

Northern Arizona Healthcare Foundation

Financial Statements as of and for the
Year Ended June 30, 2017, and
Independent Auditors' Report

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Northern Arizona Healthcare Foundation:

We have audited the accompanying financial statements of Northern Arizona Healthcare Foundation (the "Foundation"), which comprise the statement of financial position as of June 30, 2017, and the related statement of activities and changes in net assets and cash flows for the year ended June 30, 2017, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Foundation for the year ended June 30, 2017, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

June 29, 2018

NORTHERN ARIZONA HEALTHCARE FOUNDATION

STATEMENT OF FINANCIAL POSITION AS OF JUNE 30, 2017

ASSETS

UNRESTRICTED CURRENT ASSETS:

Cash and cash equivalents	\$ 3,986,087
Accounts receivable	106,467
Prepaid expenses and other current assets	<u>24,302</u>

Total unrestricted current assets 4,116,856

MAJOR MOVABLE EQUIPMENT—Net of accumulated depreciation of \$10,081 21,052

Total unrestricted assets 4,137,908

DONOR-RESTRICTED ASSETS:

Temporarily restricted assets:

Cash and cash equivalents	5,055,831
Accounts receivable	565,952
Investments	<u>5,012,772</u>

Total temporarily restricted assets 10,634,555

Permanently restricted assets:

Accounts receivable	618,222
Investments	<u>22,947,078</u>

Total permanently restricted assets 23,565,300

Total donor-restricted assets 34,199,854

TOTAL \$ 38,337,762

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES:

Accounts payable	\$ 15,258
Due to affiliates	192,905
Accrued payroll	210,468
Deferred revenue	<u>43,875</u>

Total current liabilities 462,506

LONG-TERM LIABILITIES—Deferred compensation 58,667

Total Liabilities 521,173

NET ASSETS:

Unrestricted	3,616,734
Temporarily restricted	10,634,555
Permanently restricted	<u>23,565,300</u>

Total net assets 37,816,589

TOTAL \$ 38,337,762

See notes to financial statements.

NORTHERN ARIZONA HEALTHCARE FOUNDATION

STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS FOR THE YEAR ENDED JUNE 30, 2017

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUE:				
Contributions	\$4,156,800	\$11,337,840	\$22,318,728	\$37,813,368
Contributed services	1,545,093	-	-	1,545,093
Investment income—net of \$4,102 expense	47,655	-	433,184	480,839
Net realized and unrealized gain on investments	<u>-</u>	<u>-</u>	<u>1,777,823</u>	<u>1,777,823</u>
Total	5,749,548	11,337,840	24,529,735	41,617,123
Net assets released from restrictions	<u>1,667,720</u>	<u>(703,285)</u>	<u>(964,435)</u>	<u>-</u>
Total revenues	<u>7,417,268</u>	<u>10,634,555</u>	<u>23,565,300</u>	<u>41,617,123</u>
EXPENSES:				
Community grants	1,269,897	-	-	1,269,897
Event expenses	136,242	-	-	136,242
Fund expenditures	675,881	-	-	675,881
General and administrative expenses	<u>1,718,514</u>	<u>-</u>	<u>-</u>	<u>1,718,514</u>
Total expenses	<u>3,800,534</u>	<u>-</u>	<u>-</u>	<u>3,800,534</u>
INCREASE IN NET ASSETS	3,616,734	10,634,555	23,565,300	37,816,589
BEGINNING NET ASSETS	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
ENDING NET ASSETS	<u>\$3,616,734</u>	<u>\$10,634,555</u>	<u>\$23,565,300</u>	<u>\$37,816,589</u>

See notes to financial statements.

NORTHERN ARIZONA HEALTHCARE FOUNDATION

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2017

CASH FLOWS FROM OPERATING ACTIVITIES:	
Change in net assets	\$ 37,816,589
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Restricted contributions received for endowment	(21,700,506)
Increase in unrealized gains on investments:	(1,777,988)
Depreciation	10,081
Changes in operating assets and liabilities:	
Accounts receivable	(1,290,640)
Prepaid expenses	(24,302)
Accounts payable	15,258
Due to affiliates	192,905
Accrued payroll	210,468
Deferred revenue	43,875
Deferred compensation liability	<u>58,667</u>
Net cash provided by operating activities	<u>13,554,407</u>
CASH FLOWS FROM INVESTING:	
Purchase of major movable equipment	(31,133)
Purchase of investments	<u>(26,181,862)</u>
Net cash used by investing activities	<u>(26,212,995)</u>
CASH FLOWS FROM FINANCING:	
Cash received restricted for endowment	<u>21,700,506</u>
Net cash provided by financing activities	<u>21,700,506</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	9,041,918
CASH AND CASH EQUIVALENTS—Beginning of year	<u>-</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 9,041,918</u>

See notes to financial statements.

NORTHERN ARIZONA HEALTHCARE FOUNDATION

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED JUNE 30, 2017

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Northern Arizona Healthcare Foundation (the "Foundation") is organized and operated exclusively for charitable, religious, scientific, literary, and educational purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986, as amended. The Foundation filed articles of incorporation in the State of Arizona on June 27, 2016.

Mission Statement—The mission of the Foundation is to support Northern Arizona Healthcare Corporation (NAH), while advancing community health care priorities.

Basis of Accounting—The financial statements of the Foundation have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP).

Basis of Presentation—Assets, net assets, revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Assets and net assets of the Foundation and changes therein are classified into the following three categories:

- Unrestricted assets and net assets represent the portion of expendable funds that are available for support of Foundation activities. This category also includes funds that do not have a donor restriction.
- Temporarily restricted assets and net assets consist of contributions that have been restricted by the donor for specific purposes or are time restricted.
- Permanently restricted assets and net assets consist of contributions that have been restricted by the donor that stipulate that resources be maintained permanently, but permit the Foundation to use or expend part or all of the income derived from the donated assets for specified purposes.

Revenues are reported as increases in unrestricted net assets, unless use of the related assets is limited by donor-imposed restrictions. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by donor-imposed restrictions. At the time that the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed, a reclassification is made between the applicable classes of net assets.

Cash and Cash Equivalents—The Foundation considers all highly liquid short-term investments and interest-bearing deposits with maturities of three months or less at the date of purchase to be cash and cash equivalents. The Foundation's cash and cash equivalents consisted of \$964 thousand in money market funds as of the balance sheet date.

Investments—Investments for which readily determinable market values exist are recorded at fair value based upon publicly quoted market prices or quotations of similar securities. Investments for which readily determinable market values do not exist are recorded at fair value, determined by the Foundation, based in part on audited fair value financial statements of the investment fund. The Foundation contracts with outside parties, which provide investment management and consulting services.

Net unrealized appreciation (depreciation) on investments is recorded in the statement of activities for changes in the difference between the recorded cost of the investment and the fair value of the investment at the financial statement date.

Dividend and interest income is recorded when earned. Realized gains and losses from the sale of investments are recorded on their respective trade dates and are determined using the specific identification method.

Other Assets and Major Movable Equipment—Other assets include prepaid expenses and memberships as well as major movable equipment. As of June 30, 2017, major movable equipment consists of office equipment, furniture and fixtures. Major movable equipment is depreciated over their useful lives using the straight-line method of depreciation. As of June 30, 2017, the Foundation's major movable equipment has remaining useful lives that range from 1 month to 18 months.

Contributions—Contributions are recorded as revenue at their present value when unconditionally pledged or when received, whichever is earlier. The discounted values of recorded pledges are accreted to their full values, using a risk-free interest rate, during the period beginning when the pledge is made until the time it is expected to be paid.

Contributions subject to donor-imposed restrictions for use in a future period or for a specific purpose are reported as either temporarily or permanently restricted, depending on the nature of the donor's restriction. When a donor restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Donor-restricted contributions, whose restrictions are met in the same reporting period, are reported as temporarily restricted contributions with a corresponding release from restrictions.

The Foundation reports gifts in kind as unrestricted support, unless explicit donor stipulations specify how the donated assets must be used. 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 as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Foundation reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

Use of Estimates—The preparation of financial statements in conformity with GAAP 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 financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Tax Status—The Foundation is a not-for-profit corporation and is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes is included in the accompanying financial statements. The Foundation's management is not aware of any events that would cause the Foundation to lose its tax-

exempt status. The open year subject to tax examination is fiscal year 2017. The Foundation is not aware of any uncertain tax positions as of June 30, 2017.

Recent Accounting Pronouncements—In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-14, *Not-for-Profit Entities (Topic 958) Presentation of Financial Statements of Not-for-Profit Entities*, which makes improvements to the information provided in financial statements and accompanying notes of not-for-profit entities. The amendments set forth the FASB's improvements to net asset classification requirements and the information presented about a not-for-profit entity's liquidity, financial performance, and cash flows. ASU No. 2016-14 is effective for annual financial statements issued for fiscal years beginning after December 15, 2017, and for interim periods within fiscal years beginning after December 15, 2018. Application to interim financial statements is permitted, but not required in the initial year of application. Early application is permitted. The amendments in the ASU should be initially adopted only for an annual fiscal period or for the first interim period within the fiscal year of adoption.

2. INVESTMENTS

FASB Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, establishes a single authoritative definition of fair value, sets a framework for measuring fair value, and requires additional disclosures about fair value measurements. In accordance with ASC 820, the Foundation classifies its investments into Level 1, which refers to securities valued using quoted prices from active markets for identical assets. Level 2 refers to securities not traded on an active market, but for which observable market inputs are readily available. Level 3 refers to securities valued based on significant unobservable inputs. The Foundation has no Level 2 or Level 3 securities, and there were no transfers between levels during the year. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Foundation's investments as of June 30, 2017, are summarized as follows:

	Level 1	Total
Money market funds	\$ 6,172,458	\$ 6,172,458
Equity securities:		
US equity securities	9,467,451	9,467,451
Mutual funds:		
US corporate fixed-income funds	3,939,767	3,939,767
International stock funds	6,299,092	6,299,092
Global real estate funds	<u>2,081,082</u>	<u>2,081,082</u>
Total investments	<u>\$ 27,959,850</u>	<u>\$ 27,959,850</u>

The change in net unrealized appreciation on investments is reflected in the statement of activities for the year ended June 30, 2017, and is summarized as follows:

Net unrealized appreciation—beginning of year	\$ -
Net unrealized appreciation for the year	<u>1,777,988</u>
Net unrealized appreciation—end of year	<u>\$ 1,777,988</u>

Certain investments could potentially subject the Foundation to concentration of credit risk. The Foundation places its investments with funds that have diversified investment portfolios. The Foundation has 34 percent of investments (based on current fair values) in U.S. equity securities and 14 percent of its investments in U.S. corporate fixed-income funds. The Foundation also has 23 percent of its investments in international stock funds and 7 percent in global real estate funds. The remaining 22 percent of the Foundation's investments are in money market funds. The Foundation records its investments at fair value as determined by fund management.

3. COMMITMENTS

The Foundation, as of June 30, 2017, has designated \$3 million to be used for the Williams Hospital District to fund the construction of a medical clinic in Williams, Arizona ("Williams Clinic"). Subsequent to year-end, the Foundation approved an additional \$3 million to fund the construction of the clinic.

4. ENDOWMENTS

The Foundation is subject to the endowment management requirements of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), enacted in Arizona in April 2008.

The Foundation has determined that all permanently restricted net assets that are set aside for investment and production of income are endowments. Endowments are managed in a unitized investment pool. The Foundation's investment policy is based on providing funding for its programs. The primary investment objective is to maximize long-term real (after inflation) investment returns recognizing established risk parameters and the need to preserve capital. The Foundation's spending policy generally allows for an annual distribution of 7 percent of the balance of the endowment funds. However, in accordance with UPMIFA, the Foundation also considers the following factors when determining whether to appropriate or accumulate donor-restricted endowment funds in the absence of specific instructions from the donor: the duration and purpose of the fund, general economic conditions, and the possible effect of inflation and deflation.

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 (underwater endowments). Deficiencies of this nature are reported in unrestricted net assets. As of June 30, 2017, the Foundation had no funds with a deficiency.

The endowment represents 100 percent of the permanently restricted activity during the fiscal year ended June 30, 2017. The endowment balance as of June 30, 2017, was \$23.6 million, which represents 100 percent of the permanently restricted net assets at June 30, 2017. During the year ended June 30, 2017, \$22.3 million was contributed to the endowment by NAH. The contribution from NAH was invested and generated \$433 thousand in income and experienced unrealized gains of \$1.8 million. At year end, the Foundation released \$964 thousand from the endowment in accordance with the NAH endowment agreement.

5. RELATED-PARTY TRANSACTIONS

NAH Endowment Fund Grant—During the year ended June 30, 2017, the Foundation entered into a Grant Agreement with NAH, by which NAH agreed to make a grant of \$19.6 million to the Foundation to establish the NAH Endowment Fund ("Endowment

Fund"). The purpose of the Endowment Fund is to support NAH and to support both the delivery of quality health care and to increase the impact on health in positive, collaborative ways. The Endowment Fund is intended to exist in perpetuity. The Grant Agreement allows for a payout of a percentage of the fair market value of the Endowment Fund, as determined from time to time by the Foundation's Board of Directors, to be maintained in a separate Foundation account solely for the benefit of the Endowment Fund purpose. The Grant Agreement also calls for the establishment of a grants committee, with members selected by the Board of Directors of NAH, which will evaluate and recommend potential grants from the Endowment Fund. The Grant Agreement allows the Foundation to charge a competitive administrative service fee to be paid from the Endowment Fund.

Community Health Needs Fund Grant—During the year ended June 30, 2017, the Foundation entered into a Grant Agreement with NAH and its affiliates, Flagstaff Medical Center ("FMC") and Verde Valley Medical Center ("VVMC"), by which NAH, FMC, and VVMC agreed to make a grant of \$4 million in total to the Foundation to establish the NAH Community Health Needs Fund ("CHN Fund"). The purpose of the CHN Fund is restricted to supporting the health and well-being of people throughout Northern Arizona and surrounding communities, by funding the needs identified in the community health needs assessment reports prepared and updated from time to time by NAH, FMC, VVMC, and/or the Foundation. The CHN Fund is to be administered according to restrictions, if any, placed by donors. The Grant Agreement allows the Foundation to charge a competitive administrative service fee to be paid from the CHN Fund.

Donor Restricted Funds Grant—During the year ended June 30, 2017, the Foundation entered into a Grant Agreement with NAH, FMC, and VVMC by which NAH, FMC, and VVMC agreed to make and the Foundation agreed to accept and administer grants representing funds received from numerous donors over the past several years identified for specific departments; uses; diseases or medical specialties; and/or areas of need within the NAH, FMC, or VVMC facilities and/or communities ("Donor-Restricted Funds"). In total, these grants represented a contribution of \$6.1 million to the Foundation. The Grant Agreement allows the Foundation to charge a competitive administrative service fee to be accounted for as a release from restriction.

Shared Services and Facilities Agreement—During the year ended June 30, 2017, the Foundation entered into a Shared Services and Facilities Agreement with NAH, by which NAH agreed to provide to the Foundation certain administrative, managerial, and accounting services, as well as facilities rent, telephone, Internet, utilities, insurance, and other facilities-related costs, to the Foundation ("Shared Services Agreement"). Further, the Shared Services Agreement calls for certain NAH personnel to be seconded to and under the direction of the Foundation. In accordance with the Shared Services Agreement, NAH contributed the cost of all direct and indirect services and expenses provided to the Foundation during the start-up period of operations that ended on June 30, 2017. The total value of contributed services during the period amounted to \$1.5 million during the year.

NAH Net Operating Income Donation—On December 8, 2016, the NAH Board of Directors voted to contribute \$2.1 million to the Foundation. This election is made on an annual basis at the sole discretion of the NAH Board.

Other Related-Party Transactions—During the year ended June 30, 2017, one member of the Foundation Board of Directors was also a member of the NAH Board of Directors.

6. SUBSEQUENT EVENTS

On November 16, 2017, the NAH Board of Directors authorized the donation of 5 percent, approximately \$1.2 million, of NAH's fiscal year 2017 consolidated net operating income to the Foundation.

Subsequent to June 30, 2017, the Foundation Board designated an additional \$3 million to fund the Williams Clinic, for a total of \$6 million.

Subsequent to June 30, 2017, the Foundation and NAH signed a Letter of Agreement that clarified the amount and timing of future support contributions from NAH to the Foundation. NAH agreed to contribute \$3.1 million over a five-year period beginning in fiscal year 2019. Subject to formalized documentation called for in the Letter of Agreement, the Foundation will record a pledge receivable and recognize related contribution income during fiscal year 2018, when the donation was received.

Subsequent events were evaluated through June 29, 2018, the date the financial statements were available to be issued.

* * * * *