

CONSOLIDATED FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

Hawai'i Pacific Health
Years Ended June 30, 2022 and 2021
With Report of Independent Auditors

Ernst & Young LLP



Hawai'i Pacific Health
Consolidated Financial Statements and
Supplementary Information
Years Ended June 30, 2022 and 2021

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Report of Independent Auditors

The Board of Directors
Hawai'i Pacific Health

Opinion

We have audited the consolidated financial statements of Hawai'i Pacific Health, which comprise the consolidated balance sheets as of June 30, 2022 and 2021, and the related consolidated statements of income and changes in net assets, and cash flows for the years then ended and the related notes (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of Hawai'i Pacific Health at June 30, 2022 and 2021, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

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

Responsibilities of Management for the Financial Statements

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

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

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

Other Information

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

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

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying Members of the Hawai'i Pacific Health Obligated Group combined financial statements are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Ernst + Young LLP

November 3, 2022

Hawai'i Pacific Health
Consolidated Balance Sheets

	June 30	
	2022	2021
Assets		
Current assets:		
Cash and cash equivalents	\$ 294,306,954	\$ 302,839,877
Patient accounts receivable, net	181,985,645	167,313,202
Due from third-party payors	24,520,090	21,726,090
Other receivables	18,692,736	31,852,696
Inventories	22,740,916	23,375,231
Funds held by trustee under bond indenture agreement	15,903,482	15,705,900
Prepaid expenses and other	15,195,995	22,828,143
Total current assets	573,345,818	585,641,139
Assets whose use is limited or restricted:		
Board-designated	341,240,820	374,034,004
Restricted by donor or grantor	24,801,752	22,874,606
Total assets whose use is limited or restricted	366,042,572	396,908,610
Investments	438,923,753	473,582,097
Property and equipment, net	568,743,261	569,468,558
Right of use assets – operating	121,547,153	123,036,465
Right of use assets – finance	4,017,038	5,625,324
Prepaid pension	45,142,421	11,375,832
Investments in business ventures	16,678,655	17,872,751
Other	110,290,267	92,520,487
Total assets	\$ 2,244,730,938	\$ 2,276,031,263

	June 30	
	2022	2021
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 74,062,702	\$ 48,658,187
Payroll and related liabilities	102,692,020	121,724,318
Accrued expenses	36,538,459	37,002,484
Due to third-party payors	32,815,612	57,534,232
Current portion of long-term debt	9,793,344	9,485,002
Current portion of operating lease obligations	14,769,143	12,823,512
Current portion of finance lease obligations	1,570,521	1,614,612
Total current liabilities	<u>272,241,801</u>	<u>288,842,347</u>
Long-term debt, less current portion	408,307,279	418,100,623
Operating lease obligations, less current portion	118,385,741	121,810,973
Finance lease obligations, less current portion	2,639,661	4,210,183
Other long-term liabilities	107,293,171	121,419,632
Due to third-party payors	–	23,115,924
Net assets:		
Net assets without donor restrictions	1,240,419,700	1,223,712,289
Net assets with donor restrictions	95,443,585	74,819,292
Total net assets	<u>1,335,863,285</u>	<u>1,298,531,581</u>
Total liabilities and net assets	<u><u>\$ 2,244,730,938</u></u>	<u><u>\$ 2,276,031,263</u></u>

See accompanying notes.

Hawai'i Pacific Health

Consolidated Statements of Income and Changes in Net Assets

	Year Ended June 30	
	2022	2021
Revenues		
Net patient service revenue	\$ 1,441,662,625	\$ 1,293,284,989
Premium revenue	42,097,947	39,729,780
Other revenue	118,349,491	131,713,732
Net assets released from restrictions for operations	15,826,553	14,474,833
Total revenues	<u>1,617,936,616</u>	<u>1,479,203,334</u>
Expenses		
Salaries and employee benefits	876,869,478	842,477,582
Services	237,168,050	182,050,205
Supplies	243,503,859	217,463,313
Other purchases	112,436,182	89,917,051
Depreciation and amortization	55,309,368	54,630,277
Specific purpose projects/donations	15,826,553	14,474,833
Interest	19,375,033	19,629,760
Other	16,029,047	19,014,476
Total expenses	<u>1,576,517,570</u>	<u>1,439,657,497</u>
Operating income	41,419,046	39,545,837
Business venture investment income	3,467,082	5,757,831
Other non-operating (loss)	(2,490,798)	(798,971)
Investment (loss) income, net	(65,890,906)	159,332,684
Pension non-operating income	11,850,701	4,171,852
	<u>(53,063,921)</u>	<u>168,463,396</u>
(Deficiency) excess of revenues over expenses	(11,644,875)	208,009,233
Change in net unrealized (losses) on debt securities	(5,297,708)	(1,392,287)
Net assets released from restrictions for purchase of property and equipment	5,529,063	980,780
Pension related changes other than net periodic pension costs	14,981,543	56,910,554
Change in interest rate swap value	859,096	904,260
Other changes in net assets	12,280,292	(160,271)
Increase in net assets without donor restrictions	<u>16,707,411</u>	<u>265,252,269</u>

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Hawai'i Pacific Health

Consolidated Statements of Income and Changes in Net Assets (continued)

	Year Ended June 30	
	2022	2021
Net assets with donor restrictions		
Restricted grants and contributions	\$ 44,948,715	\$ 25,728,301
Investment (loss) income	(76,189)	2,749,632
Change in net unrealized (losses) gains on investments	(1,998,334)	1,623,120
Net assets released from restrictions	(21,355,616)	(15,455,613)
Change in beneficial interest in perpetual trusts	(892,155)	1,127,332
Other changes in net assets with donor restrictions	(2,128)	(61,677)
Increase in net assets with donor restrictions	<u>20,624,293</u>	<u>15,711,095</u>
Increase in net assets	37,331,704	280,963,364
Net assets at beginning of year	1,298,531,581	1,017,568,217
Net assets at end of year	<u><u>\$ 1,335,863,285</u></u>	<u><u>\$ 1,298,531,581</u></u>

See accompanying notes.

Hawai'i Pacific Health

Consolidated Statements of Cash Flows

	Year Ended June 30	
	2022	2021
Operating activities		
Increase in net assets	\$ 37,331,704	\$ 280,963,364
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	55,309,368	54,630,277
Business venture investment income	(3,467,082)	(5,757,831)
Net losses (gains) on alternative investments	35,734,421	(117,014,631)
Net unrealized losses (gains) on debt investments	7,296,042	(230,833)
Net realized gains on debt investments	(17,134,042)	(1,735,327)
Net losses (gains) on equity investments	52,766,166	(37,654,244)
Restricted contributions	(44,948,715)	(25,728,301)
Changes in operating assets and liabilities:		
Patient accounts receivable	(14,672,443)	(23,802,612)
Due to/from third-party payors	(50,628,545)	(14,693,373)
Other receivables	13,159,960	(7,924,899)
Inventories and other assets	(9,503,317)	(44,748,440)
Restricted pledges receivable	(1,397,734)	(10,559)
Prepaid pension	(33,766,589)	(63,199,408)
Accounts payable and accrued expenses	4,920,900	29,184,546
Other long-term liabilities	(14,126,461)	24,783,987
Net cash provided by operating activities	<u>16,873,633</u>	47,061,716
Investing activities		
Purchases of property and equipment	(51,978,784)	(44,677,884)
Net distributions from business venture partnerships	4,661,180	3,881,748
Purchases of investment securities	(145,612,796)	(112,066,809)
Sales and maturities of investment securities	135,299,900	108,501,678
Increase in funds held by trustee under bond indenture agreement	(197,582)	(66,241)
Assets whose use is limited or restricted:		
Purchases of investment securities	(94,247,143)	(68,599,076)
Sales and maturities of investment securities	92,819,568	65,258,222
Net cash used in investing activities	<u>(59,255,657)</u>	(47,768,362)

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Hawai'i Pacific Health

Consolidated Statements of Cash Flows (continued)

	Year Ended June 30	
	2022	2021
Financing activities		
Payment of long-term debt	\$ (9,485,002)	\$ (157,599,509)
Payments of finance lease obligations	(1,614,612)	(1,380,102)
Decrease in escrow funds held for bond defeasance	–	152,524,306
Liquidation of escrow funds held for bond defeasance	–	(152,524,306)
Restricted contributions	44,948,715	25,728,301
Net cash provided by (used in) financing activities	<u>33,849,101</u>	<u>(133,251,310)</u>
Decrease in cash and cash equivalents	(8,532,923)	(133,957,956)
Cash and cash equivalents at beginning of year	302,839,877	436,797,833
Cash and cash equivalents at end of year	<u>\$ 294,306,954</u>	<u>\$ 302,839,877</u>

See accompanying notes.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements

June 30, 2022

1. Organization and Summary of Accounting Policies

Hawai'i Pacific Health (HPH) is the sole member of Kapi'olani Medical Center for Women and Children (KMCWC), Pali Momi Medical Center (PMMC), Pali Momi Foundation, Kapi'olani Medical Specialists, Providers Insurance Corporation (PIC), Kapi'olani Health Foundation, Straub Clinic & Hospital (SCH), Straub Foundation, Wilcox Memorial Hospital (WMH), Kauai Medical Clinic, Wilcox Health Foundation, Hawai'i Pacific Health Partners, Inc. (HPHPI), Hawai'i Health Partners and other smaller health care-related entities (some of which are for-profit) located in Hawai'i. Effective January 1, 2020, management created the Hawai'i Pacific Health Medical Group, which consolidated the Company's clinical operation service lines into a centralized medical group. HPH and the above affiliates are collectively referred to as "the Company" and are consolidated in the accompanying consolidated financial statements. All inter-organizational transactions and balances have been eliminated in consolidation.

Except with regard to unrelated business income, which is taxed at corporate income tax rates, the Company's not-for-profit organizations are: (a) exempt from federal and state income taxes pursuant to Internal Revenue Code Section 501(a) and applicable state laws, and (b) generally exempt from Hawai'i general excise tax on revenue related to their tax-exempt purpose.

The taxable affiliates of the Company utilize the liability method of accounting for income taxes. Under this method, deferred income tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities and are measured using the currently enacted tax rates and laws. Valuation allowances are used to reduce deferred tax assets to their estimated net realizable values and are established by management when it is more likely than not that a deferred tax asset will not be realized.

The accounting principles followed by the Company and the methods of applying those principles comply with accounting principles generally accepted in the United States of America and general practice within the health care industry. The significant policies are summarized below.

Cash and Cash Equivalents

Cash and cash equivalents consist primarily of cash and highly liquid investments with a maturity of three months or less when purchased.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

Inventories

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

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, ranging from 2 to 75 years for buildings and improvements and 3 to 20 years for equipment.

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

Investments

Investments in equity securities with readily determinable fair values, and all investments in debt securities, are measured at fair value on the consolidated balance sheets. Fair value is established based on quoted prices from established securities exchanges or based on quoted market prices of similar instruments. The Company determined that all marketable securities held at June 30, 2022 and 2021 are designated as other than trading. The Company uses multiple investment managers to diversify its investment portfolio.

The Company also holds investments in fund of funds and direct funds, which include private equities and limited partnerships that are classified as alternative investments. These alternative investments seek positive returns regardless of market direction and are not restricted to any particular asset class. At the investment managers' direction, these alternative investments may invest in both registered and non-registered securities in the U.S. and globally, with exposure to both emerging and developed markets. The alternative investment fund managers employ a range of investment strategies including, but not limited to, long/short equity positions, derivatives, forward and futures contracts, and currency hedges.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

The Company accounts for its ownership interests in these alternative investments under the equity method of accounting based on the Company's shares held in the funds and the funds' net asset values. The net asset value is determined based on the estimated fair value of the underlying investments. However, the fair value of such investments may have been estimated by the alternative investment fund managers in the absence of readily ascertainable fair values. Due to the inherent uncertainty of these estimates, these values may differ from the values that would have been used had an active market for these investments existed. The investment income recorded is based on the Company's proportionate share of the fund's portfolio net asset value.

Investment income, including interest and dividends received, realized gains and losses on investments, unrealized gains and losses on equity securities, and net gains on alternative investments, is included in (deficiency) excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on debt securities, except for other-than-temporary declines in fair value, are excluded from the (deficiency) excess of revenue over expenses for the years ended June 30, 2022 and 2021.

The Company determines whether a decline in the fair market value of debt securities below the cost basis is other than temporary based on objective evidence, as well as subjective factors, including knowledge of recent events and assumptions of future events. If the decline in fair value is judged to be other than temporary, the cost basis of the individual security is written down to fair value. There were no other-than-temporary losses in 2022 or 2021.

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

Equity Method Investments

Investments in business ventures that are 20% to 50% owned or where the Company has the ability to exercise significant influence over the operating and financial activities of the business venture are recorded under the equity method of accounting, which approximates the Company's interest in the business ventures' underlying net book values. Investments in business ventures that are more than 50% owned and where the Company can exert control are consolidated in the accompanying consolidated financial statements.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

At June 30, investments in business ventures that are accounted for using the equity method of accounting include ownership in the following organizations:

	Ownership Percentage	
	2022	2021
Pacific ASC, LLC	50.00%	50.00%
Invision LLC	40.00	40.00
The Cancer Center of Hawaii, LLC	30.56	30.56
Pacific Medical Collections, Inc.	33.33	33.33

Summarized financial information (unaudited) for unconsolidated business ventures is as follows:

	June 30	
	2022	2021
Current assets	\$ 11,238,000	\$ 15,285,000
Non-current assets	20,032,000	22,488,000
Total assets	<u>\$ 31,270,000</u>	<u>\$ 37,773,000</u>
Current liabilities	\$ 3,720,000	\$ 4,651,000
Non-current liabilities	6,367,000	8,563,000
Capital	21,183,000	24,559,000
Total liabilities and capital	<u>\$ 31,270,000</u>	<u>\$ 37,773,000</u>
	Year Ended June 30	
	2022	2021
Excess of revenues over expenses	<u>\$ 9,555,000</u>	<u>\$ 14,595,000</u>

Board-Designated Assets

Board-designated assets consist of investments and accumulated income that have been designated by the Board of Directors for expansion and support of fundraising activities. The Board of Directors can redesignate these assets at its discretion.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

Contributions

Contributions received, including unconditional promises to give, are recognized as revenue at fair value in the period received. Fair value is measured as the present value of estimated cash flows using a discount rate commensurate with the risks involved. Pledges receivable are stated at their estimated net realizable value and are included in other receivables and assets whose use is limited or restricted – restricted by donor or grantor on the accompanying consolidated balance sheets.

The pledges receivable are as follows:

	June 30	
	2022	2021
Receivable in less than one year	\$ 7,309,794	\$ 4,992,440
Receivable in one to five years	3,895,200	4,325,233
Thereafter	570,000	1,090,000
	11,774,994	10,407,673
Less: present value discount	701,655	483,763
Less: allowance for uncollectible pledges	1,399,190	1,395,347
	\$ 9,674,149	\$ 8,528,563

Net Assets With Donor Restrictions

Net assets with donor restrictions are used to differentiate resources, the use of which is restricted by donors or grantors to a specific time period or purpose, from resources on which no restrictions have been placed or that arise from the general operations of the Company. Donor-restricted gifts are recorded as an addition to net assets with donor restrictions in the period received. When the time period or purpose is met, the gifts are released into unrestricted net assets. Donor-restricted gifts include amounts held in perpetuity or for terms designated by donors. Earnings on donor-endowment gifts are recorded as investment income in net assets with donor restrictions and subsequently used in accordance with the donor's designation. Net assets with donor restrictions are primarily restricted for health and hospital care, plant expansion and equipment replacement and research and grants.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

Net Patient Service Revenue and Patient Accounts Receivable

Net patient accounts receivable and net patient service revenue have been adjusted to the estimated amounts expected to be received based on contractual rates for services rendered, inclusive of the estimated price concessions and retroactive adjustments. The Company has entered into agreements with third-party payors, including government programs and managed care health plans, under which the facilities are paid based upon established charges, the cost of providing services, predetermined rates per diagnosis, fixed per diem rates or discounts from established charges.

The Company uses a portfolio approach to estimate the transaction price used to record net patient service revenue. The transaction price reflects the amount of consideration the Company expects to collect in exchange for satisfying its service performance obligations. The portfolios consist of various payor classes and patient types for inpatient and outpatient revenue, including the identification of uninsured, under-insured and patient coinsurance and deductible as a separate portfolio. Based on historical collection trends and other analyses, the Company 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 transaction price, which involves significant estimates, is determined based on the Company's established charges, with a reduction recorded for price concessions. The Company estimates the transaction price associated with services provided to patients who have third-party payor coverage based on the reimbursement terms outlined in contractual agreements and historical experience and includes estimated retroactive revenue adjustments under the agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as final settlements are determined. For uninsured and under-insured patients who do not qualify for charity care, the Company determines the transaction price associated with services on the basis of charges reduced by implicit price concessions. Implicit price concessions included in the estimate of the transaction price are based on the Company's historical collection experience, changes in collection patterns, composition of patient accounts by patient type and general economic condition. Management regularly reviews payment data for each major payor in evaluating the sufficiency of the estimated allowance for price concessions.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

Net patient service revenue is recognized as performance obligations are satisfied. Inpatient service performance obligations are satisfied over time and revenue is recognized based on actual charges incurred in relation to total expected or actual charges. Unsatisfied or partially satisfied performance obligations for inpatient services primarily relate to patients in-house at the end of each reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period. Outpatient services are performance obligations satisfied over a period of time, which is often less than one day, and revenue is recognized when services are provided.

Net patient service revenue, by significant payor classification, is as follows:

	Year Ended June 30	
	2022	2021
Medicare	\$ 397,099,920	\$ 364,577,027
Medicaid/QUEST integration	306,081,981	259,372,692
Commercial	661,506,824	608,406,748
Self-pay and other	76,973,900	60,928,522
	\$ 1,441,662,625	\$ 1,293,284,989

Significant concentrations of patient accounts receivable include Hawaii Medical Service Association 26% and 27%, Medicaid and QUEST Integration programs 26% and 25%, and Medicare and Medicare Advantage 29% and 29% as of June 30, 2022 and 2021, respectively.

Government Reimbursement Programs

The Company renders service to patients under contractual arrangements with the Medicare and Medicaid programs. The Medicare program includes the traditional Medicare fee for service and Medicare managed care plans. Medicare hospital reimbursement for hospital inpatient and outpatient services are based on the Medicare prospective payment systems, fee schedules and cost reimbursement methods. A portion of the Company's Medicare reimbursement, primarily disproportionate share, medical education and bad debt, are paid during the year at an interim rate. Final settlement is determined after annual cost reports submitted by the Company are audited by the Medicare contractors. Differences between final cost report settlements and amounts accrued

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

in previous years, due to audit adjustments recorded by the Medicare contractor, are reported as current year changes to net patient service revenue. The Company has the ability to appeal the adjustments based on a process established by Medicare.

The state of Hawai'i administers its QUEST Integration Medicaid program through participating Medicaid managed care health plans under a Section 1115 waiver. The Medicaid managed care plans provide access to health care services to Medicaid eligible members. The Company contracts with the Medicaid managed care health plans to provide health care services under negotiated reimbursement rates and methodologies, which include per diem, per discharge, fee schedules, percentage of charge and capitation. Newly eligible Medicaid beneficiaries receive health care services under the traditional Medicaid program based on Hawai'i Administrative Rules pending assignment to a Medicaid managed care health plan.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigation involving allegations of potential wrongdoing that would have a material impact on the consolidated financial statements. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs.

The state of Hawai'i uses a provider fee to help finance the state's share of Medicaid expenditures. The Hospital Sustainability Program Act (HSPA) was amended in federal fiscal year 2017 to make payments to private hospitals through three payment types: (1) additional access payments based on increased rates received through Medicaid Managed Care Plans, (2) additional payments received under the state of Hawai'i pay-for-performance program, incentivizing quality care measured on a calendar year basis, and (3) additional payments made for Medicaid disproportionate share hospital portions of payments as compared to levels of uncompensated care measured on a federal fiscal year basis.

For the years ended June 30, 2022 and 2021, the Company recorded approximately \$43,157,000 and \$40,732,000, respectively, in net patient service revenues related to HSPA payments and \$20,853,000 and \$19,547,000, respectively, in other purchases related to provider tax payments.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

The Company recorded a change in estimate, for the years ended June 30, 2022 and 2021, of approximately \$12,125,000 and \$4,162,000, respectively, as an increase in net patient service revenues relating to the HSPA monies received during 2022, relating to prior year program revenues. The change was due to updated uncompensated care cost data received in the current year that supported an increase in Medicaid disproportionate share hospital payments.

Charity Care

The Company will treat patients regardless of their ability to pay. An established charity care policy sets guidelines to determine which patients qualify for care given at no charge. Since the Company does not pursue collection from qualified charity care patients, related charges are not reported as revenue. Charity care cost provided in both 2022 and 2021 was less than 1% of total net patient service revenue, as measured by applying the cost to gross charges ratio to gross uncompensated charges associated with providing charity care to patients.

Collective Bargaining Agreements (Unaudited)

The Company has several collective bargaining agreements covering approximately 35% of its labor force. As of June 30, 2022, four collective bargaining agreements with three unions, or approximately 7% of the Company's labor force, will expire within one year.

Deferred Financing Costs

Costs incurred in obtaining long-term financing, reported within long-term debt, are deferred and amortized over the terms of the related obligations using the effective-interest method.

Impairment of Long-Lived Assets

The Company reviews long-lived assets for circumstances which could indicate that carrying values may not be recoverable. Management determined that no long-lived assets were impaired as of or during the fiscal years ended June 30, 2022 or 2021.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

(Deficiency) Excess of Revenues Over Expenses

The consolidated financial statements of income and changes in net assets include the (deficiency) excess of revenues over expenses. Changes in net assets without donor restrictions, which are excluded from the (deficiency) excess of revenues over expenses, include changes in unrealized (losses) on debt securities, net assets released from restriction for purchase of property and equipment, pension related changes other than net periodic pension costs, change in interest rate swap value, and other changes in net assets.

COVID-19 Pandemic

In March 2020, the World Health Organization officially declared the novel coronavirus (COVID-19) a global pandemic. The pandemic has disrupted the normal operations of many businesses and organizations, including the Company. This pandemic resulted in significant stock volatility, temporary business closures and event cancellations, supply chain disruptions and deferral of elective medical procedures and other non-urgent treatment, which have adversely affected the Company. While the Company has experienced some operational and financial recovery since the initial declaration, it is not possible for the Company to reasonably predict the duration of the disruption or the complete magnitude on operations or financial condition at this time.

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act (CARES Act) was passed into law to address the widespread economic fallout resulting from the COVID-19 pandemic. The CARES Act allocated funds to be used for healthcare related expenses or lost revenues attributable to COVID-19. The Company received allocated payments of approximately \$55,600,000 and \$71,700,000 for the years ended June 30, 2022 and 2021, respectively, and has attested to compliance with the funds' terms and conditions. Accordingly, the Company recognized these funds within other revenues on the consolidated statements of income and changes in net assets for the years ended June 30, 2022 and 2021. The Company will continue to monitor the terms and conditions of the CARES Act funding and impact of the pandemic on revenues and expenses.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

In order to increase cash flow to providers impacted by COVID-19, the Company received advance payments under the Medicare Accelerated and Advance Payment Program of approximately \$81,877,000 in April 2020. These advances are eligible to be recouped through offsetting claims commencing April 2021 through September 2022, at which time any unpaid amounts are subject to interest of 4%. Unpaid advances of \$24,737,000 is recorded within current due to third-party payor balances, as of June 30, 2022 and \$51,256,000 and \$23,116,000 are recorded within current and non-current due to third-party payor balances, respectively, as of June 30, 2021. In October 2022, the Company repaid the Medicare Advance Payment in full.

Subsequent Events

Subsequent events have been evaluated through November 3, 2022, the date these consolidated financial statements were issued.

On August 8, 2022, Honolulu Imaging Center (a wholly-owned entity of HPHPI) entered into an agreement to acquire a 100% interest in InVision, LLC and Avanti Imaging, LLC dba InSight Imaging for \$9,000,000 and \$15,500,000, respectively. As part of these business acquisitions, a 9% ownership interest in Honolulu Imaging Center was sold to a third party for \$3,900,000. These transactions are considered to be business acquisitions. Management is currently evaluating the purchase accounting allocation relating to these acquisitions.

In August 2022, the Company entered into a commitment to issue \$205,675,000 of direct purchase forward delivery bonds in November 2023. The proceeds from the Series 2023C Bonds will be used to finance early phase costs of the Straub redevelopment project. The forward delivery bond allows the Company to lock in long-term fixed rates in advance of the November 2023 bond delivery date.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes and supplementary information. Actual results could differ from those estimates.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Accounting Policies (continued)

New Accounting Standard

In June 2016, the Financial Accounting Standards Board issued a new accounting standard, *Financial Instruments – Credit Losses*, which requires the use of an “expected loss” model on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The expected loss model requires consideration of a broader range of reasonable and supportable information to calculate credit loss estimates. This accounting standard is effective for fiscal years beginning after December 15, 2022, with early adoption permitted. Management is currently evaluating the impact of adopting this standard.

2. Liquidity and Availability

Financial assets available for general expenditures within one year of the consolidated balance sheet date are comprised of the following:

	June 30	
	2022	2021
Cash and cash equivalents	\$ 294,306,954	\$ 302,839,877
Patient accounts receivable, net	181,985,645	167,313,202
Board-designated investments	120,260,235	140,210,649
Unrestricted investments	377,394,414	412,528,468
Financial assets available to meet general expenditures within one year	<u>\$ 973,947,248</u>	<u>\$ 1,022,892,196</u>

The Company has certain board-designated assets limited to use that are available for general expenditure within one year in the normal course of operations. Accordingly, these assets have been included in the qualitative information above.

As part of the Company's liquidity management plan, a \$75,000,000 line of credit is maintained, as discussed in more detail in Note 8.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

3. Fair Value

The Company's investments are recorded at fair value based on an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the fair value measurement accounting standard establishes a three-tier fair value hierarchy and prioritizes the inputs used in measuring fair value as follows:

Level 1 – Pricing inputs are based on quoted prices, unadjusted, for identical assets or liabilities in active markets.

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

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

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

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

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

3. Fair Value (continued)

As of June 30, 2022 and 2021, the Company's alternative investments, amounting to approximately \$432,144,000 and \$472,522,000, respectively, are accounted for using the equity method of accounting and are recorded within assets whose use is limited or restricted and investments within the consolidated balance sheets. Since alternative investments are accounted for using the equity method of accounting, which is not a fair value measurement, they are omitted from the following tables.

The Company has unfunded capital commitments under alternative investment private equity funds totaling approximately \$24,313,000 as of June 30, 2022. Capital commitments are determined by fund managers and the unfunded capital commitments can be funded through May 2026.

As of June 30, 2022 and 2021, the Company's investments in cash surrender values of life insurance policies amounting to approximately \$19,496,000 and \$21,573,000, respectively, are omitted from the following table as they are accounted for as life insurance contracts and are recorded within investments on the consolidated balance sheets.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

3. Fair Value (continued)

The tables below present the Company's fair value measurements on a recurring basis as of June 30:

Description	2022				Valuation Technique
	Total	Level 1	Level 2	Level 3	
Board-designated investments:					
Money market funds	\$ 16,335,016	\$ 16,335,016	\$ -	\$ -	a
Equity securities mutual funds	95,956,739	95,956,739	-	-	a
Debt securities:					
U.S. Treasury obligations	8,319,127	8,319,127	-	-	a
Asset backed securities	4,307,077	-	4,307,077	-	a
Corporate and municipal bonds	9,215,155	-	9,215,155	-	a
Foreign bonds	166,152	-	166,152	-	a
Funds held by trustee under bond indenture agreement:					
Money market funds	15,903,482	15,903,482	-	-	a
Investments restricted by donor or grantor:					
Equity securities mutual funds	2,699,022	2,699,022	-	-	a
Debt securities:					
Asset-backed securities	93,722	-	93,722	-	a
Corporate bonds	379,055	-	379,055	-	a
Foreign bonds	8,640	-	8,640	-	a
U.S. Treasury obligations	305,796	305,796	-	-	a
Charitable remainder trust assets	66,865	-	66,865	-	a
Certificate of deposit	600,000	-	600,000	-	a
Money market funds	355,451	355,451	-	-	a
Beneficial interest in perpetual trusts	4,627,155	-	-	4,627,155	c
Unrestricted investments:					
Money market funds	20,319,765	20,319,765	-	-	a
Equity securities mutual funds	127,898,938	127,898,938	-	-	a
Global equity common stocks	89,035	89,035	-	-	a
Debt securities:					
U.S. Treasury obligations	26,717,824	26,717,824	-	-	a
Asset-backed securities	5,357,742	-	5,357,742	-	a
Corporate bonds	15,818,373	-	15,818,373	-	a
Foreign bonds	225,004	-	225,004	-	a
Deferred compensation plan assets:					
Cash	1,392,181	1,392,181	-	-	a
Money market funds	581,642	581,642	-	-	a
Mutual funds	28,256,327	28,256,327	-	-	a
Equity securities	5,075,018	5,075,018	-	-	a
Indexed option	497,243	-	-	497,243	a
Collective investment trusts	3,259,288	-	3,259,288	-	a
Total investments at fair value	<u>\$ 394,826,834</u>	<u>\$ 350,205,363</u>	<u>\$ 39,497,073</u>	<u>\$ 5,124,398</u>	
Funds held by trustee under bond indenture agreement	\$ 15,903,482				
Assets whose use is limited or restricted	366,042,572				
Investments	438,923,753				
Deferred compensation plan assets – within other assets	39,061,699				
Less alternative investments	(432,144,304)				
Less cash surrender value of life insurance policies	(19,495,991)				
Less cost method investment	(2,000,000)				
Less restricted pledge receivables, net	(7,284,012)				
Less cash and cash equivalents	(4,180,365)				
Total investments at fair value	<u>\$ 394,826,834</u>				

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

3. Fair Value (continued)

Description	2021				Valuation Technique
	Total	Level 1	Level 2	Level 3	
Board-designated investments:					
Money market funds	\$ 7,457,023	\$ 7,457,023	\$ –	\$ –	a
Equity securities mutual funds	120,238,547	120,238,547	–	–	a
Debt securities:					
U.S. Treasury obligations	5,990,163	5,990,163	–	–	a
Asset backed securities	4,047,932	–	4,047,932	–	a
Corporate and municipal bonds	8,696,215	–	8,696,215	–	a
Foreign bonds	416,611	–	416,611	–	a
Funds held by trustee under bond indenture agreement:					
Money market funds	15,705,900	15,705,900	–	–	a
Investments restricted by donor or grantor:					
Equity securities mutual funds	3,032,085	3,032,085	–	–	a
Debt securities:					
Asset-backed securities	80,438	–	80,438	–	a
Corporate bonds	339,498	–	339,498	–	a
Foreign bonds	14,228	–	14,228	–	a
U.S. Treasury obligations	231,973	231,973	–	–	a
Charitable remainder trust assets	77,132	–	77,132	–	a
Certificate of deposit	600,000	–	600,000	–	a
Money market funds	148,181	148,181	–	–	a
Beneficial interest in perpetual trusts	5,519,309	–	–	5,519,309	c
Unrestricted investments:					
Money market funds	9,614,547	9,614,547	–	–	a
Equity securities mutual funds	154,240,473	154,240,473	–	–	a
Global equity common stocks	187,869	187,869	–	–	a
Debt securities:					
U.S. Treasury obligations	18,579,504	18,579,504	–	–	a
Asset-backed securities	5,031,135	–	5,031,135	–	a
U.S. commercial paper	6,673,305	–	6,673,305	–	a
Corporate bonds	13,999,166	–	13,999,166	–	a
Foreign bonds	545,734	–	545,734	–	a
Deferred compensation plan assets:					
Cash	793,696	793,696	–	–	a
Money market funds	486,274	486,274	–	–	a
Mutual funds	30,300,881	30,300,881	–	–	a
Equity securities	3,633,879	3,633,879	–	–	a
Indexed option	426,238	–	–	426,238	a
Collective investment trusts	3,510,602	–	3,510,602	–	a
Total investments at fair value	<u>\$ 420,618,538</u>	<u>\$ 370,640,995</u>	<u>\$ 44,031,996</u>	<u>\$ 5,945,547</u>	
Funds held by trustee under bond indenture agreement	\$ 15,705,900				
Assets whose use is limited or restricted	396,908,610				
Investments	473,582,097				
Deferred compensation plan assets – within other assets	39,151,570				
Less alternative investments	(472,522,224)				
Less cash surrender value of life insurance policies	(21,572,605)				
Less cost method investment	(2,000,000)				
Less restricted pledge receivables, net	(5,886,278)				
Less cash and cash equivalents	(2,748,532)				
Total investments at fair value	<u>\$ 420,618,538</u>				

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

3. Fair Value (continued)

The Company received restricted pledges and contributions amounting to approximately \$44,949,000 and \$25,728,000 in 2022 and 2021, respectively, which are recorded within net assets with donor restrictions – restricted grants and contributions on the consolidated financial statements of income and changes in net assets. These restricted pledges are subject to fair value measurement upon initial receipt using discounted cash flow projections. Pledges receivable, net of the present value discount, using discount rates from 0.16% to 3.09%, and allowance for uncollectible pledges were approximately \$9,674,000 and \$8,529,000 as of June 30, 2022 and 2021, respectively.

4. Property and Equipment

Property and equipment are summarized as follows:

	June 30	
	2022	2021
Land and land improvements	\$ 45,876,748	\$ 46,030,598
Buildings and improvements	779,923,186	754,647,222
Equipment	434,843,615	442,807,819
Construction in progress	43,373,317	32,845,609
	1,304,016,866	1,276,331,248
Less: amortization and accumulated depreciation	735,273,605	706,862,690
Property and equipment, net	\$ 568,743,261	\$ 569,468,558

In 2022, the Company wrote off fully depreciated buildings, improvements and equipment with cost and accumulated depreciation totaling approximately \$36,867,000.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

5. Other Assets

Other assets are summarized as follows:

	June 30	
	2022	2021
Deferred compensation plan assets	\$ 39,061,699	\$ 39,151,570
Reinsurance receivable	23,841,358	25,649,633
Goodwill	37,696,133	16,873,142
Other	9,691,077	10,846,142
Total other assets	<u>\$ 110,290,267</u>	<u>\$ 92,520,487</u>

6. Other Long-Term Liabilities

Other long-term liabilities are summarized as follows:

	June 30	
	2022	2021
Deferred compensation liability	\$ 37,240,747	\$ 35,561,721
Long-term malpractice reserves	27,596,707	30,402,434
Reinsurance obligations	23,841,358	25,649,633
Other	18,614,359	29,805,844
Total other long-term liabilities	<u>\$ 107,293,171</u>	<u>\$ 121,419,632</u>

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

7. Employee Benefit Plans

Eligible employees of the Company are covered under the Hawai'i Pacific Health Retirement Plan (the Plan), a non-contributory defined benefit pension plan. Benefits are based on years of service and a percentage of the employee's compensation. The Company's policy is to accrue actuarially determined net periodic pension costs and to annually contribute an amount within regulatory guidelines. Active eligible participant accounts receive a cash balance credit, ranging from 3.0% to 6.5% of eligible compensation based on the participant's age and years of service.

The Company recorded an actuarial gain of \$110,954,000 in 2022 as a result of a change in the discount rate from 2.90% as of June 30, 2021 to 4.78% as of June 30, 2022. The change in the discount rate related to the change in yields of high-quality corporate bonds. Additionally, the actual return on plan assets resulted in a loss of \$73,460,000 in 2022 which was primarily driven by market performance.

As part of an ongoing de-risking strategy, the Plan executed a non-cancellable group annuity purchase with a third-party in April 2021, whereby all future benefit payments to certain retirees are assumed by the third-party. Approximately 292 retirees in pay status were legally transferred to the third-party in April 2021 for a premium of \$17,316,000. Accordingly, the projected benefit obligation, as of June 30, 2021, was reduced by an actuarially determined amount consistent with the premium paid.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

7. Employee Benefit Plans (continued)

The following is a summary of the changes in the projected benefit obligation and the fair value of plan assets for the fiscal years ended June 30, and the accumulated benefit obligation at June 30:

	Year Ended June 30	
	2022	2021
Projected benefit obligation		
Benefit obligation, at beginning of year	\$ 502,853,393	\$ 509,258,276
Service cost	22,939,394	21,850,219
Interest cost	10,787,811	10,240,076
Actuarial (gain) loss	(110,953,795)	2,215,662
Annuity purchase	–	(17,316,000)
Benefits paid	(40,092,902)	(23,394,840)
Benefit obligation at end of year	385,533,901	502,853,393
Fair value of plan assets		
Fair value of plan assets, at beginning of year	514,229,225	457,434,700
Contributions	30,000,000	24,000,000
Actual return on plan assets	(73,460,001)	73,505,365
Annuity purchase	–	(17,316,000)
Benefits paid	(40,092,902)	(23,394,840)
Fair value of plan assets at end of year	430,676,322	514,229,225
Prepaid pension, end of year	\$ 45,142,421	\$ 11,375,832
	Year Ended June 30	
	2022	2021
Unrecognized net actuarial loss	\$ 187,670,915	\$ 209,934,377
Unrecognized prior service credit	(49,559,857)	(56,968,037)
Accumulated other comprehensive loss	\$ 138,111,058	\$ 152,966,340

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

7. Employee Benefit Plans (continued)

The overfunded status of the Plan of approximately \$45,142,000 and \$11,376,000 at June 30, 2022 and 2021, respectively, is recognized on the accompanying consolidated balance sheets as prepaid pension. No plan assets are expected to be returned to the Company during the year ending June 30, 2023.

Components of Net Periodic Benefit Cost

	Year Ended June 30	
	2022	2021
Service cost	\$ 22,939,394	\$ 21,850,219
Interest cost	10,787,811	10,240,076
Expected return on plan assets	(27,240,031)	(23,981,452)
Recognized prior service credit	(7,408,180)	(7,408,180)
Recognized net loss	12,009,699	16,977,704
Net periodic benefit cost	\$ 11,088,693	\$ 17,678,367

Weighted-Average Assumptions Used to Determine Benefit Obligations

	June 30	
	2022	2021
Discount rate	4.78%	2.90%

Weighted-Average Assumptions Used to Determine Net Periodic Benefit Cost

	Year Ended June 30	
	2022	2021
Discount rate	2.90%	2.83%
Expected return on plan assets	5.25	5.25
Rate of compensation increase	3.50	3.50

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

7. Employee Benefit Plans (continued)

Asset Allocations

The assets of the Plan are held by the plan trustee in the HPH combined pension fund. Oversight of the combined pension fund assets is provided by the HPH Investment Advisory Group and the HPH Finance Committee of the Board of Directors. The long-term financial objectives of the combined pension fund are to comply with regulatory funding requirements and balance liquidity needs to meet benefit and expense obligations when due with long-term investment return goals to satisfy future plan obligations.

The long-term investment objective is to earn an average real return of 5%, after adjusting for inflation and management fees, over long time periods. In order to achieve this objective, the fund needs to exceed the investment objectives in certain periods in order to compensate for shortfalls in other periods. This implies a higher average allocation to equity securities. HPH's current asset allocation policy target of 43% equity securities and 57% fixed income securities and cash will change based on the Plan's status to hedge interest rate risk.

The expected return on plan assets of 5.25% was developed based upon analysis of historical market returns, current market conditions, targeted future asset allocations, the plan assets' past performance, and expectations on potential future market returns. The expected return represents a long-term average view of the performance of the plan assets, which may not be achieved during a given plan year.

The weighted average target asset allocations compared with actual asset allocations at June 30, by major asset category, are as follows:

Major asset category	Target Allocation	Percentage of Actual Plan Assets at June 30	
	2022	2022	2021
Global equity	31%	31%	36%
Fixed income	55	51	43
Marketable alternative and private investments	12	12	17
Real estate	–	3	2
Cash and cash equivalents	2	3	2
	100%	100%	100%

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

7. Employee Benefit Plans (continued)

The table below presents the plan's assets measured at fair value on a recurring basis as of June 30:

	2022				Valuation Technique (Note 3)
	Total	Level 1	Level 2	Level 3	
Equity securities:					
Mutual funds	\$ 13,369,206	\$ 13,369,206	\$ -	\$ -	a
Common stock	7,710,105	7,710,105	-	-	a
Real estate	12,170,000	-	12,170,000	-	a
Common collective funds	165,686,039	165,686,039	-	-	a
Limited liability companies	67,048,772	67,048,772	-	-	a
Cash and cash equivalents	15,119,960	15,119,960	-	-	a
Total investments	<u>281,104,082</u>	<u>\$ 268,934,082</u>	<u>\$ 12,170,000</u>	<u>\$ -</u>	
Alternative investments measured at net asset value:					
Closely held securities	14,864,651				
Common collective funds	21,479,011				
Limited partnerships	89,562,208				
Limited liability companies	<u>23,666,370</u>				
Total investments at fair value	<u>\$ 430,676,322</u>				

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

7. Employee Benefit Plans (continued)

	2021				Valuation Technique (Note 3)
	Total	Level 1	Level 2	Level 3	
Equity securities:					
Mutual funds	\$ 27,928,555	\$ 27,928,555	\$ –	\$ –	a
Common stock	13,247,986	13,247,986	–	–	a
Real estate	11,740,000	–	11,740,000	–	a
Common collective funds	184,454,070	184,454,070	–	–	a
Limited liability companies	51,968,119	51,968,119	–	–	a
Cash and cash equivalents	12,154,392	12,154,392	–	–	a
Total investments	301,493,122	<u>\$ 289,753,122</u>	<u>\$ 11,740,000</u>	<u>\$ –</u>	
Alternative investments measured at net asset value:					
Closely held securities	42,677,317				
Common collective funds	27,381,280				
Limited partnerships	109,983,448				
Limited liability companies	32,694,058				
Total investments at fair value	<u>\$ 514,229,225</u>				

The Plan has classified its common stock and mutual funds, which are considered highly liquid and easily tradable as Level 1 within the fair value hierarchy. These securities are valued using inputs observable in active markets for identical securities. The Plan's investments in real estate are classified as Level 2. Real estate is valued based on an appraisal using inputs observable in active markets for similar properties.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

7. Employee Benefit Plans (continued)

The Plan's alternative investments are reported at net asset value per share as a practical expedient or its equivalent. The following tables and explanations identify attributes relating to the nature and risk of such investments at June 30:

2022				
Fair Value	Redemption Frequency (If Currently Eligible)	Redemption Notice Period (If Currently Eligible)	Redemption Restrictions and Expiration of Restriction	
Fixed income	\$ 219,566,830	Daily	2–5 business days	–
Global ex-U.S. equity	18,996,011	Daily, monthly	1 or 10 days	–
U.S. equity growth	29,917,703	Daily, monthly	3 or 31 days	–
Emerging markets equity	9,501,140	Daily, monthly	2, 10, 30 or 32 days	–
Diversified arbitrage/ event-driven	4,836,141	Quarterly	65 days	Side pockets, gates
Distressed	339,625	Every 24 months, 25% quarterly Semi-monthly, monthly, quarterly, annually,	60–65 days	Side pockets, gates
Global long/short equity	39,624,768	semi-annually	3–65 days	Side pockets, gates, hold backs
U.S. long/short equity	23,666,370	Quarterly	45 days	–
Global macro	9,244,372	Monthly, quarterly	14–60 days	–
Private equity	26,601,369	–	–	–
Opportunistic	12,722	Every 24 months	90 days	Side pockets
	<u>\$ 382,307,051</u>			

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

7. Employee Benefit Plans (continued)

	2021			
	Fair Value	Redemption Frequency (If Currently Eligible)	Redemption Notice Period (If Currently Eligible)	Redemption Restrictions and Expiration of Restriction
Fixed income	\$ 220,661,689	Daily	2–5 business days	–
Global ex-U.S. equity	28,823,125	Daily, monthly	1 or 10 days	–
U.S. equity growth	33,931,840	Daily, monthly	3 or 31 days	–
Emerging markets equity	18,402,191	Daily, monthly	2, 5, 10 or 30 days	Gates
Diversified arbitrage/ event-driven	14,762,908	Quarterly, annually Every 24 months,	45–65 days	Side pockets, gates
Distressed	6,582,145	25% quarterly Semi-monthly, monthly, quarterly, annually, semi-annually	60–65 days	Side pockets, gates, hold backs, lock up through 10/1/21
Global long/short equity	56,294,418	Quarterly	3–65 days	–
U.S. long/short equity	25,728,920	Monthly, quarterly	45 days	–
Global macro	13,213,155	–	2–60 days	–
Private equity	30,744,982	–	–	–
Opportunistic	12,919	Every 24 months	90 days	Side pockets
	<u>\$ 449,158,292</u>			

Fixed income: Portfolios that seek to exploit mispricings in fixed income securities, utilizing a variety of investment instruments, including corporate and municipal bonds, sovereign debt, mortgage-backed securities, swaps and options. These managers often utilize leverage to magnify their returns.

Global ex-U.S. equity: This category invests in portfolios consisting of a core group of long stock positions and stock indices in global ex.-U.S. equity markets. These managers do not focus on a single sector or geographic region, instead employing a broad, global ex.-U.S. mandate.

U.S. equity growth: This category has an emphasis on equities of companies with rapid earnings growth and high multiples of earnings, dividends, and book values.

Emerging markets equity: This category has products investing in the equity securities of companies located in emerging and frontier market countries.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

7. Employee Benefit Plans (continued)

Diversified arbitrage/event-driven: This category has multi-strategy portfolios that have broad investment parameters, seeking to profit from mispricings across asset classes and strategies and exploit security mispricings caused by mergers and acquisitions, spin-offs, tracking stocks, accounting write-offs, reorganizations, bankruptcies, share buybacks and special dividends.

Distressed: This category has portfolios consisting primarily of investments in debt securities of companies that are experiencing business, financial, market or legal uncertainties, attempting to capture the difference between the market price of security or debt obligations and their underlying intrinsic value.

Global long/short equity: This category has portfolios consisting of a core group of long stock positions with short sales of stock and stock indices in global and global ex.-U.S. equity markets.

U.S. long/short equity: This category has portfolios consisting of a core group of long stock positions with short sales of stock and stock indices in U.S. equity markets.

Global macro: This category has broad, top-down strategies that seek to capitalize on perceived macroeconomic and political shifts in investor behavior and market positions. This category is unconstrained by asset class or geography and implemented through long and short positions and means of cash, asset purchases (including physical commodities), futures, options, and other instruments. Leverage is often applied, and return and volatility targets may vary sharply.

Private equity: Private equity is capital that is not traded on a public exchange. Private equity is composed of funds and investors that directly invest in private companies, or that engage in buyouts of public companies, resulting in the delisting of public equity. The Plan has unfunded capital commitments for private equity funds totaling approximately \$19,015,000 as of June 30, 2022. Capital commitments are determined by fund managers and the unfunded capital commitments can be funded through March 2027.

Opportunistic: This category has multi-strategy portfolios that have a broad mandate and employ an opportunistic investment approach, shifting capital across asset classes and strategies depending on their profitability.

The Company expects to make contributions to the Plan amounting to approximately \$15,000,000 in fiscal year 2023.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

7. Employee Benefit Plans (continued)

Benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

Year ending June 30:	
2023	\$ 28,563,695
2024	24,201,449
2025	24,746,089
2026	25,979,425
2027	27,497,002
Years 2028–2032	146,088,353

The Company has defined contribution retirement plans (Retirement Plans) that cover substantially all employees and provide participants with the ability to make pretax payroll deduction contributions for deposit into retirement savings accounts. The participants' contributions are matched at a percentage of their total contributions up to annual dollar limits per participant, as defined by the Retirement Plans. The Company may also make discretionary contributions. The total expense related to the above Retirement Plans was approximately \$23,498,000 and \$22,316,000 in 2022 and 2021, respectively.

8. Line and Letters of Credit

The Company has a \$75,000,000 unsecured revolving line of credit available, expiring March 1, 2024. The interest rate on the line is based on the lender's prime rate or the three-month London Interbank Offered Rate plus an applicable margin. There were no outstanding draws on this facility as of June 30, 2022 and 2021.

As of June 30, 2022, the Company's available letters of credit were as follows:

Coverage	Amount	Expiration Date	Interest Rate
Malpractice insurance policies:			
PIC	\$ 2,000,000	February 1, 2023	*
Workers' compensation insurance policies:			
HPH	\$ 1,000,000	February 1, 2023	*

* Interest rate would be determined if drawn upon.

There were no draws on the above letters of credit as of June 30, 2022 and 2021.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt

Long-term debt, net of issuance costs, is summarized as follows:

	June 30	
	2022	2021
Prudential 3.25% Series A Senior Note due March 2043, semi-annual amortizing principal and interest payments due in March and September, with principal payments beginning September 2023	\$ 50,000,000	\$ 50,000,000
Series 2019 Special Purpose Revenue Bonds, interest payable monthly at a fixed rate of 2.71%, principal payments in varying annual amounts ranging from \$3,032,670 to \$4,424,880 due July 2022 through 2033	41,725,878	44,485,692
Series 2018B Taxable Refunding Revenue Bonds, interest payable semi-annually at rates ranging from 3.13% to 4.27% (4.07% at June 30, 2022), principal payments in varying annual amounts ranging from \$1,805,000 to \$2,605,000 due July 2022 through 2032; \$2,715,000 to \$3,610,000 due July 2033 through July 2040	48,576,627	50,275,288
Series 2018A Taxable Refunding Revenue Bonds, interest payable semi-annually at rates ranging from 3.13% to 4.27% (4.22% at June 30, 2022), principal payments in varying annual amounts ranging from \$435,000 to \$1,665,000 due July 2022 through 2032; \$1,210,000 to \$11,605,000 due July 2033 through July 2040	85,483,629	87,814,249
Prudential 3.81% Series A Senior Note due September 2042 annual amortizing principal payments due in September and semi-annual interest payments due in March and September	50,506,841	52,055,111
Series 2013B Special Purpose Revenue Bonds, interest payable semi-annually at rates ranging from 4.00% to 5.00% (4.87% at June 30, 2022), principal payments in varying annual amounts ranging from \$2,405,000 to \$2,515,000 through 2023 upon the issuance of the forward delivery bond purchase agreement	28,789,808	29,149,749
Series 2013A Special Purpose Revenue Bonds, interest payable semi-annually at 5.00%, principal payments in varying annual amounts ranging from \$1,415,000 to \$1,505,000 through 2023 upon the issuance of the forward delivery bond purchase agreement	113,017,840	113,805,536
Total long-term debt	418,100,623	427,585,625
Less current portion	9,793,344	9,485,002
Non-current portion	\$ 408,307,279	\$ 418,100,623

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

In June 2020, the Company executed a draw on the Prudential shelf arrangement. Senior notes were issued totaling \$50,000,000 with interest at 3.25%, due March 2043. Principal and interest are payable semi-annually with interest payments starting March 2021 and principal payments starting September 2023. The proceeds from the notes were used to fund additional contributions to the pension plan in fiscal year 2020. The Company executed a shelf note arrangement (Prudential Note) in September 2017, which allows the Company to issue senior notes up to an aggregate of \$150,000,000 through September 2020. In September 2017, senior notes payable totaling \$56,500,000 were issued with interest at 3.81% due September 2042. Principal is payable annually, and interest is payable semi-annually. The proceeds from the notes were used to fund additional contributions to the Plan in fiscal year 2018.

In February 2020, the Company executed a forward delivery bond purchase agreement to issue Series 2023A&B Bonds of approximately \$106,300,000 and \$21,915,000, respectively, on July 1, 2023. The Series 2023A&B Bonds have maturity dates from July 1, 2024 through 2043, with fixed interest rates ranging between 4.00% and 5.00%, and will be collateralized by a security interest in the gross receipts and pledged assets of the Obligated Group. Upon issuance, the Series 2023A&B Bonds will be used to refund the outstanding obligation of the Company's Series 2013A&B Bonds. The Series 2023A&B Bonds will be recorded as an outstanding debt obligation upon the execution of the forward delivery bond purchase agreement, which is currently expected to occur on July 1, 2023.

In April 2018, the Company issued Series 2018A and 2018B Taxable Refunding Bonds in the amounts of \$93,025,000 and \$54,090,000, respectively. The proceeds of the Series 2018A&B Bonds had been placed in an escrow fund of U.S. Treasury obligations to be used to defease the Series 2010A&B Department of Budget and Finance of the State of Hawai'i Special Purpose Revenue Bonds. On July 1, 2020, escrow funds held for bond defeasance of approximately \$152,524,000 were used to refund the Series 2010A&B Bonds under the terms of the agreement that allowed for early optional redemption.

The 2018 A&B Bonds are subject to optional redemption prior to their stated maturities at the option of the Company at a redemption price equal to a Make-Whole Redemption Price. The 2018A&B Bonds are also subject to Extraordinary Optional Redemption at the direction of the Company. The 2018B Bonds are subject to mandatory redemption on or after July 1, 2033, payable in annual sinking fund installments from \$2,715,000 to \$3,610,000. The 2018A Bonds are subject to mandatory redemption on or after July 1, 2033, payable in annual sinking fund installments from \$1,210,000 to \$11,605,000.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

The Prudential Notes, 2018 Series Taxable Refunding Bonds, 2019 and 2013 Series Special Purpose Revenue Bonds are collateralized by a security interest in the gross receipts and pledged assets of the Obligated Group (comprised of HPH – parent company only, KMCWC, PMMC, SCH and WMH), as defined in the Master Indenture.

As of June 30, 2022 and 2021, approximately \$15,903,000 and \$15,706,000, respectively, was held by the bond trustee to fund principal maturities and accrued interest payable.

Certain bond agreements require the Obligated Group, as defined in the Company's Master Trust Indenture, to comply with various covenants, including the maintenance of a minimum long-term debt service coverage ratio. As of June 30, 2022, the Obligated Group was in compliance with all bond covenants.

Long-term debt maturities (including bond issuance costs of \$1,286,000) for the years succeeding June 30, 2022 are as follows.

Year ending June 30:	
2023	\$ 9,793,344
2024	147,579,006
2025	9,093,312
2026	9,699,327
2027	9,904,024
Thereafter	<u>232,031,610</u>
	<u>\$ 418,100,623</u>

Interest paid was approximately \$18,037,000 and \$17,915,000 in 2022 and 2021, respectively.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

10. Leases

The Company adopted Accounting Standards Update No. 2016-02, *Leases (Topic 842)*, which requires the rights and obligations arising from lease contracts to be recognized on the consolidated balance sheets.

Short-term leases, with terms of 12 months or less, are not included in the present value calculations of the right of use assets and lease obligations per the Company's accounting policy. For leases with terms greater than 12 months, management records the related right of use assets and lease obligations based on the present value of lease payments over the lease term. The Company has elected to exclude non-lease components from the minimum rent payment used to calculate the right of use assets and lease obligations. The Company has elected to utilize an incremental borrowing rate similar to a collateralized borrowing rate available to the Company commensurate with the lease term to determine the present value of lease payments. Several of the Company's leases include rental escalation clauses and renewal options that are factored into management's determination of lease payments, when appropriate.

The following table summarizes the weighted average lease term and discount rate as of June 30:

	2022	2021
Weighted average remaining term:		
Operating leases	21.6 years	22.3 years
Finance leases	2.8 years	3.7 years
Weighted average discount rate:		
Operating leases	2.38%	2.39%
Finance leases	1.32	1.39

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

10. Leases (continued)

The following table reconciles the undiscounted cash flows to the operating lease and finance lease liabilities recorded on the consolidated balance sheet as of June 30, 2022:

	Operating Leases	Finance Leases
2023	\$ 17,760,034	\$ 1,613,048
2024	16,284,989	1,472,579
2025	15,430,268	1,036,924
2026	13,649,506	159,009
2027	12,827,982	–
Thereafter	98,992,356	–
Total minimum lease payments	174,945,135	4,281,560
Less amount of lease payments representing interest	(41,790,251)	(71,378)
Present value of future minimum lease payments	133,154,884	4,210,182
Less current obligations under leases	14,769,143	1,570,521
Long-term lease obligations	<u>\$ 118,385,741</u>	<u>\$ 2,639,661</u>

The lease cost components, by lease type, for the year ended June 30, are as follows:

	2022	2021
Finance lease expense:		
Amortization of leased assets	\$ 1,608,285	\$ 1,443,807
Interest on lease liabilities	66,620	80,926
Operating leases	17,467,619	17,263,048
Short-term leases	2,325,263	1,534,459
Total lease cost	<u>\$ 21,467,787</u>	<u>\$ 20,322,240</u>

The Company accounts for all rent holidays, tenant improvement allowances, and escalation clauses by recognizing the total operating leases rent expense on a straight-line basis over the term of each operating lease. The difference between the lease expense recognized and the actual lease payment is recorded as deferred rent. The Company recorded deferred rent of approximately \$11,608,000 and \$11,598,000 as of June 30, 2022 and 2021, respectively, which is included in right of use assets – operating.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

10. Leases (continued)

Supplemental lease cash flow information for the year ended June 30 is as follows:

	<u>2022</u>	<u>2021</u>
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows for operating leases	\$ 17,778,778	\$ 17,136,876
Operating cash flows for finance leases	66,620	80,926
Financing cash flows for finance leases	1,614,612	1,380,102

Future minimum rental income to be received under non-cancelable operating leases for office space as of June 30, 2022 is as follows:

Year ending June 30:	
2023	\$ 2,021,282
2024	1,921,995
2025	1,968,654
2026	803,930
2027	791,759
Thereafter	<u>14,682,955</u>
	<u>\$ 22,190,575</u>

11. Income Taxes

Some of the Company's not-for-profit organizations have generated net operating losses (NOL) attributable to revenue-generating activities that are not related to their respective tax-exempt purposes. The Company has unused federal and Hawai'i state NOL carryforwards as of June 30, 2022 of approximately \$5,200,000 combined. The NOL carryforwards begin to expire in 2022, with NOLs accrued during the 2018 tax year and thereafter never expiring under current law. The deferred tax asset associated with these NOL carryforwards is offset by a full valuation allowance on the consolidated balance sheets, as management has determined it is more likely than not that the NOLs will not be utilized.

The Company has not recorded any expense or accrued for any related expense for any uncertain tax positions. The Company's 2017 through 2020 tax years remain subject to examination for federal income tax purposes, whereas the 2016 through 2020 tax years remain subject to examination for state taxing jurisdictions in which the Company operates.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

12. Functional Expenses

The functional classification of expenses by major classes of program services and supporting activities for the years ended June 30 are summarized as follows:

	2022		
	Patient Services	Philanthropic and Support Services	Total
Salaries and employee benefits	\$ 744,656,910	\$ 132,212,568	\$ 876,869,478
Services	199,116,152	38,051,898	237,168,050
Supplies	242,474,802	1,029,057	243,503,859
Other purchases	80,451,045	31,985,137	112,436,182
Depreciation and amortization	45,602,452	9,706,916	55,309,368
Specific purpose projects/donations	4,062,360	11,764,193	15,826,553
Interest	17,786,706	1,588,327	19,375,033
Other	9,014,821	7,014,226	16,029,047
Total expenses	<u>\$ 1,343,165,248</u>	<u>\$ 233,352,322</u>	<u>\$ 1,576,517,570</u>
	2021		
	Patient Services	Philanthropic and Support Services	Total
Salaries and employee benefits	\$ 719,735,413	\$ 122,742,169	\$ 842,477,582
Services	147,733,665	34,316,540	182,050,205
Supplies	216,502,079	961,234	217,463,313
Other purchases	60,752,218	29,164,833	89,917,051
Depreciation and amortization	44,985,611	9,644,666	54,630,277
Specific purpose projects/donations	1,005	14,473,828	14,474,833
Interest	18,052,671	1,577,089	19,629,760
Other	14,901,742	4,112,734	19,014,476
Total expenses	<u>\$ 1,222,664,404</u>	<u>\$ 216,993,093</u>	<u>\$ 1,439,657,497</u>

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

13. Commitments and Contingencies

Workers' Compensation Claims

The Company is self-insured for workers' compensation claims. The Company has an available letter of credit in favor of the state of Hawai'i (as described in Note 8), as required by self-insurance regulations of the state of Hawai'i. The Company provides its actuary with estimated claims payments and accrues workers' compensation expense based on an actuarial determined amount. Workers' compensation accruals included in payroll and related liabilities on the consolidated balance sheets totaled approximately \$5,734,000 and \$5,851,000 as of June 30, 2022 and 2021, respectively, and were recorded using a 1.45% and 2.07% discount factor as of June 30, 2022 and 2021, respectively. The aforementioned amounts include accruals for known and incurred but not reported workers' compensation claims.

Medical Malpractice Insurance

In June 2002, the Company formed PIC, a captive insurance company covering professional (medical malpractice) and general liability risks. PIC is a not-for-profit Hawai'i domiciled pure captive whose sole corporate member is HPH. PIC operates under a Certificate of Authority from the state of Hawai'i (Insurance Division) and began operations on July 1, 2002. PIC is a regulated insurance company with reserve, investment, reporting and audit requirements. The Company is covered for professional and general liability claims under a combined limit shown below per claim and in aggregate through PIC and purchase of excess insurance coverage. The professional liability coverage from PIC is claims-made and general liability is occurrence-based coverage, with PIC providing tail coverage (with certain limitations) to the Company with claims-made policies prior to July 1, 2002.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

13. Commitments and Contingencies (continued)

The PIC risk retention and total coverage amounts, including reinsurance, by policy year are as follows:

Professional Liabilities:

	PIC Retention	Total Coverage
Policy years		
July 1, 2006 through June 30, 2007	\$ 1,000,000	\$ 51,000,000
July 1, 2007 through June 30, 2014	1,000,000	76,000,000
July 1, 2014 through June 30, 2016	1,000,000	101,000,000
July 1, 2016 through April 30, 2020	2,000,000	102,000,000
May 1, 2020 through April 30, 2022	3,000,000	103,000,000
May 1, 2022 through April 30, 2023	5,000,000	105,000,000

General Liabilities:

	PIC Retention	Total Coverage
Policy years		
July 1, 2006 through June 30, 2007	\$ 1,000,000	\$ 51,000,000
July 1, 2007 through June 30, 2014	1,000,000	76,000,000
July 1, 2014 through June 30, 2016	1,000,000	101,000,000
July 1, 2016 through April 30, 2020	2,000,000	102,000,000
May 1, 2020 through April 30, 2022	3,000,000	103,000,000
May 1, 2022 through April 30, 2023	3,000,000	103,000,000

Medical malpractice expense totaled approximately \$24,051,000 and \$18,212,000 in 2022 and 2021, respectively. Medical malpractice accruals, including claims expected to be paid by reinsurance, totaled approximately \$75,665,000 and \$77,221,000 as of June 30, 2022 and 2021, respectively, and are primarily recorded within other long-term liabilities on the consolidated balance sheets. Reinsurance recoverable totaled approximately \$29,075,000 and \$30,535,000 as of June 30, 2022 and 2021, respectively, and is recorded within other assets on the consolidated balance sheets. The medical malpractice accruals have been discounted using a 2.05% and 2.18% factor at June 30, 2022 and 2021, respectively. Undiscounted medical malpractice accruals and reinsurance recoverable totaled approximately \$80,769,000 and \$30,868,000, respectively, as of June 30, 2022.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

13. Commitments and Contingencies (continued)

Litigation

The Company is involved in legal actions in the normal course of business, some of which seek monetary damages, including punitive damages, which are not covered by insurance. These actions, when finally concluded and determined, will not, in the opinion of management and the Company's general counsel, have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

Other

The Company has outstanding construction commitments of approximately \$35,637,000 as of June 30, 2022.

14. Net Assets

The Company receives contributions from individuals and organizations that support certain programs and services. Net assets with donor restrictions are summarized as follows:

	June 30	
	2022	2021
Health and hospital care	\$ 36,920,220	\$ 36,586,621
Plant expansion and equipment replacement	37,120,434	19,097,144
Research and grants	14,883,122	12,457,225
Education and scholarships	6,519,809	6,678,302
	<u>\$ 95,443,585</u>	<u>\$ 74,819,292</u>

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

14. Net Assets (continued)

From time to time, the Company's Board of Directors will designate certain unrestricted funds to be used in the future for specific projects. Board-designated funds included in net assets without donor restrictions were maintained for the following purposes at June 30:

	<u>2022</u>	<u>2021</u>
Health and hospital care	\$ 174,032,818	\$ 190,757,342
Plant expansion and equipment replacement	167,208,002	183,276,662
	<u>\$ 341,240,820</u>	<u>\$ 374,034,004</u>

15. Endowment

The Company's endowment consists of approximately 48 individual funds established for a variety of purposes. The endowment includes both donor-restricted funds and funds designated by the Board of Directors to function as endowments. Net assets associated with the endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

In June 2009, Hawai'i Revised Statute 517E was signed into law, enacting the Uniform Prudent Management of Institutional Funds Act (UPMIFA). UPMIFA became effective on July 1, 2009, replacing the Uniform Management of Institutional Funds Act. UPMIFA applies to institutional funds created after July 1, 2009, and to decisions made after July 1, 2009, for existing institutional funds. UPMIFA eliminates the concept of "historic dollar value" and allows an institution to spend or accumulate as the board determines is prudent for the uses, benefits, purposes and duration of the endowment fund unless the gift instrument states a particular rate or formula.

The Company has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Company classifies as permanently restricted net assets: (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

15. Endowment (continued)

portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is characterized as temporarily restricted net assets until those amounts are appropriated for expenditure by the Company in a manner consistent with the standard for expenditure prescribed by UPMIFA. In accordance with UPMIFA, the Company considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The general purposes of the Company and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the Company
7. The investment policies of the Company

Return Objectives and Risk Parameters

The Company has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity. Under this policy, the endowment assets are invested in a manner that is intended to produce results that equal or exceed a mix of the Russell 3000, MSCI All Country World, Consumer Price Index plus 5%, Hedge Fund Research, Inc. and Barclays Capital benchmarks. The Company expects its endowment funds to provide an annual real return, net of inflation and management fees, of approximately 5% over long time periods. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the Company relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Company targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

15. Endowment (continued)

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Company has a policy of appropriating for distribution each year 4.5% of its endowment fund's average fair value using quarter-end values for the preceding three years. The amount of the distribution is subject to a 6.0% cap and 3.0% floor applied to the most recent quarter-end value to account for market volatility. In establishing this policy, the Company considered the long-term expected return on its endowment. Accordingly, the Company expects the current spending policy to allow its endowment to grow over long time periods, which is consistent with the Company's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term, as well as to provide additional real growth through new gifts and investment returns.

The endowment net asset composition by type of fund consists of the following at June 30:

	2022		
	Without Donor Restrictions	With Donor Restrictions	Total
Donor-restricted funds	\$ –	\$ 21,980,905	\$ 21,980,905
Board-designated funds	341,240,820	–	341,240,820
	\$ 341,240,820	\$ 21,980,905	\$ 363,221,725
	2021		
	Without Donor Restrictions	With Donor Restrictions	Total
Donor-restricted funds	\$ –	\$ 25,073,276	\$ 25,073,276
Board-designated funds	374,034,004	–	374,034,004
	\$ 374,034,004	\$ 25,073,276	\$ 399,107,280

Hawai'i Pacific Health

Notes to Consolidated Financial Statements (continued)

15. Endowment (continued)

Changes in endowment net assets for the years ended June 30 consist of the following:

	2022		
	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets, beginning of year	\$ 374,034,004	\$ 25,073,276	\$ 399,107,280
Investment income:			
Investment income	7,353,225	259,172	7,612,397
Net investment losses (realized and unrealized)	(40,146,409)	(2,067,081)	(42,213,490)
Total investment (loss)	(32,793,184)	(1,807,909)	(34,601,093)
Contributions	–	45,125	45,125
Appropriation of endowment assets for expenditure	–	(342,396)	(342,396)
Beneficial interest in perpetual trust	–	(892,154)	(892,154)
Transfers	–	(95,037)	(95,037)
Endowment net assets, end of year	\$ 341,240,820	\$ 21,980,905	\$ 363,221,725
	2021		
	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets, beginning of year	\$ 302,627,875	\$ 20,155,457	\$ 322,783,332
Investment income:			
Investment income	4,503,283	189,837	4,693,120
Net investment gains (realized and unrealized)	66,902,846	3,794,928	70,697,774
Total investment gain	71,406,129	3,984,765	75,390,894
Contributions	–	84,565	84,565
Appropriation of endowment assets for expenditure	–	(186,110)	(186,110)
Beneficial interest in perpetual trust	–	1,127,332	1,127,332
Transfers	–	(92,733)	(92,733)
Endowment net assets, end of year	\$ 374,034,004	\$ 25,073,276	\$ 399,107,280

Supplementary Information

Members of the Hawai'i Pacific Health Obligated Group

Combined Balance Sheets

	June 30	
	2022	2021
Assets		
Current assets:		
Cash and cash equivalents	\$ 187,571,871	\$ 218,781,016
Patient accounts receivable, net	167,426,421	160,518,921
Due from third-party payors	24,387,986	21,507,877
Other receivables	9,380,820	16,828,702
Due from affiliates – notes receivable and other	30,494,180	28,167,652
Inventories	22,738,973	23,373,506
Funds held by trustee under bond indenture agreement	15,903,482	15,705,900
Prepaid expenses and other	7,032,680	6,527,401
Total current assets	464,936,413	491,410,975
Assets whose use is limited or restricted:		
Board-designated	248,122,526	272,139,233
Restricted by donor or grantor	82,995,662	63,011,778
Total assets whose use is limited or restricted	331,118,188	335,151,011
Investments	402,682,152	440,692,572
Property and equipment, net	553,505,006	554,948,620
Right of use assets – operating	105,999,281	108,296,225
Right of use assets – finance	4,017,038	5,607,111
Prepaid pension	45,142,421	11,375,832
Other assets:		
Investment in unconsolidated subsidiaries	66,397,118	52,062,650
Investments in business ventures	25,000	25,000
Beneficial interest in net assets of foundations	70,798,896	82,954,287
Other	19,935,757	19,730,701
Total other assets	157,156,771	154,772,638
Total assets	\$ 2,064,557,270	\$ 2,102,254,984

	June 30	
	2022	2021
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 67,567,094	\$ 45,732,640
Payroll and related liabilities	88,683,894	100,813,859
Accrued expenses	14,913,585	16,350,770
Due to third-party payors	32,816,659	56,418,910
Current portion of long-term debt	9,793,344	9,485,002
Current portion of operating lease obligations	11,873,674	10,413,975
Current portion of finance lease obligations	1,570,521	1,593,643
Total current liabilities	<u>227,218,771</u>	<u>240,808,799</u>
Long-term debt, less current portion	408,307,279	418,100,623
Operating lease obligations, less current portion	103,592,528	107,259,331
Finance lease obligations, less current portion	2,639,661	4,210,183
Other long-term liabilities	25,645,360	34,018,059
Due to third-party payors	–	23,115,924
Net assets:		
Net assets without donor restrictions	1,201,734,765	1,199,947,451
Net assets with donor restrictions	95,418,906	74,794,614
Total net assets	<u>1,297,153,671</u>	<u>1,274,742,065</u>
Total liabilities and net assets	<u><u>\$ 2,064,557,270</u></u>	<u><u>\$ 2,102,254,984</u></u>

See note to supplementary information – Members of the Hawai'i Pacific Health Obligated Group

Members of the Hawai'i Pacific Health Obligated Group

Combined Statements of Income and
Changes in Net Assets

	Year Ended June 30	
	2022	2021
Revenues		
Net patient service revenue	\$ 1,341,107,684	\$ 1,220,146,185
Premium revenue	28,558,426	26,740,305
Other revenues	221,778,506	258,539,604
Net assets released from restrictions for operations	13,832,658	12,749,964
Total revenues	<u>1,605,277,274</u>	<u>1,518,176,058</u>
Expenses		
Salaries and employee benefits	629,357,086	614,847,766
Services	440,204,647	390,049,488
Supplies	226,220,277	207,751,588
Other purchases	85,144,355	70,658,175
Depreciation and amortization	52,854,622	51,995,777
Specific purpose projects/donations	13,832,658	12,749,964
Interest	19,117,832	19,416,672
Other	12,017,225	15,990,533
Total expenses	<u>1,478,748,702</u>	<u>1,383,459,963</u>
Operating income	126,528,572	134,716,095
Business venture investment income	2,012,200	4,926,357
Investment (loss) income	(56,736,822)	137,858,435
Pension non-operating income	11,198,924	4,060,002
	<u>(43,525,698)</u>	<u>146,844,794</u>
Excess of revenues over expenses	83,002,874	281,560,889
Transfers to affiliates	(98,917,857)	(94,756,784)
Change in beneficial interest in net assets of foundations	(12,155,391)	17,228,794
Change in net losses on debt securities	(3,834,280)	(1,000,574)
Net assets released from restrictions for purchase of property and equipment	5,529,063	970,502
Pension related changes other than net periodic pension costs	14,981,543	56,910,554
Change in interest rate swap value	859,096	904,260
Other changes in net assets	12,322,266	(119,569)
Increase in net assets without donor restrictions	<u>1,787,314</u>	<u>261,698,072</u>

Continued to next page.

Members of the Hawai'i Pacific Health Obligated Group

Combined Statements of Income and
Changes in Net Assets (continued)

	Year Ended June 30	
	2022	2021
Net assets with donor restrictions		
Restricted grants and contributions	\$ 20,626,357	\$ 14,683,467
Investment income	220,857	285,632
Change in net unrealized gains on investments	(870,077)	891,928
Change in beneficial interest in net assets of foundations	20,876,037	12,479,541
Net assets released from restrictions	(19,361,721)	(13,720,466)
Change in beneficial interest in perpetual trusts	(892,155)	1,127,332
Other changes in net assets with donor restrictions	24,994	(36,340)
Increase in net assets with donor restrictions	<u>20,624,292</u>	<u>15,711,094</u>
Increase in net assets	22,411,606	277,409,166
Net assets at beginning of year	1,274,742,065	997,332,899
Net assets at end of year	<u>\$ 1,297,153,671</u>	<u>\$ 1,274,742,065</u>

See note to supplementary information – Members of the Hawai'i Pacific Health Obligated Group

Members of the Hawai'i Pacific Health Obligated Group

Combined Statements of Cash Flows

	Year Ended June 30	
	2022	2021
Operating activities		
Increase in net assets	\$ 22,411,606	\$ 277,409,166
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Change in beneficial interest in net assets of foundations	(8,720,647)	(29,708,334)
Depreciation and amortization	52,854,622	51,995,777
Business venture investment loss	(2,012,200)	(4,926,357)
Net losses (gains) on alternative investments	30,983,096	(101,456,114)
Change in net unrealized losses on investments	4,704,357	108,646
Realized losses on investments	(14,865,467)	(1,476,067)
Net losses (gains) on equity investments	45,193,731	(32,647,655)
Restricted contributions	(20,626,357)	(14,683,467)
Changes in operating assets and liabilities:		
Patient accounts receivable	(6,907,500)	(21,585,804)
Due to/from third-party payors, net	(51,924,812)	(15,747,354)
Other receivables	7,447,882	(916,301)
Inventories and other assets	(75,802)	(4,684,684)
Accounts payable and accrued expenses	7,455,749	24,458,756
Other long-term liabilities	(8,372,699)	6,748,666
Prepaid pension	(33,766,589)	(63,199,408)
Net cash provided by operating activities	<u>23,778,970</u>	<u>69,689,466</u>
Investing activities		
Purchases of property and equipment	(48,919,539)	(46,432,968)
Decrease in due to affiliates, net	-	(1,843,614)
Net (increase) decrease to unconsolidated subsidiaries	(12,322,268)	119,567
Purchases of investment securities	(118,276,284)	(83,466,951)
Sales and maturities of investment securities	114,485,521	81,064,355
Increase in funds held by trustee under bond indenture agreements	(197,582)	(66,241)
Assets whose use is limited or restricted:		
Purchases of investment securities	(67,438,029)	(48,386,475)
Sales and maturities of investment securities	68,132,355	46,113,005
Net cash used in investing activities	<u>(64,535,826)</u>	<u>(52,899,322)</u>

Continued to next page.

Members of the Hawai'i Pacific Health Obligated Group

Combined Statements of Cash Flows (continued)

	Year Ended June 30	
	2022	2021
Financing activities		
Payment of long-term debt	\$ (9,485,002)	\$ (157,599,509)
Payments of finance lease obligations	(1,593,644)	(1,331,978)
Decrease in escrow funds held for bond defeasance	–	152,524,306
Liquidation of escrow funds held for bonds	–	(152,524,306)
Note receivable to affiliate	–	(26,938,000)
Restricted contributions	20,626,357	14,683,467
Net cash provided by (used in) financing activities	9,547,711	(171,186,020)
Decrease in cash and cash equivalents	(31,209,145)	(154,395,876)
Cash and cash equivalents at beginning of year	218,781,016	373,176,892
Cash and cash equivalents at end of year	\$ 187,571,871	\$ 218,781,016

See note to supplementary information – Members of the Hawai'i Pacific Health Obligated Group

Hawai'i Pacific Health

Note to Supplementary Information – Members of the Hawai'i Pacific Health Obligated Group

June 30, 2022

1. Combined Financial Statements

The financial statements present the combined balance sheets, statements of income and changes in net assets, and statement of cash flows of the Obligated Group members.

The members of the Obligated Group are comprised of the following:

- Hawai'i Pacific Health (parent company only)
- Kapi'olani Medical Center for Women and Children
- Pali Momi Medical Center
- Straub Clinic & Hospital
- Wilcox Memorial Hospital

As prescribed in The Hawai'i Pacific Health (HPH) Master Trust Indenture, the accompanying combined financial statements include only the Members of the Obligated Group. All significant intercompany transactions within the Obligated Group have been eliminated upon combination. Non-Obligated Group subsidiaries are presented in the combined financial statements using the equity method of accounting. Accounting principles generally accepted in the United States of America require that all majority-owned subsidiaries be consolidated and all controlled affiliates be combined with the financial statements of HPH.

Effective January 1, 2020, management created the Hawai'i Pacific Health Medical Group (HPHMG), which consolidated the Company's clinical operation service lines into a centralized medical group and is not a member of the Obligated Group. As part of this transition, members of the Obligated Group entered into comprehensive service agreements with HPHMG. These agreements determine that certain Obligated Group members have the sole right to bill for physician services performed by HPHMG at the obligated group facilities, of which approximately \$178,064,000 and \$176,673,000 of net patient service revenues have been recognized for the years ended June 30, 2022 and 2021, respectively. As part of the agreements, all such amounts are subsequently remitted to HPHMG as professional services compensation and, accordingly, has been recorded within services expense in the combined statements of income and changes in net assets for the year ended June 30, 2022. Obligated Group members also paid annual service coverage fees for physician services provided by HPHMG of approximately \$46,831,000 and \$41,492,000 for the years ended June 30, 2022 and 2021, respectively.

Hawai'i Pacific Health

Note to Supplementary Information – Members of the Hawai'i Pacific Health Obligated Group (continued)

1. Combined Financial Statements (continued)

Additionally, the Obligated Group members are provided with annual compensation by HPHMG in consideration for overhead and other support expenses incurred by the Obligated Group members to operate the various clinical facilities. Such compensation amounted to approximately \$98,301,000 and \$105,523,000, which has been recorded within other revenues on the combined statements of income and changes in net assets for the years ended June 30, 2022 and 2021, respectively.

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