Consolidated Financial Statements, Reports, Supplementary Information, and Schedule Required by the Uniform Guidance

HonorHealth
Years Ended December 31, 2022 and 2021
With Reports of Independent Auditors

Ernst & Young LLP

Building a better working world

HonorHealth

Consolidated Financial Statements,
Reports, Supplementary Information, and
Schedule Required by the Uniform Guidance

Years Ended December 31, 2022 and 2021

Contents

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Building a better working world

Report of Independent Auditors

Management and the Board of Directors
HonorHealth

Report on the Audit of the Financial Statements

Opinion

We have audited the consolidated financial statements of HonorHealth (the Company), which comprise the consolidated balance sheets as of December 31, 2022 and 2021, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2022 and 2021, and the results of its operations, changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

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

Responsibilities of Management for the Financial Statements

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* 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 and *Government Auditing Standards*, we:

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

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

Other Information

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

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

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. We have not performed any procedures with respect to the audited financial statements subsequent to March 31, 2023. The Schedule of Expenditures of Federal Awards as required by Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the 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 GAAS. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 31, 2023 on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Company's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting and compliance.

Ernst + Young LLP

March 31, 2023, except for our report on the
Schedule of Expenditures of Federal Awards,
for which the date is September 11, 2023

HonorHealth

Consolidated Balance Sheets

(In Thousands)

	December 31	
	2022	**2021**
Assets		
Current assets:		
Cash and cash equivalents	**$ 217,214**	$ 541,886
Short-term investments	**754,840**	860,484
Accounts receivable, net	**423,244**	375,429
Inventories	**80,536**	85,319
Assets whose use is limited	**10,801**	6,647
Prepaid expenses and other	**137,716**	104,373
Total current assets	**1,624,351**	1,974,138
Assets whose use is limited, less current portion	**220,457**	264,919
Trust fund assets	**54,994**	54,280
Long-term investments	**293,694**	334,149
Property and equipment, net	**1,003,818**	899,304
Right-of-use assets – finance	**22,104**	24,228
Right-of-use assets – operating	**178,433**	145,125
Other assets	**164,025**	154,290
Total assets	**$ 3,561,876**	$ 3,850,433

	December 31	
	2022	**2021**
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 101,347**	$ 110,051
Accrued expenses and other	**197,971**	207,993
Current portion of finance lease obligations	**7,444**	6,374
Current portion of operating lease obligations	**33,128**	26,915
Current portion of long-term debt	**18,662**	22,170
CMS advance payment	**–**	99,213
Total current liabilities	**358,552**	472,716
Long-term debt, less current portion	**925,024**	949,530
Finance lease obligations, less current portion	**15,885**	19,435
Operating lease obligations, less current portion	**157,668**	130,578
Other liabilities	**124,167**	142,401
Net assets:		
Without donor restrictions:		
Controlling	**1,719,900**	1,830,882
Noncontrolling	**43,447**	50,981
Total without donor restrictions	**1,763,347**	1,881,863
With donor restrictions	**217,233**	253,910
Total net assets	**1,980,580**	2,135,773
Total liabilities and net assets	**$ 3,561,876**	$ 3,850,433

See accompanying notes.

HonorHealth

Consolidated Statements of Operations

(In Thousands)

	Year Ended December 31	
	2022	**2021**
Revenues:		
Net patient service revenue	**$ 2,601,880**	$ 2,407,365
Other	**200,962**	177,714
Total	**2,802,842**	2,585,079
Expenses:		
Salaries and benefits	**1,329,732**	1,202,199
Supplies, services, and other	**1,311,767**	1,146,057
Depreciation and amortization	**134,116**	131,512
Interest	**31,574**	30,750
Total	**2,807,189**	2,510,518
Operating (loss) income	**(4,347)**	74,561
Investment (loss) income	**(156,415)**	99,144
Change in fair value of interest rate swaps	**19,678**	7,450
Other	**10,467**	22,971
(Deficiency) excess of revenues over expenses	**(130,617)**	204,126
Less deficiency (excess) of revenues over expenses attributable to noncontrolling interests	**132**	(6,417)
(Deficiency) excess of revenues over expenses attributable to HonorHealth	**$ (130,485)**	$ 197,709

See accompanying notes.

HonorHealth

Consolidated Statements of Changes in Net Assets
(In Thousands)

	Year Ended December 31	
	2022	**2021**
Net assets without donor restrictions:		
Controlling:		
(Deficiency) excess of revenues over expenses attributable to HonorHealth	**$ (130,485)**	$ 197,709
Net assets released from restriction for purchase of property and equipment	**23,596**	5,369
Amortization of aggregate fair value of interest rate swaps	**201**	201
Other changes	**(4,294)**	(3,908)
(Decrease) increase in controlling	**(110,982)**	199,371
Noncontrolling:		
(Deficiency) excess of revenues over expenses attributable to noncontrolling interests	**(132)**	6,417
Distributions to noncontrolling partners	**(8,803)**	(5,331)
Contributions from noncontrolling partners	**1,401**	1,964
(Decrease) increase in noncontrolling	**(7,534)**	3,050
(Decrease) increase in net assets without donor restrictions	**(118,516)**	202,421
Net assets with donor restrictions:		
Donations received	**26,120**	20,989
Investment (loss) income	**(28,333)**	23,938
Net assets released from restriction for purchase of property and equipment	**(23,596)**	(5,369)
Net assets released from restriction for use in operations	**(10,868)**	(6,139)
(Decrease) increase in net assets with donor restrictions	**(36,677)**	33,419
(Decrease) increase in net assets	**(155,193)**	235,840
Net assets, beginning of year	**2,135,773**	1,899,933
Net assets, end of year	**$ 1,980,580**	$ 2,135,773

See accompanying notes.

HonorHealth

Consolidated Statements of Cash Flows

(In Thousands)

	Year Ended December 31	
	2022	**2021**
Operating activities		
(Decrease) increase in net assets	**$ (155,193)**	$ 235,840
Adjustments to reconcile (decrease) increase in net assets to net cash (used in) provided by operating activities:		
Depreciation and amortization	**134,116**	131,512
Bond premium and discount amortization	**(5,525)**	(5,522)
Decrease (increase) in investments designated as trading	**180,111**	(123,464)
Change in fair value of interest rate swaps	**(19,678)**	(7,450)
Donor-restricted donations	**(26,120)**	(20,989)
Gain on sale of assets	**(9,604)**	(31,495)
Distributions to noncontrolling partners	**8,803**	5,331
Investment loss (gain) on endowment funds	**28,333**	(5,284)
Loss on extinguishment of debt	**–**	10,154
Net change in operating assets and liabilities, exclusive of cash:		
Accounts receivable	**(47,815)**	(48,690)
Inventories	**4,783**	(7,497)
Prepaid expenses and other	**(33,343)**	(21,875)
Other assets	**(5,628)**	–
Accounts payable and accrued expenses	**(22,498)**	11,253
CMS advance payment	**(99,213)**	(71,654)
Other liabilities	**(1,389)**	(23,003)
Net cash (used in) provided by operating activities	**(69,860)**	27,167
Investing activities		
Purchases of property and equipment, net	**(220,023)**	(137,930)
Proceeds from sale of medical office buildings	**–**	99,000
Proceeds from sale of FastMed facilities	**–**	6,000
Increase in trust fund assets	**(714)**	(14,019)
Increase in other assets	**–**	(22,198)
Net cash used in investing activities	**(220,737)**	(69,147)
Financing activities		
Payments on long-term debt	**(22,489)**	(206,409)
Proceeds from issuance of debt	**–**	325,859
Principal payments on finance lease obligations	**(6,865)**	(7,552)
Distributions to noncontrolling partners	**(8,803)**	(5,331)
Investment (loss) gain on endowment funds	**(28,333)**	5,284
Donor-restricted donations	**26,120**	20,989
Net cash (used in) provided by financing activities	**(40,370)**	132,840
(Decrease) increase in cash, cash equivalents and restricted cash	**(330,967)**	90,860
Cash, cash equivalents and restricted cash at beginning of year	**561,754**	470,894
Cash, cash equivalents and restricted cash at end of year	**$ 230,787**	$ 561,754

HonorHealth

Consolidated Statements of Cash Flows (continued)
(In Thousands)

	Year Ended December 31	
	2022	**2021**
Noncash activity		
Property and equipment and accounts payable	**$ 3,772**	$ 4,302
Property and equipment and finance lease obligation	**$ 4,385**	$ 7,653
Excess insurance carrier receivable and payable	**$ 2,829**	$ (2,843)
Reconciliation of cash flows to the consolidated balance sheets		
Cash and cash equivalents	**$ 217,214**	$ 541,886
Restricted cash held in assets whose use is limited, less current portion	**$ 13,573**	$ 19,868
Total cash, cash equivalents and restricted cash	**$ 230,787**	$ 561,754

See accompanying notes.

1. Description of Business

HonorHealth is a nonprofit corporation exempt from income taxes under Internal Revenue Code Section 501(c)(3) and applicable state income tax codes. HonorHealth and its subsidiaries (the Company) own six acute care hospitals located in Scottsdale and Phoenix, Arizona; a captive insurance company, HonorHealth Captive Insurance Exchange (the Captive); ambulatory care centers; Innovation Care Partners (ICP), an accountable care organization (ACO); medical practices; HonorHealth Foundation (Foundation), which conducts fundraising and development programs for the benefit of the Company; and Desert Mission, an organization that provides family services, child care services, and health services for low-income families.

The Company also holds a controlling interest in the following business ventures:

- HonorHealth ASC, LLC – formed to create partnerships with physicians and to expand outpatient surgical settings outside of the hospital campuses.
- Global Rehab-Scottsdale, LLC – formed to lease a rehabilitation hospital and provide rehabilitation services to patients.
- HonorHealth FastMed Ambulatory Holdings, LLC (FastMed) – formed to operate urgent care centers.
- Intuitive Health of Maricopa County, LLC (Intuitive Health) – formed to operate freestanding emergency and urgent care centers. Intuitive Health opened its first freestanding emergency and urgent care center in 2022.

The Company holds noncontrolling interests in several health-related business ventures that are accounted for using the equity or cost method of accounting. In connection with a business venture entered into with Universal Health Services, Inc., a 120-bed Behavioral Hospital opened in 2022. The Behavioral Hospital business venture is accounted for under the equity method of accounting.

2. Summary of Significant Accounting Policies

Basis of Consolidation

The accompanying consolidated financial statements include the accounts of HonorHealth and its wholly owned subsidiaries and controlled business ventures. The Company records the unrelated investor's share of the controlled business venture as noncontrolling interests on the accompanying consolidated balance sheets and consolidated statements of operations. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of the accompanying consolidated financial statements in conformity with generally accepted accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the revenues and expenses recorded during the period. Actual results could differ from those estimates.

Fair Values

Carrying values of financial instruments classified as current assets and current liabilities approximate fair value due to the short-term liquidity of these instruments. The fair values of other financial instruments are disclosed in their respective notes.

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid investments with a remaining maturity of three months or less at the date of acquisition.

Short-Term Investments

Short-term investments include securities with maturity dates of one year or less from the consolidated balance sheet date and actively traded equity securities that are expected to be used on a short-term basis for working capital needs. These investments are stated at fair value, based on quoted market prices in active markets.

2. Summary of Significant Accounting Policies (continued)

Investments

The Company invests in various investment securities, such as equities, bonds, mutual funds, and alternative investments, which 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 financial statements.

The Company invests in alternative investments, mainly hedge funds and private equity funds (the funds), through limited partnerships. The Company accounts for its ownership interests in these alternative investments under the equity method of accounting based on the net asset value per share of the fund held by the Company. The fund net asset value is provided to the Company by each of the fund managers and is determined based on the estimated fair value of each of the underlying investments held in the funds. However, the fund's investment holdings may include investments in private investment funds which values have been estimated by the fund managers in the absence of readily determinable fair values. Due to the inherent uncertainty of these estimates, these values may differ from the values that would have been used had a ready market for these investments existed. Certain of the Company's alternative investments include provisions in which the fund can require future capital calls of up to $4,237,500. The Company is not aware of any capital calls that will be made through December 31, 2023. Alternative investments of approximately $15,000,000 have a lockup period ranging from seven to ten years.

Interest income, realized gains and losses, income on alternative investments, and unrealized gains and losses on investments are included in (deficiency) excess of revenues over expenses attributable to the Company, unless the income is restricted by the donor.

Accounts Receivable, Net

Accounts receivable have been adjusted to the estimated amounts expected to be received for services rendered to patients, inclusive of an estimated allowance for implicit price concessions. These estimated amounts are subject to further adjustments upon review by third-party payors. Management estimates the allowance for price concessions based upon a number of factors, including current contract prices, historical collection experience of each hospital, changes in collection patterns, the composition of patient accounts by payor type, the status of ongoing disputes with payors, and general economic conditions. Management regularly reviews payment data for each major payor in evaluating the sufficiency of the estimated allowance for price concessions.

2. Summary of Significant Accounting Policies (continued)

Inventories

Inventories, consisting principally of supplies and pharmaceuticals, are stated at the lower of cost or net realizable value, determined on a first-in, first-out basis.

Assets Whose Use is Limited

Assets whose use is limited include financial instruments that are to be used for the Captive's self-insurance funding arrangements and the Foundation's restricted funds.

Trust Fund Assets

Trust fund assets include allowable financial instruments that have been designated for payments under bond indenture agreements and for funds set aside from bond proceeds to be used for capital purchases.

Property and Equipment

Property and equipment are stated at cost, if purchased, or at fair value on the date received, if donated, less accumulated depreciation and amortization. Upon sale or retirement, cost and accumulated depreciation are eliminated from the respective accounts and any resulting gain or loss is included in (deficiency) excess of revenues over expenses. Depreciation is computed using the straight-line method over the estimated useful life of each class of depreciable asset, primarily ranging from 3 to 40 years. Routine maintenance and repairs are charged to expense when incurred. Expenditures that extend useful lives or increase capacities are capitalized. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Goodwill

Purchases of acquired businesses are allocated to the assets and liabilities assumed based on the estimated fair values on the respective acquisition dates. Based on these values, the excess purchase price over the fair value of the net assets acquired is allocated to goodwill. Goodwill is being amortized on a straight-line basis over ten years.

2. Summary of Significant Accounting Policies (continued)

Goodwill is subject to impairment evaluation when a triggering event occurs that indicates that the fair value of the entity is below its carrying amount. The Company has not identified any impairment triggering events as of December 31, 2022 or 2021.

Impairment of Long-Lived Assets

The Company reviews long-lived assets, other than goodwill, for impairment when events or changes in business conditions indicate that their carrying values may not be recoverable. The Company considers assets to be impaired and writes them down to fair value if expected undiscounted cash flows are less than the carrying amounts. Fair value is the present value of the associated discounted cash flows. The Company has not identified any impairment events as of December 31, 2022 or 2021.

Self-Insurance Programs

In connection with the Company's self-insurance programs, accounts have been established for the purpose of accumulating assets based on actuarial determinations. These assets can be used only for the payment of professional liability, general liability, workers' compensation, and related expenses. It is the Company's policy to record the expense and related liability for professional liability, general liability, and workers' compensation based upon undiscounted actuarial estimates. Self-insurance liabilities include estimates of the ultimate costs for both asserted and incurred but not reported claims for professional liability, workers' compensation, and general liability.

Net Assets

Net assets are classified based on the existence or absence of donor or grantor-imposed restrictions. Revenues and gains that are available for general operations and are not subjected to donor restrictions are included in net assets without donor restrictions.

Net assets with donor restrictions are those which use by the Company has been limited by donors or grantors to a specific time period or purpose. Net assets with donor restrictions also consist of endowment fund donations that have been restricted by donors to be maintained by the Foundation in perpetuity.

2. Summary of Significant Accounting Policies (continued)

Net Patient Service Revenue

The Company has agreements with third-party payors (including government programs) that provide payments to the Company at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated transaction price to reflect the total consideration expected to be received from patients, third-party payors, and others for providing patient care.

The Company uses a portfolio approach to estimate the transaction price for categories of patient contracts as a collective group, rather than recognizing revenue on an individual contract basis. The portfolios consist of major payor classes for inpatient revenue and outpatient revenue. 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 were used.

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 underinsured 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 for applicable patient portfolios.

Net patient service revenue is recognized as performance obligations are satisfied. Revenue for performance obligations satisfied over time is recognized based on the expected reimbursement for each of the performance obligations. Unsatisfied or partially unsatisfied performance obligations relate to inpatients not discharged at the end of the 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 performance obligations are satisfied over a period of time, which is typically less than one day, and revenue is recognized when services are provided, and the Company does not believe it is required to provide additional services.

2. Summary of Significant Accounting Policies (continued)

Contributions

All contributions are considered without restrictions unless specifically restricted by the donor. Amounts received that are designated for future periods or are restricted by the donor for specific purposes are reported as contributions with donor restrictions.

Restricted monetary gifts that are specifically donor designated are held in net assets with donor restrictions until the designation is met. When a donor designation is met, a stipulated time restriction ends, or a purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions.

The Company reports unconditional promises to give as donor-restricted contributions. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows, using risk-free interest rates when the unconditional promise is made. The discount rates used to record unconditional promises ranged from 0.4% to 4.7% in 2022 and ranged from 0.1% to 0.4% in 2021.

The Company reports conditional promises to give as contribution revenue when the conditions stipulated by the donor are met, at which time the conditional promise becomes unconditional.

Charity Care and Community Benefit

In the furtherance of its charitable purpose, the Company provides charity care and other benefits to the community it serves. The Company’s charity care policy is designed to provide traditional charity care without charge or at amounts less than established rates. Because the Company does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

In addition to providing traditional charity care, the Company assumes the unpaid costs of public programs, including Medicare and the Arizona Health Care Cost Containment System (AHCCCS), and delivers community outreach programs that include health education, diagnostic screenings, community health assessment surveys, and mobile services.

2. Summary of Significant Accounting Policies (continued)

The Company estimates charity care costs based on the Company's cost to charge ratio, which includes both direct and indirect costs. Costs incurred for providing charity care and other community benefits consist of the following for the years ended December 31 (in thousands):

	2022	2021
Unpaid costs relating to the AHCCCS program	**$ 162,299**	$ 138,554
Costs of providing community outreach programs	**36,289**	29,438
Traditional charity care, at cost	**36,932**	27,277
	235,520	195,269
Unpaid costs relating to the Medicare program	**255,906**	207,805
	$ 491,426	$ 403,074

Performance Indicator

The performance indicator is the (deficiency) excess of revenues over expenses attributable to the Company, which includes all changes in net assets without donor restrictions other than the net assets released from restriction for purchase of property and equipment, amortization of aggregate fair value of interest rate swaps and other changes.

New Accounting Pronouncement

In June 2016, the Financial Accounting Standards Board issued Accounting Standards Update 2016-13, *Financial Instruments – Credit Losses (Topic 326)*: *Measurement of Credit Losses on Financial Instruments*. The accounting standard focuses on estimation of expected losses on credit or loan amounts over the life of the loan and losses on other financial assets. The standard is effective for the company on January 1, 2023. The Company is currently evaluating the impact on its consolidated financial statements.

Subsequent Events

Recognized subsequent events are required to be recognized in the consolidated financial statements, and non-recognized subsequent events are required to be disclosed. The Company has evaluated subsequent events through the date of issuance, March 31, 2023.

3. Net Patient Service Revenue

The Company has agreements with third-party payors that provide for payments to the Company at amounts different from its established rates.

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

Commercial and Managed Care Payors: The Company has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Company under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Medicare: Inpatient and outpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Defined medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The Company is reimbursed for cost-reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the Company and audits thereof by the Medicare fiscal intermediary. The continuation of the Medicare program is dependent on government policies.

Laws and regulations governing the Medicare program are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded third-party payor settlement estimates will change by a material amount in the near term, as cost report adjustments become known or as cost report years are no longer subject to such audit.

AHCCCS: Inpatient services rendered to AHCCCS program beneficiaries are reimbursed based on prospectively determined rates based on clinical diagnosis. Outpatient services are reimbursed based on a fee schedule. On October 27, 2020, AHCCCS received federal approval to implement a new supplemental payment program for hospitals through the Hospital Enhanced Access Leading to Health Improvements Initiative (HEALTHII), beginning October 1, 2020. The Company recorded approximately $116,680,000 and $96,703,000 in HEALTHII revenue within net patient service revenue for the years ended December 31, 2022 and 2021, respectively.

3. Net Patient Service Revenue (continued)

In connection with the AHCCCS Medicaid Restoration program, certain hospitals within the state of Arizona were required to pay a hospital assessment fee to assist with the funding of increased Medicaid costs and provider payments. For the years ended December 31, 2022 and 2021, the Company paid approximately $124,064,000 and $107,510,000, respectively, in AHCCCS hospital assessment fees that are recorded within supplies, services, and other expenses.

Self-Pay: Self-pay includes patients without insurance and patients with deductibles and coinsurance associated with third-party payor coverage. For self-pay patients who do not qualify for charity care, the Company recognizes revenue on the basis of uninsured discounted or standard rates.

The Company has determined that the nature, amount, timing, and uncertainty of revenue and cash flows are affected by the payors, the lines of business that render services to patients and the timing of when revenue is recognized and billed. Net patient service revenue, by payor, for the years ended December 31 is as follows (in thousands):

	2022	2021
Commercial and managed care	**$ 1,165,116**	$ 1,110,293
Medicare	**1,135,825**	1,007,883
AHCCCS	**243,147**	253,430
Self-pay	**57,792**	35,759
Net patient service revenue	**$ 2,601,880**	$ 2,407,365

Net patient service revenue for the years ended December 31, by line of business, is as follows (in thousands):

	2022	2021
Hospital services	**$ 2,268,068**	$ 2,104,054
Physician services	**211,407**	178,538
Ambulatory services	**74,505**	60,843
Rehabilitation services	**27,280**	28,252
Urgent care services	**20,620**	35,678
	$ 2,601,880	$ 2,407,365

4. Concentration of Credit Risk

The Company grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor arrangements that include: (i) commercial and managed care contracts, (ii) Medicare, (iii) Medicaid funded through AHCCCS, and (iv) self-pay.

The following table summarizes the percentage of net accounts receivable as of December 31:

	2022	**2021**
Commercial and managed care	**51%**	53%
Medicare	**33**	30
AHCCCS	**9**	9
Self-pay	**7**	8
	100%	100%

The Company recognizes revenue from governmental agencies and managed care organizations is significant to the Company's operations, but management does not believe that there are any significant credit risks associated with these payors.

5. Fair Value of Financial Instruments

Fair value measurements used by the Company for all financial assets and liabilities that are recognized or disclosed at fair value in the consolidated financial statements are based on the premise that fair value is defined as 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 a liability. As a basis for considering such assumptions, the following three-tier fair value hierarchy has been used in determining the input used in measuring fair value:

- *Level 1*: Pricing is based on observable inputs, such as quoted prices in active markets for identical instruments.

5. Fair Value of Financial Instruments (continued)

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

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

Assets and liabilities measured at fair value are based on one or more of the following two valuation techniques. Where more than one technique is noted, individual assets or liabilities were valued based upon the lowest level of input that is significant to the fair value estimate. 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) Income approach – techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option pricing, and excess earnings models).

The Company's alternative investments were approximately $47,417,000 and $71,539,000 as of December 31, 2022 and 2021, respectively, which are omitted from the fair value hierarchy in the following schedule, as they are accounted for using the equity method of accounting.

5. Fair Value of Financial Instruments (continued)

The Company held the following investments as of December 31, which are recorded within the consolidated balance sheets as follows:

	2022	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a,b)
	(In Thousands)				
Money market	$ 37,797	$ 37,797	$ –	$ –	a
Debt securities					
U.S. Treasury/government obligations	52,490	–	52,490	–	a
Corporate bonds	91,926	–	91,926	–	a
Mortgage and asset-backed securities	123,378	–	123,378	–	a
Equity securities					
Marketable U.S. equity securities	194,177	194,177	–	–	a
International equities	63,685	63,685	–	–	a
Guaranteed investment contract	4,823	–	–	4,823	b
Mutual funds					
Mutual funds – U.S. funds	674,028	674,028	–	–	a
Mutual funds – international	70,290	70,290	–	–	a
Total investments at fair value	$ 1,312,594	$ 1,039,977	$ 267,794	$ 4,823	
Short-term investments	$ 754,840				
Assets whose use is limited	231,258				
Trust fund assets	54,994				
Long-term investments	293,694				
Other assets (457(b) Plan)	25,225				
Less alternative investments	(47,417)				
Total fair value investments	$ 1,312,594				
Interest rate swap liability (included in other liabilities)	$ (13,493)	$ –	$ (13,493)	$ –	b

5. Fair Value of Financial Instruments (continued)

	2021	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b)
			(In Thousands)		
Money market and cash	$ 42,707	$ 42,707	$ –	$ –	a
Debt securities					
U.S. Treasury/government obligations	85,343	–	85,343	–	a
Corporate bonds	89,273	–	89,273	–	a
Mortgage, asset-backed securities, and commercial paper	100,152	–	100,152	–	a
Equity securities					
Marketable U.S. equity securities	237,379	237,379	–	–	a
International equities	76,705	76,705	–	–	a
Guaranteed investment contract	5,106	–	–	5,106	b
Mutual funds					
Mutual funds – U.S. funds	743,192	743,192	–	–	a
Mutual funds – international	100,419	100,419	–	–	a
Total investments at fair value	$ 1,480,276	$ 1,200,402	$ 274,768	$ 5,106	
Short-term investments	$ 860,484				
Assets whose use is limited	271,566				
Trust fund assets	54,280				
Long-term investments	334,149				
Other assets (457(b) plan assets)	31,336				
Less alternative investments	(71,539)				
Total fair value investments	$ 1,480,276				
Interest rate swap liability (included in other liabilities)	$ (33,372)	$ –	$ (33,372)	$ –	b

6. Assets Whose Use is Limited

Assets whose use is limited primarily include assets held by the Foundation that are restricted for use and assets that have been set aside for payment of medical malpractice, general liability, workers' compensation in accordance with the Company's self-insurance programs.

Assets whose use is limited consist of the following as of December 31 (in thousands):

	2022	2021
Foundation and Board endowment funds	**$ 172,655**	$ 203,808
General and professional liability and workers' compensation funds	**53,557**	59,257
Rabbi trust retirement plan fund and other	**5,046**	8,501
	231,258	271,566
Less current portion	**(10,801)**	(6,647)
	$ 220,457	$ 264,919

A summary of investment (loss) income consists of the following for the years ended December 31 (in thousands):

	2022	2021
Interest and dividend income, net of fees	**$ 27,947**	$ 20,492
Net realized gains on sales of investments	**87,667**	27,957
Income (loss) from alternative investments	**(1,875)**	12,133
Change in unrealized (losses) gains, net	**(270,154)**	38,562
	$ (156,415)	$ 99,144

7. Property and Equipment

Property and equipment consist of the following as of December 31 (in thousands):

	2022	2021
Land and improvements	**$ 259,340**	$ 167,348
Buildings and improvements	**1,153,299**	1,125,860
Equipment	**984,887**	948,268
Construction-in-progress	**123,178**	97,336
	2,520,704	2,338,812
Less accumulated depreciation	**(1,516,886)**	(1,439,508)
	$ 1,003,818	$ 899,304

A substantial portion of real property and related equipment owned by the Company secures the Company's tax-exempt debt obligations.

8. Other Assets

Other assets consist of the following as of December 31 (in thousands):

	2022	2021
Goodwill, net of amortization of $24,931 and $16,723 in 2022 and 2021, respectively	**$ 59,746**	$ 67,954
457(b) plan assets	**25,225**	31,336
Noncontrolling investment in business ventures	**38,916**	28,936
Insurance recovery receivable	**10,421**	8,200
Pledge receivables	**17,167**	13,024
Other	**12,550**	4,840
	$ **164,025**	$ 154,290

9. Long-Term Debt

	December 31 2022	2021
	(In Thousands)	
Series 2014A Hospital Revenue Bonds with a fixed interest rate of 5.00%. Interest is due semiannually. Principal due in annual debt service payments ranging from $4,455 to $29,115, with final maturity in 2042.	**$ 272,100**	$ 276,555
Series 2019A Hospital Revenue Bonds with fixed interest rates of 4.13% and 5.00%. At December 31, 2022 and 2021, the interest rate was 5%. Interest is due semiannually. Principal due in annual debt service payments ranging from $3,625 to $16,425, with final maturity in 2042.	**167,090**	174,605
Series 2019B Hospital Revenue Bonds with an initial long-term fixed interest rate of 5.00% through 2024, at which time the 2019B Bonds are subject to mandatory tender and interest rate mode reset in 2024. Interest is due semiannually. Principal due in annual debt service payments starting in 2043 ranging from $14,530 to $15,565, with final maturity in 2045.	**45,135**	45,135
Series 2019C Hospital Revenue Bonds with a variable interest rate. Interest is due monthly. At December 31, 2022 and 2021, the interest rate was 4.46% and 0.84%, respectively. The 2019C Bonds are subject to mandatory tender and interest rate mode reset in 2024. Principal due in annual debt service payments starting in 2046 ranging from $16,250 to $17,405, with final maturity in 2048.	**50,470**	50,470
Series 2021A Hospital Revenue Bonds with fixed interest rates of 3.00%, 4.00%, and 5.00%. At December 31, 2022 and 2021, the interest rate was 5%. Interest is due semiannually. Principal is due in annual debt service payments starting in 2024 ranging from $1,000 to $29,250, with final maturity in 2051.	**168,180**	168,180
Series 2021B Hospital Revenue Bonds (Federally Taxable) with fixed interest rate of 3.167%. Interest is due semiannually. Principal is due in annual debt service payments starting in 2046 ranging from $7,700 to $8,995, with final maturity in 2051.	**50,000**	50,000
Series 2021C Hospital Revenue Bonds with a variable interest rate. Interest is due monthly. At December 31, 2022 and 2021, the interest rate was 4.19% and 0.57% respectively. Principal due in annual debt service payments starting in 2038 ranging from $3,300 to $15,865, with final maturity in 2045.	**76,600**	76,600

9. Long-Term Debt (continued)

	December 31 2022	2021
	(In Thousands)	
Equipment note with fixed interest rate of 2.10%. Interest is due monthly. Principal due in annual debt service payments ranging from $8,541 to $11,093, with final maturity in 2027. The note is collateralized by certain hospital equipment, as defined in the note agreement.	**$ 51,552**	$ 61,753
Other notes payable	**202**	521
Unamortized premiums and discounts, net	**69,073**	75,091
Unamortized bond issuance costs	**(6,716)**	(7,210)
	943,686	971,700
Less current portion	**(18,662)**	(22,170)
	$ 925,024	$ 949,530

All of the active bond issues are limited obligations of the Industrial Development Authority of the County of Maricopa and the Arizona Health Facilities Authority and are payable from payments to be made under related loan agreements by the Company's Obligated Group (the Obligated Group), as defined in the Master Trust Indenture. The loan agreements require the Obligated Group to make payments on the notes to the trustee in amounts that are sufficient to pay the principal and interest on the bonds when due. In addition, the loan agreements require the Obligated Group to maintain compliance with certain financial covenants. At December 31, 2022 and 2021, the Obligated Group was in compliance with these debt covenants.

Future maturities of long-term debt at December 31, 2022 are as follows (in thousands). The future maturities of long-term debt exclude net unamortized premiums, discounts, and bond issuance costs included within long-term debt.

2023	$ 18,785
2024	25,236
2025	29,102
2026	30,662
2027	26,605
Thereafter	750,939
	$ 881,329

9. Long-Term Debt (continued)

Interest expense consists of the following for the years ended December 31 (in thousands):

	2022	2021
Interest paid during the year	**$ 32,937**	$ 29,165
Interest costs capitalized	**(4,207)**	(3,688)
Interest rate swap payments	**2,755**	3,968
Change in accrued interest	**89**	1,305
	$ 31,574	$ 30,750

Interest Rate Swap Agreements

The Company entered into multiple interest rate swap agreements that effectively convert the London Interbank Offered Rate (LIBOR) rate into fixed rates for the each of the established notional amounts, as defined in the swap agreements. The interest rate swaps are insured by Assurance Guaranty and are subject to collateral posting if the rating of Assurance Guaranty falls below a threshold defined in the swap agreement. The Company entered into a two-year Swap Management Agreement with Assurance Guaranty on February 11, 2021, which was extended for two years to February 2025, which maintained the same collateral posting levels. There were no collateral postings as of December 31, 2022 or 2021.

The interest rate swaps did not qualify for hedge accounting treatment under accounting standards for derivative instruments and hedging activity. As of December 31, 2022 and 2021, the estimated fair value of the interest rate swaps resulted in a net imputed obligation of approximately $13,493,000 and $33,372,000, respectively, which is recorded in other long-term liabilities on the accompanying consolidated balance sheets. For the years ended December 31, 2022 and 2021, the Company recognized a gain of approximately $19,678,000 and $7,450,000, respectively, for the aggregate change in the fair value of the interest rate swaps. The fair value of the interest rate swaps is based on the forward LIBOR curve, with a blended average duration of approximately 20 years.

The net realized portion of the interest rate swaps for the years ended December 31, 2022 and 2021, recorded in interest expense, was approximately $2,755,000 and $3,968,000, respectively.

10. Leases

The Company leases office and clinical facilities, as well as equipment under operating and finance-type leases. For leases with terms greater than 12 months, management records the related right-of-use assets and lease obligations at 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 liabilities. The Company uses a risk-free discount rate 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 December 31:

	2022	**2021**
Weighted average remaining term:		
Operating leases	**8 years**	6 years
Finance leases	**7 years**	7 years
Weighted average discount rate:		
Operating leases	**2.0%**	1.8%
Finance leases	**2.7%**	1.5%

10. Leases (continued)

The following table reconciles the undiscounted cash flows to the finance lease liabilities and operating lease liabilities recorded on the consolidated balance sheets as of December 31, 2022 (in thousands):

	Operating Leases	Finance Leases
2023	$ 36,368	$ 7,931
2024	31,540	5,285
2025	26,975	2,780
2026	22,135	1,855
2027	18,966	1,106
Thereafter	69,709	7,676
Total minimum lease payments	205,693	26,633
Less amount of lease payments representing interest	(14,897)	(3,304)
Present value of future minimum lease payments	190,796	23,329
Less current obligations under leases	(33,128)	(7,444)
Long-term lease obligations	$ 157,668	$ 15,885

The lease cost components, by lease type, for the years ended December 31 are as follows (in thousands):

	2022	2021
Finance lease expense:		
Amortization of leased assets	**$ 6,539**	$ 5,182
Interest on lease liabilities	**178**	162
Operating leases	**31,023**	27,050
Short-term leases	**10,399**	9,995
Total lease cost	**$ 48,139**	$ 42,389

The Company accounts for all rent holidays, tenant improvement allowances, and escalation clauses by recognizing the total operating lease 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 a reduction to the right-of-use assets – operating.

10. Leases (continued)

Supplemental lease cash flow information for the years ended December 31 is as follows (in thousands):

	2022	2021
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows for operating leases	**$ 32,136**	$ 28,135
Operating cash flows for finance leases	**178**	162
Financing cash flows for finance leases	**6,865**	7,552

11. Other Liabilities

Other liabilities consist of the following as of December 31 (in thousands):

	2022	2021
Accrued medical malpractice and general insurance liability	**$ 43,488**	$ 45,078
Fair value of interest and basis rate swaps	**13,493**	33,372
Executive deferred compensation 457(b)	**25,225**	31,336
Deferred ground lease revenue	**15,289**	15,564
Supplemental executive retirement plan	**4,988**	6,206
Other liability	**21,684**	10,845
	$ 124,167	$ 142,401

12. Net Assets

Net assets with donor restrictions are restricted for the following purposes as of December 31 (in thousands):

	2022	2021
Subject to expenditure for specified purpose		
Hospital programs	**$ 41,374**	**$ 57,448**
Education and research	**12,392**	9,568
Facilities and equipment	**2,092**	4,227
Community service	**6,144**	5,394
	62,002	76,637
Subject to spending policy and appropriation		
Endowment fund to be held in perpetuity, for which the investment earnings are used to support:		
Hospital programs	**127,642**	145,619
Education and research	**20,142**	22,927
Community service	**7,096**	8,324
Facilities and equipment	**351**	403
	155,231	177,273
Total net assets with donor restrictions	**$ 217,233**	$ 253,910

Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions. The Foundation classifies permanent endowment donations within net assets with donor restrictions. The Foundation adopted a policy to appropriate for distribution a percentage of the endowment fund investment earnings as determined annually by the Foundation, in the absence of donor-imposed restrictions.

12. Net Assets (continued)

The Foundation considers the following factors in making a determination as to the annual endowment fund distribution:

(1) The duration and preservation of the fund

(2) The purposes of the Foundation 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 organization.

(7) The investment policies of the Foundation

The Foundation has adopted an endowment investment and spending policy that attempts to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Under this policy, the endowment assets are invested in a manner that is intended to produce a rate of return, net of inflation and investment management costs, to retain the purchasing power of the endowment assets.

The Foundation targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term objectives within prudent risk constraints.

12. Net Assets (continued)

Changes in endowment net assets for the years ended December 31, 2022 and 2021 consisted of the following (in thousands):

	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets, January 1, 2021	$ 17,890	$ 169,015	$ 186,905
Investment gain, net	–	23,938	23,938
Contributions	–	1,759	1,759
Appropriation of endowment assets for expenditure	–	(8,794)	(8,794)
Endowment net assets, December 31, 2021	17,890	185,918	203,808
Investment loss, net	**(466)**	**(28,333)**	**(28,799)**
Contributions		**197**	**197**
Appropriation of endowment assets for expenditure	**–**	**(2,551)**	**(2,551)**
Endowment net assets, December 31, 2022	**$ 17,424**	**$ 155,231**	**$ 172,655**

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires the Foundation to retain as a fund of perpetual duration. No deficiencies of this nature were reported as of December 31, 2022 or 2021.

13. Functional Expenses

The Company provides health care services, including inpatient, outpatient, physician, rehab, ambulatory, and urgent care services, to individuals within its geographic areas supported by its acute care centers. Administrative and other includes support services such as finance and accounting, information technology, human resources, marketing, and supply chain, as well as the Foundation, ACO, the Captive, and Desert Mission. The following statements of functional expenses report the Company's operating expenses, as presented on the consolidated statements of operations, by the Company's major operating functions for the years ended December 31, 2022 and 2021. Operating expenses attributable to more than one operating function have been allocated using a basis representative of the operating expenditure, such as patient volume, full-time equivalent, or facility size.

13. Functional Expenses (continued)

	Operating Expenses Year Ended December 31, 2022		
	Health Care Services	Administrative and Other	Total
		(In Thousands)	
Expenses:			
Salaries and benefits	**$ 1,023,890**	**$ 305,842**	**$ 1,329,732**
Supplies, services, and other	**1,148,078**	**163,689**	**1,311,767**
Depreciation and amortization	**98,805**	**35,311**	**134,116**
Interest	**30,424**	**1,150**	**31,574**
Total expenses	**$ 2,301,197**	**$ 505,992**	**$ 2,807,189**

	Operating Expenses Year Ended December 31, 2021		
	Health Care Services	Administrative and Other	Total
		(In Thousands)	
Expenses:			
Salaries and benefits	$ 927,313	$ 274,886	$ 1,202,199
Supplies, services, and other	985,977	160,080	1,146,057
Depreciation and amortization	99,109	32,403	131,512
Interest	30,109	641	30,750
Total expenses	$ 2,042,508	$ 468,010	$ 2,510,518

14. Commitments and Contingent Liabilities

Health Care Regulatory Environment

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, and government health care program participation requirements; reimbursement for patient services; and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes the Company is in compliance with fraud and abuse regulations, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

14. Commitments and Contingent Liabilities (continued)

In addition to general and professional liability claims, the Company is involved in litigation and regulatory investigations arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, these matters are expected to be resolved without material adverse effect on the Company’s consolidated financial position, results of operations, or cash flows.

15. Medical Malpractice Claims

The Company currently self-insures medical malpractice and general liability claims for the first $3,000,000 per occurrence with an additional $2,000,000 per occurrence coverage for hospital professional liability claims. Coverage is limited at $21,000,000 in the aggregate. Insurance coverage has been purchased by the Company to cover excess claim settlements up to $20,000,000 per occurrence and in aggregate.

It is the Company’s policy to record the expense and related liability for medical malpractice and general liability losses based on actuarial estimates on an undiscounted basis. Included on the accompanying consolidated balance sheets is an actuarially computed accrual of approximately $51,460,000 and $48,886,000 at December 31, 2022 and 2021, respectively, for medical malpractice and general liability claims, which includes $4,734,000 and $6,139,000 , respectively, of estimated obligation for medical malpractice and general liability claims that will be covered by the excess insurance carrier. Of the amounts recorded at December 31, 2022 and 2021, approximately $7,972,000 and $3,808,000, respectively, represent the current portion of the medical malpractice and general liability claims recorded in accrued expenses on the consolidated balance sheets.

16. Retirement Plans

Defined Contribution Plan

The Company has a defined contribution plan covering all eligible employees who elect to contribute at least 2% of defined earnings to the plan. The Company matched 100% of eligible employee contributions up to 4% in 2022 and 2021. Effective January 1, 2022, new participants must have three years of service to be fully vested in the employer contribution. Company contributions to the defined contribution plan were approximately $34,376,000 and $29,393,000 for the years ended December 31, 2022 and 2021, respectively.

16. Retirement Plans (continued)

457(b) Retirement Plan

The Company has a 457(b) retirement plan that covers certain members of management who elect to participate under the terms of the plan. Both the eligible employees and the Company contribute to the plan in order to meet the future benefit obligation. The Company retains title to all of the assets and obligations of these plans. At December 31, 2022 and 2021, plan investments and liabilities were approximately $25,225,000 and $31,336,000, respectively.

17. Income Taxes

The Company calculates income taxes using the liability method, under which deferred tax assets and liabilities are determined based upon the differences between the financial accounting and tax bases of assets and liabilities. The Company recognizes the tax benefit from uncertain tax positions, only if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Company annually reviews its uncertain tax positions and, based on this review, has not recorded any expense or accrued for any uncertain tax positions as of December 31, 2022 or 2021. The statute of limitations for tax returns filed for years 2019 through 2022 remains open in U.S. tax jurisdictions in which the Company is subject to taxation.

18. Liquidity

Financial assets available for general expenditure within one year of the consolidated balance sheet date consist of the following as of December 31 (in thousands):

	2022	2021
Cash and cash equivalents	**$ 217,214**	$ 541,886
Patient accounts receivable	**423,244**	375,429
Short-term investments	**754,840**	860,484
	$ 1,395,298	$ 1,777,799

The Company has the ability to structure its financial assets to be available as its general expenditures and other obligations come due. Cash in excess of daily requirements is invested in short-term investments.

19. ACO Shared Savings

ICP is a participant in the Medicare Shared Savings Program (MSSP) and has also entered into several shared savings contracts and risk share contracts with other unrelated commercial insurance companies (ICP revenue contracts). ICP has established a provider network consisting of HonorHealth facilities, employed HonorHealth providers and participating independent provider networks. Each of the commercial insurance companies retains the responsibility to pay the health care provider claims. The Company recorded revenue from the ICP contracts of approximately $9,156,000 for the year ended December 31, 2022, and $18,801,000 for the year ended December 31, 2021. The revenue from the ICP revenue contracts has been recorded within other revenue on the consolidated statements of operations.

20. COVID-19

In March 2020, the World Health Organization designated COVID-19 as a global pandemic. During the pandemic, the Company experienced supply chain disruptions, including significant price increases in medical supplies, personal protective equipment and labor costs. The federal government announced that the Public Health Emergency will end May 11, 2023.

In March 2020, the Coronavirus Aid, Recovery, and Economic Security (CARES) Act was enacted, which provided additional sources of funds to health care providers during the pandemic. Under the CARES Act, the Company recorded approximately $15,986,000 of provider relief funds in 2022 and $21,923,000 of provider relief funds in 2021 from the U.S. Department of Health and Human Services (HHS), which has been recognized as revenue on the accompanying consolidated statements of operations. The Company recognizes grant payments as revenue when there is reasonable assurance that the grant conditions are met.

The CARES Act also provides for an expansion of the Medicare Accelerated and Advance Payment Program, which allowed the Centers for Medicare & Medicaid Services (CMS) to accelerate payments for future Medicare services. The Company received approximately $170,867,000 in 2020 from CMS for Medicare advance payments. Recoupment by CMS began in April 2021 and all of the Medicare advance payments were repaid as of December 31, 2022.

Reports Required by the Uniform Guidance

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Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Management and the Board of Directors
HonorHealth

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States (*Government Auditing Standards*), the consolidated financial statements of HonorHealth (the Company), which comprise the consolidated balance sheet as of December 31, 2022, and the related consolidated statements of operations, changes in net assets and cash flows for the year then ended, and the related notes (collectively referred to as the "financial statements"), and have issued our report thereon dated March 31, 2023.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses or significant deficiencies may exist that were not identified.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst & Young LLP

March 31, 2023

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Report of Independent Auditors on Compliance for the Major Federal Program and Report on Internal Control Over Compliance Required by the Uniform Guidance

Management and the Board of Directors
HonorHealth

Report of Independent Auditors on Compliance for the Major Federal Program

Opinion on the Major Federal Program

We have audited HonorHealth's compliance with the types of compliance requirements identified as subject to audit in the U.S. Office of Management and Budget (OMB) *Compliance Supplement* that could have a direct and material effect on HonorHealth's major federal program for the year ended December 31, 2022. HonorHealth's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

In our opinion, HonorHealth complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2022.

Basis for Opinion on the Major Federal Program

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America (GAAS); the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States (*Government Auditing Standards*); and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Our responsibilities under those standards and the Uniform Guidance are further described in the Auditor's Responsibilities for the Audit of Compliance section of our report.

We are required to be independent of HonorHealth and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on compliance for the major federal program. Our audit does not provide a legal determination of HonorHealth's compliance with the compliance requirements referred to above.

Responsibilities of Management for Compliance

Management is responsible for compliance with the requirements referred to above and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to HonorHealth's federal programs.

Auditor's Responsibilities for the Audit of Compliance

Our objectives are to obtain reasonable assurance about whether material noncompliance with the compliance requirements referred to above occurred, whether due to fraud or error, and express an opinion on HonorHealth's compliance based on our audit. 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, *Government Auditing Standards*, and the Uniform Guidance will always detect material noncompliance when it exists. The risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Noncompliance with the compliance requirements referred to above is considered material, if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about HonorHealth's compliance with the requirements of the major federal program as a whole.

In performing an audit in accordance with GAAS, *Government Auditing Standards*, and the Uniform Guidance, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material noncompliance, 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 HonorHealth's compliance with the compliance requirements referred to above and performing such other procedures as we considered necessary in the circumstances.

- Obtain an understanding of HonorHealth's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of HonorHealth's internal control over compliance. Accordingly, no such opinion is expressed.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that we identified during the audit.

Building a better working world

Report on Internal Control Over Compliance

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the Auditor's Responsibilities for the Audit of Compliance section above and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance. Given these limitations during our audit, we did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, material weaknesses or significant deficiencies in internal control over compliance may exist that were not identified.

Our audit was not designed for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, no such opinion is expressed.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Ernst & Young LLP

September 11, 2023

Supplementary Information

HonorHealth

Schedule of Expenditures of Federal Awards

Year Ended December 31, 2022

Federal Grantor/Program Title/ Cluster Title/*Pass-Through Grantor*	Assistance Listing Number	Pass-Through Number	Research and Development Cluster	Other Expenditures	Total Expenditures
U.S. Department of Agriculture					
Child and Adult Care Food Program Pass-Through Programs:					
Arizona Department of Education	10.558	CTD-07-22-06	$ –	$ 35,736	$ 35,736
Arizona Department of Education	10.558	CTD-07-93-01	–	11,141	11,141
Total Child and Adult Care Food Program			–	46,877	46,877
SNAP Cluster:					
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program Pass-Through Program:					
Arizona Department of Health Services	10.561	C86-18-027-3-02	–	85,592	85,592
Total SNAP Cluster			–	85,592	85,592
Food Distribution Cluster:					
Commodity Supplemental Food Program Pass-Through Program:					
Westside Food Bank[(a)]	10.565	CSFP 50605	–	191,971	191,971
Emergency Food Assistance Program (Administrative Costs) Pass-Through Program:					
Westside Food Bank[(a)]	10.568	TEFAP 50002	–	455,133	455,133
Total Food Distribution Cluster			–	647,104	647,104
Total U.S. Department of Agriculture			**–**	**779,573**	**779,573**
U.S. Department of Defense					
Military Medical Research and Development Pass-Through Program:					
University of Miami	12.420	W81XWH1610756	6,601	–	6,601
Total U.S. Department of Defense			**6,601**	**–**	**6,601**

HonorHealth

Schedule of Expenditures of Federal Awards (continued)

Year Ended December 31, 2022

Federal Grantor/Program Title/ Cluster Title/*Pass-Through Grantor*	Assistance Listing Number	Pass-Through Number	Research and Development Cluster	Other Expenditures	Total Expenditures
U.S. Department of Justice					
Crime Victim Assistance Pass-Through Program:					
Arizona Department of Public Safety	16.575	2017-VA-GX-0046	$ –	$ 143,150	$ 143,150
Total U.S. Department of Justice			**–**	**143,150**	**143,150**
U.S. Department of Veterans Affairs					
Veterans Home Based Primary Care Pass-Through Program:					
Carl T. Hayden VA Medical Center	64.U01	PAADC644005	–	62,740	62,740
Total U.S. Department of Veterans Affairs			**–**	**62,740**	**62,740**
U.S. Department of Health and Human Services					
Aging Cluster:					
Special Programs for the Aging, Title III, Part B, Grants for Supportive Services and Senior Centers	93.044		–	46,386	46,386
Total Aging Cluster			–	46,386	46,386
National Family Caregiver Support, Title III, Part E	93.052		–	77,134	77,134
Cancer Cause and Prevention Research Pass-Through Program:					
Beckman Research Institute of the City of Hope	93.393	61998.2006995.669303	39,065	–	39,065
COVID-19 – HRSA COVID-19 Claims Reimbursement for the Uninsured Program and the COVID-19 Coverage Assistance Fund	93.461		–	676,031	676,031

Federal Grantor/Program Title/ Cluster Title/*Pass-Through Grantor*	Assistance Listing Number	Pass-Through Number	Research and Development Cluster	Other Expenditures	Total Expenditures
COVID-19 – Provider Relief Fund and American Rescue Plan (ARP) Rural Distribution	93.498		$ –	$ 2,874,519	$ 2,874,519
Social Services Block Grant Pass-Through Program:					
Area Agency on Aging, Region One, Incorporated	93.667	2020-22-HHL	–	43,218	43,218
Total U. S. Department of Health and Human Services			**39,065**	**3,717,288**	**3,756,353**
Total Expenditures of Federal Awards			**$ 45,666**	**$ 4,702,751**	**$ 4,748,417**

[a] Represents a noncash federal award. Total expenditures reflected in the Schedule of Expenditures of Federal Awards is based on the total pounds of food distributed multiplied by the $1.92 fair value per pound during the year. The fair value of the total pounds of food was determined by Feeding America to the Arizona Association Foodbanks.

See notes to Schedules of Expenditures of Federal Awards.

HonorHealth

Notes to Schedule of Expenditures of Federal Awards

Year Ended December 31, 2022

1. Summary of Significant Accounting Policies

Basis of Accounting

The accompanying Schedule of Expenditures of Federal Awards (SEFA) includes the federal grant activity of HonorHealth and is presented using the accrual basis of accounting. The information in the SEFA is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). For purposes of the SEFA, federal awards include any assistance provided by a federal agency directly or indirectly in the form of grants, contracts, cooperative agreements, loan and loan guarantees, or other noncash assistance. The SEFA does not include payments received under the traditional Medicare and Medicaid reimbursement programs, as these programs are outside the scope of the Uniform Guidance. There were no donated goods and personal protected equipment received from federal sources that required recognition or disclosure in the notes to the SEFA.

HonorHealth has reimbursement-type federal grant contracts and noncash federal grant contracts. Payments of federal awards received under the terms of the reimbursement-type grant contracts are used to reimburse HonorHealth's allowable program expenditures. Noncash federal expenditures are reported on the SEFA based on the total pounds of food distributed by HonorHealth multiplied by the fair value per pound of food, as of the receipt date, as determined by Feeding America to the Arizona Association of Foodbanks.

HonorHealth does not pass any federal awards to subrecipients.

2. Indirect Costs

HonorHealth has elected to use the 10% de minimis indirect cost rate allowed by the Uniform Guidance.

3. Provider Relief Fund

The amount presented on the SEFA for Assistance Listing Number 93.498, COVID-19 – Provider Relief Fund and American Rescue Plan (ARP) Rural Distribution (PRF Funds), is for the year ended December 31, 2022. The amount presented in the table below reconciles to the Provider Relief Fund (PRF) information reported to the Health Resources and Services Administration (HRSA) as follows:

Name of Reporting Entity for HRSA Reporting Period 4 PRF Report	Reporting Entity Tax Identification Number	Type of Distribution	Other Provider Relief Fund and American Rescue Plan Expenses	Lost Revenues	Total
HonorHealth	860181654	American Rescue Plan	$ –	$ 2,701,540	$ 2,701,540
GlobalRehab Scottsdale, LLC	274160293	General and American Rescue Plan	172,979	–	172,979
Total PRF expenditures			$ 172,979	$ 2,701,540	$ 2,874,519

Health and Human Services (HHS) has indicated the PRF Funds on the SEFA be reported corresponding to reporting requirements of the HRSA PRF Reporting Portal. Payments from HHS for PRF are assigned to 'Payment Received Periods' (each, a Period) based upon the date each payment from the PRF was received. Each Period has a specified Period of Availability and timing of reporting requirements. Entities report into the HRSA PRF Reporting Portal after each Period's deadline to use the funds (i.e., after the end of the Period of Availability).

The SEFA includes $2,874,519 of PRF Funds received from HHS between January 1, 2021 through December 31, 2021. In accordance with guidance from HHS, these amounts are presented as Period 3 and Period 4. Such amount was recognized as provider relief funds in HonorHealth's consolidated financial statements in the year ended December 31, 2021.

Schedule Required by the Uniform Guidance

HonorHealth

Schedule of Findings and Questioned Costs

For the Year Ended December 31, 2022

Section I – Summary of Auditor's Results

Financial Statements

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP*:*	Unmodified
Internal control over financial reporting:	
Material weakness(es) identified?	____Yes X No
Significant deficiency(ies) identified?	____Yes X None reported
Noncompliance material to financial statements noted?	____Yes X No

Federal Award

Internal control over major federal program:	
Material weakness(es) identified?	____Yes X No
Significant deficiency(ies) identified?	____Yes X None reported
Type of auditor's report issued on compliance for major federal program:	Unmodified
Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?	____Yes X No

Identification of major federal program:

Assistance Listing Number	Name of Federal Program or Cluster
93.498	COVID-19 – Provider Relief Fund and American Rescue Plan (ARP) Rural Distribution

Dollar threshold used to distinguish between Type A and Type B programs:	$ 750,000
Auditee qualified as low-risk auditee?	____Yes X No

Section II – Financial Statement Findings

No matters were reported.

Section III – Federal Award Findings and Questioned Costs

No matters were reported.

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Summary Schedule of Prior Audit Findings
For the Year Ended December 31, 2022

Federal Award Findings and Questioned Costs

Finding 2021-001

Internal Control Deficiency over Activities Allowed or Unallowed, Allowable Costs/Cost Principles, Eligibility and Special Tests and Provisions

Auditee Status Update:

The HRSA COVID-19 Claims Reimbursement for the Uninsured Program and the COVID-19 Coverage Assistance Fund stopped accepting claims on March 22, 2022 for testing and treatment and April 5, 2022 for vaccine administration and thus there are no changes required related to this particular program. However, if this program begins accepting claims again, management will implement controls regarding retention of required documentation.

Finding 2021-002

Noncompliance Over Provider Relief Fund Labor Costs

Auditee Status Update:

Management has refined the process for future provider relief fund reports regarding ensuring all costs submitted represent actual supported costs and excludes estimated accruals. The entity continues to have excess lost revenues to substantiate the payments received.

Summary Schedule of Prior Audit Findings
For the Year Ended December 31, 2022 (continued)

Finding 2020-001

Internal Control Deficiency over Activities Allowed or Unallowed and Eligibility relating to retaining documentation of management's oversight of billing Health Resources and Services Administration for eligible uninsured claims associate with the COVID-19 Claims Reimbursement to Health Care Providers and Facilities for Testing, Treatment, and Vaccine Administration for the Uninsured federal program.

Auditee Status Update:

The HRSA COVID-19 Claims Reimbursement for the Uninsured Program and the COVID-19 Coverage Assistance Fund stopped accepting claims on March 22, 2022 for testing and treatment and April 5, 2022 for vaccine administration and thus there are no changes required related to this particular program. However, if this program begins accepting claims again, management will implement controls regarding retention of required documentation.

Finding 2020-002

Noncompliance over the period of performance compliance requirement relating to charging costs outside of the federal award period for the Coronavirus Relief Fund entered into with the Arizona Department of Health Services.

Auditee Status Update:

HonorHealth received no additional money from the Arizona Department of Health Services for the Staffing Surge Grant. Other eligible expenditures were incurred during the period of performance which exceeded the questioned costs identified and that support the full amount of the expended grant. No further action needed on Finding 2020-002.