services. These uninsured discounts are recorded with contractual adjustments as a deduction of patient service revenue. The estimated uncollectible amounts due from self-pay patients are generally considered implicit price concessions that are direct reductions of accounts receivable. The implicit price concessions are recognized immediately based on historical results.

Assets Limited as to Use or Restricted

Assets limited as to use or restricted include assets set aside by PHS for future long-term purposes, including capital improvements and self-insurance, over which PHS retains control and may at its discretion subsequently use for other purposes and investments held by PNI that are used to meet specified capital requirements for regulatory purposes. In addition, assets limited as to use or

2. Summary of Significant Accounting Policies (continued)

restricted include assets held by trustees under bond indenture agreements, contributions by donors with stipulated restrictions, and amounts on deposit to satisfy statutory requirements of the New Mexico Office of Superintendent of Insurance.

These assets consist primarily of cash, cash equivalents, government securities, other fixed-income securities, equity securities, derivatives, and alternative investments. The carrying amounts of investments in marketable debt and equity securities are reported on the combined balance sheets at fair value. Alternative investments are reported under the equity method of accounting using the NAV as a practical expedient, except for alternative investments held by the Foundation, which are reported at fair value.

PHS also invests in various commingled funds, which are assets from multiple accounts blended into a single fund. Commingled funds do not have a readily determinable fair value; therefore, the net asset value is used as a practical expedient for fair value. As such, they are excluded from the fair value hierarchy.

Income or loss related to the investment portfolio (including realized and unrealized gains and losses on investments, interest, and dividends) is included in the excess (deficiency) of revenues over expenses unless the income or loss is restricted by donor or law. Income or loss restricted by donor or law is classified as a change in net assets with donor restrictions consistent with the applicable restrictions.

As a condition of its Medicaid Centennial Care contract with the New Mexico Human Services Department (HSD), PHP is required to maintain an account with a balance equal to 90% of the average of the past three months' capitation payments made to PHP from HSD. As of December 31, 2019 and 2018, $192,000 and $112,926, respectively, were held in bonds and cash in a restricted managed asset account to satisfy this requirement.

2. Summary of Significant Accounting Policies (continued)

Fair Value Measurements

Accounting Standards Codification (ASC) 820, *Fair Value Measurement*, requires the categorization of financial assets and liabilities into a three-level hierarchy based on pricing inputs to the valuation technique. The fair value hierarchy gives the highest priority to the quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable inputs. The various levels of the fair value hierarchy are described as follows:

> Level 1 – Pricing is based on observable inputs, such as quoted prices in active markets.
>
> Level 2 – Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
>
> Level 3 – Pricing inputs are generally unobservable and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using factors that involve considerable judgment and interpretations, including, but not limited to, private and public comparables, third-party appraisals, discounted cash flow models, and fund manager estimates.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques noted in ASC 820. Where more than one technique is noted, individual assets or liabilities were valued using one or more of the noted techniques. The valuation techniques are as follows:

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

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

2. Summary of Significant Accounting Policies (continued)

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

(d) *Net Asset Value (NAV)* – Represents the difference between the assets and liabilities of an investment fund or partnership expressed on a per share or unit basis on the valuation date. Underlying asset and liability values may utilize techniques (a), (b), or (c).

When observable market data is available, it is required to be used in determining the fair value measurement. When inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level of input that is significant to the fair value measurement.

The majority of PHS's marketable debt and equity securities are measured based on observable market prices. PHS's interest rate swaps are measured using models based upon observable pricing inputs. Note 7 further describes the methods applied to determine the fair value of PHS's financial assets and liabilities.

The carrying values of financial instruments classified as current assets and current liabilities approximate fair value due to their liquidity and short-term natures.

Inventories

Inventories, consisting of drugs and supplies, are stated at the lower of cost (first-in, first-out method) or net realizable value.

Property and Equipment, Net

Property and equipment purchases are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. The following useful lives are being used by PHS:

Land improvements	2–25 years
Buildings and improvements	5–40 years
Equipment and capitalized software	3–20 years

2. Summary of Significant Accounting Policies (continued)

Interest cost incurred on borrowed funds, net of interest earned on assets held by trustee during the period of construction of qualified capital projects, is capitalized as a component of the cost of acquiring those assets.

Leases

PHS leases property and equipment, all of which are currently classified as operating leases. Prior to the adoption of ASU 2016-02, operating leases were not recorded on the balance sheet. On January 1, 2019, PHS adopted ASU 2016-02, which requires a right-of-use asset and lease liability to be recorded for operating leases. The related assets and liabilities are initially recorded at the present value of the lease payments over the term of the agreement. Most of the PHS contracts do not provide a readily determinable implicit rate in the contract. Therefore, PHS has elected to discount the payments using a risk-free rate effective as of the commencement of each contract. PHS elected not to record lease assets and liabilities on short-term leases, which are defined as leases with terms of 12 months or less. The related right-of-use assets and liabilities are not considered material to the financial statements.

Goodwill and Other Intangible Assets

PHS follows the provisions of ASC 350, *Intangibles – Goodwill and Other*. Management assesses goodwill impairment using a qualitative evaluation, unless impairment triggers are identified. There was no goodwill impairment in either 2019 or 2018.

On September 1, 2018, PHP acquired approximately 83,000 Medicaid members previously served by another health plan. As a result of the purchase, PHP recorded an intangible asset equal to the cash paid of $42,011 and, in accordance with ASC 350, determined a useful life of ten years. PHP has recorded $4,201 and $1,396 in amortization costs related to this intangible asset for the years ended December 31, 2019 and 2018, respectively.

(Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

Impairment of Long-Lived Assets

PHS evaluates whether events and circumstances have occurred that indicate the remaining estimated useful lives of long-lived assets, other than goodwill, may not be recoverable. The assessment of possible impairment is based on the ability to recover the carrying amount of the asset based on undiscounted cash flows. Impairments are calculated as the total by which the carrying amount of the asset exceeds its estimated fair value. For the years ended December 31, 2019 and 2018, management determined that there was no impairment of its long-lived assets.

Net Assets With Donor Restrictions

Unconditional pledges to give cash and other assets are reported at fair value at the date the pledge is received. The gifts are reported as net assets with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and recognized as a component of other operating revenue. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in other operating revenue.

Premium Revenues, Medical Claims Payable, and Health Care Expenses

Premium revenues are recognized in the month in which members are entitled to health care services. Premiums collected in advance are recorded as unearned premiums and are included in accrued liabilities on the accompanying combined balance sheets. During 2019 and 2018, premium revenue was as follows:

	Year Ended December 31	
	2019	**2018**
Net premiums:		
Medicaid	**$ 2,419,839**	$ 1,470,272
Medicare	**425,268**	417,074
Commercial	**344,708**	410,633
Total	**$ 3,189,815**	$ 2,297,979

2. Summary of Significant Accounting Policies (continued)

Coordination of benefits and subrogation are recognized in the period such amounts are determined to be recoverable from other insurers.

PHP is contracted with the state of New Mexico to serve the Medicaid population under the New Mexico Centennial Care program. All Medicaid services, including physical health, behavioral health, and long-term care, are provided as part of this program. PHP is one of three HMOs currently contracted by the state to administer the New Mexico Centennial Care program.

Under this contract, PHP receives a fixed premium from the state to provide comprehensive health care services for enrollees, including those enrollees receiving services from PHS. PHS facilities and physicians are paid capitated or discounted fee-for-service rates from each of the HMOs. The medical claims costs of PHP on the combined statements of operations are net of intercompany eliminations for services rendered by PHS facilities, totaling $761,415 and $784,960 for the years ended December 31, 2019 and 2018, respectively.

Under the Medicaid Centennial Care contract, PHP is permitted to retain 100% of the underwriting gain generated up to 3% annually. Underwriting gains above 3% are shared 50/50 between PHP and HSD. Additionally, for Hepatitis C drugs, PHP is subject to risk corridor adjustments. PHP and HSD share in excess gains or losses generated under the contract based on a tiered structure. Liabilities for the underwriting gain limitation and risk corridors of $29,949 and $20,752 as of December 31, 2019 and 2018, respectively, were recorded on the accompanying combined balance sheets in due under Medicaid contract.

PHP and PIC serve as plan sponsors to offer Medicare Part D prescription drug insurance coverage under a contract with the Centers for Medicare & Medicaid Services (CMS). Premium revenue is recognized ratably over the period in which eligible individuals are entitled to receive prescription drug benefits. Premium revenues are subject to a comprehensive risk reconciliation under which CMS shares in a portion of direct surplus or deficit related to Medicare Part D premiums. In addition to premium revenues, PHP and PIC receive prepayments from CMS related to low income, cost sharing, and catastrophic reinsurance subsidies. PHP and PIC are fully reimbursed by CMS for costs incurred under these contract elements and, accordingly, there is no insurance risk to either company. Amounts received for these subsidies are not reflected as premium revenue, but rather are accounted for as deposits with the related liability recorded on the combined balance sheets. Pharmacy benefit costs not related to low income, cost sharing, or catastrophic reinsurance subsidies and administrative costs under the contract are expensed as incurred.

2. Summary of Significant Accounting Policies (continued)

The estimated cost of all health services rendered to members through December 31, but not yet paid as of that date, is included in medical claims payable. This claims expense estimate is developed using actuarial assumptions based on historical experience with respect to the timing of payments in relation to the dates of service. Subsequent changes to prior period estimates are reflected in the current period. Losses on contracts are recognized in the period when health care costs are expected to exceed premium revenue.

Patient Service Revenue

PHS records net patient service revenue at the transaction price estimated to reflect the total consideration due from patients and third-party payors in exchange for providing goods and services in patient care. These services are considered to be single performance obligations and have durations of less than one year. Revenues are recorded as these goods and services are provided. The transaction price, which involves significant estimates, is determined based on PHS's standard charges for the goods and services provided, with a reduction recorded for price concessions related to third-party contractual arrangements, as well as patient discounts and price concessions. PHS determines the transaction price by grouping contracts with similar characteristics using a portfolio approach as it believes there would not be a material difference using a portfolio of similar contracts than if based on individual contracts.

PHS has agreements with third-party payors that provide for payments at amounts different from established charges. The basis for payment under these agreements includes prospectively determined rates, cost reimbursement, and negotiated discounts from established charges.

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 due to future audits, reviews, and investigations. The differences between the estimated and actual adjustments are recorded as part of patient service revenue in future periods, as the amounts become known, or as years are no longer subject to such audits, reviews, and investigations.

Currently, New Mexico utilizes supplemental reimbursement programs for the purpose of providing reimbursement to providers to offset a portion of the cost of providing care to Medicaid and uninsured patients. Under these programs, PHS recognizes revenue in the period in which amounts are estimable and collection is reasonably assured. Reimbursement under these programs is reflected in net patient service revenue.

(Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

For uninsured patients who do not qualify for charity care, PHS recognizes revenue on the basis of discounted rates, as provided by its policy. On the basis of historical experience, a significant portion of PHS's uninsured patients will be unable or unwilling to pay for the services provided. The estimated uncollectible amounts due from these patients are generally considered implicit price concessions that are a direct reduction to net patient service revenue.

Net patient service revenue, net of contractual allowances, discounts, and implicit price concessions, is recognized from the major payor sources as follows:

	December 31	
	2019	**2018**
Net patient service revenue:		
Medicare	**$ 342,982**	$ 346,791
Medicaid	**151,864**	206,730
Managed care and other third-party payors	**605,076**	562,885
Self pay	**19,216**	30,999
Total	**$ 1,119,138**	$ 1,147,405

Charity Care

As an integral part of its mission, PHS provides care to all patients, regardless of ability to pay for needed services. A patient is classified as a charity care patient in accordance with standards established across PHS and its affiliates. Charity care represents services rendered for which no, or only partial, payment is expected and, as such, is not included in revenues on the combined statements of operations.

Excess (Deficiency) of Revenues Over Expenses

The combined statements of operations include a measurement for excess (deficiency) of revenues over expenses. Changes in net assets without donor restrictions, which are excluded from excess (deficiency) of revenues over expenses, include contributions of long-lived assets (including assets acquired using contributions that, by donor restrictions, were to be used for the purpose of acquiring such assets) and changes in the pension liability.

2. Summary of Significant Accounting Policies (continued)

Other Income and Loss

Activities that result in gains or losses and are unrelated to the primary mission of PHS are considered to be other income and losses. Accordingly, investment income, changes in unrealized gains and losses on investments, loss on debt extinguishment, loss on the settlement of pension obligations, and unrealized changes in the fair value of interest rate swaps are reported as a component of other income (loss).

Taxes

PHS and all of its affiliates, except for PNI and its subsidiaries, have been determined to be tax-exempt corporations by the Internal Revenue Service and generally are not subject to federal taxes on income.

The taxable affiliates utilize the liability method in accounting for income taxes. Under this method, deferred income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the currently enacted tax rates and laws. Valuation allowances are used to reduce deferred tax assets to their estimated net realizable values when management determines ultimate recovery is not probable.

PHP and PIC are required to pay premium taxes to the state based on a percentage of adjusted premiums received related to the Commercial and Medicaid product lines. As a result of paying premium taxes, PHP and PIC are exempt from paying state income taxes. PHP and PIC recorded net premium tax expense totaling $86,433 and $55,589 in 2019 and 2018, respectively. These amounts are included within purchased services and other expenses on the accompanying combined statements of operations.

ASC 740, *Income Taxes*, prescribes criteria for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. As of December 31, 2019 and 2018, there was no significant impact on the combined financial statements related to the tax positions taken. There were no significant tax positions taken by management that required accrual as of December 31, 2019 or 2018.

2. Summary of Significant Accounting Policies (continued)

Derivative and Hedging Instruments

In accordance with ASC 815, *Derivatives and Hedging*, derivatives are recognized as either assets or liabilities at fair value on the combined balance sheets, regardless of the purpose or intent for holding them. For those derivatives not designated as hedges under such standards, the changes in fair value are recognized in the excess (deficiency) of revenues over expenses. PHS has not designated its derivatives related to marketable securities as hedged financial instruments. Accordingly, the change in the fair value of derivatives is recognized as a component of investment income.

One of PHS's investment managers, which utilizes derivative instruments, has executed a master netting arrangement related to marketable securities for each of the derivative instruments held by the same counterparty, which are legally offset as the instrument is settled. PHS's derivative contracts related to marketable securities were reported on a net basis on the accompanying combined balance sheets as of December 31, 2019.

Benefit Plans

PHS is the plan sponsor of a defined benefit pension plan (Plan I) and five other limited postretirement benefit plans. The funded status of Plan I is recognized on the combined balance sheets as the difference between the fair value of the investments and the actuarially determined pension obligation. Other required disclosures of ASC 715, *Compensation – Retirement Benefits*, include the accumulated benefit obligation and fair value of the plan's assets, assumptions used in the benefit obligation calculation, contributions, the asset allocation of the plan, and the expected benefits to be paid, which can be found in Note 11.

In addition to the plans described above, PHS sponsors certain defined contribution plans. Contributions to these plans are expensed as earned by the employees.

Use of Estimates

The preparation of combined 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, liabilities, revenue, and expenses in the combined financial statements. Actual results could differ from those estimates.

(Dollar Amounts in Thousands)

3. Patient Service Revenue

A summary of payment arrangements with major third-party payors follows:

Medicare – Inpatient acute care and certain outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge or procedure. These rates vary according to patient classification systems based on clinical, diagnostic, and other factors.

Medicaid – The State Medicaid program consists of two primary plans. The larger plan is the New Mexico Centennial Care program. Medicaid services, including physical health, behavioral health, and long-term care, are provided as part of the New Mexico Centennial Care program. The smaller plan is a traditional Medicaid plan. PHS facilities and physicians are paid for inpatient acute care services on prospectively determined rates per discharge. Payments for outpatient services are made on a discounted fee-for-service basis.

Others – PHS has also entered into payment agreements with certain commercial insurance carriers, HMOs, and preferred provider organizations. The basis for payment to PHS under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Amounts received from third-party payors in excess of expected reimbursement are reflected as estimated third-party payor settlements on the accompanying combined financial statements.

4. Other Operating Revenues

Other operating revenues consist of the following:

	Year Ended December 31	
	2019	**2018**
Health plan administrative fees	**$ 28,672**	$ 25,189
Contributions and other	**46,962**	32,311
Tax appropriation revenue	**8,357**	8,231
	$ 83,991	$ 65,731

5. Community Benefit

In support of its mission and philosophy, PHS voluntarily provides free care to patients who cannot afford health care due to inadequate resources and/or patients who are uninsured. Because PHS does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as patient service revenues. The estimated cost of this voluntary free care less the amount, if any, ultimately received was $35,773 and $40,987 in 2019 and 2018, respectively.

In addition, PHS provides services to other patients under certain government-reimbursed public aid programs, which pay providers amounts that are generally less than the cost of rendering the services provided to the patients. The estimated unreimbursed cost of this care was approximately $237,914 and $186,487 in 2019 and 2018, respectively. These unreimbursed costs and costs of voluntary free care do not include any governmental funds received for providing access to health care to all residents of the local community.

PHS uses information from its cost accounting system and certain cost-to-charge ratios, where applicable, to estimate the cost of financial assistance and other community benefits reported.

PHS, in furtherance of its mission, also commits significant time and resources to endeavors and critical services that meet otherwise unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable. Such programs include health screenings and assessments; cancer and other support groups; hospice programs; free transportation, lodging, meals, and medications for transient patients when needed; funding for homeless health care programs; significant ongoing and temporary donations of office space and telephone systems for nonprofit health care organizations, including the Meals on Wheels program; free flu vaccine clinics; participation in regular blood drives; and the provision of educational opportunities for students interested in pursuing medical-related or pastoral careers.

6. Assets Limited as to Use or Restricted

PHS has designated the accumulation of certain funds for future replacement of property and equipment, other capital improvements, debt retirement, self-insurance reserves, and other long-term purposes. Under the terms of the Master Trust Indenture for the outstanding bond issues, funds held by the trustee have been established and legally designated for debt service and qualifying capital expenditures.

(Dollar Amounts in Thousands)

6. Assets Limited as to Use or Restricted (continued)

The following is a summary of assets limited as to use or restricted at fair value, except for certain alternative investments, which are recorded at NAV using the equity method:

	December 31	
	2019	**2018**
Cash and cash equivalents	**$ 321,563**	$ 47,498
Fixed-income securities	**593,959**	871,168
Equity securities	**1,037,347**	833,038
Government securities	**499,268**	138,986
Public master limited partnerships	**70,041**	64,879
Alternative investments	**292,556**	281,776
	$ 2,814,734	$ 2,237,345

Fixed-Income and Government Securities – These investment classes include investments in various fixed-income instruments that include investment-grade and senior secured below investment-grade domestic and international bonds, mortgage pools, and bonds issued by U.S. government agencies. These investment classes also include investments in commingled, mutual funds, and separately managed accounts that hold investments in fixed-income securities. The fixed-income investments are exposed to various kinds and levels of risk, including interest rate risk, credit risk, foreign exchange risk, and liquidity risk.

Equity Securities – This investment class consists primarily of common equity securities of domestic and international companies. These securities trade through the major public domestic and international exchanges. This investment class also includes investments in commingled and mutual funds that hold investments in equity securities. The equity securities investments are exposed to various risks, including market risk; individual security risk; foreign exchange risk; and, for common equity of companies with a small market capitalization, liquidity risk.

Public Master Limited Partnerships – This investment class consists of master limited partnerships that invest in various domestic infrastructure assets within the energy industry. The master limited partnerships trade through the major public domestic exchanges and are exposed to various risks, including market risk, individual security risk, regulatory risk, interest rate risk, and liquidity risk.

6. Assets Limited as to Use or Restricted (continued)

Alternative Investments – Funds in this class are invested with external investment managers who invest primarily in various alternative categories, including real estate, long and short equity positions, merger and event arbitrage, natural resources, distressed credit, managed futures, fixed-income arbitrage, and foreign exchange. The managers employ various strategies, including long/short equity, event-driven, relative value, and tactical trading. A long/short equity strategy will take both long and short equity positions in publicly traded stocks to provide maximum capital appreciation, while limiting downside risk. Event-driven strategies deploy funds opportunistically across multiple asset categories seeking positive returns from companies involved in mergers, acquisitions, bankruptcy, litigation, regulatory uncertainty, and other matters with the potential to unlock value. Relative value funds use a variety of different strategies across a broad array of equity and fixed-income securities to take advantage of market inefficiencies between asset pairs, while maintaining a market-neutral risk position. Tactical trading strategies invest primarily in liquid markets, such as fixed-income and mortgage derivative securities, convertible debt, currencies, interest rate swaps, equity indices, and commodities and energy derivatives, while seeking to take advantage of changes in global economies and discrepancies among related sets of securities and derivatives resulting in asymmetrical outcomes. These investments are domestic and international in nature and have varying degrees of illiquidity. The risks associated with these investments are numerous and include liquidity risk, market risk, event risk, interest rate risk, foreign exchange risk, and investment manager risk. In addition, the investment managers are not required to register with the Securities and Exchange Commission and are not subject to regulatory controls. As unregistered investment vehicles, these funds are not required to disclose the holdings in their portfolios to investors. Given the numerous risks involved, these funds have a greater likelihood of losing invested capital.

(Dollar Amounts in Thousands)

6. Assets Limited as to Use or Restricted (continued)

As of December 31, 2019 and 2018, PHS had alternative investments representing various hedge funds and real asset investments that include limited liability companies and limited liability partnerships, as follows:

	December 31 2019	2018
Equity long/short	**$ 13,549**	$ 15,039
Event driven	**49,741**	33,272
Relative value	**43,700**	44,720
Tactical trading	**44,362**	34,200
Private equity	**6,278**	5,089
Real assets	**87,203**	117,905
Total cost basis	**244,833**	250,225
Unrealized gain, net	**47,723**	31,551
	$ 292,556	$ 281,776

Approximately 89% of the value of these alternative investments represent investments with original lockup periods ranging from one month to five years. The remaining exposure represents investments with longer lockups and limited redemption rights. At December 31, 2019, PHS had unfunded commitments for alternative investments totaling $72,162.

Investment (loss) income on assets limited as to use or restricted (excluding restricted by donor) consists of the following:

	Year Ended December 31 2019	2018
Interest and dividend income	**$ 52,024**	$ 54,184
Net realized gains on marketable securities	**3,667**	46,784
Total investment income	**55,691**	100,968
Net unrealized gains (losses) on marketable securities	**255,582**	(204,131)
Net unrealized gains (losses) on alternative investments	**16,171**	(167)
	$ 327,444	$ (103,330)

(Dollar Amounts in Thousands)

7. Fair Value Measurements

The following tables present the fair value hierarchy for PHS's financial assets and liabilities measured at fair value, and financial assets measured at NAV at December 31, 2019:

	Level 1	Level 2	Commingled Investments at NAV	Equity Method Investments at NAV	Total Financial Instruments	Valuation Technique* (a, b, c, d)
Designated for long-term purposes						
Cash and cash equivalents	$ 7,110	$ –	$ –	$ –	$ 7,110	a
Government securities	398,169	–	–	–	398,169	a
Fixed-income securities	–	301,380	195,562	–	496,942	b, d
Equity securities	359,460	–	588,531	–	947,991	a, d
Public master limited partnerships	63,428	–	–	–	63,428	a
Alternative investments	–	–	–	261,805	261,805	d
Total designated for long-term purposes	$ 828,167	$ 301,380	$ 784,093	$ 261,805	$ 2,175,445	
Designated for self-insurance funds						
Cash and cash equivalents	$ 843	$ –	$ –	$ –	$ 843	a
Government securities	21,350	–	–	–	21,350	a
Fixed-income securities	–	13,739	16,875	–	30,614	b, d
Equity securities	18,097	–	51,742	–	69,839	a, d
Public master limited partnerships	5,290	–	–	–	5,290	a
Alternative investments	–	–	–	20,200	20,200	d
Total designated for self-insurance funds	$ 45,580	$ 13,739	$ 68,617	$ 20,200	$ 148,136	
Restricted by donors						
Cash and cash equivalents	$ 320	$ –	$ –	$ –	$ 320	a
Government securities	7,987	–	–	–	7,987	a
Fixed-income securities	–	6,178	4,131	–	10,309	b, d
Equity securities	7,452	–	12,065	–	19,517	a, d
Public master limited partnerships	1,323	–	–	–	1,323	a
Alternative investments	–	–	–	10,551	10,551	d
Total restricted by donors	$ 17,082	$ 6,178	$ 16,196	$ 10,551	$ 50,007	
Held by trustee						
Cash and cash equivalents	$ 247,929	$ –	$ –	$ –	$ 247,929	a
Restricted for statutory requirements						
Cash and cash equivalents	$ 65,361	$ –	$ –	$ –	$ 65,361	a
Government securities	40,199	31,563	–	–	71,762	a, b
Fixed-income securities	–	56,094	–	–	56,094	b
	$ 105,560	$ 87,657	$ –	$ –	$ 193,217	
Financial liabilities						
Interest rate swaps	$ –	$ (20,088)	$ –	$ –	$ (20,088)	b

(Dollar Amounts in Thousands)

7. Fair Value Measurements (continued)

The following tables present the fair value hierarchy for PHS's financial assets and liabilities measured at fair value, and financial assets measured at NAV at December 31, 2018:

	Level 1	Level 2	Commingled Investments at NAV	Equity Method Investments at NAV	Total Financial Instruments	Valuation Technique* (a, b, c, d)
Designated for long-term purposes						
Cash and cash equivalents	$ 8,839	$ –	$ –	$ –	$ 8,839	a
Government securities	71,465	–	–	–	71,465	a
Fixed-income securities	353,152	214,616	189,534	–	757,302	a, b, d
Equity securities	270,405	–	490,583	–	760,988	a, d
Public master limited partnerships	58,693	–	–	–	58,693	a
Alternative investments	–	–	–	251,555	251,555	d
Total designated for long-term purposes	$ 762,554	$ 214,616	$ 680,117	$ 251,555	$ 1,908,842	
Designated for self-insurance funds						
Cash and cash equivalents	$ 3,499	$ –	$ –	$ –	$ 3,499	a
Government securities	2,099	–	–	–	2,099	a
Fixed-income securities	29,036	5,441	16,205	–	50,682	a, b, d
Equity securities	14,534	–	40,910	–	55,444	a, d
Public master limited partnerships	4,887	–	–	–	4,887	a
Alternative investments	–	–	–	21,236	$21,236	d
Total designated for self-insurance funds	$ 54,055	$ 5,441	$ 57,115	$ 21,236	$ 137,847	
Restricted by donors						
Cash and cash equivalents	$ 218	$ –	$ –	$ –	$ 218	a
Government securities	1,552	–	–	–	1,552	a
Fixed-income securities	7,829	4,660	4,116	–	16,605	a, b, d
Equity securities	5,953	–	10,653	–	16,606	a, d
Public master limited partnerships	1,299	–	–	–	1,299	a
Alternative investments	–	–	–	8,985	8,985	d
Total restricted by donors	$ 16,851	$ 4,660	$ 14,769	$ 8,985	$ 45,265	
Held by trustee						
Cash and cash equivalents	$ 31,250	$ –	$ –	$ –	$ 31,250	a
Restricted for statutory requirements						
Cash and cash equivalents	$ 3,692	$ –	$ –	$ –	$ 3,692	a
Government securities	39,149	24,721	–	–	63,870	a, b
Fixed-income securities	–	46,579	–	–	46,579	b
	$ 42,841	$ 71,300	$ –	$ –	$ 114,141	
Financial assets (liabilities)						
Interest rate swaps	$ –	$ (15,642)	$ –	$ –	$ (15,642)	b

(Dollar Amounts in Thousands)

7. Fair Value Measurements (continued)

Derivative contracts related to marketable securities were reported as a net liability of $129 as of December 31, 2019, and were included within assets limited as to use. There were no derivative contracts related to marketable securities as of December 31, 2018.

	Level 1	Level 2	Total Financial Instruments	Valuation Technique* (a, b, c, d)
Derivative assets				
Futures contracts	$ 293,703	$ –	$ 293,703	a
Interest rate swap agreements	–	196,089	196,089	b
	$ 293,703	$ 196,089	$ 489,792	
Derivative liabilities				
Futures contracts	$ (293,703)	$ –	$ (293,703)	a
Interest rate swap agreements	–	(195,960)	(195,960)	b
	$ (293,703)	$ (195,960)	$ (489,663)	

*Valuation techniques are described in Note 2.

There were no changes in the fair value level classification, between Level 1 and Level 2, for any investments in 2019 or 2018. PHS has no Level 3 investments. As a result of further analysis of the characteristics of certain private commingled funds, amounts that were previously reported as Level 2 at December 31, 2018, have been removed from the fair value hierarchy and presented as commingled investments at NAV, consistent with the 2019 presentation.

(Dollar Amounts in Thousands)

8. Property and Equipment, Net

Property and equipment, net, consist of the following:

	December 31	
	2019	**2018**
Land and improvements	**$ 140,195**	$ 126,372
Buildings and improvements	**1,232,839**	1,184,087
Equipment	**669,208**	625,245
Software	**304,440**	250,386
	2,346,682	2,186,090
Less accumulated depreciation and amortization	**(1,343,288)**	(1,235,767)
	1,003,394	950,323
Construction-in-progress	**70,647**	78,976
	$ 1,074,041	$ 1,029,299

Unamortized software was $68,265 and $43,186 as of December 31, 2019 and 2018, respectively. Software amortization expense was $29,090 and $24,438 for the years ended December 31, 2019 and 2018, respectively, and is included in depreciation and amortization expense.

At December 31, 2019, PHS has future capital commitments of $41,298.

9. Medical Claims Expense

For the years ended December 31, 2019 and 2018, medical claims expense increased by $3,798 and decreased by $10,669 in 2019 and 2018, respectively, as a result of changes in estimates of prior periods' unpaid claims and claims adjustment expenses. These changes generally are the result of ongoing analyses of recent loss development trends. Original estimates are increased or decreased as additional information becomes known regarding individual claims.

(Dollar Amounts in Thousands)

10. Long-Term Debt and Interest Rate Swaps

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

	December 31 2019	December 31 2018
2019 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates of 3.0% to 5.0% payable semiannually on the established interest payment dates, principal payments beginning in 2025 through 2048	**$ 146,400**	$ –
2019 Series B Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rate of 5.0% payable semiannually on the established interest payment dates, principal payments due in 2025	**75,000**	–
2019 Series C Taxable Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), variable rate demand bonds with an interest rate of 1.65% at December 31, 2019, payable monthly on the established interest payment date, principal payments beginning in 2033 through 2042	**82,845**	–
2017 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates of 2.0% to 5.0% payable semiannually on the established interest payment dates, principal payments through 2046	**238,335**	238,730
2017 Series B Taxable Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates of 4.0% and 5.0% payable semiannually on the established interest payment dates, principal payments beginning in 2037 through 2046	**65,665**	65,665
2015 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates from 4.125% to 5.0% payable semiannually on the established interest payment dates, principal payments through 2044	**212,990**	218,195
2012 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates from 4.0% to 5.0% payable semiannually on the established interest payment dates, principal payments beginning in 2033 through 2042	**–**	75,000
2008 Series B, C, and D Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), variable-rate demand bonds with interest rates of 1.70% to 1.73% at December 31, 2019, and 1.75% to 1.80% at December 31, 2018, payable monthly on the established interest payment date, principal payable in annual installments through 2034	**161,075**	171,165
2012 note payable to bank, variable rate, interest payable quarterly at one-month LIBOR plus .90% (2.60% at December 31, 2019, and 3.36% at December 31, 2018) due October 2022	**50,000**	50,000
Other obligations	**4,321**	4,790
	1,036,631	823,545
Premiums on long-term debt, net	**56,769**	30,148
Less deferred financing fees	**(7,980)**	(6,870)
	1,085,420	846,823
Less current portion	**(16,829)**	(16,161)
	$ 1,068,591	$ 830,662

10. Long-Term Debt and Interest Rate Swaps (continued)

The 2019 Series A and B Revenue Bonds totaling $221,400 were issued through the New Mexico Hospital Equipment Loan Council in December 2019. Proceeds of the bonds will be used primarily for the construction of a new patient tower on the Presbyterian main hospital campus in Albuquerque, New Mexico, and the build-out of an ambulatory surgery center on the Kaseman hospital campus. The 2019 Series A Bonds are fixed rate and include serial bonds with annual maturities beginning in August 2025 through 2039 and term bonds with maturities beginning in August 2044 and 2048. The 2019 Series B Bonds are fixed-rate term bonds maturing in 2049 with an initial interest period ending August 1, 2025, at which time they are subject to mandatory tender or rate adjustment for a new interest period.

The 2019 Series C Taxable Revenue Bonds totaling $82,845 were issued through the New Mexico Hospital Equipment Loan Council in December 2019. Proceeds of the bonds were used to defease the 2012 Series A Revenue Bonds. The 2019 Series C Bonds are variable-rate demand obligations and bear interest on a weekly rate period at amounts set by a remarketing agent. The interest rate mode can be modified under the terms of the legal documents. To secure the tender price of the 2019 Series C Bonds, PHS has entered into a standby bond purchase agreement with JPMorgan Chase Bank, N.A. with an expiration in December 2024. The 2019 Series C Bonds are subject to optional redemption at the discretion of PHS. In addition, the 2019 Series C Bonds have a schedule of mandatory sinking fund deposits in 2033 through 2042.

The 2017 Series A Revenue Bonds totaling $239,115 were issued through the New Mexico Hospital Equipment Loan Council in May 2017. Proceeds of the bonds were issued to defease the 2009 Series A Revenue Bonds and provide funding for the construction of a new hospital facility in Santa Fe, New Mexico, which opened in October 2018. The 2017 Series A bonds are fixed-rate bonds and have annual maturities that began in August 2018 and continue through 2046.

The 2017 Series B Taxable Revenue Bonds totaling $65,665 were issued through the New Mexico Hospital Equipment Loan Council in May 2017. Proceeds of the bonds are being used to fund the construction of a physician office building adjacent to the new hospital in Santa Fe, New Mexico, and expand PHS's administrative office in Albuquerque, New Mexico. The 2017 Series B bonds are fixed rate bonds and have annual maturities beginning in August 2037 and continuing through 2046.

10. Long-Term Debt and Interest Rate Swaps (continued)

The 2015 Series A Revenue Bonds were issued through the New Mexico Hospital Equipment Loan Council. Proceeds of the bonds were used to defease the 2008 Series A Bonds and fund various health care facilities throughout the PHS system. The 2015 bonds are fixed-rate serial and term bonds and have scheduled maturities and mandatory sinking fund deposits that began in August 2016, and continue through 2044.

In August 2012, PHS also obtained a $50,000 taxable bank direct loan (the 2012 Bank Loan), of which $50,000 was outstanding as of December 31, 2019 and 2018. Proceeds of the 2012 Bank Loan were used for a new system corporate office, which was completed in 2014.

The 2008 Revenue Bonds were issued through the New Mexico Hospital Equipment Loan Council in four series (Series A, Series B, Series C, and Series D) (the Series 2008 Bonds) in November 2008. The Series 2008 Bonds were designed to defease the 2005 Series A and B Revenue Bonds ($201,895); to pay off a Wells Fargo Credit Agreement, which defeased the 2004 Series A through D Bonds ($128,655) and the 1993A Bonds ($17,900) during March and April 2008; to reimburse PHS for prior capital expenditures; and to pay certain costs of issuing the Series 2008 Bonds. The Series 2008 A Bonds were refunded in their entirety in 2015 and have been legally defeased. The Series 2008 B through D Bonds are variable-rate demand obligations and bear interest on a daily (Series C and D) and weekly (Series B) rate period at amounts set by a remarketing agent. The interest rate mode can be modified under the terms of the legal documents. To secure the tender price of the Series 2008 B Bonds, PHS has entered into a standby bond purchase agreement with JPMorgan Chase Bank, N.A with expirations in November 2020. The Series 2008 C and D Bonds are supported by standby bond purchase agreements with Wells Fargo Bank, N.A. with expiration dates in November 2021 and 2022, respectively. The Series 2012 A Bonds were defeased in 2019 and a loss of $3,920 was recognized.

The Series 2008 B, C, and D Bonds are further subject to optional redemption at the discretion of PHS. In addition, the Series 2008 Bonds have a schedule of mandatory sinking fund deposits through 2034.

All of the outstanding bonds are collateralized by a pledge of unrestricted receivables of the Obligated Group, as defined under the Master Trust Indenture. The Master Trust Indenture of the Obligated Group requires, among other things, that certain funds be established and held by a trustee. The Master Trust Indenture also requires certain limitations on additional indebtedness, liens on property, and disposition or transfers of assets, as well as the maintenance of certain cash balances and other financial ratios. The Obligated Group was in compliance with all such covenants at December 31, 2019.

(Dollar Amounts in Thousands)

10. Long-Term Debt and Interest Rate Swaps (continued)

Scheduled principal payments and sinking fund requirements on long-term debt at December 31 are as follows:

	Long-Term Debt
2020	$ 16,829
2021	17,548
2022	18,285
2023	19,059
2024	19,862
Thereafter	945,048
	$ 1,036,631

Interest Rate Swaps

PHS has entered into several interest rate swaps associated with bond issuances, some of which have bonds that are no longer outstanding. The 2005 swaps provide that PHS receives a floating amount based on a percentage of one-month LIBOR (58.30% of LIBOR plus 0.36%) and PHS pays a fixed rate of 3.085% based on a notional amount of $136,330 and $146,420 at December 31, 2019 and 2018, respectively.

The 2006 swaps provide that PHS receives a floating amount based on a percentage of one-month LIBOR (68%) and PHS pays a weighted average fixed rate of 3.577% based on a notional amount of $24,745 at both December 31, 2019 and 2018.

In connection with the issuance of the Series 2019 C Bonds in December 2019, PHS entered into a swap agreement (the 2019 Swap) whereby PHS receives a floating amount based on one-month LIBOR and PHS pays a fixed rate of 1.96% on the notional amount of $82,845 at December 31, 2019.

10. Long-Term Debt and Interest Rate Swaps (continued)

All derivatives that are being measured by PHS under ASC 820 are considered Level 2 assets (liabilities) because a quoted price can be obtained from a number of dealer counterparties and other market sources based on observable interest rates and yield curves for the full term of the asset or liability. In order to measure the fair value of municipal derivatives under ASC 820, PHS adjusted its mid-market periodic values of the swaps outstanding to incorporate nonperformance risk by PHS (when the financial instrument is a liability) or the counterparty (when the financial instrument is an asset). In order to determine the risk of nonperformance when the financial instrument is a liability, PHS has determined the change in the credit market for debt issues by entities with the same credit characteristics as PHS. To determine nonperformance risk when the instrument is an asset, PHS determines the change in the credit market for debt issues by the counterparty.

As of December 31, 2019 and 2018, the fair value of the 2005 and 2006 swaps was a net liability of $20,024 and $15,642, respectively. As of December 31, 2019, the fair value of the 2019 Swap was a liability of $64. The combined net swap liability change is included in other liabilities on the accompanying combined balance sheets.

If the liability related to the 2005 and 2006 swaps were to exceed $40,000, PHS would be required to post a cash deposit for amounts in excess of the threshold as collateral with the counterparty. This collateral threshold would be reduced to $30,000 if PHS's current AA credit rating were to fall to A+, reduced to $20,000 at a rating of A, and further reduced to zero at a credit rating below A. If the liability related to the 2019 Swap was to exceed $75,000, PHS would be required to post a cash deposit for amounts in excess of the threshold as collateral with the counterparty. The collateral threshold would be reduced to $50,000 if PHS's current AA credit rating were to fall to A+, reduced to $30,000 at a rating of A, reduced to $15,000 at a rating of A-, and further reduced to zero at a credit rating below A-.

Interest expense included $2,492 and $2,958 in 2019 and 2018, respectively, related to net periodic payments to the counterparty.

11. Employee Benefit Plans

PHS has a defined benefit pension plan (the original plan) that previously covered substantially all of the employees of its related organizations, except employees of PNI. Effective January 1, 2006, the original plan was closed to new entrants, but it continued to accrue benefits for those employees in the plan as of December 31, 2005, until December 31, 2012, when the original plan was amended to cease future benefit accruals. Any benefits earned by participants under the original plan at December 31, 2012, will be preserved and will be payable based on the original plan's provisions.

In December 2018, certain participants in the original plan were removed from the original plan through lump-sum payments and annuities. Remaining participants in the original plan were transferred to a new ongoing plan (Plan I) and the original plan was terminated. The termination of the original plan resulted in a pension settlement charge of $19,867, which was recorded in 2018.

PHS contributes such amounts as necessary on an actuarial basis to provide Plan I with assets sufficient to meet the benefits to be paid to Plan I participants. PHS contributed $29,399 and $31,739 in 2019 and 2018, respectively, to Plan I.

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

A summary of Plan I's benefit obligation, assets, and funded status is as follows:

	Year Ended December 31	
	2019	**2018**
Change in benefit obligation:		
Benefit obligation at beginning of year	**$ 465,825**	$ 553,711
Service cost	**2,900**	4,300
Interest cost	**20,424**	21,346
Plan settlements	**–**	(54,527)
Actuarial loss (gain)	**64,044**	(33,704)
Benefits paid and plan expenses	**(22,310)**	(25,301)
Benefit obligation at end of year	**$ 530,883**	$ 465,825
Change in assets:		
Fair value of assets at beginning of year	**$ 306,071**	$ 376,386
Actual return on assets	**53,971**	(22,226)
Employer contribution	**29,399**	31,739
Plan settlements	**–**	(54,527)
Benefits paid and plan expenses	**(22,310)**	(25,301)
Fair value of plan assets at end of year	**$ 367,131**	$ 306,071
Funded status at year-end	**$ (163,752)**	$ (159,754)
Amounts not yet reflected in net periodic benefit cost and included in net assets:		
Accumulated loss	**$ (203,042)**	$ (176,253)
Cumulative changes in unrestricted net assets	**(203,042)**	(176,253)
Cumulative employer contributions in excess of net periodic benefit cost	**39,290**	16,499
Net amount recognized in the combined balance sheets	**$ (163,752)**	$ (159,754)

The actuarial loss recorded in 2019 was primarily due to the change in discount rate from 4.48% to 3.45%. This change increased the benefit obligation by $67,700 in 2019.

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

In 2018, PHS recorded settlement and curtailment charges of $19,867 for the risk transfer activities that occurred in 2018. These charges are in addition to the regular periodic benefit cost of $6,936 for 2018.

A summary of the projected benefit obligation, accumulated benefit obligation, and fair value of plan assets is as follows:

	2019	2018
Projected benefit obligation	**$ 530,883**	$ 465,825
Accumulated benefit obligation	**530,883**	465,825
Fair value of plan assets	**367,131**	306,071

Assumptions used to determine the benefit obligation as of the measurement date are as follows:

	2019	2018
Discount rate at end of year	**3.45%**	4.48%
Rate of increase in compensation levels	**N/A**	N/A

Net periodic pension benefit cost includes the following components:

	2019	2018
Service cost – benefits earned during the year	**$ 2,900**	$ 4,300
Interest cost on projected benefit obligation	**20,424**	21,346
Expected return on Plan I assets	**(21,575)**	(24,589)
Amortization of prior service credit	**1,535**	1,561
Recognized net actuarial loss	**3,324**	4,318
Net periodic pension benefit cost	**$ 6,608**	$ 6,936

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

Assumptions used to determine net periodic pension benefit cost are as follows:

	2019	2018
Discount rate at beginning of year	**4.48%**	3.93%
Rate of increase in compensation levels	**N/A**	N/A
Expected long-term rate of return on assets at beginning of year	**6.50%**	6.75%

Contributions to be made during 2020 have not been finalized but are expected to be $28,524.

The expected return on Plan I assets has been developed using both historical and future expected returns for each asset class. Based on the target asset mix, PHS selected a long-term rate of return of 6.5% and 6.0% for 2019 and 2020, respectively. The asset allocation for Plan I, by asset class at the measurement date, was as follows:

	2019	2018
Cash and cash equivalents	**3%**	4%
Fixed-income securities	**44**	44
Common stock and equity	**39**	35
Absolute return, hedge funds, and other	**14**	17
	100%	100%

Plan I assets have historically been invested in a portfolio designed to preserve principal and obtain competitive investment returns and long-term investment growth, consistent with actuarial assumptions, while minimizing unnecessary investment risk. Diversification is achieved by retaining multiple investment managers with complementary philosophies, styles, and approaches.

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

Plan I asset allocation targets at the measurement date were as follows:

	Target	Range
Cash and cash equivalents	1%	0%–6%
Fixed-income securities	44%	39–49%
Domestic equity securities	20%	15–25%
International equity securities	20%	15–25%
Other	15%	7–25%

The following tables present the fair value hierarchy for PHS's Plan I financial assets and liabilities measured at fair value and financial assets measured at NAV at December 31:

	Level 1	Level 2	Commingled Investments at NAV	Equity Method Investments at NAV	Total	Valuation Techniques* (a, b, c, d)
2019						
Cash and cash equivalents	**$ 10,722**	**$ –**	**$ –**	**$ –**	**$ 10,722**	**a**
Fixed-income securities	**69,384**	**4,294**	**86,887**	**–**	**160,565**	**a, b, d**
Equity securities	**58,052**	**–**	**88,274**	**–**	**146,326**	**a, d**
Public master limited partnerships	**19,694**	**–**	**–**	**–**	**19,694**	**a**
Alternative investments	**–**	**–**	**–**	**29,824**	**29,824**	**d**
Total financial assets	**$ 157,852**	**$ 4,294**	**$ 175,161**	**$ 29,824**	**$ 367,131**	
2018						
Cash and cash equivalents	$ 11,894	$ –	$ –	$ –	$ 11,894	a
Fixed-income securities	38,591	6,026	89,072	–	133,689	a, b, d
Equity securities	42,433	–	65,293	–	107,726	a, d
Public master limited partnerships	13,148	–	–	–	13,148	a
Alternative investments	–	–	–	39,614	39,614	d
Total financial assets	$ 106,066	$ 6,026	$ 154,365	$ 39,614	$ 306,071	

*Valuation techniques are described in Note 2.

There were no changes in the fair value level classification, between Level 1 and Level 2, for any investments in 2019 or 2018. PHS has no Level 3 investments. As a result of further analysis of the characteristics of certain private commingled funds, amounts that were previously reported as Level 2 at December 31, 2018, have been removed from the fair value hierarchy and presented as commingled investments at NAV, consistent with the 2019 presentation.

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

Derivative contracts related to marketable securities were reported as a net liability of $0 as of December 31, 2019, and were included within PHS's Plan I assets. There were no derivative contracts related to marketable securities as of December 31, 2018.

	Level 1	Level 2	Commingled Investments at NAV	Equity Method Investments at NAV	Total	Valuation Techniques* (a, b, c, d)
December 31, 2019						
Derivative assets						
Future derivative asset contracts	$ 19,271	$ –	$ –	$ –	$ 19,271	
Future derivative liability contracts	(19,271)	–	–	–	(19,271)	
Total financial assets	$ –	$ –	$ –	$ –	$ –	

* Valuation techniques are described in Note 2.

Plan I's alternative investments are comprised of a hedge fund-of-funds and a private real estate investment trust (REIT). As described in Note 2, management has elected to use the NAV per share, or its equivalent, as a practical expedient for the fair value of Plan I's interest in alternative investments. The underlying funds have restrictions on the timing of withdrawals, which may reduce liquidity from three to six months.

Expected benefits to be paid to the Plan I participants and beneficiaries are as follows:

2020	$ 21,343
2021	22,837
2022	24,279
2023	25,663
2024–2029	171,910

In addition to Plan I, PHS also has five other limited postretirement benefit plans subject to the funded status recognition provisions of ASC 715. Plan I is funded, and the other postretirement plans are unfunded. As a result of the change in pension obligation, net assets without donor restrictions increased by $28,422 and decreased by $14,578 during 2019 and 2018, respectively.

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

PHS has a defined contribution plan (Plan II), which consists of a Section 403(b) plan and a Section 401(a) plan under the Code. Plan II requires PHS to pay a basic employer contribution, as well as match participant contributions up to a stated maximum percentage of the participant's salary. Contributions to Plan II are expensed as earned by employees and were $33,631 and $29,615 in 2019 and 2018, respectively.

PHP has a 401(k) defined contribution plan (Plan III) for PHP employees. Plan III requires PHP to match participant contributions up to a stated maximum percentage of the participant's salary. Plan III additionally provides an employer contribution for all employees regardless of whether the employee individually contributes to Plan III. PHP contributions to Plan III are expensed as earned by employees and were $5,158 and $3,692 in 2019 and 2018, respectively.

12. Net Assets With Donor Restrictions

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

	2019	2018
Subject to expenditure for specific purpose		
Program services and facility improvements	**$ 36,048**	$ 30,784
Education	**4,816**	4,230
	$ 40,864	$ 35,014
Subject to PHS's spending policy and appropriation		
Investment in perpetuity (including amounts above original gift amount) that once appropriated is expendable to support:		
Program services and facility improvements	**$ 10,005**	$ 9,959
Education	**1,827**	1,836
	$ 11,832	$ 11,795
Total net assets with donor restrictions	**$ 52,696**	$ 46,809

(Dollar Amounts in Thousands)

12. Net Assets With Donor Restrictions (continued)

Net assets with donor restrictions are comprised of the following at December 31:

	2019	2018
Marketable securities	**$ 49,351**	$ 44,686
Pledges receivable	**2,689**	1,544
Other	**656**	579
	$ 52,696	$ 46,809

13. Concentration of Credit Risk

PHS provides health care services through its inpatient and outpatient care facilities throughout New Mexico. PHS grants credit to patients, most of whom are insured under third-party payor agreements, without requiring collateral or other security in extending credit to patients. However, PHS routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, HMOs, and commercial insurance policies). The following table summarizes the percentage of net patient accounts receivable from all payors:

	December 31	
	2019	**2018**
Managed care and other third-party payors	**72%**	73%
Government	**20**	20
Self-pay	**8**	7
Total	**100%**	100%

Managed care and other third-party payors consist of receivables from various payors, including contracted third-party payors providing commercial and government programs. Management does not believe there is any significant concentration of credit risk associated with accounts receivable. Furthermore, management continually monitors and adjusts its allowances (contractual and implicit price concessions) associated with these receivables.

14. Commitments and Contingencies

Litigation and Other Contingent Liabilities

PHS is subject to pending and threatened legal actions arising during the ordinary course of business. Management and legal counsel periodically assess whether losses have been incurred related to pending or threatened litigation, claims, and assessments. Loss estimates are continually monitored and reviewed, and as estimates are adjusted, changes in estimated losses are reflected in current operations. Losses incurred due to the actual results of litigation could differ from estimates recorded. In management's opinion, upon consultation with legal counsel, these matters should not have a material adverse effect on PHS's combined financial condition, results of operations, or cash flows. However, PHS's evaluation of the likely effects of these actions could change in the future, and an unfavorable outcome, depending upon the amount and timing, could have a material effect on PHS's combined financial condition, results of operations, or cash flows of a future period.

On June 6, 2019, PHS discovered anonymous, unauthorized access to Protected Health Information (PHI) was gained through a phishing email sent to some of PHS's workforce in early May 2019. The affected email accounts contained data that included patient and/or health plan member names and, in some cases, dates of birth, Social Security numbers and clinical and/or health plan information. No credit card information was accessed. PHS has notified the appropriate state and federal regulatory agencies of the unauthorized access, and patients and members whose PHI was identified as potentially subject to unauthorized access were mailed breach notification letters. PHS made separate written notification to additional individuals whose Personally Identifiable Information (PII) was subject to unauthorized access in accordance with state law requirements.

Presbyterian implemented additional security safeguards to address issues identified in its ongoing investigation. Further disclosures and notifications are likely to occur, although the extent is unknown at this time.

14. Commitments and Contingencies (continued)

Health Insurer Fee

Section 9010 of the Patient Protection and Affordable Care Act (ACA) imposes a fee on each covered entity engaged in the business of providing health insurance for United States health risks. The annual fee is allocated to health insurers based on the ratio of the amount of an insurer's premium written during the preceding calendar year to the amount of health insurance for all U.S. health risk for those certain lines of business that is written in the preceding calendar year. The expense is recorded in the year that the fees are due. In 2018, the fee was due for both PHP and PIC based on premiums written in 2017. As a result, fees paid and expensed in 2018 were $34,900. This fee was suspended in 2019, and no amounts were expensed or paid in 2019.

Health Care Regulatory Environment

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in exclusion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed and paid. Management believes that it has established adequate reserves to investigate, defend, and ultimately resolve any alleged instances of noncompliance. Compliance with such laws and regulations can be subject to future government review, as well as regulatory actions unknown or unasserted at this time.

Self-Insurance Plans

PHS is self-insured for professional and general liability, workers' compensation, and employee health insurance. PHS purchases claims-made insurance to cover professional liability and workers' compensation claims in excess of the self-insured limits. There are known claims and incidents that may result in the assertion of additional claims, as well as claims for unknown incidents that may be asserted arising from services provided to patients. PHS has engaged independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued professional liability, general liability, and workers' compensation losses of $207,660 and $167,159 at December 31, 2019 and 2018, respectively, have been discounted at 2.34% and 3.47%, respectively, and, in management's opinion, such amounts provide an adequate reserve for loss contingencies. The increase in the accrued liability can be attributed to adverse claim

14. Commitments and Contingencies (continued)

development. The accrued liability relating to professional and general liability and workers' compensation at December 31, 2019 and 2018, is reported on a gross basis and, therefore, has not been reduced by estimated insurance recoveries of $81,314 and $41,013, respectively, which are reported in other receivables. The accrued liability for estimated employee health claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported and totaled $4,885 and $4,650 at 2019 and 2018, respectively.

At December 31, 2019 and 2018, PHS had an available line of credit to collateralize workers' compensation coverage of $10,400, of which none was outstanding.

Surety Bond

The Medicaid Centennial Care contract requires PHP to provide a performance bond equal to 90% of the average of the past three months' capitation payments made to PHP from HSD. As of December 31, 2019 and 2018, PHP held a surety bond issued by an unrelated insurance company in the amount of $191,000 and $111,100, respectively.

(Dollar Amounts in Thousands)

15. Functional Expenses

PHS provides general health care services to residents within its geographic region. PHS allocates expenses between functional categories through an analysis of each accounting unit within the organization. Accounting units with expenses that are attributable to more than one functional category, such as depreciation, information technology, and insurance, are allocated ratably, based on directly assigned expenses, across all categories. Expenses related to providing these services are as follows:

	Patient Care	Insurance Operations	Other Programs	Supporting Services	Total
Year Ended December 31, 2019					
Medical claims	**$ –**	**$ 2,012,319**	**$ –**	**$ –**	**$ 2,012,319**
Salaries, wages, and benefits	**755,408**	**164,360**	**117,299**	**175,333**	**1,212,400**
Purchased services and other	**216,655**	**251,831**	**78,539**	**56,357**	**603,382**
Supplies	**334,973**	**993**	**18,793**	**(510)**	**354,249**
Professional fees	**34,003**	**3**	**6,164**	**9,481**	**49,651**
Depreciation and amortization	**74,388**	**8,725**	**13,849**	**19,054**	**116,016**
Interest	**301**	**549**	**30,993**	**819**	**32,662**
	$ 1,415,728	**$ 2,438,780**	**$ 265,637**	**$ 260,534**	**$ 4,380,679**
Year Ended December 31, 2018					
Medical claims	$ –	$ 1,404,083	$ –	$ –	$ 1,404,083
Salaries, wages, and benefits	663,081	114,535	102,748	155,873	1,036,237
Purchased services and other	191,143	227,875	64,277	36,793	520,088
Supplies	286,834	671	17,791	(6,947)	298,349
Professional fees	37,125	4	4,706	8,317	50,152
Depreciation and amortization	67,228	2,022	14,185	14,361	97,796
Interest	332	490	29,145	79	30,046
	$ 1,245,743	$ 1,749,680	$ 232,852	$ 208,476	$ 3,436,751

(Dollar Amounts in Thousands)

16. Liquidity

PHS's financial assets available within one year of the balance sheet date for general expenditure are as follows for the years ended December 31:

	2019	2018
Cash and cash equivalents	**$ 245,160**	$ 284,331
Patient accounts receivable	**146,065**	138,523
Other accounts receivable	**222,761**	139,246
Assets limited as to use	**2,145,814**	1,891,180
	$ 2,759,800	$ 2,453,280

PHS has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, PHS invests cash in excess of daily requirements in short-term investments, which are included in cash and cash equivalents on the combined balance sheets.

17. Income Taxes

The components of the provision for income taxes for the years ended December 31 are as follows:

	2019	2018
Current	**$ 9,927**	$ 14,655
Deferred	**8,345**	(4,403)
Total provision for income taxes	**$ 18,272**	$ 10,252

(Dollar Amounts in Thousands)

17. Income Taxes (continued)

The differences between the actual and expected provision for income taxes or benefit computed by applying the federal corporate income tax rate of 21% in 2019 and 2018, plus a state rate of 4.8% for PNI operations only, to income before income taxes for the years ended December 31 are as follows:

	2019	2018
Computed tax expense at combined rate	**$ 17,311**	$ 3,938
Tax reform – tax rate differential	**–**	(516)
ACA health provider fee	**–**	7,329
Change in valuation allowance	**1,546**	1,122
Other permanent differences	**200**	(172)
Provision to return differences	**197**	(345)
State taxes and other	**(982)**	(1,104)
	$ 18,272	$ 10,252

(Dollar Amounts in Thousands)

17. Income Taxes (continued)

Deferred tax assets (liabilities) were included within accrued liabilities on the accompanying combined balance sheets and were comprised of the following at December 31:

	2019	2018
Deferred tax assets:		
Medical liabilities and other reserves	**$ 4,450**	$ 4,490
Medical claims payable (incurred but not reported)	**781**	473
Deferred compensation	**211**	61
Investments	**1,310**	568
Unrealized loss on investments	**–**	1,774
Net operating loss carryforwards	**3,282**	1,813
Deferred intercompany loss	**10,441**	8,590
Other	**862**	265
Total deferred tax assets	**21,337**	18,034
Deferred tax liabilities:		
Amortization of intangibles	**(14,051)**	(14,052)
Prepaid insurance	**–**	(100)
Partnership – book/tax difference	**(4,158)**	(740)
Gains on sale of securities	**(327)**	(1)
Unrealized gains on investments	**(4,848)**	(240)
Total deferred tax liabilities	**(23,384)**	(15,133)
Valuation allowance	**(13,839)**	(10,441)
Deferred tax liabilities, net	**$ (15,886)**	$ (7,540)

At December 31, 2019 and 2018, PNI had no federal net operating loss carryforwards. PNI is subject to state income tax and has state net operating loss carryforwards at December 31, 2019 and 2018, of $56,259 and $31,081, respectively, of which a portion is expiring each year.

At December 31, 2019 and 2018, a valuation allowance in the amount of $13,839 and $10,441, respectively, was established against the deferred tax asset related to the state net operating loss carryforwards, capital loss carryforwards, and deferred intercompany loss, as management currently believes that the benefit from some or all of these deferred tax assets may not be realized.

17. Income Taxes (continued)

In the normal course of business, PNI is subject to examination by taxing authorities, and PNI is no longer subject to U.S. federal, state, or local income tax examinations for years before 2015. PNI does not have any current federal tax disputes.

18. Subsequent Events

PHS has evaluated subsequent events occurring between the end of the most recent year-end and April 16, 2020, the date the combined financial statements were issued.

Subsequent to year end, global efforts to contain the spread of COVID-19, often referred to as Coronavirus, have significantly impacted healthcare organizations and the overall economy. This public health emergency is likely to adversely affect certain operating revenues and expenses. However, the extent of the financial impact, including the long-term impact on PHS's investment portfolio, are uncertain at this time.

Supplementary Information

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Building a better working world

Report of Independent Auditors on Supplementary Information

The Board of Directors
Presbyterian Healthcare Services

Our audit was conducted for the purpose of forming an opinion on the combined financial statements as a whole. The combining balance sheet and statement of operations for the year ended December 31, 2019, are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements, or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the combined financial statements as a whole.

Ernst & Young LLP

April 16, 2020

Presbyterian Healthcare Services and Affiliates

Combining Balance Sheet

December 31, 2019

	Obligated Group	Presbyterian Network, Inc.	Other Non-Obligated Group Members	Eliminations	Combined
			(In Thousands)		
Assets					
Current assets:					
Cash and cash equivalents	$ 143,287	$ 101,023	$ 850	$ –	$ 245,160
Accounts receivable	174,389	–	5,553	(33,877)	146,065
Other receivables	39,663	182,892	286	(80)	222,761
Inventories, prepaid expenses, and other current assets	51,677	9,863	1,795	–	63,335
Total current assets	409,016	293,778	8,484	(33,957)	677,321
Assets limited as to use or restricted:					
Designated for long-term purposes	1,777,598	397,275	572	–	2,175,445
Designated for self-insurance funds	148,136	–	–	–	148,136
Restricted by donors	50,007	–	–	–	50,007
Held by trustee	247,929	–	–	–	247,929
Restricted for statutory requirements	–	193,217	–	–	193,217
	2,223,670	590,492	572	–	2,814,734
Property and equipment, net	942,020	57,318	74,703	–	1,074,041
Goodwill	200	52,501	–	–	52,701
Other assets	165,607	47,050	126,900	(114,934)	224,623
Intercompany receivables (payables)	22,330	(56,005)	33,675	–	–
Total assets	$ 3,762,843	$ 985,134	$ 244,334	$ (148,891)	$ 4,843,420

Presbyterian Healthcare Services and Affiliates

Combining Balance Sheet (continued)

	Obligated Group	Presbyterian Network, Inc.	Other Non-Obligated Group Members	Eliminations	Combined
			(In Thousands)		
Liabilities and net assets					
Current liabilities:					
Accounts payable	$ 72,404	$ 18,954	$ 3,666	$ –	$ 95,024
Due under Medicaid contract	–	30,276	–	–	30,276
Accrued liabilities	128,072	113,439	4,121	(473)	245,159
Medical claims payable	–	289,288	–	(33,484)	255,804
Estimated third-party payor settlements	7,645	–	1,486	–	9,131
Current portion of long-term debt	16,829	–	–	–	16,829
Total current liabilities	224,950	451,957	9,273	(33,957)	652,223
Long-term debt, net of current portion	1,068,591	–	–	–	1,068,591
Employee benefit plans	220,291	–	–	–	220,291
Self-insurance plans	207,345	–	–	–	207,345
Other liabilities	97,711	32,753	1,293	–	131,757
Total liabilities	1,818,888	484,710	10,566	(33,957)	2,280,207
Net assets:					
Net asset without donor restrictions	1,891,259	500,424	233,768	(114,934)	2,510,517
Net asset with donor restrictions	52,696	–	–	–	52,696
Total net assets	1,943,955	500,424	233,768	(114,934)	2,563,213
Total liabilities and net assets	$ 3,762,843	$ 985,134	$ 244,334	$ (148,891)	$ 4,843,420

Presbyterian Healthcare Services and Affiliates

Combining Statement of Operations

Year Ended December 31, 2019

	Obligated Group	Presbyterian Network, Inc.	Other Non-Obligated Group Members	Eliminations	Combined
			(In Thousands)		
Operating revenues:					
Net premiums	$ –	$ 3,189,815	$ –	$ –	$ 3,189,815
Net patient service revenue	1,818,548	–	60,608	(760,018)	1,119,138
Other operating revenues	66,447	44,513	9,480	(36,449)	83,991
Total operating revenues	1,884,995	3,234,328	70,088	(796,467)	4,392,944
Expenses:					
Medical claims	–	2,773,734	–	(761,415)	2,012,319
Salaries, wages, and employee benefits	1,020,775	164,360	33,173	(5,908)	1,212,400
Purchased services and other	363,937	251,830	16,759	(29,144)	603,382
Supplies	348,677	993	4,579	–	354,249
Professional fees	46,290	3	3,358	–	49,651
Depreciation and amortization	101,573	8,725	5,718	–	116,016
Interest	31,294	549	819	–	32,662
Total expenses	1,912,546	3,200,194	64,406	(796,467)	4,380,679
Operating (loss) income	(27,551)	34,134	5,682	–	12,265
Other income:					
Investment income	37,447	17,031	1,213	–	55,691
Change in net unrealized gains on investments	240,483	31,270	–	–	271,753
Loss on debt extinguishment	(3,920)	–	–	–	(3,920)
Change in fair value of interest rate swaps	(5,467)	–	–	–	(5,467)
Total other income	268,543	48,301	1,213	–	318,057
Excess of revenues over expenses before income taxes	240,992	82,435	6,895	–	330,322
Provision (benefit) for income taxes	77	18,512	(317)	–	18,272
Excess of revenues over expenses	$ 240,915	$ 63,923	$ 7,212	$ –	$ 312,050

Combined Financial Statements and Supplementary Information

Presbyterian Healthcare Services and Affiliates
Years Ended December 31, 2021 and 2020
With Reports of Independent Auditors

Ernst & Young LLP

Building a better working world

Presbyterian Healthcare Services and Affiliates

Combined Financial Statements
and Supplementary Information

Years Ended December 31, 2021 and 2020

Contents

Report of Independent Auditors....1

Combined Financial Statements

Combined Balance Sheets....3
Combined Statements of Operations....4
Combined Statements of Changes in Net Assets....5
Combined Statements of Cash Flows....6
Notes to Combined Financial Statements....7

Supplementary Information

Report of Independent Auditors on Supplementary Information....52
Combining Balance Sheet – December 31, 2021....53
Combining Statement of Operations – Year Ended December 31, 2021....55

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Report of Independent Auditors

The Board of Directors
Presbyterian Healthcare Services

We have audited the combined financial statements of Presbyterian Healthcare Services and Affiliates (the Company), which comprise the combined balance sheets as of December 31, 2021 and 2020, and the related combined statements of operations, changes in net assets and cash flows for the years then ended, and the related notes (collectively referred to as the "financial statements").

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

Basis for Opinion

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

Responsibilities of Management for the Financial Statements

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information

Management is responsible for the other information. The other information comprises the Annual Report but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

Ernst & Young LLP

April 28, 2022

Presbyterian Healthcare Services and Affiliates

Combined Balance Sheets

	December 31 2021	December 31 2020
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 474,550**	$ 575,195
Accounts receivable	**182,905**	158,573
Other receivables	**291,054**	185,624
Inventories, prepaid expenses, and other current assets	**74,664**	91,229
Total current assets	**1,023,173**	1,010,621
Assets limited as to use or restricted:		
Designated for long-term purposes	**2,631,909**	2,360,029
Designated for self-insurance funds	**182,083**	164,293
Restricted by donors	**65,980**	57,675
Held by trustee	**145,538**	222,153
Restricted for statutory requirements	**244,866**	221,780
	3,270,376	3,025,930
Property and equipment, net	**1,204,461**	1,126,165
Goodwill	**108,042**	108,042
Other assets	**335,602**	284,430
Total assets	**$ 5,941,654**	$ 5,555,188
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 116,323**	$ 98,747
Due under Medicaid contract	**137,143**	78,147
Accrued liabilities	**264,182**	286,666
Medical claims payable	**394,089**	308,285
Estimated third-party payor settlements	**10,101**	4,951
Short-term borrowings and current installments on long-term debt	**117,549**	117,924
Total current liabilities	**1,039,387**	894,720
Long-term debt, net of current portion	**1,031,714**	1,051,380
Employee benefit plans	**211,496**	265,872
Self-insurance plans	**290,077**	271,595
Other liabilities	**180,241**	188,667
Total liabilities	**2,752,915**	2,672,234
Net assets without donor restrictions:		
Attributable to Presbyterian Healthcare Services	**3,069,064**	2,775,377
Attributable to non-controlling interests	**51,606**	47,939
Net assets without donor restrictions	**3,120,670**	2,823,316
Net assets with donor restrictions	**68,069**	59,638
Total net assets	**3,188,739**	2,882,954
Total liabilities and net assets	**$ 5,941,654**	$ 5,555,188

See accompanying notes.

Presbyterian Healthcare Services and Affiliates

Combined Statements of Operations

	Year Ended December 31	
	2021	2020
	(In Thousands)	
Operating revenues:		
Net premiums	**$ 3,692,491**	$ 3,513,885
Net patient service revenue	**1,280,691**	1,243,509
Other operating revenues	**129,623**	191,629
Total operating revenues	**5,102,805**	4,949,023
Expenses:		
Medical claims	**2,387,158**	2,211,877
Salaries, wages, and employee benefits	**1,344,753**	1,291,243
Purchased services and other	**690,181**	758,742
Supplies	**418,264**	368,873
Professional fees	**38,195**	38,559
Depreciation and amortization	**120,464**	122,735
Interest	**34,775**	37,795
Total expenses	**5,033,790**	4,829,824
Operating income	**69,015**	119,199
Other income (loss):		
Investment income	**189,612**	140,611
Change in net unrealized gains on investments	**43,570**	116,753
Pension settlement loss	**–**	(65,309)
Change in fair value of interest rate swaps	**13,457**	(15,842)
Total other income	**246,639**	176,213
Excess of revenues over expenses before income taxes	**315,654**	295,412
Provision for income taxes	**41,646**	49,554
Excess of revenues over expenses	**274,008**	245,858
Less excess of revenues over expenses attributable to non-controlling interests	**(9,058)**	(5,537)
Excess of revenues over expenses attributable to Presbyterian Healthcare Services	**$ 264,950**	$ 240,321

See accompanying notes.

Presbyterian Healthcare Services and Affiliates

Combined Statements of Changes in Net Assets

	Year Ended December 31	
	2021	**2020**
	(In Thousands)	
Net assets without donor restrictions		
Excess of revenues over expenses attributable to Presbyterian Healthcare Services	**$ 264,950**	$ 240,321
Change in pension obligation	**25,797**	24,835
Other changes in net assets	**2,940**	(296)
Increase attributable to Presbyterian Healthcare Services	**293,687**	264,860
Non-controlling interest of acquired entity	**–**	44,529
Distributions to non-controlling interests	**(7,544)**	(2,127)
Ambulatory surgery center interests sold	**2,153**	–
Excess of revenues over expenses attributable to non-controlling interests	**9,058**	5,537
Increase attributable to non-controlling interests	**3,667**	47,939
Net assets with donor restrictions		
Donor-restricted contributions	**5,923**	5,101
Investment income and other	**5,934**	4,451
Net assets released from restrictions	**(3,426)**	(2,610)
Increase in net assets with donor restrictions	**8,431**	6,942
Change in net assets	**305,785**	319,741
Net assets, beginning of year	**2,882,954**	2,563,213
Net assets, end of year	**$ 3,188,739**	$ 2,882,954

See accompanying notes.

Presbyterian Healthcare Services and Affiliates

Combined Statements of Cash Flows

	Year Ended December 31 2021	2020
	(In Thousands)	
Operating activities		
Change in net assets	**$ 305,785**	$ 319,741
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Change in net unrealized gains on investments	**(43,570)**	(116,753)
Change in fair value of interest rate swaps	**(13,457)**	15,842
Non-controlling interest acquired in business combination	**–**	(44,529)
Ambulatory surgery center interests sold	**(2,153)**	–
Distributions to non-controlling interests	**7,544**	2,127
Depreciation and amortization	**120,464**	122,735
Changes in operating assets and liabilities:		
Accounts receivable	**(24,332)**	(9,415)
Other receivables	**(105,430)**	37,137
Inventories, prepaid expenses, and other current assets	**16,565**	(27,148)
Trading securities, net	**(357,597)**	(147,117)
Other assets	**(55,373)**	(64,006)
Accounts payable	**17,576**	1,045
Due under Medicaid contract	**58,996**	47,871
Accrued liabilities	**(22,484)**	40,037
Medical claims payable	**85,804**	52,481
Estimated third-party payor settlements	**5,150**	(4,180)
Other liabilities	**(32,938)**	150,966
Net cash (used in) provided by operating activities	**(39,450)**	376,834
Investing activities		
Sales of assets held by trustee and statutory deposits	**106,290**	141,139
Purchases of assets held by trustee and statutory deposits	**(52,761)**	(143,926)
Ambulatory surgery center acquisitions	**–**	(13,234)
Purchases of property and equipment	**(194,206)**	(167,286)
Net cash used in investing activities	**(140,677)**	(183,307)
Financing activities		
Proceeds from issuance of long-term debt	**–**	100,000
Payments on long-term debt	**(17,880)**	(16,826)
Ambulatory surgery center interests sold	**2,153**	–
Distributions to non-controlling interests	**(7,544)**	(2,127)
Net cash used in financing activities	**(23,271)**	81,047
Change in cash, cash equivalents, and restricted cash	**(203,398)**	274,574
Cash, cash equivalents, and restricted cash, beginning of year	**841,297**	566,723
Cash, cash equivalents, and restricted cash, end of year	**$ 637,899**	$ 841,297
Supplemental disclosures of cash flow information		
Cash paid for interest, net of amounts capitalized	**$ 36,714**	$ 36,934
Cash paid for income taxes	**$ 28,627**	$ 53,155

See accompanying notes.

1. Organization

Presbyterian Healthcare Services (PHS) is a New Mexico nonprofit corporation exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code (the Code). PHS is a diversified health care organization that owns, leases, controls, operates, or manages a variety of health-care-related organizations, including seven hospitals in New Mexico, a for-profit health maintenance organization (HMO), and several other affiliated organizations. PHS provides a broad range of health care services, including inpatient, outpatient, subacute, home health care, and physician services.

PHS consists of the following divisions and affiliates:

Presbyterian Healthcare Services Divisions

- Presbyterian Hospital,* including the following, which are designated as remote locations of Presbyterian Hospital:
  - Presbyterian Kaseman Hospital*
  - Presbyterian Northside*
  - Presbyterian Rust Medical Center*
- Santa Fe Medical Center*
- Plains Regional Medical Center*
- Presbyterian Española Hospital*
- Socorro General Hospital*
- Lincoln County Medical Center (leased facility)
- Dr. Dan C. Trigg Memorial Hospital (leased facility)

Presbyterian Healthcare Services Affiliates

- Southwest Health Foundation
- Presbyterian Network, Inc.:
  - Presbyterian Insurance Company, Inc.
  - Presbyterian Health Plan, Inc.
  - Fluent Health, LLC
  - Albuquerque Imaging Associates
  - Southwest Magnetic Imaging Associates
- Presbyterian Properties, Inc.
- Presbyterian Healthcare Foundation*
- Bernalillo County Health Care Corporation d.b.a. Albuquerque Ambulance Service*
- New Mexico Orthopaedic Surgery Center ASC, LLC
- PHS/USP Health Ventures, LLC
- Presbyterian Hospital ASC, LLC
- Presbyterian Rust Medical Center ASC, LLC

*Denotes Obligated Group members.

1. Organization (continued)

PHS accesses the capital markets through an Obligated Group. Obligated Group members include PHS and certain divisions and affiliates as noted above, which are jointly and severally liable for the long-term debt outstanding under a Master Trust Indenture. None of the other PHS affiliates have any obligation related to requirements of the Master Trust Indenture. The Obligated Group's net assets represent approximately 71% of PHS and affiliates' combined net assets at both December 31, 2021 and 2020.

Presbyterian Network, Inc. (PNI) is a wholly owned subsidiary of Southwest Health Foundation. PNI is the parent organization of two wholly owned subsidiaries: Presbyterian Health Plan, Inc. (PHP) and Presbyterian Insurance Company, Inc. (PIC). PHP is a state-licensed HMO in New Mexico and is also a federally qualified HMO under Title XIII of the Public Health Service Act. PHP provides comprehensive health care services in New Mexico to individuals primarily through health maintenance contracts with employer groups and individuals. PHP has a five-year contract with the state of New Mexico to provide physical health, behavioral health, and long-term care services to Medicaid eligible individuals under the Centennial Care program. The current five-year contract began January 1, 2019. PHP also offers an HMO product to Medicare-eligible individuals (Medicare Advantage). The Medicare Advantage product provides managed care services that include all Medicare benefits and, in some cases, additional managed care services. PIC offers preferred provider and indemnity products to individuals through contracts with employer groups, as well as stop-loss coverage to some of PHP's self-funded employer groups.

Fluent Health, LLC (Fluent) is a management services organization owned by PNI, PHP, and PIC. The business purpose of Fluent is to provide claims processing, administrative, management, and consulting services to health plans. Currently, Fluent provides these services to PHP and PIC.

On February 1, 2020, PHS entered into an agreement to purchase an ownership interest in New Mexico Orthopaedic Surgery Center LLC (NMOSC). PHS, and another owner of NMOSC, contributed their shares of NMOSC to the newly formed PHS/USP Health Ventures, LLC (PUHV). PUHV consolidates NMOSC through its control and 69.5% ownership in NMOSC. PHS consolidates PUHV through its control and 64.75% ownership in PUHV. Certain transactions between these entities are eliminated in consolidation and PHS reflects the activity attributable to the other owners as non-controlling interest in the accompanying combined financial statements.

1. Organization (continued)

On February 1, 2020, PHS established the Presbyterian Hospital ASC, LLC (PHASC). PHS holds a 98.75% interest in PHASC with the remaining 1.25% held by physician investors. PHS consolidates PHASC through its control and 98.75% ownership in PHASC. Certain transactions between these entities are eliminated in consolidation and PHS reflects the activity attributable to the other owners as non-controlling interest in the accompanying combined financial statements.

On March 1, 2021, PHS established the Presbyterian Rust Medical Center ASC, LLC (Rust ASC). PHS holds a 90% interest in Rust ASC with the remaining 10% held by its development partner Ortholink/New Mexico ASC, Inc. Certain transactions between these entities are eliminated in consolidation and PHS reflects the activity attributable to the other owners as non-controlling interest in the accompanying combined financial statements.

Basis of Presentation

The accompanying financial statements include the combined accounts of PHS and its affiliates as described in Note 1 (collectively, Presbyterian Healthcare Services), including Presbyterian Healthcare Foundation (the Foundation), which is not a controlled entity. However, the Foundation is organized for the benefit and support of PHS, and its financial position and results of operations are combined herein. All significant intercompany balances and transactions have been eliminated in combination.

2. Summary of Significant Accounting Policies

Adopted Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2017-04*, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. The accounting standard simplified the test used to evaluate goodwill and other intangibles for impairment. Under the new accounting standard, the Company performs its annual goodwill impairment test by comparing the fair value of the reporting unit with its carrying amount. An impairment charge would be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the impairment loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. A company still has the option to perform the qualitative assessment for a reporting unit. PHS adopted this ASU effective January 1, 2021. The adoption of this new standard did not have a material impact on the accompanying combined financial statements.

(Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents include bank deposits and highly liquid investments with original maturities at the time of purchase of three months or less. The carrying value of cash and cash equivalents approximates fair value.

Cash, cash equivalents, and restricted cash as reported on the combined statements of cash flows are presented separately within the combined balance sheets in the following asset classes:

	Year Ended December 31	
	2021	**2020**
Cash and cash equivalents	**$ 474,550**	$ 575,195
Assets limited as to use or restricted	**163,349**	266,102
Total cash, cash equivalents, and restricted cash	**$ 637,899**	$ 841,297

Accounts Receivable

Accounts receivable consist of patient accounts that are recorded at net realizable value based on certain assumptions. In evaluating the collectibility of accounts receivable, PHS analyzes its history and identifies trends for the appropriate allowances to reduce accounts receivable to net realizable value of its major payor sources of revenue, as well as self-pay patients.

Management regularly reviews data about these major sources of revenue in evaluating the sufficiency of the allowances on accounts receivable. For receivables associated with services provided to patients who have third-party coverage, PHS analyzes historical collections as a basis for estimating future collections of accounts receivable. PHS has a policy of providing discounts to self-pay patients without insurance. PHS' uninsured discount policies during 2021 and 2020 provided for a discount of 30% from standard rates for most services. These uninsured discounts are recorded with contractual adjustments as a reduction of patient service revenue. The estimated uncollectible amounts due from self-pay patients are generally considered implicit price concessions that are direct reductions of accounts receivable. The implicit price concessions are recognized immediately based on historical results.

2. Summary of Significant Accounting Policies (continued)

Assets Limited as to Use or Restricted

Assets limited as to use or restricted include assets set aside by PHS for future long-term purposes, including capital improvements and self-insurance, over which PHS retains control and may at its discretion subsequently use for other purposes and investments held by PNI that are used to meet specified capital requirements for regulatory purposes. In addition, assets limited as to use or restricted include assets held by trustees under bond indenture agreements, contributions by donors with stipulated restrictions, and amounts on deposit to satisfy statutory requirements of the New Mexico Office of Superintendent of Insurance.

These assets consist primarily of cash, cash equivalents, government securities, other fixed-income securities, equity securities, derivatives, and alternative investments. The carrying amounts of investments in marketable debt and equity securities are reported on the combined balance sheets at fair value. Alternative investments are reported under the equity method of accounting using the net asset value (NAV) as a practical expedient, except for alternative investments held by the Foundation, which are reported at fair value.

PHS also invests in various commingled funds, which are assets from multiple accounts blended into a single fund. Commingled funds do not have a readily determinable fair value; therefore, the NAV is used as a practical expedient for fair value. As such, they are excluded from the fair value hierarchy.

Income or loss related to the investment portfolio (including realized and unrealized gains and losses on investments, interest, and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Income or loss restricted by donor or law is classified as a change in net assets with donor restrictions consistent with the applicable restrictions.

As a condition of its Medicaid Centennial Care contract with the New Mexico Human Services Department (HSD), PHP is required to maintain an account with a balance equal to 90% of the average of the past three months' capitation payments made to PHP from HSD. As of December 31, 2021 and 2020, $243,645 and $220,554, respectively, were held in bonds and cash in a restricted managed asset account to satisfy this requirement.

2. Summary of Significant Accounting Policies (continued)

Fair Value Measurements

Accounting Standards Codification (ASC) 820, *Fair Value Measurement*, requires the categorization of financial assets and liabilities into a three-level hierarchy based on pricing inputs to the valuation technique. The fair value hierarchy gives the highest priority to the quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable inputs. The various levels of the fair value hierarchy are described as follows:

Level 1 – Pricing is based on observable inputs, such as quoted prices in active markets.

Level 2 – Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

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

Assets and liabilities measured at fair value are based on one or more of three valuation techniques noted in ASC 820. Where more than one technique is noted, individual assets or liabilities were valued using one or more of the noted techniques. The valuation techniques are as follows:

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

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

2. Summary of Significant Accounting Policies (continued)

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

(d) *NAV* – Represents the difference between the assets and liabilities of an investment fund or partnership expressed on a per share or unit basis on the valuation date. Underlying asset and liability values may utilize techniques (a), (b), or (c).

When observable market data is available, it is required to be used in determining the fair value measurement. When inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level of input that is significant to the fair value measurement.

The majority of PHS' marketable debt and equity securities are measured based on observable market prices. PHS' interest rate swaps are measured using models based upon observable pricing inputs. Note 7 further describes the methods applied to determine the fair value of PHS' financial assets and liabilities.

The carrying values of financial instruments classified as current assets and current liabilities approximate fair value due to their liquidity and short-term natures.

Inventories

Inventories, consisting of drugs and supplies, are stated at the lower of cost (first-in, first-out method) or net realizable value.

(Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment purchases are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. The following useful lives are being used by PHS:

Land improvements	2–25 years
Buildings and improvements	5–40 years
Equipment and capitalized software	3–20 years

Interest cost incurred on borrowed funds, net of interest earned on assets held by trustee during the period of construction of qualified capital projects, is capitalized as a component of the cost of acquiring those assets.

Goodwill and Other Intangible Assets

PHS follows the provisions of ASC 350, *Intangibles – Goodwill and Other*. Management assesses goodwill impairment using a qualitative evaluation, unless impairment triggers are identified. There was no goodwill impairment in either 2021 or 2020.

On September 1, 2018, PHP acquired approximately 83,000 Medicaid members previously served by another health plan. As a result of the purchase, PHP recorded an intangible asset equal to the cash paid of $42,011 and, in accordance with ASC 350, determined a useful life of ten years. PHP has recorded $4,201 and $4,199 in amortization costs related to this intangible asset for the years ended December 31, 2021 and 2020, respectively.

As a result of the transactions between PHS, PUHV, and NMOSC in February 2020, PHS recorded goodwill of $55,341, net of elimination.

(Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

Impairment of Long-Lived Assets

PHS evaluates whether events and circumstances have occurred that indicate the remaining estimated useful lives of long-lived assets, other than goodwill, may not be recoverable. The assessment of possible impairment is based on the ability to recover the carrying amount of the asset based on undiscounted cash flows. Impairments are calculated as the total by which the carrying amount of the asset exceeds its estimated fair value. For the years ended December 31, 2021 and 2020, management determined that there was no impairment of its long-lived assets.

Net Assets With Donor Restrictions

Unconditional pledges to give cash and other assets are reported at fair value at the date the pledge is received. The gifts are reported as net assets with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and recognized as a component of other operating revenue. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in other operating revenue.

Premium Revenues, Medical Claims Payable, and Health Care Expenses

Premium revenues are recognized in the month in which members are entitled to health care services. Premiums collected in advance are recorded as unearned premiums and are included in accrued liabilities on the accompanying combined balance sheets. During 2021 and 2020, premium revenue was as follows:

	Year Ended December 31	
	2021	**2020**
Net premiums:		
Medicaid	**$ 2,883,475**	$ 2,763,370
Medicare	**568,175**	464,962
Commercial	**240,841**	285,553
Total	**$ 3,692,491**	$ 3,513,885

2. Summary of Significant Accounting Policies (continued)

Coordination of benefits and subrogation are recognized in the period such amounts are determined to be recoverable from other insurers.

PHP is contracted with the state of New Mexico to serve the Medicaid population under the New Mexico Centennial Care program. All Medicaid services, including physical health, behavioral health, and long-term care, are provided as part of this program. PHP is one of three HMOs currently contracted by the state to administer the New Mexico Centennial Care program.

Under this contract, PHP receives a fixed premium from the state to provide comprehensive health care services for enrollees, including those enrollees receiving services from PHS. PHS facilities and physicians are paid capitated or discounted fee-for-service rates from each of the HMOs. The medical claims costs of PHP on the combined statements of operations are net of intercompany eliminations for services rendered by PHS facilities, totaling $736,548 and $674,883 for the years ended December 31, 2021 and 2020, respectively.

Under the Medicaid Centennial Care contract, PHP is permitted to retain 100% of the underwriting gain generated up to 3% annually. Underwriting gains above 3% are shared 50/50 between PHP and HSD. Additionally, for Hepatitis C drugs, PHP is subject to risk corridor adjustments. PHP and HSD share in excess gains or losses generated under the contract based on a tiered structure. Liabilities for the underwriting gain limitation and risk corridors of $132,564 and $73,090 as of December 31, 2021 and 2020, respectively, were recorded on the accompanying combined balance sheets in due under Medicaid contract.

PHP and PIC serve as plan sponsors to offer Medicare Part D prescription drug insurance coverage under a contract with the Centers for Medicare & Medicaid Services (CMS). Premium revenue is recognized ratably over the period in which eligible individuals are entitled to receive prescription drug benefits. Premium revenues are subject to a comprehensive risk reconciliation under which CMS shares in a portion of direct surplus or deficit related to Medicare Part D premiums. In addition to premium revenues, PHP and PIC receive prepayments from CMS related to low income, cost sharing, and catastrophic reinsurance subsidies. PHP and PIC are fully reimbursed by CMS for costs incurred under these contract elements and, accordingly, there is no insurance risk to either company. Amounts received for these subsidies are not reflected as premium revenue, but rather are accounted for as deposits with the related liability recorded on the combined balance sheets. Pharmacy benefit costs not related to low income, cost sharing, or catastrophic reinsurance subsidies and administrative costs under the contract are expensed as incurred.

2. Summary of Significant Accounting Policies (continued)

The estimated cost of all health services rendered to members through December 31, but not yet paid as of that date, is included in medical claims payable. This claims expense estimate is developed using actuarial assumptions based on historical experience with respect to the timing of payments in relation to the dates of service. Subsequent changes to prior period estimates are reflected in the current period. Losses on contracts are recognized in the period when health care costs are expected to exceed premium revenue.

Patient Service Revenue

PHS records net patient service revenue at the transaction price estimated to reflect the total consideration due from patients and third-party payors in exchange for providing goods and services in patient care. These services are considered to be single performance obligations and have durations of less than one year. Revenues are recorded as these goods and services are provided. The transaction price, which involves significant estimates, is determined based on PHS' standard charges for the goods and services provided, with a reduction recorded for price concessions related to third-party contractual arrangements, as well as patient discounts and price concessions. PHS determines the transaction price by grouping contracts with similar characteristics using a portfolio approach as it believes there would not be a material difference using a portfolio of similar contracts than if based on individual contracts.

PHS has agreements with third-party payors that provide for payments at amounts different from established charges. The basis for payment under these agreements includes prospectively determined rates, cost reimbursement, and negotiated discounts from established charges.

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 due to future audits, reviews, and investigations. The differences between the estimated and actual adjustments are recorded as part of patient service revenue in future periods, as the amounts become known, or as years are no longer subject to such audits, reviews, and investigations.

Currently, New Mexico utilizes supplemental reimbursement programs for the purpose of providing reimbursement to providers to offset a portion of the cost of providing care to Medicaid and uninsured patients. Under these programs, PHS recognizes revenue in the period in which amounts are estimable and collection is reasonably assured. Reimbursement under these programs is reflected in net patient service revenue.

(Dollar Amounts in Thousands)

2. Summary of Significant Accounting Policies (continued)

For uninsured patients who do not qualify for charity care, PHS recognizes revenue on the basis of discounted rates, as provided by its policy. On the basis of historical experience, a significant portion of PHS' uninsured patients will be unable or unwilling to pay for the services provided. The estimated uncollectible amounts due from these patients are generally considered implicit price concessions that are a direct reduction to net patient service revenue.

Net patient service revenue, net of contractual allowances, discounts, and implicit price concessions, is recognized from the major payor sources as follows:

	December 31	
	2021	**2020**
Net patient service revenue:		
Medicare	**$ 437,495**	$ 397,247
Medicaid	**115,580**	169,008
Managed care and other third-party payors	**701,456**	650,222
Self-pay	**26,160**	27,032
Total	**$ 1,280,691**	$ 1,243,509

Charity Care

As an integral part of its mission, PHS provides care to all patients, regardless of ability to pay for needed services. A patient is classified as a charity care patient in accordance with standards established across PHS and its affiliates. Charity care represents services rendered for which no, or only partial, payment is expected and, as such, is not included in revenues on the combined statements of operations.

Excess of Revenues Over Expenses

The combined statements of operations include a measurement for excess of revenues over expenses. Changes in net assets without donor restrictions, which are excluded from excess of revenues over expenses, include contributions of long-lived assets (including assets acquired using contributions that, by donor restrictions, were to be used for the purpose of acquiring such assets) and changes in the pension liability.

2. Summary of Significant Accounting Policies (continued)

Other Income and Loss

Activities that result in gains or losses and are unrelated to the primary mission of PHS are considered to be other income and losses. Accordingly, investment income, changes in unrealized gains and losses on investments, loss on debt extinguishment, loss on the settlement of pension obligations, and unrealized changes in the fair value of interest rate swaps are reported as a component of other income (loss).

Taxes

PHS and all of its affiliates, except for PNI and its subsidiaries, have been determined to be tax-exempt corporations by the Internal Revenue Service and generally are not subject to federal taxes on income.

The taxable affiliates utilize the liability method in accounting for income taxes. Under this method, deferred income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the currently enacted tax rates and laws. Valuation allowances are used to reduce deferred tax assets to their estimated net realizable values when management determines ultimate recovery is not probable.

PHP and PIC are required to pay premium taxes to the state based on a percentage of adjusted premiums received related to the Commercial and Medicaid product lines. As a result of paying premium taxes, PHP and PIC are exempt from paying state income taxes. PHP and PIC recorded net premium tax expense totaling $99,722 and $94,908 in 2021 and 2020, respectively. These amounts are included within purchased services and other expenses on the accompanying combined statements of operations.

ASC 740, *Income Taxes*, prescribes criteria for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. PHS recognizes interest accrued related to tax contingencies in interest expense and penalties in operating expenses. As of December 31, 2021 and 2020, there was no significant impact on the combined financial statements related to the tax positions taken. There were no significant tax positions taken by management that required accrual as of December 31, 2021 or 2020.

2. Summary of Significant Accounting Policies (continued)

Derivative and Hedging Instruments

In accordance with ASC 815, *Derivatives and Hedging*, derivatives are recognized as either assets or liabilities at fair value on the combined balance sheets, regardless of the purpose or intent for holding them. For those derivatives not designated as hedges under such standards, the changes in fair value are recognized in the excess of revenues over expenses. PHS has not designated its derivatives related to marketable securities as hedged financial instruments. Accordingly, the change in the fair value of derivatives is recognized as a component of other income (loss).

Two of PHS' investment managers, which utilize derivative instruments, have executed master netting arrangements related to marketable securities for each of the derivative instruments held by the same counterparty, which are legally offset as the instrument is settled. PHS' derivative contracts related to marketable securities were reported on a net basis on the accompanying combined balance sheets as of December 31, 2021 and 2020, and are shown separately for assets and liabilities within Note 7.

Benefit Plans

PHS is the plan sponsor of a defined benefit pension plan (Plan I) and five other limited postretirement benefit plans. The funded status of Plan I is recognized on the combined balance sheets as the difference between the fair value of the investments and the actuarially determined pension obligation. Other required disclosures of ASC 715, *Compensation – Retirement Benefits*, include the accumulated benefit obligation and fair value of the plan's assets, assumptions used in the benefit obligation calculation, contributions, the asset allocation of the plan, and the expected benefits to be paid, which can be found in Note 11.

In addition to the plans described above, PHS sponsors certain defined contribution plans. Contributions to these plans are expensed as earned by the employees.

Use of Estimates

The preparation of combined 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, liabilities, revenue, and expenses in the combined financial statements. Actual results could differ from those estimates.

(Dollar Amounts in Thousands)

3. Patient Service Revenue

A summary of payment arrangements with major third-party payors follows:

Medicare – Inpatient acute care and certain outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge or procedure. These rates vary according to patient classification systems based on clinical, diagnostic, and other factors.

Medicaid – The State Medicaid program consists of two primary plans. The larger plan is the New Mexico Centennial Care program. Medicaid services, including physical health, behavioral health, and long-term care, are provided as part of the New Mexico Centennial Care program. The smaller plan is a traditional Medicaid plan. PHS facilities and physicians are paid for inpatient acute care services on prospectively determined rates per discharge. Payments for outpatient services are made on a discounted fee-for-service basis.

Others – PHS has also entered into payment agreements with certain commercial insurance carriers, HMOs, and preferred provider organizations. The basis for payment to PHS under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Amounts received from third-party payors in excess of expected reimbursement are within net patient service revenue on the combined statement of operations.

4. Other Operating Revenues

Other operating revenues consist of the following:

	Year Ended December 31	
	2021	**2020**
COVID-19-related funding	**$ 44,100**	$ 109,625
Contributions and other	**41,760**	38,807
Health plan administrative fees	**36,283**	35,869
Tax appropriation revenue	**7,480**	7,328
	$ 129,623	$ 191,629

5. Community Benefit

In support of its mission and philosophy, PHS voluntarily provides free care to patients who cannot afford health care due to inadequate resources and/or patients who are uninsured. Because PHS does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as patient service revenues. The estimated cost of this voluntary free care less the amount, if any, ultimately received was $43,505 and $43,951 in 2021 and 2020, respectively.

In addition, PHS provides services to other patients under certain government-reimbursed public aid programs, which pay providers amounts that are generally less than the cost of rendering the services provided to the patients. The estimated unreimbursed cost of this care was approximately $295,623 and $315,179 in 2021 and 2020, respectively. These unreimbursed costs and costs of voluntary free care do not include any governmental funds received for providing access to health care to all residents of the local community.

PHS uses information from its cost accounting system and certain cost-to-charge ratios, where applicable, to estimate the cost of financial assistance and other community benefits reported.

PHS, in furtherance of its mission, also commits significant time and resources to endeavors and critical services that meet otherwise unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable. Such programs include health screenings and assessments; cancer and other support groups; hospice programs; free transportation, lodging, meals, and medications for transient patients when needed; funding for homeless health care programs; significant ongoing and temporary donations of office space and telephone systems for nonprofit health care organizations, including the Meals on Wheels program; free flu vaccine clinics; participation in regular blood drives; and the provision of educational opportunities for students interested in pursuing medical-related or pastoral careers.

6. Assets Limited as to Use or Restricted

PHS has designated the accumulation of certain funds for future replacement of property and equipment, other capital improvements, debt retirement, self-insurance reserves, and other long-term purposes. Under the terms of the Master Trust Indenture for the outstanding bond issues, funds held by the trustee have been established and legally designated for debt service and qualifying capital expenditures.

(Dollar Amounts in Thousands)

6. Assets Limited as to Use or Restricted (continued)

The following is a summary of assets limited as to use or restricted at fair value, except for certain alternative investments, which are recorded at NAV using the equity method:

	December 31	
	2021	**2020**
Cash and cash equivalents	**$ 163,349**	$ 266,102
Fixed-income securities	**911,588**	626,709
Equity securities	**1,224,661**	1,199,912
Government securities	**494,920**	581,921
Alternative investments	**475,858**	351,286
	$ 3,270,376	$ 3,025,930

Fixed-income and Government securities – These investment classes include investments in various fixed-income instruments that include investment-grade and senior secured below investment-grade domestic and international bonds, mortgage pools, and bonds issued by U.S. government agencies. These investment classes also include investments in commingled, mutual funds, and separately managed accounts that hold investments in fixed-income securities. The fixed-income investments are exposed to various kinds and levels of risk, including interest rate risk, credit risk, foreign exchange risk, and liquidity risk.

Equity securities – This investment class consists primarily of common equity securities of domestic and international companies. These securities trade through the major public domestic and international exchanges. This investment class also includes investments in commingled and mutual funds that hold investments in equity securities. The equity securities investments are exposed to various risks, including market risk; individual security risk; foreign exchange risk; and, for common equity of companies with a small market capitalization, liquidity risk.

6. Assets Limited as to Use or Restricted (continued)

Alternative investments – Funds in this class are invested with external investment managers who invest primarily in various alternative categories, including real estate, long and short equity positions, merger and event arbitrage, natural resources, distressed credit, managed futures, fixed-income arbitrage, foreign exchange, and private equity. The managers employ various strategies, including long/short equity, event-driven, relative value, and tactical trading. A long/short equity strategy will take both long and short equity positions in publicly traded stocks to provide maximum capital appreciation, while limiting downside risk. Event-driven strategies deploy funds opportunistically across multiple asset categories seeking positive returns from companies involved in mergers, acquisitions, bankruptcy, litigation, regulatory uncertainty, and other matters with the potential to unlock value. Relative value funds use a variety of different strategies across a broad array of equity and fixed-income securities to take advantage of market inefficiencies between asset pairs, while maintaining a market-neutral risk position. Tactical trading strategies invest primarily in liquid markets, such as fixed-income and mortgage derivative securities, convertible debt, currencies, interest rate swaps, equity indices, and commodities and energy derivatives, while seeking to take advantage of changes in global economies and discrepancies among related sets of securities and derivatives resulting in asymmetrical outcomes. Investments in real estate include open ended funds and partnership interests both of which seek rental income and long-term appreciation. Private equity investments seek to provide capital to privately held companies to increase their value for a subsequent sale. These investments are domestic and international in nature and have varying degrees of illiquidity. The risks associated with these investments are numerous and include liquidity risk, market risk, event risk, interest rate risk, foreign exchange risk, and investment manager risk. In addition, the investment managers are not required to register with the Securities and Exchange Commission and are not subject to regulatory controls. As unregistered investment vehicles, these funds are not required to disclose the holdings in their portfolios to investors. Given the numerous risks involved, these funds have a greater likelihood of losing invested capital.

(Dollar Amounts in Thousands)

6. Assets Limited as to Use or Restricted (continued)

As of December 31, 2021 and 2020, PHS had alternative investments representing various hedge funds and real asset investments that include limited liability companies and limited liability partnerships, as follows:

	December 31	
	2021	**2020**
Equity long/short	**$ 13,500**	$ 13,500
Event-driven	**50,164**	55,137
Relative value	**46,700**	43,700
Tactical trading	**58,109**	49,362
Private equity	**35,095**	7,101
Real assets	**156,856**	130,571
Total cost basis	**360,424**	299,371
Unrealized gain, net	**115,434**	51,915
	$ 475,858	$ 351,286

Approximately 46% of the value of these alternative investments represent investments with original lockup periods ranging from one month to five years. The remaining exposure represents investments with longer lockups and limited redemption rights. At December 31, 2021, PHS had unfunded commitments for alternative investments totaling $161,688.

Investment income (loss) on assets limited as to use or restricted (excluding restricted by donor) consists of the following:

	Year Ended December 31	
	2021	**2020**
Interest and dividend income	**$ 57,734**	$ 60,673
Net realized gains on marketable securities	**131,878**	79,938
Total investment income	**189,612**	140,611
Net unrealized (losses) gains on marketable securities	**(19,949)**	112,561
Net unrealized gains on alternative investments	**63,519**	4,192
	$ 233,182	$ 257,364

(Dollar Amounts in Thousands)

7. Fair Value Measurements

The following tables present the fair value hierarchy for PHS' financial assets and liabilities measured at fair value, and financial assets measured at NAV at December 31, 2021:

	Level 1	Level 2	Commingled Investments at NAV	Equity Method Investments at NAV	Total Financial Instruments	Valuation Technique* (a, b, c, d)
Designated for long-term purposes						
Cash and cash equivalents	$ 13,603	$ –	$ –	$ –	$ 13,603	a
Government securities	249,705	85,637	–	–	335,342	a
Fixed-income securities	–	595,625	141,820	–	737,445	a, b, d
Equity securities	459,110	–	651,067	–	1,110,177	a, d
Alternative investments	–	–	–	435,342	435,342	d
Total designated for long-term purposes	$ 722,418	$ 681,262	$ 792,887	$ 435,342	$ 2,631,909	
Designated for self-insurance funds						
Cash and cash equivalents	$ 415	$ –	$ –	$ –	$ 415	a
Government securities	8,946	7,707	–	–	16,653	a
Fixed-income securities	–	36,284	11,855	–	48,139	a, b, d
Equity securities	26,305	–	59,703	–	86,008	a, d
Alternative investments	–	–	–	30,868	30,868	d
Total designated for self-insurance funds	$ 35,666	$ 43,991	$ 71,558	$ 30,868	$ 182,083	
Restricted by donors						
Cash and cash equivalents	$ 524	$ –	$ –	$ –	$ 524	a
Government securities	6,209	2,188	–	–	8,397	a
Fixed-income securities	–	15,311	3,624	–	18,935	a, b, d
Equity securities	11,840	–	16,636	–	28,476	a, d
Alternative investments	–	–	–	9,648	9,648	d
Total restricted by donors	$ 18,573	$ 17,499	$ 20,260	$ 9,648	$ 65,980	
Held by trustee						
Cash and cash equivalents	$ 145,538	$ –	$ –	$ –	$ 145,538	a
Restricted for statutory requirements						
Cash and cash equivalents	$ 3,269	$ –	$ –	$ –	$ 3,269	a
Government securities	62,218	72,310	–	–	134,528	a, b
Fixed-income securities	–	107,069	–	–	107,069	b
	$ 65,487	$ 179,379	$ –	$ –	$ 244,866	
Financial liabilities						
Interest rate swaps	$ –	$ (22,602)	$ –	$ –	$ (22,602)	b

*Valuation techniques are described in Note 2.

(Dollar Amounts in Thousands)

7. Fair Value Measurements (continued)

The following tables present the fair value hierarchy for PHS' financial assets and liabilities measured at fair value, and financial assets measured at NAV at December 31, 2020:

	Level 1	Level 2	Commingled Investments at NAV	Equity Method Investments at NAV	Total Financial Instruments	Valuation Technique* (a, b, c, d)
Designated for long-term purposes						
Cash and cash equivalents	$ 33,729	$ –	$ –	$ –	$ 33,729	a
Government securities	288,541	138,709	–	–	427,250	a
Fixed-income securities	–	343,975	149,517	–	493,492	b, d
Equity securities	429,644	–	658,635	–	1,088,279	a, d
Public master limited partnerships	–	–	–	–	–	a
Alternative investments	–	–	–	317,279	317,279	d
Total designated for long-term purposes	$ 751,914	$ 482,684	$ 808,152	$ 317,279	$ 2,360,029	
Designated for self-insurance funds						
Cash and cash equivalents	$ 242	$ –	$ –	$ –	$ 242	a
Government securities	9,576	11,715	–	–	21,291	a
Fixed-income securities	–	20,546	13,035	–	33,581	b, d
Equity securities	18,791	–	68,700	–	87,491	a, d
Public master limited partnerships	–	–	–	–	–	a
Alternative investments	–	–	–	21,688	21,688	d
Total designated for self-insurance funds	$ 28,609	$ 32,261	$ 81,735	$ 21,688	$ 164,293	
Restricted by donors						
Cash and cash equivalents	$ 937	$ –	$ –	$ –	$ 937	a
Government securities	6,203	3,066	–	–	9,269	a
Fixed-income securities	–	7,703	3,305	–	11,008	b, d
Equity securities	9,585	–	14,557	–	24,142	a, d
Public master limited partnerships	–	–	–	–	–	a
Alternative investments	–	–	–	12,319	12,319	d
Total restricted by donors	$ 16,725	$ 10,769	$ 17,862	$ 12,319	$ 57,675	
Held by trustee						
Cash and cash equivalents	$ 222,153	$ –	$ –	$ –	$ 222,153	a
Restricted for statutory requirements						
Cash and cash equivalents	$ 9,041	$ –	$ –	$ –	$ 9,041	a
Government securities	67,199	56,912	–	–	124,111	a, b
Fixed-income securities	–	88,628	–	–	88,628	b
	$ 76,240	$ 145,540	$ –	$ –	$ 221,780	
Financial liabilities						
Interest rate swaps	$ –	$ (35,995)	$ –	$ –	$ (35,995)	b

*Valuation techniques are described in Note 2.

(Dollar Amounts in Thousands)

7. Fair Value Measurements (continued)

Derivative contracts related to marketable securities were reported as a net liability, as described in Note 2, of $228 and $435 as of December 31, 2021 and 2020, respectively, and were included within assets limited as to use.

	2021			
	Level 1	**Level 2**	**Total Financial Instruments**	**Valuation Technique* (a, b, c, d)**
Derivative assets				
Futures contracts	**$ 182,159**	**$ –**	**$ 182,159**	**a**
Interest rate swap agreements	**–**	**187,382**	**187,382**	**b**
Forward contracts	**–**	**45,907**	**45,907**	**b**
	$ 182,159	**$ 233,289**	**$ 415,448**	
Derivative liabilities				
Futures contracts	**$ (182,253)**	**$ –**	**$ (182,253)**	**a**
Interest rate swap agreements	**–**	**(187,561)**	**(187,561)**	**b**
Forward contracts	**–**	**(45,862)**	**(45,862)**	**b**
	$ (182,253)	**$ (233,423)**	**$ (415,676)**	

	2020			
	Level 1	**Level 2**	**Total Financial Instruments**	**Valuation Technique* (a, b, c, d)**
Derivative assets				
Futures contracts	$ 64,799	$ –	$ 64,799	a
Interest rate swap agreements	–	171,381	171,381	b
Forward contracts	–	31,909	31,909	b
	$ 64,799	$ 203,290	$ 268,089	
Derivative liabilities				
Futures contracts	$ (64,799)	$ –	$ (64,799)	a
Interest rate swap agreements	–	(171,525)	(171,525)	b
Forward contracts	–	(32,200)	(32,200	b
	$ (64,799)	$ (203,725)	$ (268,524)	

*Valuation techniques are described in Note 2.

There were no changes in the fair value level classification, between Level 1 and Level 2, for any investments in 2021 or 2021. PHS has no Level 3 investments.

(Dollar Amounts in Thousands)

8. Property and Equipment, Net

Property and equipment, net, consist of the following:

	December 31 2021	December 31 2020
Land and improvements	**$ 144,980**	$ 144,371
Buildings and improvements	**1,344,322**	1,260,199
Equipment	**740,873**	702,432
Software	**359,675**	339,414
	2,589,850	2,446,416
Less accumulated depreciation and amortization	**(1,564,585)**	(1,450,563)
	1,025,265	995,853
Right of use assets	**2,667**	1,841
Construction-in-progress	**176,529**	128,471
	$ 1,204,461	$ 1,126,165

Unamortized software was $64,904 and $72,967 as of December 31, 2021 and 2020, respectively. Software amortization expense was $25,390 and $30,687 for the years ended December 31, 2021 and 2020, respectively, and is included in depreciation and amortization expense.

At December 31, 2021, PHS has future capital commitments of $55,206, which are expected to be completed in 2023.

9. Medical Claims Expense

As of December 31, 2021 and 2020, medical claims expense for prior years decreased by $26,073 and increased by $35,252 in 2021 and 2020, respectively, as a result of changes in estimates of prior periods' unpaid claims and claims adjustment expenses. These changes generally are the result of ongoing analyses of recent loss development trends. Original estimates are increased or decreased as additional information becomes known regarding individual claims.

(Dollar Amounts in Thousands)

10. Long-Term Debt and Interest Rate Swaps

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

	2021	2020
2019 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates of 3.0% to 5.0% payable semiannually on the established interest payment dates, principal payments beginning in 2025 through 2048	**$ 146,400**	$ 146,400
2019 Series B Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rate of 5.0% payable semiannually on the established interest payment dates, principal payments beginning in 2025 through 2049	**75,000**	75,000
2019 Series C Taxable Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), variable rate demand bonds with an interest rate of 0.12% at December 31, 2021, payable monthly on the established interest payment dates, principal payments beginning in 2033 through 2042	**82,845**	82,845
2017 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates of 3.5% to 5.0% payable semiannually on the established interest payment dates, principal payments through 2046	**237,510**	237,930
2017 Series B Taxable Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rate of 4.4% payable semiannually on the established interest payment dates, principal payments beginning in 2037 through 2046	**65,665**	65,665
2015 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates from 4.125% to 5.000% payable semiannually on the established interest payment dates, principal payments through 2044	**201,690**	207,500
2008 Series B, C, and D Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), variable-rate demand bonds with interest rates of 0.08% to 0.12% at December 31, 2021, payable monthly on the established interest payment dates, principal payable in annual installments through 2034	**139,865**	150,645
2012 note payable to bank, variable rate, interest payable quarterly at one-month LIBOR plus .90% (1.01% at December 31, 2021) due October 2022	**50,000**	50,000
Other obligations	**5,382**	6,252
	1,004,357	1,022,237
Premiums on long-term debt, net	**52,619**	54,694
Less deferred financing fees	**(7,713)**	(7,627)
	1,049,263	1,069,304
Less current portion of long-term debt	**(17,549)**	(17,924)
	$ 1,031,714	$ 1,051,380

10. Long-Term Debt and Interest Rate Swaps (continued)

The 2019 Series A and B Revenue Bonds totaling $221,400 were issued through the New Mexico Hospital Equipment Loan Council in December 2019. Proceeds of the bonds will be used primarily for the construction of a new patient tower on the Presbyterian main hospital campus in Albuquerque, New Mexico. The 2019 Series A Bonds are fixed rate and include serial bonds with annual maturities beginning in August 2025 through 2039 and term bonds with maturities beginning in August 2044 and 2048. The 2019 Series B Bonds are fixed-rate term bonds maturing in 2049 with an initial interest period ending August 1, 2025, at which time they are subject to mandatory tender or rate adjustment for a new interest period.

The 2019 Series C Taxable Revenue Bonds totaling $82,845 were issued through the New Mexico Hospital Equipment Loan Council in December 2019. Proceeds of the bonds were used to defease the 2012 Series A Revenue Bonds. The 2019 Series C Bonds are variable-rate demand obligations and bear interest on a weekly rate period at amounts set by a remarketing agent. The interest rate mode can be modified under the terms of the legal documents. To secure the tender price of the 2019 Series C Bonds, PHS has entered into a standby bond purchase agreement with JPMorgan Chase Bank, N.A. with an expiration in December 2024. The 2019 Series C Bonds are subject to optional redemption at the discretion of PHS. In addition, the 2019 Series C Bonds have a schedule of mandatory sinking fund deposits in 2033 through 2042.

The 2017 Series A Revenue Bonds totaling $239,115 were issued through the New Mexico Hospital Equipment Loan Council in May 2017. Proceeds of the bonds were issued to defease the 2009 Series A Revenue Bonds and provide funding for the construction of a new hospital facility in Santa Fe, New Mexico, which opened in October 2018. The 2017 Series A bonds are fixed-rate bonds and have annual maturities that began in August 2018 and continue through 2046.

The 2017 Series B Taxable Revenue Bonds totaling $65,665 were issued through the New Mexico Hospital Equipment Loan Council in May 2017. Proceeds of the bonds were used to fund the construction of a physician office building adjacent to the new hospital in Santa Fe, New Mexico, and expand PHS' administrative office in Albuquerque, New Mexico. The 2017 Series B bonds are fixed rate bonds and have annual maturities beginning in August 2037 and continuing through 2046.

10. Long-Term Debt and Interest Rate Swaps (continued)

The 2015 Series A Revenue Bonds totaling $237,160 were issued through the New Mexico Hospital Equipment Loan Council. Proceeds of the bonds were used to defease the 2008 Series A Bonds and fund various health care facilities throughout the PHS system. The 2015 bonds are fixed-rate serial and term bonds and have scheduled maturities and mandatory sinking fund deposits that began in August 2016 and continue through 2044.

In August 2012, PHS obtained a $50,000 taxable bank direct loan (the 2012 Bank Loan), of which $50,000 was outstanding as of December 31, 2021 and 2020. Proceeds of the 2012 Bank Loan were used for a new system corporate office, which was completed in 2014.

The 2008 Revenue Bonds were issued through the New Mexico Hospital Equipment Loan Council in four series (Series A, Series B, Series C, and Series D) (the Series 2008 Bonds) in November 2008. The Series 2008 Bonds were designed to defease the 2005 Series A and B Revenue Bonds ($201,895); to pay off a Wells Fargo Credit Agreement, which defeased the 2004 Series A through D Bonds ($128,655) and the 1993A Bonds ($17,900) during March and April 2008; to reimburse PHS for prior capital expenditures; and to pay certain costs of issuing the Series 2008 Bonds. The Series 2008 A Bonds were refunded in their entirety in 2015 and have been legally defeased. The Series 2008 B through D Bonds are variable-rate demand obligations and bear interest on a daily (Series C and D) and weekly (Series B) rate period at amounts set by a remarketing agent. The interest rate mode can be modified under the terms of the legal documents. To secure the tender price of the Series 2008 C and D Bonds, PHS has entered into standby bond purchase agreements with Wells Fargo Bank N.A. with expiration dates in November 2025 and 2022, respectively. The Series 2008 B Bonds are supported by a standby bond purchase agreement with JP Morgan Chase Bank, N.A. with an expiration date in November 2023. The Series 2012 A Bonds were defeased in 2019.

The Series 2008 B, C, and D Bonds are further subject to optional redemption at the discretion of PHS. In addition, the Series 2008 Bonds have a schedule of mandatory sinking fund deposits through 2034.

All of the outstanding bonds are collateralized by a pledge of unrestricted receivables of the Obligated Group, as defined under the Master Trust Indenture. The Master Trust Indenture of the Obligated Group requires, among other things, that certain funds be established and held by a trustee. The Master Trust Indenture also requires certain limitations on additional indebtedness,

(Dollar Amounts in Thousands)

10. Long-Term Debt and Interest Rate Swaps (continued)

liens on property, and disposition or transfers of assets, as well as the maintenance of certain cash balances and other financial ratios. The Obligated Group was in compliance with all such covenants at December 31, 2021.

Scheduled principal payments on long-term debt at December 31 are as follows:

	Long-Term Debt
2022	$ 17,549
2023	19,623
2024	20,427
2025	22,605
2026	23,128
Thereafter	901,025
	$ 1,004,357

Interest Rate Swaps

PHS has entered into several interest rate swaps associated with bond issuances, some of which have bonds that are no longer outstanding. The 2005 swaps provide that PHS receives a floating amount based on a percentage of one-month London Interbank Offered Rate (LIBOR) (58.30% of LIBOR plus 0.36%) and PHS pays a fixed rate of 3.085% based on a notional amount of $115,120 and $125,900 at December 31, 2021 and 2020, respectively.

The 2006 swaps provide that PHS receives a floating amount based on a percentage of one-month LIBOR (68%) and PHS pays a weighted average fixed rate of 3.577% based on a notional amount of $24,745 at both December 31, 2021 and 2020.

In connection with the issuance of the Series 2019 C Bonds in December 2019, PHS entered into a swap agreement (the 2019 Swap) whereby PHS receives a floating amount based on one-month LIBOR and PHS pays a fixed rate of 1.96% on the notional amount of $82,845 at both December 31, 2021 and 2020.

10. Long-Term Debt and Interest Rate Swaps (continued)

All derivatives that are being measured by PHS under ASC 820 are considered Level 2 assets (liabilities) because a quoted price can be obtained from a number of dealer counterparties and other market sources based on observable interest rates and yield curves for the full term of the asset or liability. In order to measure the fair value of municipal derivatives under ASC 820, PHS adjusted its mid-market periodic values of the swaps outstanding to incorporate nonperformance risk by PHS (when the financial instrument is a liability) or the counterparty (when the financial instrument is an asset). In order to determine the risk of nonperformance when the financial instrument is a liability, PHS has determined the change in the credit market for debt issues by entities with the same credit characteristics as PHS. To determine nonperformance risk when the instrument is an asset, PHS determines the change in the credit market for debt issues by the counterparty.

As of December 31, 2021 and 2020, the fair value of the 2005 and 2006 swaps was a net liability of $17,786 and $24,815, respectively. As of December 31, 2021 and 2020, the fair value of the 2019 Swap was a liability of $4,816 and $11,180, respectively. The combined net swap liability is included in other liabilities on the accompanying combined balance sheets.

If the liability related to the 2005 and 2006 swaps were to exceed $40,000, PHS would be required to post a cash deposit for amounts in excess of the threshold as collateral with the counterparty. This collateral threshold would be reduced to $30,000 if PHS' current AA credit rating were to fall to A+, reduced to $20,000 at a rating of A, and further reduced to zero at a credit rating below A. If the liability related to the 2019 Swap was to exceed $75,000, PHS would be required to post a cash deposit for amounts in excess of the threshold as collateral with the counterparty. The collateral threshold would be reduced to $50,000 if PHS' current AA credit rating were to fall to A+, reduced to $30,000 at a rating of A, reduced to $15,000 at a rating of A-, and further reduced to zero at a credit rating below A-.

Interest expense included $5,660 and $4,864 in 2021 and 2020, respectively, related to net periodic payments to the counterparty.

10. Long-Term Debt and Interest Rate Swaps (continued)

Short-Term Borrowing

In April 2020, PHS obtained a $100 million short-term bank loan as additional working capital in response to the COVID-19 pandemic. The loan was renewed in January 2021 with a maturity date of January 28, 2022, and bears interest at a fixed rate of 0.89%. The borrowing is secured under the terms of the Master Trust Indenture of the Obligated Group. In January 2022, the loan was renewed with a maturity date of January 27, 2023, at a fixed rate of 1.45% and can be repaid without penalty beginning in June 2022.

11. Employee Benefit Plans

PHS has a defined benefit pension plan (the original plan) that previously covered substantially all of the employees of its related organizations, except employees of PNI. Effective January 1, 2006, the original plan was closed to new entrants, but it continued to accrue benefits for those employees in the plan as of December 31, 2005 until December 31, 2012, when the original plan was amended to cease future benefit accruals. Any benefits earned by participants under the original plan at December 31, 2012, will be preserved and will be payable based on the original plan's provisions.

In December 2018, certain participants in the original plan were removed from the original plan through lump-sum payments and annuities. Remaining participants in the original plan were transferred to a new ongoing plan (Plan I) and the original plan was terminated.

In October 2020, PHS purchased an insurance company annuity that removed 862 retiree participants from the plan, reduced plan liabilities by $148,200 and resulted in a pension settlement charge of $65,309, which was recorded in 2020.

PHS contributes such amounts as necessary on an actuarial basis to provide Plan I with assets sufficient to meet the benefits to be paid to Plan I participants. PHS contributed $33,503 and $8,387 in 2021 and 2020, respectively, to Plan I.

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

A summary of Plan I's benefit obligation, assets, and funded status is as follows:

	Year Ended December 31	
	2021	**2020**
Change in benefit obligation:		
Benefit obligation at beginning of year	**$ 422,122**	$ 530,883
Service cost	**2,400**	3,000
Interest cost	**11,522**	17,079
Plan settlements	**–**	(162,764)
Actuarial (gain) loss	**(14,633)**	57,763
Benefits paid and plan expenses	**(13,689)**	(23,839)
Benefit obligation at end of year	**$ 407,722**	$ 422,122
Change in assets:		
Fair value of assets at beginning of year	**$ 220,009**	$ 367,131
Actual return on assets	**17,547**	31,094
Employer contribution	**33,503**	8,387
Plan settlements	**–**	(162,764)
Benefits paid and plan expenses	**(13,689)**	(23,839)
Fair value of plan assets at end of year	**$ 257,370**	$ 220,009
Funded status at year-end	**$ (150,352)**	$ (202,113)
Amounts not yet reflected in net periodic benefit cost and included in net assets:		
Accumulated loss	**$ (152,361)**	$ (177,356)
Cumulative changes in net assets without donor restriction	**(152,361)**	(177,356)
Cumulative employer contributions in excess of net periodic benefit cost	**2,009**	(24,757)
Net amount recognized on the combined balance sheets	**$ (150,352)**	$ (202,113)

The actuarial gain recorded in 2021 was primarily due to the change in discount rate from 2.77% to 3.04%. This change decreased the benefit obligation by $16,400 in 2021.

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

In 2020, PHS recorded settlement charges of $65,309 for the risk transfer activities that occurred in 2020. These charges are in addition to the regular periodic benefit cost of $7,125 for 2020. There was no settlement charge in 2021.

A summary of the projected benefit obligation, accumulated benefit obligation, and fair value of plan assets is as follows:

	2021	2020
Projected benefit obligation	**$ 407,722**	$ 422,122
Accumulated benefit obligation	**407,722**	422,122
Fair value of plan assets	**257,370**	220,009

Assumptions used to determine the benefit obligation as of the measurement date are as follows:

	2021	2020
Discount rate at end of year	**3.04%**	2.77%
Rate of increase in compensation levels	**N/A**	N/A

Net periodic pension benefit cost includes the following components:

	2021	2020
Service cost – benefits earned during the year	**$ 2,400**	$ 3,000
Interest cost on projected benefit obligation	**11,522**	17,079
Expected return on Plan I assets	**(13,676)**	(19,935)
Amortization of prior service credit	**1,535**	1,535
Recognized net actuarial loss	**4,956**	5,446
Net periodic pension benefit cost	**$ 6,737**	$ 7,125

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

Assumptions used to determine net periodic pension benefit cost are as follows:

	2021	2020
Discount rate at beginning of year	**2.77%**	3.42%
Rate of increase in compensation levels	**N/A**	N/A
Expected long-term rate of return on assets at beginning of year	**6.00%**	6.00%

Contributions to be made during 2022 have not been finalized but are expected to be approximately $6,842.

The expected return on Plan I assets has been developed using both historical and future expected returns for each asset class. Based on the target asset mix, PHS selected a long-term rate of return of 6.5% and 6.0% for 2022 and 2021, respectively. The asset allocation for Plan I, by asset class at the measurement date, was as follows:

	2021	2020
Cash and cash equivalents	**1%**	1%
Fixed-income securities	**43**	40
Common stock and equity	**40**	45
Absolute return, hedge funds, and other	**16**	14
	100%	100%

Plan I assets have historically been invested in a portfolio designed to preserve principal and obtain competitive investment returns and long-term investment growth, consistent with actuarial assumptions, while minimizing unnecessary investment risk. Diversification is achieved by retaining multiple investment managers with complementary philosophies, styles, and approaches.

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

Plan I asset allocation targets at the measurement date were as follows:

	Target	Range
Cash and cash equivalents	1%	0%–6%
Fixed-income securities	44%	39–49%
Domestic equity securities	20%	15–25%
International equity securities	20%	15–25%
Other	15%	7–25%

The following tables present the fair value hierarchy for PHS' Plan I financial assets and liabilities measured at fair value and financial assets measured at NAV at December 31:

	Level 1	Level 2	Commingled Investments at NAV	Equity Method Investments at NAV	Total	Valuation Techniques* (a, b, c, d)
2021						
Money market	**$ 2,058**	**$ –**	**$ –**	**$ –**	**$ 2,058**	**a**
Bond funds	**2,210**	**38,740**	**68,853**	**–**	**109,803**	**a, b, d**
Common equities	**43,265**	**–**	**59,842**	**–**	**103,107**	**a, d**
Alternative investments	**–**	**–**	**–**	**42,402**	**42,402**	**d**
Total financial assets	**$ 47,533**	**$ 38,740**	**$ 128,695**	**$ 42,402**	**$ 257,370**	
2020						
Money market	$ 3,089	$ –	$ –	$ –	$ 3,089	a
Bond funds	1,246	–	86,476	–	87,722	a, b, d
Common equities	36,271	–	62,484	–	98,755	a, d
Alternative investments	–	–	–	30,443	30,443	d
Total financial assets	$ 40,606	$ –	$ 148,960	$ 30,443	$ 220,009	

*Valuation techniques are described in Note 2.

There were no changes in the fair value level classification, between Level 1 and Level 2, for any investments in 2021 or 2020. PHS has no Level 3 investments.

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

Derivative contracts related to marketable securities were reported as a net liability of $1 and $571 as of December 31, 2021 and 2020, respectively, and were included within PHS' Plan I assets.

	Level 1	Level 2	Commingled Investments at NAV	Equity Method Investments at NAV	Total	Valuation Techniques* (a, b, c, d)
December 31, 2021						
Derivative assets						
Future derivative asset contracts	**$ 12,674**	**$ –**	**$ –**	**$ –**	**$ 12,674**	**a**
Future derivative liability contracts	**(12,675)**	**–**	**–**	**–**	**(12,675)**	**a**
Total financial assets	**$ (1)**	**$ –**	**$ –**	**$ –**	**$ (1)**	

	Level 1	Level 2	Commingled Investments at NAV	Equity Method Investments at NAV	Total	Valuation Techniques* (a, b, c, d)
December 31, 2020						
Derivative assets						
Future derivative asset contracts	$ 757	$ –	$ –	$ –	$ 757	a
Future derivative liability contracts	(1,328)	–	–	–	(1,328)	a
Total financial assets	$ (571)	$ –	$ –	$ –	$ (571)	

*Valuation techniques are described in Note 2.

Plan I's alternative investments are composed of a hedge fund-of-funds and a private real estate investment fund. As described in Note 2, management has elected to use the NAV per share, or its equivalent, as a practical expedient for the fair value of Plan I's interest in alternative investments. The underlying funds have restrictions on the timing of withdrawals, which may reduce liquidity from three to six months.

Expected benefits to be paid to the Plan I participants and beneficiaries are as follows:

2022	$ 13,607
2023	15,089
2024	16,536
2025	17,608
2026	18,496
2027–2031	104,937

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

In addition to Plan I, PHS also has five other limited postretirement benefit plans subject to the funded status recognition provisions of ASC 715. Plan I is funded, and the other postretirement plans are unfunded. As a result of changes in pension obligations, net assets without donor restrictions decreased by $25,797 and $24,835 during 2021 and 2020, respectively.

PHS has a defined contribution plan (Plan II), which consists of a Section 403(b) plan and a Section 401(a) plan under the Code. Plan II requires PHS to pay a basic employer contribution, as well as match participant contributions up to a stated maximum percentage of the participant's salary. Contributions to Plan II are expensed as earned by employees and were $35,282 and $37,962 in 2021 and 2020, respectively.

PHP has a 401(k) defined contribution plan (Plan III) for PHP employees. Plan III requires PHP to match participant contributions up to a stated maximum percentage of the participant's salary. Plan III additionally provides an employer contribution for all employees regardless of whether the employee individually contributes to Plan III. PHP contributions to Plan III are expensed as earned by employees and were $5,963 and $5,899 in 2021 and 2020, respectively.

12. Net Assets With Donor Restrictions

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

	2021	2020
Subject to expenditure for specific purpose		
Program services and facility improvements	**$ 47,593**	$ 41,503
Education	**6,108**	5,906
	$ 53,701	$ 47,409
Subject to PHS' spending policy and appropriation		
Investment in perpetuity (including amounts above original gift amount) that once appropriated is expendable to support:		
Program services and facility improvements	**$ 12,459**	$ 10,385
Education	**1,909**	1,844
	$ 14,368	$ 12,229
Total net assets with donor restrictions	**$ 68,069**	$ 59,638

(Dollar Amounts in Thousands)

12. Net Assets With Donor Restrictions (continued)

Net assets with donor restrictions are composed of the following at December 31:

	2021	2020
Marketable securities	**$ 65,173**	$ 56,983
Pledges receivable	**2,089**	1,963
Other	**807**	692
	$ 68,069	$ 59,638

13. Concentration of Credit Risk

PHS provides health care services through its inpatient and outpatient care facilities throughout New Mexico. PHS grants credit to patients, most of whom are insured under third-party payor agreements, without requiring collateral or other security in extending credit to patients. However, PHS routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, HMOs, and commercial insurance policies). The following table summarizes the percentage of net patient accounts receivable from all payors:

	December 31	
	2021	**2020**
Managed care and other third-party payors	**66%**	68%
Government	**27**	24
Self-pay	**7**	8
Total	**100%**	100%

Managed care and other third-party payors consist of receivables from various payors, including contracted third-party payors providing commercial and government programs. Management does not believe there is any significant concentration of credit risk associated with accounts receivable. Furthermore, management continually monitors and adjusts its allowances (contractual and implicit price concessions) associated with these receivables.

14. Commitments and Contingencies

Litigation and Other Contingent Liabilities

PHS is subject to pending and threatened legal actions arising during the ordinary course of business. Management and legal counsel periodically assess whether losses have been incurred related to pending or threatened litigation, claims, and assessments. Loss estimates are continually monitored and reviewed, and as estimates are adjusted, changes in estimated losses are reflected in current operations. Losses incurred due to the actual results of litigation could differ from estimates recorded. In management's opinion, upon consultation with legal counsel, these matters should not have a material adverse effect on PHS' combined financial condition, results of operations, or cash flows. However, PHS' evaluation of the likely effects of these actions could change in the future, and an unfavorable outcome, depending upon the amount and timing, could have a material effect on PHS' combined financial condition, results of operations, or cash flows of a future period.

On June 6, 2019, PHS discovered anonymous, unauthorized access to Protected Health Information was gained through a phishing email sent to some of PHS' workforce in early May 2019. The affected email accounts contained data that included patient and/or health plan member names and, in some cases, dates of birth, Social Security numbers, and clinical and/or health plan information. No credit card information was accessed. PHS implemented additional security safeguards to address issues identified in its investigation. The Office for Civil Rights found voluntary compliance and closed this matter in February 2022.

14. Commitments and Contingencies (continued)

Health Insurer Fee

Section 9010 of the Patient Protection and Affordable Care Act (ACA) imposes a fee on each covered entity engaged in the business of providing health insurance for United States health risks. The annual fee is allocated to health insurers based on the ratio of the amount of an insurer's premium written during the preceding calendar year to the amount of health insurance for all U.S. health risk for those certain lines of business that is written in the preceding calendar year. The expense is recorded in the year that the fees are due. In 2020, the fee was due for both PHP and PIC based on premium written in 2019, totaling $47,177 (including the Medicaid-related portion of $33,023 subsequently reimbursed by HSD). In 2021, the Health Insurer Fee was discontinued and as a result, no fees were paid or expensed.

Health Care Regulatory Environment

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in exclusion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed and paid. Management believes that it has established adequate reserves to investigate, defend, and ultimately resolve any alleged instances of noncompliance. Compliance with such laws and regulations can be subject to future government review, as well as regulatory actions unknown or unasserted at this time.

Self-Insurance Plans

PHS is self-insured for professional and general liability, workers' compensation, and employee health insurance. PHS purchases claims-made insurance to cover professional liability and workers' compensation claims in excess of the self-insured limits. There are known claims and incidents that may result in the assertion of additional claims, as well as claims for unknown incidents that may be asserted arising from services provided to patients. PHS has engaged independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. At December 31, 2021 and 2020, accrued professional liability, general liability, and workers'

14. Commitments and Contingencies (continued)

compensation losses of $285,694 and $265,295, respectively, have been discounted at 1.76% and 1.13%, respectively. In management's opinion, such amounts provide an adequate reserve for loss contingencies. The increase in the accrued liability can be attributed to adverse claim development. The accrued liability relating to professional and general liability and workers' compensation at December 31, 2021 and 2020, is reported on a gross basis and, therefore, has not been reduced by estimated insurance recoveries of $143,644 and $121,616, respectively, which are reported in other assets. The accrued liability for estimated employee health claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported and totaled $4,426 and $6,300 at December 31, 2021 and 2020, respectively.

At December 31, 2021 and 2020, PHS had an available line of credit to collateralize workers' compensation coverage of $14,462, of which none was outstanding.

Surety Bond

The Medicaid Centennial Care contract requires PHP to provide a performance bond equal to 90% of the average of the past three months' capitation payments made to PHP from HSD. As of December 31, 2021 and 2020, PHP held a surety bond issued by an unrelated insurance company in the amount of $250,000 and $220,000, respectively.

(Dollar Amounts in Thousands)

15. Functional Expenses

PHS provides general health care services to residents within its geographic region. PHS allocates expenses between functional categories through an analysis of each accounting unit within the organization. Accounting units with expenses that are attributable to more than one functional category, such as depreciation, information technology, and insurance, are allocated ratably, based on directly assigned expenses, across all categories. Expenses related to providing these services are as follows:

	Patient Care	Insurance Operations	Other Programs	Supporting Services	Total
Year Ended December 31, 2021					
Medical claims	**$ –**	**$ 2,387,158**	**$ –**	**$ –**	**$ 2,387,158**
Salaries, wages, and benefits	**848,040**	**167,013**	**147,961**	**181,739**	**1,344,753**
Purchased services and other	**259,017**	**301,649**	**113,861**	**15,654**	**690,181**
Supplies	**404,001**	**673**	**18,800**	**(5,210)**	**418,264**
Professional fees	**19,881**	**4**	**9,870**	**8,440**	**38,195**
Depreciation and amortization	**69,860**	**16,046**	**17,921**	**16,637**	**120,464**
Interest	**672**	**356**	**33,542**	**205**	**34,775**
	$ 1,601,471	**$ 2,872,899**	**$ 341,955**	**$ 217,465**	**$ 5,033,790**
Year Ended December 31, 2020					
Medical claims	$ –	$ 2,211,877	$ –	$ –	$ 2,211,877
Salaries, wages, and benefits	816,255	162,698	129,520	182,770	1,291,243
Purchased services and other	262,914	365,783	79,181	50,864	758,742
Supplies	349,724	828	21,080	(2,759)	368,873
Professional fees	22,759	4	6,639	9,157	38,559
Depreciation and amortization	73,061	13,589	17,312	18,773	122,735
Interest	668	383	36,445	299	37,795
	$ 1,525,381	$ 2,755,162	$ 290,177	$ 259,104	$ 4,829,824

(Dollar Amounts in Thousands)

16. Liquidity

PHS' financial assets available within one year of the balance sheet date for general expenditure are as follows for the years ended December 31:

	2021	2020
Cash and cash equivalents	**$ 474,550**	$ 575,195
Patient accounts receivable	**182,905**	158,573
Other accounts receivable	**280,602**	185,624
Assets limited as to use	**2,533,049**	2,322,696
	$ 3,471,106	$ 3,242,088

PHS has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, PHS invests cash in excess of daily requirements in short-term investments, which are included in cash and cash equivalents on the combined balance sheets.

17. Income Taxes

The components of the provision for income taxes for the years ended December 31 are as follows:

	2021	2020
Current	**$ 38,959**	$ 42,860
Deferred	**2,687**	6,694
Total provision for income taxes	**$ 41,646**	$ 49,554

(Dollar Amounts in Thousands)

17. Income Taxes (continued)

The differences between the actual and expected provision for income taxes or benefit computed by applying the federal corporate income tax rate of 21% in 2021 and 2020, plus a state rate of 4.8% for PNI operations only, to income before income taxes for the years ended December 31 are as follows:

	2021	2020
Computed tax expense at combined rate	**$ 39,518**	$ 39,936
ACA health provider fee	**–**	9,907
Change in valuation allowance	**237**	(1,201)
Other permanent differences	**703**	339
Provision to return differences	**(235)**	(255)
State taxes and other	**1,423**	828
	$ 41,646	$ 49,554

(Dollar Amounts in Thousands)

17. Income Taxes (continued)

Deferred tax assets (liabilities) were included within accrued liabilities on the accompanying combined balance sheets and were composed of the following at December 31:

	2021	2020
Deferred tax assets:		
Medical liabilities and other reserves	**$ 6,056**	$ 4,043
Medical claims payable (incurred but not reported)	**1,171**	962
Deferred compensation	**1,416**	1,260
Investments	**416**	601
Net operating loss carryforwards	**4,313**	4,099
Deferred intercompany loss	**8,342**	8,341
Premium deficiency reserve	**2,031**	2,537
Other	**3,604**	1,241
Total deferred tax assets	**27,349**	23,084
Deferred tax liabilities:		
Amortization of intangibles	**(13,437)**	(13,437)
Partnership – book/tax difference	**(8,537)**	(7,301)
Gains on sale of securities	**(415)**	(451)
Unrealized gains on investments	**(17,353)**	(11,838)
Total deferred tax liabilities	**(39,742)**	(33,027)
Valuation allowance	**(12,873)**	(12,636)
Deferred tax liabilities, net	**$ (25,266)**	$ (22,579)

At December 31, 2021 and 2020, PNI had no federal net operating loss carryforwards. PNI is subject to state income tax and has state net operating loss carryforwards at December 31, 2021 and 2020, of $92,537 and $87,934, respectively, of which a portion begins to expire in 2033.

At December 31, 2021 and 2020, a valuation allowance in the amount of $12,873 and $12,636, respectively, was established against the deferred tax asset related to the state net operating loss carryforwards, capital loss carryforwards, and deferred intercompany loss, as management currently believes that the benefit from some or all of these deferred tax assets may not be realized.

17. Income Taxes (continued)

In the normal course of business, PNI is subject to examination by taxing authorities, and PNI is no longer subject to U.S. federal, state, or local income tax examinations for years before 2017. PNI does not have any current federal tax disputes.

18. COVID-19

On March 11, 2020, the World Health Organization designated COVID-19 as a global pandemic. Beginning in mid-March 2020 various government policies were implemented, such as stay-at-home orders, business closures, and suspension of elective and non-emergent services. These policies reduced both net patient service revenue and medical claims expense. In addition to the impact of the policies related to COVID-19, some patients chose to defer health care, which accentuated the reductions in patient revenue and medical claims expense. Consumer demand for health care is expected to increase in 2022 as the hospitalization rates decrease due to vaccinations and other interventions. However, the ultimate impact is uncertain and dependent on the length and intensity of the pandemic, as well as general economic uncertainty.

A variety of federal, state, and local efforts have been initiated in response to the COVID-19 crisis, the largest of which is the Coronavirus Aid, Relief, and Economic Securities (CARES) Act that was enacted on March 27, 2020. The CARES Act is a federal stimulus package designed to provide emergency assistance to individuals and businesses, including hospitals and other health care providers. PHS has received approximately $1,394 and $126,889 in Provider Relief Funds from the CARES Act to cover unreimbursed health-care-related expenses attributable to the public health emergency and lost revenue resulting from the COVID-19 pandemic as of December 31, 2021 and 2020, respectively. PHS recognized $18,877 and $109,046 in CARES Act revenue within other operating revenue for the years ended December 31, 2021 and 2020, respectively. PHS follows grant accounting to recognize the stimulus funding as other operating revenue based on guidance from the U.S. Department of Health & Human Services. The remaining $360 is recorded in accrued liabilities and is expected to be used to offset qualifying unreimbursed expenses or lost revenue related to the pandemic during 2022. In 2021, the American Rescue Plan Act (ARPA) was passed, which included funding for rural health care providers. PHS, received, and recognized $18,067 of ARPA revenue for the year ended December 31, 2021. PHS has also recognized revenue for COVID-19-related projects obligated through the Federal Emergency Management Agency (FEMA) as well as other COVID-19-related grants. PHS recognized revenue from FEMA, and other COVID-19-related grants, of $7,156 and $579 for the years ended December 31, 2021 and 2020, respectively. In addition, PHS received $10,818 of Medicare

18. COVID-19 (continued)

Advance and Accelerated Payments, recorded in accrued liabilities as of December 30, 2020, to help support liquidity needs in the short term. The advance payments were fully repaid in 2021. The CARES Act also allows for deferred payment of the employer portion of certain payroll taxes between March 27, 2020 and December 31, 2021, with 50% due December 31, 2021, and the remaining 50% due December 31, 2022. As of December 31, 2021, PHS had deferred payroll tax payments of approximately $19,178, which is recorded in accrued liabilities.

19. Subsequent Events

PHS has evaluated subsequent events occurring between the end of the most recent year-end and April 28, 2022, the date the accompanying combined financial statements were issued.

Supplementary Information

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Building a better working world

Report of Independent Auditors on Supplementary Information

The Board of Directors
Presbyterian Healthcare Services

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying combining balance sheet and statement of operations for the year ended December 31, 2021 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Ernst & Young LLP

April 28, 2022

Presbyterian Healthcare Services and Affiliates

Combining Balance Sheet

December 31, 2021

	Obligated Group	Presbyterian Network, Inc.	Other Non-Obligated Group Members	Eliminations	Combined
			(In Thousands)		
Assets					
Current assets:					
Cash and cash equivalents	$ 228,631	$ 231,396	$ 14,523	$ –	$ 474,550
Accounts receivable	221,447	–	16,277	(54,819)	182,905
Other receivables	27,002	256,973	5,857	1,222	291,054
Inventories, prepaid expenses,	–	–	–	–	–
and other current assets	56,531	15,454	2,679	–	74,664
Total current assets	533,611	503,823	39,336	(53,597)	1,023,173
Assets limited as to use or restricted:					
Designated for long-term purposes	2,060,077	571,105	727	–	2,631,909
Designated for self-insurance funds	182,083	–	–	–	182,083
Restricted by donors	65,980	–	–	–	65,980
Held by trustee	145,538	–	–	–	145,538
Restricted for statutory requirements	–	244,866	–	–	244,866
	2,453,678	815,971	727	–	3,270,376
Property and equipment, net	1,017,894	63,757	122,810	–	1,204,461
Goodwill	200	52,501	55,341	–	108,042
Other assets	275,144	33,974	169,083	(142,599)	335,602
Intercompany receivables (payables)	19,538	(32,444)	12,906	–	–
Total assets	$ 4,300,065	$ 1,437,582	$ 400,203	$ (196,196)	$ 5,941,654

Presbyterian Healthcare Services and Affiliates

Combining Balance Sheet (continued)

	Obligated Group	Presbyterian Network, Inc.	Other Non-Obligated Group Members	Eliminations	Combined
			(In Thousands)		
Liabilities and net assets					
Current liabilities:					
Accounts payable	$ 91,425	$ 13,491	$ 6,181	$ 5,226	$ 116,323
Due under Medicaid contract	–	137,143	–	–	137,143
Accrued liabilities	157,671	101,323	11,956	(6,768)	264,182
Medical claims payable	–	448,908	–	(54,819)	394,089
Estimated third-party payor settlements	9,058	–	1,043	–	10,101
Current portion of long-term debt	118,285	–	1,343	(2,079)	117,549
Total current liabilities	376,439	700,865	20,523	(58,440)	1,039,387
Long-term debt, net of current portion	1,028,882	–	6,638	(3,806)	1,031,714
Employee benefit plans	211,496	–	–	–	211,496
Self-insurance plans	290,077	–	–	–	290,077
Other liabilities	132,105	37,976	29,524	(19,364)	180,241
Total liabilities	2,038,999	738,841	56,685	(81,610)	2,752,915
Net asset without donor restrictions:					
Attributable to Presbyterian Healthcare Services	2,192,997	698,741	291,912	(114,586)	3,069,064
Attributable to non-controlling interests	–	–	51,606	–	51,606
Net assets without donor restrictions	2,192,997	698,741	343,518	(114,586)	3,120,670
Net asset with donor restrictions	68,069	–	–	–	68,069
Total net assets	2,261,066	698,741	343,518	(114,586)	3,188,739
Total liabilities and net assets	$ 4,300,065	$ 1,437,582	$ 400,203	$ (196,196)	$ 5,941,654

Presbyterian Healthcare Services and Affiliates

Combining Statement of Operations

Year Ended December 31, 2021

	Obligated Group	Presbyterian Network, Inc.	Other Non-Obligated Group Members	Eliminations	Combined
			(In Thousands)		
Operating revenues:					
Net premiums	$ –	$ 3,692,491	$ –	$ –	$ 3,692,491
Net patient service revenue	1,841,703	–	150,197	(711,209)	1,280,691
Other operating revenues	144,648	59,024	16,697	(90,746)	129,623
Total operating revenues	1,986,351	3,751,515	166,894	(801,955)	5,102,805
Expenses:					
Medical claims	–	3,123,706	–	(736,548)	2,387,158
Salaries, wages, and employee benefits	1,130,152	167,013	52,693	(5,105)	1,344,753
Purchased services and other	413,222	301,650	35,730	(60,421)	690,181
Supplies	385,529	673	32,062	–	418,264
Professional fees	35,617	4	2,574	–	38,195
Depreciation and amortization	94,538	16,046	9,880	–	120,464
Interest	33,913	356	506	–	34,775
Total expenses	2,092,971	3,609,448	133,445	(802,074)	5,033,790
Operating (loss) income	(106,620)	142,067	33,449	119	69,015
Other income:					
Investment income	169,534	19,848	230	–	189,612
Change in net unrealized gains on investments	17,306	26,264	–	–	43,570
Change in fair value of interest rate swaps	13,457	–	–	–	13,457
Total other income	200,297	46,112	230	–	246,639
Excess of revenues over expenses before income taxes	93,677	188,179	33,679	119	315,654
Provision (benefit) for income taxes	1,831	40,230	(415)	–	41,646
Excess of revenues over expenses	91,846	147,949	34,094	119	274,008
Less excess of revenues over expenses attributable to non-controlling interests	–	–	(9,058)	–	(9,058)
Excess of revenues over expenses attributable to Presbyterian Healthcare Services	$ 91,846	$ 147,949	$ 25,036	$ 119	$ 264,950

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