

Franciscan Alliance, Inc. and Affiliates

**Consolidated Financial Statements
December 31, 2020 and 2019**

Franciscan Alliance, Inc. and Affiliates

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December 31, 2020 and 2019

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Report of Independent Auditors

To the Board of Trustees of Franciscan Alliance, Inc.

We have audited the accompanying consolidated financial statements of Franciscan Alliance, Inc. and Affiliates (collectively referred to as the "Company"), which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of operations and changes in net assets and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Franciscan Alliance, Inc. and Affiliates as of December 31, 2020 and 2019, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

April 20, 2021

Franciscan Alliance, Inc. and Affiliates
Consolidated Statements of Financial Position
December 31, 2020 and 2019
(In thousands)

	2020	2019		2020	2019
Assets			Liabilities and Net Assets		
Current assets			Current liabilities		
Cash and cash equivalents	\$ 42,678	\$ 28,376	Current portion of long-term debt	\$ 26,467	\$ 24,180
Short-term investments	402,478	153,981	Current portion of lease liabilities	27,826	28,774
Patient accounts receivable	403,514	388,390	Accounts payable and accrued expenses	319,076	328,973
Inventories of supplies	68,289	57,688	Accrued payroll and related expenses	160,703	128,104
Other current assets	<u>131,581</u>	<u>149,542</u>	Estimated third-party payor settlements	<u>185,046</u>	<u>47,730</u>
Total current assets	1,048,540	777,977	Total current liabilities	719,118	557,761
Board designated and other investments	3,174,338	2,721,264	Long-term debt, net of current portion	1,162,556	1,179,985
Property, plant, and equipment, net	1,992,288	2,005,405	Lease liabilities, net of current portion	122,937	125,104
Investments in unconsolidated affiliates	13,397	13,051	Fair value of interest rate swap contracts	79,409	65,449
Right of use leased assets	148,827	152,736	Accrued pension liability	197,052	196,543
Other assets	164,364	162,017	Estimated insurance liabilities	130,189	115,456
Goodwill	24,541	24,541	Other liabilities	<u>339,319</u>	<u>92,161</u>
			Total liabilities	<u>2,750,580</u>	<u>2,332,459</u>
			Net assets without donor restrictions		
			Controlling interest	3,716,335	3,448,675
			Noncontrolling interest in consolidated affiliates	<u>54,495</u>	<u>34,312</u>
			Total net assets without donor restrictions	3,770,830	3,482,987
			Net assets with donor restrictions	<u>44,885</u>	<u>41,545</u>
			Total net assets	<u>3,815,715</u>	<u>3,524,532</u>
Total assets	<u>\$ 6,566,295</u>	<u>\$ 5,856,991</u>	Total liabilities and net assets	<u>\$ 6,566,295</u>	<u>\$ 5,856,991</u>

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

Franciscan Alliance, Inc. and Affiliates
Consolidated Statements of Operations and Changes in Net Assets
Years Ended December 31, 2020 and 2019
(In thousands)

	2020	2019
Changes in net assets without donor restrictions		
Revenues, gains, and other support		
Patient service revenue	\$ 2,907,255	\$ 3,060,470
Capitation and premium revenue	35,853	60,383
Other operating revenue	358,476	170,520
Equity in losses of investments in unconsolidated affiliates	(1,590)	(4,518)
Net unrealized investment gains	9,786	15,743
Net assets released from restrictions used for operations	108	110
Total revenues, gains, and other support	<u>3,309,888</u>	<u>3,302,708</u>
Operating expenses		
Salaries	1,297,331	1,269,989
Employee benefits	332,085	333,136
Physicians' fees	96,126	90,371
Medical supplies	221,741	241,895
Drugs and pharmaceuticals	213,496	209,483
Purchased services	310,447	282,383
Hospital assessment fees	110,572	112,356
Insurance	41,079	32,748
Interest	30,004	36,113
Depreciation and amortization	189,219	185,422
Other supplies and expenses	364,304	361,835
Total operating expenses before accelerated depreciation	<u>3,206,404</u>	<u>3,155,731</u>
Operating income before accelerated depreciation	<u>103,484</u>	<u>146,977</u>
Accelerated depreciation	<u>7,092</u>	<u>1,792</u>
Operating income	96,392	145,185
Nonoperating income (expense)		
Investment income	39,126	109,943
Net unrealized investment gains	202,357	208,392
Net unrealized losses and periodic settlements on interest rate swap contracts	(23,936)	(19,076)
Net assets released from restrictions	5,399	4,114
Contributions	666	795
Other, net	8,303	(16,927)
Total nonoperating income, net	<u>231,915</u>	<u>287,241</u>
Consolidated excess of revenues over expenses	<u>328,307</u>	<u>432,426</u>
Less amounts attributable to noncontrolling interest in consolidated affiliates	<u>(21,793)</u>	<u>(23,402)</u>
Excess of revenues over expenses attributable to the Corporation	<u>\$ 306,514</u>	<u>\$ 409,024</u>

(continued on next page)

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

Franciscan Alliance, Inc. and Affiliates
Consolidated Statements of Operations and Changes in Net Assets (continued)
Years Ended December 31, 2020 and 2019
(In thousands)

	Year Ended December 31, 2020			Year Ended December 31, 2019		
	Total	Controlling	Noncontrolling	Total	Controlling	Noncontrolling
Changes in net assets without donor restrictions						
Excess of revenues over expenses	\$ 328,307	\$ 306,514	\$ 21,793	\$ 432,426	\$ 409,024	\$ 23,402
Change in pension and postretirement benefits other than net periodic pension costs included in accrued pension liability	(42,199)	(42,199)	-	(29,326)	(29,326)	-
Contributions received of property, plant, and equipment	2,024	2,024	-	345	345	-
Distributions to noncontrolling interests in consolidated affiliates	(1,610)	-	(1,610)	(22,636)	-	(22,636)
Net assets released from restrictions used for purchase of property, plant, and equipment	1,616	1,616	-	754	754	-
Other, net	(295)	(295)	-	434	434	-
Increase in net assets without donor restrictions	287,843	267,660	20,183	381,997	381,231	766
Changes in net assets with donor restrictions						
Contributions	6,287	6,287	-	7,695	7,695	-
Investment income	578	578	-	827	827	-
Net assets released from restrictions	(5,507)	(5,507)	-	(4,224)	(4,224)	-
Net assets released from restrictions used for purchase of property, plant, and equipment	(1,616)	(1,616)	-	(754)	(754)	-
Net unrealized investment gains	3,538	3,538	-	1,319	1,319	-
Other, net	60	60	-	371	371	-
Increase in net assets with donor restrictions	3,340	3,340	-	5,234	5,234	-
Increase in net assets	291,183	271,000	20,183	387,231	386,465	766
Net assets at beginning of year	3,524,532	3,490,220	34,312	3,137,301	3,103,755	33,546
Net assets at end of year	\$ 3,815,715	\$ 3,761,220	\$ 54,495	\$ 3,524,532	\$ 3,490,220	\$ 34,312

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

Franciscan Alliance, Inc. and Affiliates
Consolidated Statements of Cash Flows
Years Ended December 31, 2020 and 2019
(In thousands)

	2020	2019
Cash flows from operating activities		
Increase in net assets	\$ 291,183	\$ 387,231
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation and amortization	196,352	187,214
Gain (loss) on sale/disposal of assets	(2,469)	1,621
Net investment gains	(251,269)	(334,078)
Net unrealized losses on interest rate swap contracts	13,960	12,234
Distributions to noncontrolling interest in consolidated affiliates, net of contributions	1,610	22,636
Distributions from unconsolidated affiliates	947	1,185
Equity in losses of investments in unconsolidated affiliates	1,590	4,518
Other changes in investments of unconsolidated affiliates	96	-
Change in pension and postretirement benefits other than net periodic pension costs included in accrued pension liability	(42,199)	(29,326)
Changes in operating assets and liabilities		
Patient accounts receivable	(15,124)	(13,012)
Inventories of supplies and other assets	4,634	(82,950)
Accounts payable and other current liabilities	162,021	(6,780)
Estimated insurance liabilities and other liabilities	261,891	14,067
Accrued pension liability	42,708	23,277
Total adjustments	<u>374,748</u>	<u>(199,394)</u>
Net cash provided by operating activities	<u>665,931</u>	<u>187,837</u>
Cash flows from investing activities		
Purchases of investments	(7,768,486)	(6,808,323)
Proceeds from sale of investments	7,602,739	6,858,579
Purchases of property, plant, and equipment	(169,350)	(189,123)
Proceeds from sale of property, plant, and equipment	783	210
Acquisition of physician practices and other health care providers	-	(27)
Capital contributions to investment in unconsolidated affiliates	(2,979)	(4,421)
Net cash used by investing activities	<u>(337,293)</u>	<u>(143,105)</u>
Cash flows from financing activities		
Principal payments on long-term debt	(28,129)	(28,396)
Distributions to noncontrolling interest in consolidated affiliates, net of contributions	(1,610)	(22,636)
Proceeds from donors	6,287	7,695
Other	(77)	-
Net cash used by financing activities	<u>(23,529)</u>	<u>(43,337)</u>
Net increase in cash and cash equivalents and restricted cash and cash equivalents	305,109	1,395
Cash and cash equivalents and restricted cash and cash equivalents, beginning of year	<u>133,803</u>	<u>132,408</u>
Cash and cash equivalents and restricted cash and cash equivalents, end of year	<u>\$ 438,912</u>	<u>\$ 133,803</u>

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

Franciscan Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Years Ended December 31, 2020 and 2019

1. Description of Organization, Mission, and Values

Organization

Franciscan Alliance, Inc. and Affiliates (collectively referred to as the “Corporation”), under the sponsorship of the Sisters of St. Francis of Perpetual Adoration, Inc., is an Indiana non-profit, Catholic health care system. The Corporation is dedicated to providing comprehensive health care services, including emergency, medical, surgical, behavioral, rehabilitative, and other health services in inpatient and outpatient settings; home health care services; and primary and specialty physician services to communities within four geographic regions in Indiana and Illinois (the “Health Centers”). Additionally, the Corporation has an accountable care organization, a physician hospital organization, a non-profit foundation, and a number of support related divisions and affiliates including a corporate office, a consolidated information technology services division, various back office/management support organizations, a construction company, and a captive insurance company. The Corporation also has various investments in consolidated and unconsolidated affiliates (Note 11). The Corporation is incorporated as a not-for-profit corporation under the laws of Indiana and is a tax-exempt organization as described in Section 501(c)(3) of the Internal Revenue Code (“IRC”).

Mission and Values

The Corporation’s mission statement is as follows:

Continuing Christ’s Ministry in Our Franciscan Tradition

The Corporation’s values are as follows:

Respect for Life

Fidelity to Our Mission

Compassionate Concern

Joyful Service

Christian Stewardship

Franciscan Alliance, Inc. and Affiliates
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Years Ended December 31, 2020 and 2019
(In thousands)

Consistent with its mission and values, the Corporation provides medical care to all patients regardless of their ability to pay and continually works to enhance the health status of the communities in which it operates. As illustrated in the following summary of quantifiable community benefits, which has been prepared in accordance with the Catholic Health Association of the United States' policy document, the Corporation commits significant resources to provide services intended to benefit the poor and underserved with benefits measured at the total cost net of any offsetting revenues, donations, or other funds used to defray such costs.

	(Unaudited)	
	2020	2019
	(in thousands)	
Benefits for the poor and underserved		
Unreimbursed costs of Medicaid and other indigent care programs	\$ 145,832	\$ 126,218
Cost of charity care provided	114,412	114,648
Programs for those who are poor and underserved		
Community health improvement services	1,278	1,441
Subsidized health services	422	488
Financial and in-kind contributions	1,142	1,065
Community building activities	1	3
Total benefits for the poor and underserved	<u>263,087</u>	<u>243,863</u>
Benefits for the broader community		
Subsidized health services	51,100	44,481
Health professions education	12,409	13,136
Community health improvement services	8,477	3,676
Financial and in-kind contributions	350	820
Research	1,508	1,311
Community building activities	56	1,960
Community benefit operations	29	422
Total benefits for the broader community	<u>73,929</u>	<u>65,806</u>
Total quantifiable community benefits	<u>337,016</u>	<u>309,669</u>
Unreimbursed costs of Medicare	393,394	401,843
Total quantifiable community benefits including unreimbursed costs of Medicare	<u>\$ 730,410</u>	<u>\$ 711,512</u>

Total quantifiable community benefits including unreimbursed costs of Medicare were approximately 23% of total operating expenses for both the years ended December 31, 2020 and 2019.

The Corporation also provides a significant amount of uncompensated care to patients which is not reported in the summary of quantifiable community benefits. Effective January 1, 2018, the Corporation adopted the Financial Accounting Standards Board ("FASB") Accounting Standard Update ("ASU") 2014-9, *Revenue from Contracts with Customers (Topic 606)* which requires revenue to be recognized in an amount that reflects the consideration the entity expects to be entitled to in an exchange for goods or services. Adoption of this ASU does not allow the separate reporting of the uncollectible amounts due from patients; however, the identification of this amount is needed for other purposes including governmental reporting and reimbursement calculations.

Franciscan Alliance, Inc. and Affiliates
Notes to Consolidated Financial Statements
Years Ended December 31, 2020 and 2019
(In thousands)

The Corporation has a system-wide charity care and uninsured discount policy that includes administrative procedures for qualifying and enrolling patients for charity care or uninsured/underinsured discounts. The Corporation also uses various analytical programs to assess a patient's ability to pay and it utilizes numerous mechanisms to inform and educate patients about financial assistance. Despite these rigorous efforts, patients who need subsidized care may not seek this assistance nor choose to enroll in Medicaid or other financial assistance programs. For these and other reasons, the Corporation believes a portion of its uncollectible amounts due from patients represents charity care delivered to individuals in the communities it serves consistent with its charitable health care mission. During the years ended December 31, 2020 and 2019, the Corporation incurred approximately \$18.3 million and \$52.5 million, respectively, as uncollectible amounts due from patients based on accumulated charges.

Benefits for the poor and underserved include the cost of providing programs and services to persons who are economically poor or are medically indigent and cannot afford to pay for health care services because they have inadequate resources and/or are uninsured or underinsured.

Benefits for the broader community include the costs of providing programs and services aimed at persons and groups for reasons other than poverty. These persons and groups may include needy populations that may not qualify as poor but need special services and support or broader populations who benefit from healthy community initiatives. These programs and services are not intended to be financially self-supporting.

Unreimbursed costs of Medicaid and other indigent care programs represent the cost (determined using a cost to charge ratio) of providing services to beneficiaries of public programs including State Medicaid and indigent care programs in excess of any payments received.

Charity care represents the cost (determined using a cost to charge ratio) of health care services, provided in accordance with the Corporation's charity care and uninsured patient discount policy, for which no or partial reimbursement will be received because of the recipient's inability to pay for those services.

Subsidized health services are net costs for billed services that are subsidized by the Corporation. These include services offered despite a financial loss because they are needed in the community and either other providers are unwilling to provide the services or the services would otherwise not be available in sufficient amount. Examples of services include emergency services, free standing community clinics, hospice care, behavioral health services, prenatal services, women's and children's services, palliative care, and parish nurse programs.

Health professions education includes the unreimbursed cost of training health professionals such as medical residents, nursing students, technicians, and students in allied health professions.

Community health improvement services are activities and services carried out to improve community health and well-being for which no patient bill exists. These services are not expected to be financially self-supporting, although some may be supported by outside grants or funding, which is netted against any amounts reported. Some examples include health education, health fairs, free or low cost health screening, immunization services, prescription medication assistance programs, and other various community outreach programs. The Corporation actively collaborates with community groups and agencies to assist those in need in providing such services.

Franciscan Alliance, Inc. and Affiliates
Notes to Consolidated Financial Statements
Years Ended December 31, 2020 and 2019
(In thousands)

Financial and in-kind contributions are made by the Corporation on behalf of the poor and underserved to various community agencies. These amounts include funds used for charitable activities as well as resources contributed directly to programs, organizations, and foundations for efforts on behalf of the poor and underserved. In-kind services include hours donated by staff to the community while on work time, overhead expenses of space donated to community groups, and donations of food, equipment, supplies, and other direct costs.

Research includes the unreimbursed cost of clinical and community health research and studies on health care delivery.

Community building activities include the costs of programs that improve the physical environment, promote economic development, enhance other community support systems, provide leadership development skills training, and build community coalitions.

Community benefit operations include costs associated with dedicated staff, community health needs and/or asset assessments, and other costs associated with the community benefit strategy and operations.

Unreimbursed costs of Medicare represent the cost (determined using a cost to charge ratio) of providing services primarily to elderly beneficiaries of the Medicare program in excess of any payments received.

2. Summary of Significant Accounting Policies and Significant Events

Principles of Consolidation

The consolidated financial statements include the accounts of the Corporation and all wholly owned, majority-owned, and controlled organizations with all significant transactions and accounts between affiliates eliminated in consolidation. Investments in affiliates where the Corporation owns less than or equal to 50% and does not have operational control are recorded under the equity method of accounting unless the Corporation's control or investment percentage is insignificant in which case the Corporation uses the fair value method.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management of the Corporation to make assumptions, estimates, and judgments that affect the amounts reported in the consolidated financial statements, including the notes thereto, and related disclosures of commitments and contingencies, if any. The Corporation considers critical accounting policies to be those that require more significant judgments and estimates in the preparation of its consolidated financial statements, including the following: recognition of patient service revenue; recorded values of investments and goodwill; reserves for employee health costs and losses and expenses related to professional and general liabilities; and risks and assumptions for measurement of the pension liability. Management relies on historical experience and other assumptions believed to be reasonable in making its judgments and estimates. Actual results could differ materially from those estimates.

Franciscan Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Years Ended December 31, 2020 and 2019

(In thousands)

New Accounting Pronouncements Not Yet Applicable

In August 2018, the FASB issued ASU 2018-14, *Compensation – Retirement Benefits – Defined Benefit Plans - General (Topic 715)*. This ASU modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. The ASU is effective January 1, 2021 with retrospective application required and early adoption permitted. The Corporation is currently assessing the impact of this ASU on its consolidated financial statements.

In May 2019, the FASB issued ASU 2019-06, *Intangibles – Goodwill and Other (Topic 350), Business Combinations (Topic 805), and Not-for-Profit Entities (Topic 958): Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities*. This ASU allows not-for-profits to apply accounting alternatives that simplify the subsequent accounting for goodwill and accounting for certain intangibles assets that are acquired. Not-for-profits that elect the goodwill accounting alternative must amortize goodwill over a period not greater than 10 years. Additionally, goodwill is only required to be tested for impairment when a triggering event occurs. Not-for-profits that elect the intangible asset accounting alternative may recognize fewer identifiable intangible assets in an acquisition. The Corporation is currently evaluating whether to elect the alternative.

Cash and Cash Equivalents

Cash and cash equivalents and restricted cash and restricted cash equivalents primarily consist of cash, treasuries, and other liquid marketable securities including interest bearing securities with original maturities of three months or less. The carrying amount of cash and cash equivalents approximates fair value because of the short maturities of these instruments.

Short-Term Investments

Short-term investments primarily consist of certificates of deposit, treasuries, and other highly liquid interest bearing securities with original maturities extending longer than three months.

Patient Accounts Receivable and Patient Service Revenue

Patient accounts receivable and patient service revenue is reported at the amount that reflects the consideration the Corporation expects to be entitled to in exchange for providing patient care.

Inventories of Supplies

Inventories, consisting primarily of medical/surgical supplies and pharmaceuticals, are stated at the lower of cost (average cost method) or net realizable value.

Board Designated and Other Investments and Investment Income

Board designated investments represents investments set aside by board policy for future purposes including capital expenditures, acquisitions, improvements, mission programs, and, in addition, to provide for the Corporation to meet any current liquidity needs. The Corporation's board retains control of these investments and may, at its discretion and in certain circumstances, use them for other purposes. Assets limited as to use include assets under bond indenture and collateral related to interest rate swap agreements, investments maintained for the payment of estimated insurance liabilities, and amounts contributed by donors with stipulated restrictions.

Substantially all of the Corporation's board designated and other investments are invested and managed by professional managers in accordance with agreed-upon investment and socially responsible investing guidelines and are held in custody with a financial institution.

Franciscan Alliance, Inc. and Affiliates
Notes to Consolidated Financial Statements
Years Ended December 31, 2020 and 2019
(In thousands)

Board designated and other investments are measured at fair value, and consist of: cash and cash equivalents; U.S. government, state, municipal, and agency obligations; other fixed income securities; equity securities; asset backed securities; index funds, exchange traded funds, and mutual funds; unregistered mutual funds; and real estate investment trusts. Board designated and other investments also include alternative investments, consisting of investments in hedge funds, private credit and private equity investments, and real assets, which are generally measured based on their net asset value as a practical expedient for fair value that is further described in Note 4.

Investment earnings consist of dividends, interest, and realized gains and losses. In accordance with industry practice, investment earnings and unrealized gains and losses on assets limited as to use under bond indenture and interest rate swap agreements and estimated insurance liability funds are included in other operating revenue in the consolidated statements of operations and changes in net assets. Investment earnings and unrealized gains and losses from all other investments and board designated funds are included in nonoperating income (expense) in the consolidated statements of operations and changes in net assets, unless the investment earnings and any associated unrealized gains and losses are restricted by donor or by law.

Board designated and other investments are exposed to various risks such as interest rate, market, liquidity, performance, and credit risk. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term may affect the amounts reported in the consolidated statements of financial position and the consolidated statements of operations and changes in net assets.

Fair Value Measurement

The Corporation's consolidated financial statements reflect certain assets and liabilities recorded at fair value. Assets measured at fair value on a recurring basis in the Corporation's consolidated statements of financial position include: cash and cash equivalents; U.S. government, state, municipal, and agency obligations; other fixed income securities; asset backed securities; index funds, exchange traded funds, and mutual funds; corporate and foreign income securities; various types of equity securities; hedge funds; private credit and private equity investments; real assets; and benefit plan assets.

Fair value measurements reflected in the consolidated financial statements conceptually represent the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Generally accepted accounting principles establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs.

Franciscan Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Years Ended December 31, 2020 and 2019

(In thousands)

The three levels of fair value hierarchy and a description of the valuation methodologies used for instruments measured at fair value are as follows:

- Level 1 Valuation is based upon quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 Valuation is based upon quoted prices for similar assets and liabilities in active markets or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial asset or liability.
- Level 3 Valuation is based upon other unobservable inputs that are significant to the fair value measurement.

The categorization of fair value measurements by hierarchy level is based upon the lowest level input that is significant to the overall fair value measurement for a given asset or liability.

The Corporation applies the guidance in Accounting Standards Codification 820-10-15-4, *Fair Value Measurements of Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalent)*. Under this guidance, the Corporation is permitted, as a practical expedient, to estimate the fair value of certain investments on the basis of the net asset value per share. In the normal course of business, the Corporation holds certain investments that qualify for the usage of this practical expedient. Fair value measurements of certain investments for which the measurement was based on net asset value ("NAV") or its equivalent as provided by an external manager are not required to be included within the fair value hierarchy leveling tables.

In the event that changes in the inputs used in the fair value measurements of an asset or liability results in a transfer of the fair value measurement to a different categorization (e.g., from Level 3 to Level 2), such transfers between categories are recognized at the end of the reporting period.

Property, Plant, and Equipment

Property, plant, and equipment (including internal-use software) are recorded at cost if purchased or at fair value on the date received through affiliation or donation, less accumulated depreciation. Expenditures that materially increase values, change capacities, or extend useful lives are capitalized. Routine maintenance, repairs, and minor equipment replacement costs are charged to expense when incurred. Cost incurred in the development and installation of internal-use software are expensed or capitalized depending on whether they are incurred in the preliminary project stage, application development stage, or post implementation stage. Upon sale or retirement of property, plant, and equipment, the cost and related accumulated depreciation are eliminated from the respective accounts, and the resulting gain or loss is included in the consolidated statements of operations and changes in net assets. Interest costs incurred during the period of construction or development of capital assets are capitalized as a component of the cost of acquiring those assets. Depreciation is provided over the estimated useful lives of the assets utilizing the straight-line method or an accelerated method with a useful life range of between 3 to 60 years. Useful lives may be reassessed from time to time as facts and circumstances change in regard to how assets are being used. Assets under finance lease obligations are amortized utilizing the straight-line method over the shorter of the lease term or estimated useful life of the asset. Amounts capitalized for internal-use software are amortized over the useful life of the developed asset following project completion.

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(In thousands)

A conditional asset retirement obligation is recorded for any legal obligation associated with the retirement of long-lived assets resulting from the acquisition, construction, development, and/or normal use of the underlying assets. The associated asset retirement costs are capitalized as part of the carrying amount of the underlying asset and depreciated over the asset's estimated useful life. The liability is accreted through charges to operating expense. If the conditional asset retirement obligation is settled for other than the carrying amount of the liability, a gain or loss on sale/disposal of assets is recognized. As of December 31, 2020 and 2019, conditional asset retirement obligations of approximately \$4.8 million and \$5.1 million, respectively, are included within accounts payable and accrued expenses and other liabilities in the consolidated statements of financial position.

Leases

The Corporation has operating and finance leases for various real estate and certain equipment. The Corporation determines if an arrangement is a lease at inception. Operating leases are included in right of use leased assets; current portion of lease liabilities; and lease liabilities, net of current portion on the consolidated statements of financial position. Finance leases are included in property, plant, and equipment, net; current portion of long-term debt; and long-term debt, net of current portion on the consolidated statements of financial position. Leases with an initial term of 12 months or less are not recognized on the consolidated statements of financial position; instead, lease expense for these agreements is recognized over the lease term.

Right of use leased assets and lease liabilities are recognized based on the net present value of the future minimum lease payments over the lease term at commencement date. The Corporation uses either the implicit rate noted within such agreement, when the rate can be determined, or a risk-free rate for measuring lease liabilities and for classification purposes. The right of use leased assets also includes any lease payments made and excludes lease incentives and initial direct costs incurred. The right of use leased assets include a value for options to extend or terminate, in the case it is reasonably certain that the option will be exercised. Lease payments are recognized on a straight-line basis over the lease term. Variable lease expense is recognized in the period in which the payments are made for these lease obligations.

On March 18, 2020, Meridian Development Services, LLC ("Meridian"), a wholly owned affiliate of an independent orthopedic physician organization, entered into a \$194 million non-recourse taxable loan from a private placement lender for the development of an orthopedic center of excellence in Carmel, Indiana. Simultaneously, the Corporation entered into a 25-year credit tenant lease on the property with an effective rent commencement date of April 1, 2022. The orthopedic center of excellence campus will include a specialty hospital, an ambulatory surgery center, and a medical office building. The Corporation has agreements in place to sublease 64% of the medical office building to the above referenced independent orthopedic physician organization and sublease 100% of the ambulatory surgery center to a surgery center company that is 51% owned by the Corporation with both subleases co-terminus with the credit tenant lease. The Corporation has an accordion option to prepay up to 10% of the loan before the final construction disbursement is made. The credit tenant lease fully amortizes over 25 years starting April 1, 2022 through 2046 with a 2% annual escalation. At the end of the lease, the Corporation will own the following buildings and land in the indicated percentages: specialty hospital and land 100%, ambulatory surgery center 51%, and medical office building 36%. A right of use leased asset and lease liability will be recorded on the consolidated statements of financial position when the certificate of occupancy has been issued and certificate of substantial completion has been delivered. The sublease with the independent orthopedic physician organization and the surgery center company will be considered an operating lease and the Corporation will be the sublessor.

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Lease revenue will be included in the Corporation's consolidated statements of operations and changes in net assets with disclosure of the amount of the credit tenant lease that is offset by the sublease.

Goodwill and Intangible Assets

Goodwill represents the future economic benefits arising from assets acquired that are not individually identified nor separately recognized. Goodwill is not amortized but is subject to an annual impairment test as well as more frequent reviews whenever circumstances indicate a possible impairment may exist.

Intangible assets are comprised primarily of covenants not to compete, which are amortized on a straight-line basis over periods ranging from 2 to 5 years, and are included within other assets in the consolidated statements of financial position.

Asset Impairment

Property and Equipment – The Corporation evaluates long-lived assets for possible impairment whenever events or changes in circumstances indicate that the carrying amount of the asset, or related group of assets, may not be recoverable from estimated future undiscounted cash flows. If the estimated future undiscounted cash flows are less than the carrying value of the asset, the impairment recognized is calculated as the carrying value of the long-lived assets in excess of the fair value of the assets. The fair value of the assets is estimated based on appraisals, established market values of comparable assets, or internal estimates of future net cash flows expected to result from the use and ultimate disposition of the assets.

Goodwill – Goodwill is tested for impairment on an annual basis or when an event or change in circumstance indicates the value of a reporting unit may have changed. Testing is conducted at the reporting unit level. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Estimates of fair value are based on appraisals, established market prices for comparable assets, internal estimates of future net cash flows, as well as other generally accepted valuation methodologies.

Deferred Financing Costs

Deferred financing costs incurred with the Hospital and Health System Revenue and Refunding Bonds are amortized using the bonds outstanding method. Costs associated with securing the direct pay letters of credit to support its variable rate demand bonds are amortized over the term of the associated liquidity facility. Costs associated with the issuance of direct placement bonds are amortized over the associated direct placement period. Unamortized deferred financing costs are included in long-term debt, net of current portion in the consolidated statements of financial position.

Estimated Insurance Liabilities

The provision for estimated insurance liabilities includes actuarial estimates of the ultimate costs for both reported claims and claims incurred but not reported for professional liability, general liability, long-term disability insurance, workers' compensation, and amounts self-insured for allocated loss adjustment expenses.

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Net Assets

The Corporation's financial statements have been prepared in accordance with U.S. GAAP, which require the Corporation to report information regarding its financial position and activities according to the following net asset classifications:

Net Assets Without Donor Restrictions – Net assets that are available for use in general operations and not subject to donor restrictions. These net assets may be used at the discretion of the Corporation and board of trustees.

Net Assets With Donor Restrictions – Net assets subject to stipulations imposed by donors and grantors. Some donor restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor or grantor. Other donor restrictions are perpetual in nature, whereby the donor has stipulated the funds be maintained in perpetuity.

Donor restricted contributions are reported as increases in net assets with donor restrictions. When a restriction expires, net assets are reclassified from net assets with donor restrictions to net assets without donor restrictions in the consolidated statements of operations and changes in net assets. Donor restricted contributions whose restrictions are met within the same year as received are reported as net assets without donor restrictions in the consolidated financial statements.

During 2020 and 2019, net assets of \$7.1 million and \$5.0 million, respectively, were released from donor restrictions by incurring expenses or capital expenditures satisfying the restricted purposes or by the passage of time.

Performance Indicator

The consolidated statements of operations and changes in net assets includes a performance indicator, excess of revenues over expenses, which includes operating income and nonoperating income (expense). The performance indicator excludes the change in pension and postretirement benefits other than net periodic pension costs which is included in accrued pension liability; contributions and distributions to noncontrolling interest in consolidated affiliates; and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Operating and Nonoperating Activities

The Corporation's primary mission is to meet the health care needs in the communities it is privileged to serve by providing a broad range of general and specialized health care services, including emergency, medical, surgical, behavioral, rehabilitative, and other health services in inpatient and outpatient settings; home health care services; and primary and specialty physician services. Additionally, the Corporation has an accountable care organization and a physician hospital organization. Activities directly associated with the furtherance of this purpose are considered to be operating activities. Other activities that result in gains or losses peripheral to the Corporation's primary mission are considered to be nonoperating activities.

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(In thousands)

Charity Care

As an integral part of its mission, the Corporation provides care to patients who meet certain criteria under its charity care and uninsured patient discount policy without charge or at amounts less than its established rates. The cost of charity care, as estimated below, is determined based on each Health Center's total cost as a percentage of total charges and that ratio is applied to the charges incurred by patients qualifying for charity care under the Corporation's policy. The charges associated with the provision of such care are not included in patient service revenue in the consolidated statements of operations and changes in net assets. The estimated cost of charity care provided approximated \$114.4 million and \$114.6 million for the years ended December 31, 2020 and 2019, respectively. The Corporation maintains records to identify and monitor the level of charity it provides.

Capitation and Premium Revenue

The Corporation has certain Health Centers that arrange for the delivery of health care services to enrollees through various contracts with providers and common provider entities. Enrollee contracts are negotiated on an annual basis. Premiums are due monthly and are recognized as revenue during the period in which the Corporation is obligated to provide services to enrollees.

Certain of the Corporation's Health Centers have entered into capitation agreements whereby they accept the risk for the provision of certain health care services to health plan members. Under these agreements, the Corporation's Health Centers are financially responsible for services provided to health plan members by other health care providers. Capitation revenue is recognized during the period for which the Health Centers are obligated to provide services to health plan enrollees under capitation contracts.

Reserves for incurred but not reported claims have been established to cover the unpaid costs of health care services under capitation and premium arrangements. Capitation and premium arrangement reserves are classified within accounts payable and accrued expenses in the consolidated statements of financial position. The liability is estimated based on actuarial studies, historical reporting, and payment trends. Actual claims experience differs from estimated liabilities due to variances in estimated and actual utilization of health care services, charge amounts, and other factors. As settlements are made and estimates revised, any differences are reflected in current operations. The Corporation limits a portion of its liabilities through stop-loss reinsurance.

Income Taxes

The Corporation has established its status as an organization exempt from income taxes under the IRC Section 501(c)(3) and the laws of the states in which it operates. The Corporation is, however, subject to federal and state income taxes on unrelated business income under IRC Section 511. Certain divisions and affiliates are subject to federal and state income taxes; however, such amounts are not material to the consolidated financial statements.

Derivative Financial Instruments

Derivative financial instruments consist of interest rate swap contracts that are measured at fair value. The Corporation accounts for any changes in the fair value of derivative financial instruments in nonoperating income (expense) in the consolidated statements of operations and changes in net assets. The Corporation has reflected the fair value of its interest rate swap contracts as a long-term liability on the consolidated statements of financial position (Note 8).

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Consolidated Statements of Cash Flows

Supplemental disclosure of cash flow information and noncash investing and financing activities are summarized as follows.

The following table provides a reconciliation of cash and cash equivalents, and restricted cash and cash equivalents reported within the consolidated statements of financial position to amounts shown in the consolidated statements of cash flows:

	2020	2019
	(in thousands)	
Cash and cash equivalents	\$ 42,678	\$ 28,376
Board designated investments	350,947	62,353
Restricted cash and cash equivalents included in assets whose use is limited	<u>45,287</u>	<u>43,074</u>
Total cash and cash equivalents and restricted cash and cash equivalents shown in the consolidated statements of cash flows	<u>\$ 438,912</u>	<u>\$ 133,803</u>

Amounts included in restricted cash and cash equivalents included in assets whose use is limited includes the following:

	2020	2019
	(in thousands)	
Assets under bond indenture and interest rate swap agreements	\$ 28,865	\$ 22,665
Other restricted investments	<u>16,422</u>	<u>20,409</u>
	<u>\$ 45,287</u>	<u>\$ 43,074</u>

Cash paid for interest, net of amounts capitalized, amounted to \$29.9 million and \$37.4 million for the years ended December 31, 2020 and 2019, respectively.

Net cash paid for income taxes was \$359,000 for the year ended December 31, 2020 and net cash refunded for income taxes was \$93,000 for the year ended December 31, 2019.

Included in accounts payable and accrued expenses and other liabilities at December 31, 2020 and 2019 are approximately \$11.2 million and \$12.4 million, respectively, of costs related to construction in progress and for the acquisition of property, plant, and equipment.

The Corporation paid \$54.6 million and \$55.6 million related to operating leases and \$3.9 million and \$4.9 million related to finance leases for the years ended December 31, 2020 and 2019, respectively. For the years ended December 31, 2020 and 2019, there were non-cash decreases in right of use leased assets and lease liabilities related to operating leases of \$3.9 million and \$3.1 million, and \$17.5 million and \$16.3 million, respectively. There were also non-cash increases in both property, plant, and equipment, net and in long-term debt related to finance lease liabilities of \$9.2 million and \$15.6 million for the years ended December 31, 2020 and 2019, respectively.

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COVID-19 Pandemic and CARES Act Funding

On March 11, 2020, the World Health Organization designated COVID-19 as a global pandemic and the disease continued to spread throughout the United States and other parts of the world in 2020. The Corporation's patient volumes and related revenue for most services were significantly impacted beginning in mid-March 2020 as various policies were implemented by federal, state, and local governments to combat the outbreak of COVID-19, such as stay-at-home orders, business closures, and the suspension and cancellation of elective or nonemergent medical procedures. Certain of these government policies were lifted within the Corporation's markets between late April through mid-June 2020 allowing for the gradual improvement in volumes and related revenue. In addition to experiencing volume disruptions as a result of COVID-19, certain operating expenses increased during 2020. Supplies, such as personal protective equipment, and purchased labor were utilized at higher rates and at elevated prices. Also, during the suspension and cancellation of medical procedures, the Corporation instituted pay continuance policies to keep an assembled workforce.

In response to COVID-19, the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") was signed into law on March 27, 2020. The CARES Act authorizes funding to hospitals and other health care providers through the Public Health and Social Services Emergency Fund ("Provider Relief Fund"). Provider Relief Fund grant payments are intended to reimburse health care providers for health care-related expenses and/or lost revenues attributable to COVID-19. Recipients are not required to repay these funds, provided they attest to and comply with certain terms and conditions. As of December 31, 2020, the Corporation received \$201.0 million of Provider Relief Fund payments, of which the Corporation recognized approximately \$152.7 million as other operating revenue in the consolidated statements of operations and changes in net assets. The unrecognized amount of the Provider Relief Fund payments is included in estimated third-party payor settlements in the accompanying consolidated statements of financial position as of December 31, 2020. Future regulations or changes in interpretation may result in a reversal of amounts recognized given the lack of clarity and ever-changing terms and conditions of the program. The CARES Act also reimburses health care providers who submit claim requests for COVID-19-related treatment of uninsured patients at Medicare rates, for which the Corporation ultimately received approximately \$3.5 million through December 31, 2020.

In April 2020, the Corporation received approximately \$304.7 million in Medicare Accelerated and Advance payments as provided for in the CARES Act which allows eligible health care facilities to request up to six months of advance Medicare payments to ensure providers have the resources needed to combat COVID-19. The funds provided for under this program represents advances on payments for future goods or services provided to Medicare patients. Subsequent legislation amended the repayment methodology and repayment period for this program. As of December 31, 2020, the current and noncurrent portion of the Medicare Accelerated and Advance payment liability of approximately \$95.8 million and \$208.9 million is included in estimated third party payor settlements and other liabilities, respectively, on the consolidated statements of financial position based on the Centers for Medicare and Medicaid Services' current repayment terms for the program.

The CARES Act also allows for deferred payment of the employer portion of certain payroll taxes between March 27, 2020 and December 31, 2020 with 50% due December 31, 2021 and the remaining 50% due December 31, 2022. As of December 31, 2020, the Corporation had deferred payroll tax payments of approximately \$40.0 million outstanding with 50% included in accrued payroll and related expenses and the remaining 50% included in other liabilities on the consolidated statements of financial position.

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The Corporation is also considering other federal, state, and local sources of grants for qualifying expenses. Due to the evolving nature of the COVID-19 pandemic, the ultimate impact to the Corporation and its financial condition is presently unknown.

3. Patient Service Revenue

The Corporation provides health care services through various inpatient, outpatient, and ambulatory care settings. The Corporation recognizes patient service revenue at the amount that reflects the consideration to which it expects to be paid for providing such care. These amounts are due from patients, third-party payors (including health insurers and government programs) and others, and include variable consideration for retroactive adjustments due to settlement of audits and reviews by Medicare, and amounts received under various state Medicaid hospital assessment and disproportionate share programs. Generally, the Corporation bills patients and third-party payors several days after the services are performed and/or when a patient is discharged. Performance obligations are determined based on the nature of the services provided by the Corporation and patient service revenue is recognized as performance obligations are satisfied.

Patient service revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected or actual charges. Generally, performance obligations satisfied over time relate to patients in the Corporation's hospitals receiving inpatient acute care services. The performance obligation is measured from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Outpatient services are performance obligations generally satisfied at a point in time and revenue is recognized when goods or services are provided. The Corporation believes that this method provides a fair depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligations.

Because all of its performance obligations relate to contracts with a duration of less than one year, the Corporation has elected to apply the optional exemption provided in FASB ASU 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially satisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which typically occurs within days or weeks of the end of the Corporation's reporting period.

The Corporation determines the transaction price based on standard charges for goods and services provided to patients reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured and underinsured patients in accordance with the Corporation's policy, and/or implicit price concessions provided to uninsured and underinsured patients. The Corporation determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience. The Corporation determines its estimate of implicit price concessions based on the aging of its patient accounts receivable, historical collection experience with uninsured and underinsured patients, and other relevant factors.

Patients who meet the Corporation's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as patient service revenue as described in Note 2.

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

The Corporation has agreements with third-party payors that provide for payments at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare – Acute inpatient, outpatient, and home health services rendered to Medicare program beneficiaries are paid primarily at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain services are reimbursed at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediaries. Professional services rendered by physicians are paid based on the Medicare allowable fee schedule. One of the Corporation's Health Centers was granted Critical Access Status by Medicare and is paid based upon a cost plus reimbursement methodology with final settlement determined after submission of an annual cost report. In addition to these payment methodologies, Medicare has various mandatory and voluntary value based provider reimbursement programs.

Medicaid – Reimbursement for services rendered to Medicaid program beneficiaries includes prospectively determined rates per discharge, per diem payments, and fee schedules.

Certain of the Corporation's Health Centers qualify as State of Indiana Medicaid Acute Disproportionate Share and Medicaid Safety Net Hospitals ("DSH") under Indiana law (IC 12-15-16 (1-3)), and are eligible to receive DSH payments linked to the State's fiscal year, which differs from the Corporation's fiscal year. The amount of these additional DSH funds is dependent on regulatory approval by federal and state agencies and is determined by the level, extent, and cost of uncompensated care (as defined) and various other factors. The Corporation records such amounts as a component of revenue when payments are received or based upon data from the State of Indiana that payments are determinable and probable of receipt. For the years ended December 31, 2020 and 2019, the Corporation recognized revenue of approximately \$30.5 million and \$40.4 million, respectively, related to the DSH program in the consolidated statements of operations and changes in net assets.

The Corporation's Indiana Health Centers participate in the State of Indiana's Hospital Assessment Fee ("HAF") program. The HAF program is a supplemental reimbursement program designed to help providers offset a portion of the cost of providing care to Medicaid and indigent patients. The HAF program is funded by a combination of federal and state resources and fees levied on hospital providers. The fee is used in part to increase reimbursement to eligible hospitals for services provided in both Medicaid fee-for-service and Medicaid managed care programs, and to fund the State share of disproportionate share hospital payments. For the years ended December 31, 2020 and 2019, the Corporation's Indiana Health Centers recognized supplemental HAF reimbursement of \$101.9 million and \$108.2 million, respectively, which is recorded as a component of patient service revenue in the Corporation's consolidated statements of operations and changes in net assets. For the years ended December 31, 2020 and 2019, the Corporation's Indiana Health Centers recognized HAF fees of \$98.7 million and \$101.2 million, respectively, in the consolidated statement of operations and changes in net assets.

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The Corporation's Illinois Health Centers are obliged under Illinois Public Act 95-859 to participate in the State of Illinois Hospital Assessment Program ("HAP") that assists in financing the State's Medicaid Program. In 2018, the Illinois General Assembly enacted legislation to redesign the HAP to be implemented in four phases over six years consisting of two, two-year phases followed by two, one-year phases with completion in 2024. On June 30, 2020, phase one of the HAP ended. The Illinois General Assembly and the Centers for Medicare and Medicaid Services approved legislation for phase two of the HAP, which was signed by the Governor of Illinois having an effective date of July 1, 2020. For the years ended December 31, 2020 and 2019, the Corporation's Illinois Health Centers recognized supplemental HAP and related reimbursement of \$21.2 million and \$19.4 million, respectively, which is recorded as a component of patient service revenue in the Corporation's consolidated statements of operations and changes in net assets. For the years ended December 31, 2020 and 2019, the Corporation's Illinois Health Centers recognized HAP related fees of \$11.9 million and \$11.2 million, respectively, in the consolidated statement of operations and changes in net assets.

The State of Illinois' Medicaid program has operated with budget deficits. The deficits include the continued practice of deferring Illinois Medicaid bills to future periods and have led to the State of Illinois' slowdown in claims processing and payments. As of December 31, 2020 and 2019, the Corporation's patient accounts receivable included amounts due from Illinois Medicaid of approximately \$12.0 million and \$15.8 million, respectively, representing approximately 5.0 and 11.0 months, respectively, of outstanding claims. Management continues to value these patient accounts receivable using historical collection rates.

Other – Reimbursement for services to certain patients is received from commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for reimbursement includes prospectively determined rates per discharge, discounts from established charges, prospectively determined per diem rates, and fee schedules. Like Medicare, commercial insurance companies are entering into various fee-for-value reimbursement programs with qualifying providers. In 2020 and 2019, the Corporation participated in various commercial ACO reimbursement programs in which the Corporation receives a care management fee per ACO participant and the opportunity to receive limited gainsharing and incentives based upon its performance as compared to established quality and efficiency benchmarks.

The composition of patient service revenue by payor for the years ended December 31, 2020 and 2019, is as follows:

	2020	2019
	(in thousands)	
Medicare	\$ 586,526	\$ 663,765
Medicare managed care	300,031	255,144
Medicaid	167,742	160,576
Medicaid managed care	193,464	180,668
Other third-party payors	1,558,671	1,664,196
Self-pay	76,984	111,723
Other	23,837	24,398
	<u>\$ 2,907,255</u>	<u>\$ 3,060,470</u>

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The Corporation grants credit without collateral to its patients, most of who are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at December 31, 2020 and 2019, is as follows:

	2020	2019
	(in thousands)	
Medicare	\$ 52,530	\$ 54,194
Medicare managed care	39,635	28,922
Medicaid	31,390	32,438
Medicaid managed care	20,725	22,326
Other third-party payors	199,537	184,972
Self-pay	36,538	49,111
Other	23,159	16,427
	<u>\$ 403,514</u>	<u>\$ 388,390</u>

The Corporation's practice is to assign a patient to the primary payor and not reflect other uninsured balances (for example, copays and deductibles) as self-pay. Therefore the payors listed contain patient responsibility components, such as co-pays and deductibles.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory action including fines, penalties, and/or exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that recorded estimates may change in the near term. Patient service revenue increased (decreased) by approximately \$6.8 million and (\$2.6) million for the years ended December 31, 2020 and 2019, respectively, due to changes in estimates related to prior-year settlements with third party payors.

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4. Short-Term, Board Designated, and Other Investments

The composition of short-term, board designated, and other investments, at December 31, 2020 and 2019, is as follows:

	2020	2019
	(in thousands)	
Short-term investments	<u>\$ 402,478</u>	<u>\$ 153,981</u>
Board designated investments		
Funded depreciation and other Board projects	2,906,453	2,481,983
Other designated investments	<u>2,329</u>	<u>2,126</u>
	2,908,782	2,484,109
Assets limited as to use		
Estimated insurance liability funds	194,620	174,980
Assets under bond indenture and interest rate swap agreements	28,865	22,665
Other restricted investments	<u>42,071</u>	<u>39,510</u>
	<u>265,556</u>	<u>237,155</u>
Short-term, board designated, and other investments	<u>3,576,816</u>	<u>2,875,245</u>
Less short-term investments	<u>402,478</u>	<u>153,981</u>
Board designated and other investments, classified as noncurrent	<u>\$ 3,174,338</u>	<u>\$ 2,721,264</u>

Short-term, board designated, and other investments at December 31, 2020 and 2019, consist of the following:

	2020	2019
	(in thousands)	
Cash and cash equivalents	\$ 396,234	\$ 105,427
U.S. government, state, municipal, and agency obligations	294,508	285,411
Other fixed income securities	398,263	329,850
Equity securities	892,058	749,639
Asset backed securities	344,125	343,154
Index funds, exchange traded funds, and mutual funds	34,743	29,716
Unregistered mutual funds	581,696	368,890
Real estate investment trusts	7,563	2,674
Hedge funds	397,886	415,196
Private credit	12,910	13,540
Private equity	98,345	84,402
Real assets	<u>118,485</u>	<u>147,346</u>
	<u>\$ 3,576,816</u>	<u>\$ 2,875,245</u>

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The following tables present the fair value hierarchy of the valuation techniques utilized to determine the fair value of the Corporation's short-term, board designated, and other investments as of December 31, 2020 and 2019:

Asset category	Level 1	Level 2	Level 3	Balance
				as of December 31, 2020
				(in thousands)
Cash and cash equivalents	\$ 396,234	\$ -	\$ -	\$ 396,234
U.S. government, state, municipal, and agency obligations	276,682	17,826	-	294,508
Other fixed income securities	-	398,263	-	398,263
Equity securities	891,994	-	64	892,058
Asset backed securities	-	344,125	-	344,125
Index funds, exchange funds, and mutual funds	34,743	-	-	34,743
Real estate investment trusts	7,563	-	-	7,563
	<u>\$ 1,607,216</u>	<u>\$ 760,214</u>	<u>\$ 64</u>	2,367,494
Investments measured at net asset value				1,209,322
Total investments at fair value as of December 31, 2020				<u>\$ 3,576,816</u>

Asset category	Level 1	Level 2	Level 3	Balance
				as of December 31, 2019
				(in thousands)
Cash and cash equivalents	\$ 105,427	\$ -	\$ -	\$ 105,427
U.S. government, state, municipal, and agency obligations	260,077	25,334	-	285,411
Other fixed income securities	-	329,850	-	329,850
Equity securities	749,511	-	128	749,639
Asset backed securities	-	343,154	-	343,154
Index funds, exchange funds, and mutual funds	29,716	-	-	29,716
Real estate investment trusts	2,674	-	-	2,674
	<u>\$ 1,147,405</u>	<u>\$ 698,338</u>	<u>\$ 128</u>	1,845,871
Investments measured at net asset value				1,029,374
Total investments at fair value as of December 31, 2019				<u>\$ 2,875,245</u>

Certain investments categorized within Level 2 are not traded in active markets but are measured using pricing sources such as broker quotes or using models with externally verifiable inputs, such as relevant interest or exchange rates.

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The following table summarizes the Corporation's investments calculated on a NAV per share basis (or its equivalent), the unfunded commitments, and the associated redemption provisions at December 31, 2020:

	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
	(in thousands)			
Unregistered mutual funds	\$ 581,696	\$ -	Monthly	1 day
Hedge funds	397,886	-	Monthly, quarterly, annually	5 - 180 days
Private credit	12,910	3,573	Not currently redeemable	-
Private equity	98,345	129,211	Not currently redeemable	-
Real assets	118,485	9,101	Monthly, quarterly, not currently redeemable	45 days
	<u>\$ 1,209,322</u>	<u>\$ 141,885</u>		

Unregistered mutual funds include funds that primarily invest in domestic and international equities and short-term government, investment grade, high yield, and mortgage-related fixed income securities. The fair values of the investments in this class have been estimated using the NAV per share of the investments.

Hedge funds include investments in funds that utilize market movement, trends, and inconsistencies when selecting securities across a variety of markets. Certain hedge funds are usually less exposed to the overall market and are likely to include long equity positions hedged with short positions to cancel out short-term uncertainty. The fair values of the investments in this class have been estimated using the NAV per share of the investments.

Private credit includes investments that are secured by high quality assets or backed by a senior claim on stable cash flows. Investments in this asset class will be made opportunistically during periods of broad market or security specific distress. The fair values of the investments in this class have been estimated using the NAV of the Corporation's ownership interest in the partners' capital. Investments within these funds cannot be currently redeemed. After the expiration of the investment period, distributions from each fund will be received as the underlying investments of the funds are liquidated. It is estimated that the underlying assets of the funds will be liquidated over the next 1 to 2 years. However, the individual investments that will be sold have not yet been determined.

Private equity includes funds that invest globally using strategies that include leveraged buyouts, venture capital, growth capital, distressed investments, and mezzanine capital. The fair values of the investments in this class have been estimated using the NAV of the Corporation's ownership interest in the partners' capital. Investments within these funds cannot be currently redeemed. After the expiration of the investment period, distributions from each fund will be received as the underlying investments of the funds are liquidated. It is estimated that the underlying assets of the funds will be liquidated over the next 1 to 10 years. However, the individual investments that will be sold have not yet been determined.

Real assets include energy and energy-related investments and private real estate funds that invest in both U.S. and international commercial real estate. Energy and energy-related investment exposure mainly relate to oil and gas properties which include exploration, production, processing, servicing, or transportation of oil, natural gas, and other hydrocarbon fuels. Private real estate investment strategies include core, value-add, and opportunistic real estate which typically seek to earn a return over inflation. The fair values of the investments in this class have been estimated

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using the NAV of the Corporation's ownership interest in the partners' capital. Investments representing approximately 65% of the value of the investments in this class cannot be redeemed because the investments include redemption restrictions that range from 1 to 10 years after acquisition. After the expiration of the investment period, distributions from each fund will be received as the underlying investments of the funds are liquidated. It is estimated that the underlying assets of the funds will be liquidated over the next 1 to 5 years. However, the individual investments that will be sold have not yet been determined.

Investment returns including net unrealized gains included in the consolidated statements of operations and changes in net assets for the years ended December 31, 2020 and 2019, are as follows:

	2020	2019
	(in thousands)	
Revenues, gains, and other support		
Investment income in other operating revenue	\$ 5,003	\$ 5,176
Net unrealized investment gains	9,786	15,743
	<u>14,789</u>	<u>20,919</u>
Nonoperating income (expense)		
Investment income	39,126	109,943
Net unrealized investment gains	202,357	208,392
	<u>241,483</u>	<u>318,335</u>
Net assets with donor restrictions, controlling interest		
Investment income	578	827
Net unrealized investment gains	3,538	1,319
	<u>4,116</u>	<u>2,146</u>
	<u>\$ 260,388</u>	<u>\$ 341,400</u>

5. Property, Plant, and Equipment

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

	2020	2019
	(in thousands)	
Land and land improvements	\$ 176,600	\$ 173,376
Buildings and building equipment	1,652,003	1,850,386
Departmental equipment	1,863,651	1,665,626
Construction in progress	92,766	52,258
	<u>3,785,020</u>	<u>3,741,646</u>
Less accumulated depreciation	1,792,732	1,736,241
	<u>\$ 1,992,288</u>	<u>\$ 2,005,405</u>

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At December 31, 2020, the remaining contractual commitments on construction in progress is approximately \$38.5 million and will be financed by a combination of cash flow from operations and existing funds.

In 2020, the Corporation authorized the development of a replacement hospital for its Franciscan Health Crown Point facility and a demolition plan for certain portions of the current hospital campus. In January 2019, the Corporation relocated the majority of clinical operations at its Franciscan Health Michigan City campus to a newly constructed campus. These activities required a change in the estimated useful life of the campus assets resulting in the acceleration of depreciation for the years ended December 31, 2020 and 2019 of \$7.1 million and \$1.8 million, respectively.

6. Leases

Effective January 1, 2019, the Corporation adopted FASB ASU 2016-02, *Leases (Topic 842)*, using the optional transition implementation method, in which it did not have to adjust comparable prior period information and disclosures, and utilized the package of practical expedients made available under the standard which allowed the Corporation to carryforward the historical assessment of whether contracts are or contain leases, lease classification, and initial direct costs. As a result of adopting this standard on January 1, 2019, the Corporation recorded \$170.2 million of right of use leased assets and lease liabilities on its consolidated statements of financial position.

The Corporation has lease commitments for real estate as well as medical and office equipment. The lease term begins at the lease commencement date which is determined based on the noncancelable term of the lease. The Corporation's remaining operating lease terms range from 1 to 18 years, with the obligations ending December 31, 2038. The Corporation's remaining finance lease terms range from 1 to 6 years, with the obligations ending November 30, 2026. The finance lease agreements have standard lease payments that may include purchase options at the end of the agreements.

The following table summarizes the Corporation's leased assets and lease liabilities within the consolidated statements of financial position at December 31, 2020 and 2019:

	2020	2019
	(in thousands)	
Total leased assets		
Operating lease assets classified as right of use leased assets	\$ 148,827	\$ 152,736
Finance lease assets classified as property, plant, and equipment, net	31,615	23,006
	<u>\$ 180,442</u>	<u>\$ 175,742</u>
Total lease liabilities		
Operating lease liabilities	\$ 150,763	\$ 153,878
Finance lease liabilities	33,681	24,412
	<u>\$ 184,444</u>	<u>\$ 178,290</u>

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The components of lease expense are recorded as other expenses in the consolidated statements of operations and changes in net assets, excluding interest on finance lease liabilities which is recorded to interest expense. The components of lease expense included in the consolidated statements of operations and changes in net assets for the years ending December 31, 2020 and 2019 are as follows:

	2020	2019
	(in thousands)	
Operating lease expense	\$ 34,893	\$ 36,441
Short-term lease expense	1,326	973
Variable lease expense	18,340	18,184
Finance lease expense		
Depreciation of leased assets	4,764	4,167
Interest on lease liabilities	897	759
Total lease expense	<u>\$ 60,220</u>	<u>\$ 60,524</u>

At December 31, 2020, the minimum future lease payments under these leases are as follows:

	(in thousands)		
Years ended December 31,	Operating	Finance	Total
2021	31,459	7,096	\$ 38,555
2022	25,983	6,182	32,165
2023	22,746	5,609	28,355
2024	19,594	3,817	23,411
2025	17,245	3,546	20,791
Thereafter	46,856	9,685	56,541
Total lease payments	<u>\$ 163,883</u>	<u>\$ 35,935</u>	<u>\$ 199,818</u>
Less: imputed interest	<u>(13,120)</u>	<u>(2,254)</u>	<u>(15,374)</u>
Present value of minimum lease payments	<u>\$ 150,763</u>	<u>\$ 33,681</u>	<u>\$ 184,444</u>

Other information related to leases for the years ending December 31, 2020 and 2019, is as follows:

Weighted-average remaining lease term (in years):	2020	2019
Operating leases	8.07	8.10
Finance leases	7.19	7.37
Weighted-average discount rate:		
Operating leases	2.35%	2.59%
Finance leases	2.71%	3.35%

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7. Long-Term Debt

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

	Year of Final Maturity	Interest Rate Range over Life of Bonds	2020	2019
(in thousands)				
Tax Exempt Hospital and Health System Revenue and Refunding Bonds				
Fixed rate term and serial bonds				
Series 2008C	2022	5.0%	\$ 12,600	\$ 22,650
Series 2016A	2051	4.0%-5.0%	200,000	200,000
Series 2016B	2041	3.0%-5.0%	83,645	83,730
Series 2017B	2032	5.0%	148,135	148,135
Series 2017C	2039	3.0%-5.0%	188,580	191,140
Bond discounts and premiums, net			40,431	45,029
Fixed rate term and serial bonds			<u>\$ 673,391</u>	<u>\$ 690,684</u>
Series 2012A fixed rate direct placement bonds	2048		75,000	-
Total fixed rate term and serial bonds and direct placement bonds			<u>\$ 748,391</u>	<u>\$ 690,684</u>
		Interest Rate Range 2020	Interest Rate Range 2019	
Variable rate direct placement bonds				
Series 2012A	2048	0.47% - 1.77%	1.72% - 2.37%	\$ - \$ 75,000
Series 2014A	2048	0.60% - 1.91%	1.85% - 2.93%	50,000 50,000
Series 2016C	2041	0.76% - 1.91%	1.84% - 2.42%	71,055 72,920
Series 2016D	2041	0.69% - 1.84%	1.77% - 2.35%	70,950 72,810
Series 2016E	2048	0.70% - 1.91%	1.84% - 2.42%	63,895 63,895
Series 2017A	2048	0.65% - 2.21%	1.91% - 2.52%	45,250 45,250
Total variable rate direct placement bonds			<u>\$ 301,150</u>	<u>\$ 379,875</u>
Variable rate demand bonds, subject to seven-day or daily put provisions supported by direct pay bank letters of credit				
Series 2008F	2048	0.09% - 5.13%	1.04% - 2.32%	45,200 45,200
Series 2008I	2037	0.02% - 8.00%	0.85% - 2.30%	32,505 34,285
Series 2008J	2037	0.02% - 8.00%	0.85% - 2.30%	32,510 34,285
Total variable rate demand bonds			<u>\$ 110,215</u>	<u>\$ 113,770</u>
Other debt				
Finance lease obligations (excluding imputed interest of \$2,254 and \$2,818 at December 31, 2020 and 2019, respectively)			\$ 33,681	\$ 24,412
Deferred financing costs and other			(4,414)	(4,576)
Total long-term debt			1,189,023	1,204,165
Less current portion of long-term debt			(26,467)	(24,180)
Long-term debt, net of current portion			<u>\$ 1,162,556</u>	<u>\$ 1,179,985</u>

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At December 31, 2020, scheduled principal payments on long-term debt are as follows:

Years ended December 31	Fixed and Variable Rate Bonds	Finance Lease & Other Obligations (in thousands)	Total
2021	\$ 20,920	\$ 5,547	\$ 26,467
2022	21,835	5,800	27,635
2023	22,885	5,400	28,285
2024	23,955	3,745	27,700
2025	25,145	3,545	28,690
Thereafter	1,004,585	9,644	1,014,229
	<u>\$ 1,119,325</u>	<u>\$ 33,681</u>	<u>\$ 1,153,006</u>

Total interest costs incurred on the long-term debt less capitalized interest for the years ended December 31, 2020 and 2019 are as follows:

	2020	2019
	(in thousands)	
Interest costs incurred	\$ 30,513	\$ 36,900
Less capitalized interest	<u>509</u>	<u>787</u>
Interest expense included in operating income	<u>\$ 30,004</u>	<u>\$ 36,113</u>

Obligated Group and Designated Group Affiliates and Other Requirements - The Corporation has long-term debt outstanding under a Master Trust Indenture dated November 1, 1997, as amended and supplemented (“MTI”). The MTI permits the Corporation to issue obligations to finance certain activities. The Corporation and any future other members of the Obligated Group created under the MTI are jointly and severally liable with respect to the payment of each obligation issued under the MTI. In addition, the MTI provides that certain affiliates of the Corporation may be designated as Designated Group Affiliates from time to time and the Corporation covenants to cause each of its Designated Group Affiliates to pay, loan, or otherwise transfer to the Obligated Group such amounts necessary to pay the obligations issued under the MTI. The Designated Group Affiliates are not members of the Obligated Group and are not directly liable for payments on the obligations. The Corporation has granted a security interest in its unrestricted receivables for the benefit of the owners of the obligations. The MTI includes covenants which require the Corporation to maintain a minimum debt service coverage ratio of 1.10 and limit the Obligated Group’s and Designated Affiliates’ ability to encumber certain of their assets. As of December 31, 2020 and 2019, the Corporation was in compliance with the terms of the MTI and there were no other Obligated Group members nor any Designated Group Affiliates.

Fixed Rate Direct Placement Bonds – During 2020, the Corporation reissued its \$75 million Series 2012A variable rate direct placement bonds through an amendment with the associated credit provider. The Series 2012A fixed rate direct placement agreement expires October 2027.

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Variable Rate Direct Placement Bonds – Included in the Corporation's debt is approximately \$301.2 million of variable rate direct placement bonds. The Corporation has executed various variable rate direct placement agreements whereby the credit provider purchased these bonds for a predetermined period after which the agreement must be extended or the bonds must be remarketed or refinanced. Termination dates for these various variable rate direct placement agreements have expiration dates extending from October 2023 through October 2026.

Variable Rate Demand Bonds – Included in the Corporation's debt is approximately \$110.2 million of variable rate demand bonds. The Corporation has entered into irrevocable letters of credit with multiple financial institutions to secure bond repayment and interest obligations associated with its variable rate demand bonds. These liquidity facilities are available to the Corporation should the obligations be presented for purchase and not remarketed. There were no outstanding draws on the letters of credit as of December 31, 2020. Additionally, these facilities (if utilized) generally have repayment terms for bonds held by the letter of credit banks that amortize ratably over 3 to 5 years, depending on the facility used. Termination dates for the various liquidity facility agreements have expiration dates extending through October 2022.

8. Interest Rate Swap Contracts

The Corporation utilizes interest rate swaps to manage interest rate risk associated with its variable rate bonds. Cash payments on the interest rate swap contracts totaled \$10.0 million and \$6.8 million for the years ended December 31, 2020 and 2019, respectively. At December 31, 2020 and 2019, the interest rate swap contracts were in a liability position with a fair value of approximately \$79.4 million and \$65.4 million, respectively. The fair value of the Corporation's interest rate swap contracts are based on observable inputs, such as interest rates and credit risk spreads, that fall within Level 2 of the hierarchy of fair value inputs as described in Note 2. Certain of the Corporation's interest rate swap agreements include collateral funding requirements based on the market value of these contracts. At December 31, 2020 and 2019, the Corporation had posted \$28.9 million and \$22.7 million, respectively, to satisfy its collateral funding obligations on these contracts which are included in assets under bond indenture and interest rate swap agreements within board designated and other investments on the consolidated statements of financial position.

9. Retirement Benefits

Prior to 2014, the Corporation had various retirement programs in place due to acquisitions made over the years. Effective January 1, 2014, the Corporation amended its retirement program to have all employees (except for those from one of its Health Centers and its construction company) covered by one comprehensive retirement program that administers benefits under two different tracks. Under track A, future employer-provided retirement benefits are provided entirely through the defined benefit pension plan. Under track B, future employer-provided retirement benefits are provided through both the defined benefit pension plan and the defined contribution benefit plan. Effective September 1, 2015, the Corporation further amended its retirement program for all new employees so that employer-provided retirement benefits will be provided entirely through the defined contribution benefit program (track C).

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Noncontributory Defined Benefit Pension Plan – As discussed above, the Corporation has a qualified, noncontributory defined benefit pension plan covering eligible employees in retirement tracks A and B. The plan provides defined benefits based on years of service and final average salary. Because the qualified, non-contributory defined benefit pension plan has church plan status as defined in the Employee Retirement Income Security Act of 1974 (“ERISA”), funding in accordance with ERISA is not required. The Corporation’s funding policy for the qualified plan, which is reviewed annually and may be adjusted as needed, is to fund the normal service cost based on the accrued benefit liability for the plan’s year and amortize any under or over funding over a ten year period.

In 2020, the Corporation amended its defined benefit plan to no longer allow active participants to take their benefits as a lump sum when they terminate employment or retire which increased the plan’s projected benefit obligation by \$44.8 million. In 2019, the plan’s projected benefit obligation decreased by \$52.9 million related to lump sum distributions.

The Corporation’s measurement date for all pension calculations is December 31.

The change in projected benefit obligation, change in plan assets, and funded status of the Corporation’s pension plans as of December 31, 2020 and 2019, are as follows:

	2020	2019
	(in thousands)	
Change in benefit obligation		
Benefit obligation, beginning of year	\$ 1,783,274	\$ 1,513,451
Service cost	55,672	43,262
Interest cost	58,156	64,712
Plan amendments	44,800	-
Plan curtailment and termination	-	(2,257)
Actuarial loss	193,214	265,132
Expenses paid	(2,214)	(2,536)
Benefits paid from plan assets	<u>(79,127)</u>	<u>(98,490)</u>
Benefit obligation, end of year	<u>2,053,775</u>	<u>1,783,274</u>
Change in plan assets		
Fair value of plan assets, beginning of year	1,586,533	1,310,859
Actual return on plan assets	272,750	293,833
Employer contributions	79,793	82,867
Expenses paid	(2,214)	(2,536)
Benefits paid from plan assets	<u>(79,127)</u>	<u>(98,490)</u>
Fair value of plan assets, end of year	<u>1,857,735</u>	<u>1,586,533</u>
Funded status	<u>\$ (196,040)</u>	<u>\$ (196,741)</u>
Amounts recognized in the consolidated statements of financial position		
Noncurrent assets	\$ 1,012	\$ 173
Current liabilities	-	(371)
Noncurrent liabilities	<u>(197,052)</u>	<u>(196,543)</u>
Total amount recognized	<u>\$ (196,040)</u>	<u>\$ (196,741)</u>

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The amounts in net assets without donor restriction, including amounts arising during the year and amounts reclassified into net periodic benefit cost, are as follows:

	Net Gain (Loss)	Prior Service Cost (in thousands)	Total
December 31, 2018	\$ (401,930)	\$ 25,086	\$ (376,844)
Amounts reclassified into net periodic benefit cost	30,241	(4,767)	25,474
Amounts arising during the year	<u>(54,800)</u>	<u>-</u>	<u>(54,800)</u>
December 31, 2019	(426,489)	20,319	(406,170)
Amounts reclassified into net periodic benefit cost	29,596	(4,767)	24,829
Amounts arising during the year	<u>(22,228)</u>	<u>(44,800)</u>	<u>(67,028)</u>
December 31, 2020	<u>\$ (419,121)</u>	<u>\$ (29,248)</u>	<u>\$ (448,369)</u>

The following are estimated amounts to be amortized from net assets without donor restriction into net periodic pension cost in the next fiscal year. Unrecognized prior service cost/credit is amortized on a straight line basis over the average remaining service period of participants who are expected to receive a benefit and are active at the date of the plan amendment.

	(in thousands)
Unrecognized prior service cost	\$ (637)
Unrecognized loss	<u>(25,777)</u>
Total amount expected to be amortized from net assets in 2021	<u>\$ (26,414)</u>

The accumulated benefit obligation ("ABO") at December 31, 2020 and 2019 was \$1.90 billion and \$1.65 billion, respectively. The following information is provided for plans with an ABO in excess of plan assets at December 31, 2020 and 2019:

	2020	2019
	(in thousands)	
Projected benefit obligation	\$ 2,049,551	\$ 1,779,126
ABO	\$ 1,893,732	\$ 1,653,841
Fair value of plan assets	\$ 1,853,029	\$ 1,582,213

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Components of net periodic pension cost for the years ended December 31, 2020 and 2019 are as follows:

	2020	2019
	(in thousands)	
Service cost	\$ 55,672	\$ 43,262
Interest cost	58,156	64,712
Expected return on plan assets	(101,764)	(84,363)
Amortization of prior service cost	(4,767)	(4,767)
Amortization of net loss	29,596	30,241
Net periodic pension cost	<u>\$ 36,893</u>	<u>\$ 49,085</u>

The following weighted-average assumptions were used to determine the Corporation's benefit obligations and net periodic pension cost for the years ended December 31:

	2020	2019
Benefit obligation		
Discount rate	2.74 %	3.37 %
Rate of compensation increase	4.70 %	4.70 %
Net periodic pension cost		
Discount rate	3.37 %	4.43 %
Expected rate of return on plan assets	6.45 %	6.45 %
Rate of compensation increase	4.70 %	4.70 %

In developing the expected rate of return on plan assets assumption, the Corporation considered the historical returns and the expectation for future returns of each asset class, as well as the target asset allocation of the pension investment portfolio. The rate of return on plan assets assumption also considers investment and administrative expenses.

The discount rate assumption reflects the yield of a portfolio of high quality bonds matched against the timing and amount of projected future benefit payments as of the measurement date.

As of December 31, 2019, the Corporation adopted the Society of Actuaries Pri-2012 Mortality Table and MMP-2019 Mortality Improvement Projection Scale to update longevity expectations related to the pension plans.

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The Corporation's pension investment policy considers the long-term nature of the asset pool as well as the liabilities it is designated to fund. The pension investment policy utilizes a liability driven investment strategy to better hedge against interest rate risk on investments and volatility of the pension liability given changes in the discount rate. The Corporation considers the risk and return characteristics of the various asset classes available to institutional investors and seeks guidance from outside investment advisors. The Corporation has established the following targeted asset allocation that categorizes assets into de-risking assets (cash and liability-driven fixed income assets) and return seeking/growth assets (equity securities and multi-strategy hedge fund of funds) given different levels of the pension plans' funded status.

Pension Plan Funded Status	De-Risking Assets	Return Seeking/ Growth Assets
< 90%	45%	55%
90% - 95%	55%	45%
95% - 100%	65%	35%
100% - 105%	75%	25%
105% - 110%	80%	20%
110%+	85%	15%

For the years ended December 31, 2020 and 2019, the funded status of the Corporation's pension plans was 90% and 89%, respectively, when measured on a projected benefit obligation basis. For each level of funded status, the acceptable range of allocation among the de-risking and return seeking/growth assets, is plus or minus 10% around the strategic targets outlined above. The Corporation's asset allocation as of December 31, 2020 and 2019 was as follows:

	Percentage of Plan Assets	
	2020	2019
De-Risking Portfolio	54%	56%
Return Seeking/Growth Portfolio	46%	44%
	<u>100%</u>	<u>100%</u>

Assets are invested to achieve a rate of return consistent with the policy allocation targets which significantly contributes to meeting the current and future obligation of the plan and helps to ensure solvency of the plan over time. It is expected that this objective can be achieved through a well-diversified asset portfolio and an emphasis on long-term capital appreciation as a primary source of return. The plan utilizes a multi-manager structure of complementary investment styles and classes with manager performance judged over an investment market cycle which is generally 3 to 5 years. Plan assets are exposed to risk and fluctuations in market value from year to year. To minimize risk, each manager is required to maintain adequate portfolio diversification to insulate the plan assets from substantial loss in any single security or market sector. Asset allocation is reviewed every quarter and rebalanced as necessary.

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Cash Flows

During 2021, the Corporation anticipates making contributions of approximately \$34.6 million to fund the normal service cost in accordance with its standard funding policy. The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

	(in thousands)
2021	\$ 62,615
2022	68,042
2023	73,290
2024	78,586
2025	83,225
Years 2026-2030	476,897

The following tables summarize the Corporation's pension assets, measured at fair value as of December 31, 2020 and 2019, respectively.

Asset category	Level 1	Level 2 (in thousands)	Balance as of December 31, 2020
Cash and cash equivalents	\$ 40,604	\$ -	\$ 40,604
U.S. government, state, municipal, and agency obligations	212,193	51,957	264,150
Other fixed income securities	-	722,956	722,956
Equity securities	457,837	-	457,837
Real estate investment trusts	2,323	-	2,323
	<u>\$ 712,957</u>	<u>\$ 774,913</u>	<u>1,487,870</u>
Investments measured at net asset value			<u>369,865</u>
Total investments at fair value as of December 31, 2020			<u>\$ 1,857,735</u>

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Asset category	Level 1	Level 2 (in thousands)	Balance as of December 31, 2019
Cash and cash equivalents	\$ 34,012	\$ -	\$ 34,012
U.S. government, state, municipal, and agency obligations	175,772	52,698	228,470
Other fixed income securities	-	657,145	657,145
Equity securities	404,791	-	404,791
Real estate investment trusts	4,747	-	4,747
	<u>\$ 619,322</u>	<u>\$ 709,843</u>	<u>1,329,165</u>
Investments measured at net asset value			<u>257,368</u>
Total investments at fair value as of December 31, 2019			<u>\$ 1,586,533</u>

There were no significant transfers to or from Levels 1 and 2 during the years ended December 31, 2020 and 2019.

Defined Contribution Benefit Plans - The Corporation sponsors various defined contribution benefit plans covering eligible employees. These employees may contribute a portion of their pre-tax and/or after-tax compensation to the plans, in accordance with specified guidelines. In addition to any discretionary contributions, these plans provide for established contribution percentages up to certain limits for eligible employees. The defined contribution benefit plan expense for the years ended December 31, 2020 and 2019 aggregated \$32.5 million and \$31.5 million, respectively.

10. Liability Insurance and Contingencies

The Corporation has a comprehensive risk management and insurance program designed to safeguard its assets and properties. Hills Insurance Company, Inc. ("Hills Inc."), the wholly owned captive insurance subsidiary of the Corporation, provides certain professional and general liability coverage for the Health Centers and its other corporate entities. Hills has limited its exposure by purchasing reinsurance and excess insurance coverage. In the unlikely event that any of the excess insurance coverages fail, the Corporation would be liable for such defaults, however the Corporation purchases its excess insurance policies from highly rated insurance companies to mitigate that risk. In addition, the Corporation is self-insured for its employee health, long-term disability, and workers' compensation employee benefit programs. Excess workers compensation insurance is in place to limit self-insurance exposure. The Corporation maintains directors and officer's liability policies and property insurance.

The estimated insurance liabilities provide for reported losses and for losses incurred but not reported based on projections by independent actuaries using information provided by the Corporation's management. The estimated insurance liabilities, which consist of professional liability, general liability, long-term disability insurance, workers' compensation, and amounts self-insured for allocated loss adjustment expenses, approximated \$152.0 million and \$137.0 million on an undiscounted basis at December 31, 2020 and 2019, respectively.

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From time to time, the Corporation is subject to various legal proceedings and claims arising in the ordinary course of business. Although the outcome of these claims cannot be predicted with certainty, management believes the ultimate disposition of such matters will not have a material adverse effect on the Corporation's financial condition, results of operations, or cash flow.

Hospitals and health facilities, including those operated by the Corporation, are subject to numerous legal, regulatory, environmental, professional and private licensing, and certification and accreditation requirements. Also, the laws and regulations governing the Medicare, Medicaid, and other governmental health care programs that the Corporation participates in are extremely complex and subject to interpretation, making compliance an ongoing challenge for health care organizations. The federal government has ongoing enforcement activity, including audits and investigations related to billing practices, clinical documentation, and other related matters. Allegations concerning possible violations of regulations can result in the imposition of significant fines and penalties and significant repayment of billed and collected revenues for patient services. The Corporation maintains a compliance program designed to educate its employees and to prevent, detect, and correct possible violations.

In 2016, the Corporation was notified it was a defendant in a lawsuit filed in the U.S. District Court for the Northern District of Illinois and shortly thereafter was notified of a similar lawsuit filed in the U.S. District Court for the Northern District of Indiana with both actions consolidated for the U.S. District Court of Northern Indiana to review on behalf of the affected class of beneficiaries. The consolidated act challenged the Corporation's defined benefit pension plan's eligibility as a church plan and the associated exemption from ERISA. The class was never certified and the action was dismissed.

11. Noncontrolling Interest in Consolidated Affiliates and Investments in Unconsolidated Affiliates

The Corporation is involved in various health service entity joint ventures that support the Corporation's mission whose operations have been included in the consolidated financial statements.

Noncontrolling Interest in Consolidated Affiliates

The Corporation's consolidated financial statements include all assets, liabilities, revenues, and expenses of less than 100% owned entities that it controls. Accordingly, the Corporation has recorded the noncontrolling interest in the earnings and equities of such entities in its consolidated financial statements.

Investments in Unconsolidated Affiliates

The Corporation has investments in entities that are recorded under the equity method of accounting.

At December 31, 2020 and 2019, the Corporation had a 33%, economic interest in Alverno Clinical Laboratories, LLC ("ACL, LLC"), an Indiana limited liability company created to direct, operate, maintain, and manage a centralized clinical laboratory in Hammond, Indiana supporting the Corporation and an unrelated health care system. The Corporation is also an owner of Alverno Provena Hospital Laboratories, LLC ("APHL"), a non-profit cooperative corporation created to direct, operate, maintain, and manage the on-site laboratories of the owners' health centers. Governance of ACL, LLC and APHL (collectively referred to as the "Laboratories") is shared between the health system members. The Corporation accounts for its investment in ACL, LLC under the equity method, which approximated \$6.0 million at both December 31, 2020 and 2019.

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The Corporation's capital account in APHL approximates \$50,000 at both December 31, 2020 and 2019.

The Corporation's share of the equity in losses of investments in unconsolidated affiliates accounted for on the equity method is approximately (\$1.6) million and (\$4.5) million for the years ended December 31, 2020 and 2019, respectively, which is included in total revenues, gains, and other support in the consolidated statements of operations and changes in net assets.

The unaudited summarized financial position and results of operations for the entities accounted for under the equity method as of and for the periods ended December 31 is as follows:

	2020	2019
	(in thousands)	
Total assets	\$ 71,143	\$ 67,909
Total liabilities	43,508	35,731
Net assets	27,635	32,178
Total revenues, gains, and other support	313,783	308,708
Excess of revenues over expenses	255	675

12. Net Assets with Donor Restrictions

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

	2020	2019
	(in thousands)	
Capital needs and equipment	\$ 4,876	\$ 4,680
Medical education programs	9,688	8,656
Health care operations and patient services	23,583	21,700
Other restrictions - spiritual care and mission related activities	6,738	6,509
	<u>\$ 44,885</u>	<u>\$ 41,545</u>

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13. Liquidity and Availability

The following table represents the financial assets and liquidity resources available for general expenditures within one year as of December 31, 2020 and 2019. The Corporation defines general expenditures as the normal expenditures related to operations of the Corporation, excluding capital expenditures. The Corporation invests cash in excess of daily requirements needed to satisfy general expenditures in short-term investments and board designated and other investments. The Corporation has structured its financial assets to be available as its general expenditures, liabilities, and other obligations come due. Board designated investments represent investments set aside by board policy for future purposes including capital expenditures, acquisitions, improvements, mission programs, and, in addition, to provide for the Corporation to meet current liquidity needs.

	2020	2019
	(in thousands)	
Financial assets:		
Cash and cash equivalents	\$ 42,678	\$ 28,376
Short-term investments	402,478	153,981
Patient accounts receivable	403,514	388,390
Board designated and other investments	<u>3,174,338</u>	<u>2,721,264</u>
Total financial assets	4,023,008	3,292,011
Less amounts not available within one year or not designated for general expenditures:		
Estimated insurance liability funds	194,620	174,980
Assets under bond indenture and swap agreements	28,865	22,665
Other restricted investments	42,071	39,510
Private credit	12,910	13,540
Private equity	<u>98,345</u>	<u>84,402</u>
Total financial assets not available within one year	<u>376,811</u>	<u>335,097</u>
Financial assets and liquidity resources available for general expenditures within one year	<u>\$ 3,646,197</u>	<u>\$ 2,956,914</u>

The estimated insurance liability funds are set aside for the Corporation's captive insurance program and are not available for general expenditures. The Corporation's other restricted investments consist of foundation assets not available within one year or for general expenditures. Private credit and private equity investments are not available within one year due to the nature of those investments or contractual restrictions which prevent redemption of all or a portion of such funds.

14. Related Party Transactions

The Corporation's Health Centers incurred clinical laboratory charges from the Laboratories of approximately \$87.1 million and \$74.7 million for the years ended December 31, 2020 and 2019, respectively, which is included in purchased services in the consolidated statements of operations and changes in net assets. The Corporation provides information technology services, central procurement and disbursement services, and rents the core lab facilities to the Laboratories for which the Corporation has recorded approximately \$4.3 million and \$4.2 million for the years ended December 31, 2020 and 2019, respectively, as other operating revenue on the consolidated statements of operations and changes in net assets.

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15. Functional Expenses

The tables below present expenses by both their nature and function for the years ending December 31, 2020 and 2019:

	(in thousands)				
	Health Care Servicys	General and Administrative	Construction Company	Accountable Care Organizations	Total
Year ended December 31, 2020					
Salaries, benefits, and physician fees	\$ 1,382,398	\$ 307,339	\$ 22,065	\$ 13,740	\$ 1,725,542
Supplies, drugs, purchased services, and other	785,417	274,487	69,849	21,314	1,151,067
Hospital assessment fees	110,572	-	-	-	110,572
Depreciation and amortization	109,731	86,167	413	-	196,311
Interest	30,004	-	-	-	30,004
	<u>\$ 2,418,122</u>	<u>\$ 667,993</u>	<u>\$ 92,327</u>	<u>\$ 35,054</u>	<u>\$ 3,213,496</u>
Year ended December 31, 2019					
Salaries, benefits, and physician fees	\$ 1,338,010	\$ 328,071	\$ 7,598	\$ 19,817	\$ 1,693,496
Supplies, drugs, purchased services, and other	858,398	189,557	33,609	46,780	1,128,344
Hospital assessment fees	112,356	-	-	-	112,356
Depreciation and amortization	171,765	15,219	228	2	187,214
Interest	36,113	-	-	-	36,113
	<u>\$ 2,516,642</u>	<u>\$ 532,847</u>	<u>\$ 41,435</u>	<u>\$ 66,599</u>	<u>\$ 3,157,523</u>

The consolidated financial statements report certain categories of expenses that are attributable to more than one supporting function. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. These expenses are allocated on a variety of factors including hours worked and areas supported.

16. Subsequent Events

Management has evaluated events and transactions occurring subsequent to December 31, 2020 through April 20, 2021, the date the consolidated financial statements were issued. During this period, there were no subsequent events requiring recognition in the consolidated financial statements and no unrecognized subsequent events requiring disclosure.

