REPORT OF INDEPENDENT AUDITORS AND FINANCIAL STATEMENTS WITH REQUIRED SUPPLEMENTARY INFORMATION

PALOMAR HEALTH

June 30, 2022 and 2021

MOSSADAMS

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Overview

Palomar Health ("PH" or the "District") is a public health care district and is a political subdivision of the state of California (the "State") organized pursuant to Division 23 of the Health and Safety Code of the State.

This section of PH's annual financial report presents management's discussion and analysis of the financial performance for the years ended June 30, 2022 and 2021. Although the 2020 condensed statement of net position, the condensed statement of revenue, expenses, and changes in net position, and the condensed statement of cash flows are presented in this section, they are not presented in the accompanying audited financial statements and notes to the financial statements. PH adopted the provisions of Governmental Accounting Standards Board (GASB) 87, *Leases,* effective July 1, 2020. Accordingly, the 2020 financial information included in management's discussion and analysis has not been adjusted for the impact of GASB 87. We encourage the reader to consider the information presented here in conjunction with the audited financial statements that follow this section.

This annual financial report includes:

- Management's Discussion and Analysis
- Report of Independent Auditors
- Financial statements of PH, including notes that explain in more detail some of the information in the financial statements
- Schedule of changes in total Other Post Retirement Benefits (OPEB) liability and related ratios

The financial statements of PH include the financial statements of Arch Health Partners, Inc., dba Palomar Health Medical Group ("PHMG"); Pacific Accountable Management San Diego, LLC ("PAM-SD"); Pacific Accountable Management, LLC ("PAM"); Pacific Accountable Care, LLC ("PAC"); and Palomar Health Development, Inc. In accordance with GASB Codification Section 2100, *The Financial Reporting Entity,* for financial reporting purposes, PH's reporting entity includes PHMG as a blended component unit as a result of the fiscal dependency of PHMG on PH, and because PH is the sole corporate member of PHMG. Effective August 31, 2017, PH, PHMG, and U.S. Bank National Association added PHMG as an additional member of the Obligated Group created pursuant to the Master Trust Indenture. PH and PHMG collectively own 100% of PAC, PAM, and PAM-SD. Therefore, PAC, PAM, and PAM-SD are included as blended components of PH's reporting entity. Unless otherwise indicated, amounts presented in Management's Discussion and Analysis are in thousands.

Required Financial Statements

Statements of Net Position

The statements of net position include all of PH's assets and liabilities. They also provide information about the nature and amounts of investments in resources (assets), obligations to PH's creditors (liabilities), and net position, which is the difference between assets and liabilities. The statements of net position also provide the basis for evaluating the capital structure of PH and assessing the liquidity and financial flexibility of PH.

Table 1: Assets, Deferred Outflow of Resources, Liabilities, Deferred Inflow of Resources, and Net Position as of June 30:

				2022–2021 Change		2021–2020 Change	
ASSETS AND DEFERRED OUTFLOW OF RESOURCES	2022	2021	2020	Amount	Percentage	Amount	Percentage
CURRENT ASSETS	$ 541,644	$ 569,159	$ 519,681	$ (27,515)	-5%	$ 49,478	10%
CAPITAL ASSETS, net	978,401	969,786	1,006,984	8,615	1%	(37,198)	-4%
NONCURRENT ASSETS	389,547	400,411	74,969	(10,864)	-3%	325,442	434%
Total assets	1,909,592	1,939,356	1,601,634	(29,764)	-2%	337,722	21%
DEFERRED OUTFLOW OF RESOURCES	50,800	53,564	56,329	(2,764)	-5%	(2,765)	-5%
Total assets and deferred outflow of resources	$ 1,960,392	$ 1,992,920	$ 1,657,963	$ (32,528)	-2%	$ 334,957	20%
LIABILITIES, DEFERRED INFLOW OF RESOURCES, AND NET POSITION							
CURRENT LIABILITIES	$ 232,951	$ 221,995	$ 179,541	$ 10,956	5%	$ 42,454	24%
OTHER NONCURRENT LIABILITIES	5,371	4,072	4,142	1,299	32%	(70)	-2%
MEDICARE ACCELERATED PAYMENTS	-	18,837	48,852	(18,837)	-100%	(30,015)	-61%
LONG-TERM DEBT, net of current portion	1,265,915	1,286,844	1,265,729	(20,929)	-2%	21,115	2%
LEASE LIABILITY, net	250,278	258,065	-	(7,787)	-3%	258,065	-
FAIR VALUE OF INTEREST RATE SWAP	12,587	25,739	35,184	(13,152)	-51%	(9,445)	-27%
Total liabilities	1,767,102	1,815,552	1,533,448	(48,450)	-3%	282,104	18%
DEFERRED INFLOW OF RESOURCES	44,228	47,580	7,604	(3,352)	-7%	39,976	526%
Total liabilities and deferred inflow of resources	1,811,330	1,863,132	1,541,052	(51,802)	-3%	322,080	21%
INVESTED IN CAPITAL ASSETS, net of related debt	(234,199)	(173,322)	(164,396)	(60,877)	35%	(8,926)	5%
RESTRICTED, expendable for							
Repayment of debt	31,727	25,295	21,176	6,432	25%	4,119	19%
Capital acquisitions	20,223	9,028	9,911	11,195	124%	(883)	-9%
Other purposes	353	353	351	-	0%	2	1%
UNRESTRICTED	330,958	268,434	249,869	62,524	23%	18,565	7%
Total net position	149,062	129,788	116,911	19,274	15%	12,877	11%
Total liabilities, deferred inflow of resources, and net position	$ 1,960,392	$ 1,992,920	$ 1,657,963	$ (32,528)	-2%	$ 334,957	20%

2022: Analysis of the Statement of Net Position from 2021 to 2022

- Current assets decreased by $27,515 or 5% during the year ended June 30, 2022, primarily due to a decrease in cash of $21,499, a decrease in other receivables of $9,748, a decrease in investments of $17,964, a decrease in estimated third-party settlements receivable of $20,954, offset by an increase in patient accounts receivable of $36,708, and an increase in restricted cash and investments, current of $7,776.

- Capital assets, net increased by $8,615 or 1% due to continued investment in equipment and facilities.

- Noncurrent assets decreased by $10,864 or 3% due to decreases in lease right-of-use assets of $12,107 and a reduction in total restricted cash and investments of $31,064, offset by an increase in estimated third-party settlement receivable of $32,172.

- Deferred outflow of resources decreased by $2,764 or 5% due to the amortization of losses on refunding of debt.

- Current liabilities increased by $10,956 or 5% primarily due to increases in accounts payable of $29,407, an increase in current portion of lease obligations of $3,777, offset by a decrease in accrued compensation and related liabilities of $4,959, a decrease in current portion of Medicare Accelerated repayments of $10,848, and a decrease in current other accrued liabilities of $6,687.

- Long-term debt net of current portion decreased by $59,406 or 4% due to reduction in General Obligation bonds net of $3,041 and a reduction in other long-term debt, net of $17,888.

- Net position increased by $19,274 or 15% due to income from operations of $12,193 plus non-operating income of $7,081.

2021: Analysis of the Statement of Net Position from 2020 to 2021

- Current assets increased by $49,478 or 10% during the year ended June 30, 2021, primarily due to increase in cash of $31,036, an increase in patient accounts receivable of $27,324, an increase in other receivables of $18,142, and an increase in restricted cash and investments of $9,230, offset by a decrease in investments of $40,980.

- Capital assets, net decreased by $37,198 or 4% primarily due to depreciation and amortization expense of $44,697, the net disposal of assets from the sale of the Palomar Medical Center Downtown Escondido Campus of $16,197, offset by purchases related to major building projects of $24,734.

- Noncurrent assets and deferred outflow of resources increased by $322,677 or 246% primarily due to recording lease right-of-use assets in accordance with GASB 87 of $257,661 and increases in restricted noncurrent cash and investments of $26,235 primarily resulting from restricted funds related to the 2021 certificates of participation (COP) bonds.

- Current liabilities increased by $42,454 or 24% primarily due to increases in accrued compensation and related benefits of $14,491 and increases in Medicare accelerated payments of $25,206.

- Noncurrent liabilities decreased by $18,415 or 1% primarily due to the 2021 COP bonds of $34,118 (inclusive of the original issue premium) offset by a reduction in the Medicare accelerated payment liability of $30,015.

- Lease liability, net increase of $258,065 due to the 2021 restatement in accordance with GASB 87 right-of-use asset lease accounting.

- Net position increased by $12,877 or 11% due to income from operations of $8,593 plus nonoperating income of $4,284, and an adjustment to the 2022 opening balances in accordance with the provisions of GASB 87.

Statements of revenue, expenses, and changes in net position – All of PH's revenue, expenses, and changes in net position are included in the statements of revenue, expenses, and changes in net position. The financial statements measure the success of PH's operations during the years presented and are used to determine if PH has successfully recovered all of its costs through its fees and other sources of revenue. It also shows profitability and creditworthiness. Over time, increases or decreases in PH's net position are one indicator of PH's financial health.

In accordance with accounting principles generally accepted in the United States of America (also known as U.S. GAAP (or generally accepted accounting principles) for governmental health care providers, PH's statements of revenue, expenses, and changes in net position reflect non-operating income (expenses) including interest expense, which for nongovernment hospitals is typically grouped as an operating expense. While these GASB requirements make district hospitals conform to other governmental entities, such as cities and counties, they may be less comparable to nongovernment hospitals because of these GASB requirements. This must be a consideration of any comparison of PH to nonprofit and for-profit hospitals.

Table 2: Operating Results and Changes in Net Position for the years ended June 30:

				2022–2021 Change		2021–2020 Change	
	2022	2021	2020	Amount	Percentage	Amount	Percentage
OPERATING REVENUE							
Net patient service revenue	$ 795,891	$ 728,947	$ 670,918	$ 66,944	9%	$ 58,029	9%
Shared risk revenue	99,990	97,614	82,625	2,376	2%	14,989	18%
Other revenue	17,195	16,340	12,385	855	5%	3,955	32%
Total operating revenue	913,076	842,901	765,928	70,175	8%	76,973	10%
OPERATING EXPENSES	900,883	834,308	797,754	66,575	8%	36,554	5%
INCOME (LOSS) FROM OPERATIONS	12,193	8,593	(31,826)	3,600	42%	40,419	-127%
NON-OPERATING INCOME (EXPENSE)							
Investment income (loss)	(5,490)	(267)	6,762	(5,223)	1956%	(7,029)	-104%
Unrealized gain (loss) on interest rate swap	13,152	9,445	(9,643)	3,707	39%	19,088	-198%
Interest expense	(74,713)	(68,981)	(63,190)	(5,732)	8%	(5,791)	9%
Property tax revenue – unrestricted	20,184	19,319	18,356	865	4%	963	5%
Property tax revenue – restricted	44,402	39,851	28,873	4,551	11%	10,978	38%
Other, net	9,546	4,917	18,866	4,629	94%	(13,949)	-74%
Total non-operating income (expense), net	7,081	4,284	24	2,797	65%	4,260	17750%
CHANGE IN NET POSITION	19,274	12,877	(31,802)	6,397	50%	44,679	-140%
NET POSITION, beginning of year	129,788	116,911	148,713	12,877	11%	(31,802)	-21%
NET POSITION, end of year	$ 149,062	$ 129,788	$ 116,911	$ 19,274	15%	$ 12,877	11%

2022: Analysis of the Statement of Revenue, Expenses, and Changes in Net Position from 2021 to 2022

- Total operating revenue increased by $70,175 or 8% during the year ended June 30, 2022, due to an increase in net patient revenue primarily related to significant increases in certain third-party payor contracts and a full year worth of activity for Graybill Medical Group ("Graybill") during the fiscal year. Additionally, there were new service lines acquired during the year.

- Operating expenses are those expenses related to the treatment of patients as well as overhead and administrative expenses. Operating expenses increased by $66,575 or 8% during the year ended June 30, 2022, primarily due to the impact of the Graybill acquisition on wage, supply, and other expenses combined with inflation increases on salaries, supplies, and purchased services. Salaries, wages, and benefits increased by $72,282 due to the Graybill acquisition as well as an increase in PHMG physician costs. Supplies increased by $6,562 resulting from Coronavirus Disease 2019 (COVID-19) related supply purchases. Rent decreased by $10,848 due to amended lease agreements during the year. Purchased services and professional fees decreased by $5,521 resulting from a decrease in fees for COVID-19 lab related testing. Depreciation and amortization increased by $556 due to new capital acquisitions (inclusive of Graybill), and other expenses increased by $2,027 mainly due to the Graybill acquisition.

- Non-operating income (expenses), net increased by $2,797 during the year ended June 30, 2022. Investment loss increased by $5,223 due to the impact of the pandemic on interest rates. There was a gain on the interest rate swap, resulting in an increase of $3,707. Unrestricted property tax revenue increased by $865, while restricted property tax revenue for G.O. Bonds increased by $4,551. Other, net increased by $4,629 primarily due to Coronavirus Aid, Relief, and Economic Security (CARES) Act provider relief funds (PRF) received in the prior year.

- As a result of the factors noted above, net position increased by $19,274 or 15% during the year ended June 30, 2022.

2021: Analysis of the Statement of Revenue, Expenses, and Changes in Net Position from 2020 to 2021

- Total operating revenue increased by $76,973 or 10% during the year ended June 30, 2021, due to an increase in net patient revenue primarily related to the acquisition of Graybill Medical Group ("Graybill") on December 1, 2020. Elective surgical procedures increased gradually during the year following the state mandated cancellation of elective surgical procedures in March 2020.

- Operating expenses are those expenses related to the treatment of patients as well as overhead and administrative expenses. Operating expenses increased by $36,554 or 5% during the year ended June 30, 2021, primarily due to the impact of the Graybill acquisition on wage, supply, and other expenses combined with inflation increases on salaries, supplies, and purchased services. Salaries, wages, and benefits increased by $26,289 due to the Graybill acquisition as well as an increase in PHMG physician costs. Supplies increased by $3,933 resulting from COVID-19 related supply purchases. Rent decreased by $2,288 due to the adoption of GASB 87. Purchased services decreased by $5,254 resulting from a decrease in fees for COVID-19 lab related testing. Depreciation and amortization increased by $9,595 due to the adoption of GASB 87, and other expenses.

- As a result of the factors noted above, net position increased $12,877 or 11% during the year ended June 30, 2021.

Statements of Cash Flows

The statements of cash flows report cash receipts, cash payments, and net changes in cash resulting from operating, investing, and financing activities, which provides answers to such questions as to what were the sources and uses of cash, and what was the change in the cash balance during the reporting year.

Table 3: Statement of Cash Flows for the years ended June 30:

				2022–2021 Change		2021–2020 Change	
	2022	2021	2020	Amount	Percentage	Amount	Percentage
CASH FLOWS FROM							
Operating activities	$ 18,223	$ 33,198	$ 89,585	$ (14,975)	-45%	$ (56,387)	-63%
Noncapital financing activities	20,184	19,613	38,489	571	3%	(18,876)	-49%
Capital and related financing activities	(108,587)	(17,165)	(72,651)	(91,422)	533%	55,486	-76%
Investing activities	48,681	(4,610)	(83,232)	53,291	-1156%	78,622	-94%
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(21,499)	31,036	(27,809)	(52,535)	-169%	58,845	-212%
CASH AND CASH EQUIVALENTS, beginning of year	53,363	22,327	50,136	31,036	139%	(27,809)	-55%
CASH AND CASH EQUIVALENTS, end of year	$ 31,864	$ 53,363	$ 22,327	$ (21,499)	-40%	$ 31,036	139%

2022: Analysis of the Statement of Cash Flows from 2021 to 2022

- Net cash inflows provided by operating activities reflected a decrease of $14,975 during the year ended June 30, 2022, over the year ended June 30, 2021. This decrease is primarily due to an increase in receipts from patients of $2,724 and other sources of $15,181 combined with a decrease in payments to employees of $90,433 and an increase in payments to suppliers of $57,553.

- Net cash inflows provided by noncapital financing activities reflected an increase of $571 during the year ended June 30, 2022, due to an increase in district tax revenue receipts of $865 and an offset by a decrease in proceeds received from federal grants of $294.

- Net cash outflows used in capital and related financing activities increased by $91,422 primarily due to an increase in acquisition of capital assets of $25,509 and increase in interest payments on long-term debt of $29,401.

- Net cash inflows from investing activities during the year ended June 30, 2022, increased by $53,291 primarily due to an increase in purchase of investments of $91,642, combined with a decrease in proceeds from sale of investments of $56,026, and increase in interest received on investments and notes receivable of $5,572, during the year ended June 30, 2021.

- The ending cash and cash equivalents of $31,864 at June 30, 2022, reflect the checking account and overnight investment balances held by PH. In addition, PH held investments of $221,077 at June 30, 2022, with maturities of one year or less which are classified as current assets.

2021: Analysis of the Statement of Cash Flows from 2020 to 2021

- Net cash inflows provided by operating activities reflected a decrease of $56,387 during the year ended June 30, 2021, over the year ended June 30, 2020. This decrease is primarily due to a decrease in receipts from patients of $26,310 and other sources of $3,404, combined with an increase in payments to employees of $8,174 and supplies of $18,499.

- Net cash inflows provided by noncapital financing activities reflected a decrease of $18,876 during the year ended June 30, 2021, due to an increase in district tax revenue receipts of $963 and a decrease in proceeds received from the CARES Act PRF of $19,839.

- Net cash outflows used in capital and related financing activities increased by $55,486 primarily due to proceeds from the issuance of debt totaling $34,118, combined with a decrease in acquisition of capital assets of $14,925 and increase in receipt of property taxes restricted for debt service on general obligation bonds of $10,978.

- Net cash used in investing activities during the year ended June 30, 2021, increased by $78,622 primarily due to an increase in purchase of investments of $11,637 and proceeds from the sale of investments of $79,986, combined with a decrease of $8,047 due to the acquisition of Graybill.

- The ending cash and cash equivalents of $53,363 at June 30, 2021, reflect the checking account and overnight investment balances held by PH. In addition, PH held investments of $239,041 at June 30, 2021, with maturities of one year or less which are classified as current assets.

Capital Assets and Long-Term Debt

In 2004, the Board of Directors approved the Facilities Master Plan budgeted at $1,057,000. In November 2004, the residents of the District voted and approved to fund $496,000 of this expansion by the issuance of G.O. Bonds. Payment for these bonds was funded by an *ad valorem* property tax levied on District residents. The approximate amount of the tax levy for each taxable property was 0.038% and 0.037% of assessed value during the years ended June 30, 2022 and 2021, respectively. The levy was established by a Board of Directors' resolution each year in an amount sufficient to service the debt for the upcoming year together with a reserve amount.

One of the major components of the Facilities Master Plan included the construction of Palomar Medical Center ("PMC"). On August 19, 2012, PH opened the 288-bed facility, which includes critical, intermediate, and general inpatient care, surgical and interventional services, a women's center, and emergency and trauma services.

Other current building projects include the renovation of existing hospital facilities at various locations in the District and construction of a medical office building and parking structure.

PH has five outstanding revenue bonds and five outstanding G.O. Bonds that are classified as long-term debt. The revenue bonds are comprised of the 2006 COP, the 2017 COP, 2021 COP, and the 2016 and 2017 Refunding Revenue Bonds. The G.O. Bonds are comprised of the Series 2007A, 2009A, 2010A, and 2016 A and B bonds. Principal payments of $13,855 and $13,295 during the years ended June 30, 2022 and 2021, respectively, reduced the revenue bonds' principal to $585,010 and $598,865. Principal payments of $7,299 and $6,497 during the years ended June 30, 2022 and 2021, respectively, reduced the G.O. Bonds' principal to $408,228 and $415,527. All debt payments have been made timely. See Note 9 in the accompanying footnotes of the financial statements.

Liquidity and Capital Resources

PH's unrestricted liquid assets as of June 30, 2022, were $252,941, including $31,864 in operating cash and $221,077 in unrestricted investments stated at fair market value. PH's unrestricted liquid assets as of June 30, 2021, were $292,404, including $53,363 in operating cash and $239,041 in unrestricted investments stated at fair market value. The current liquidity position represents a $39,463 decrease from the $292,404 in available liquidity as of June 30, 2021, and equaled 40% of the total outstanding debt as of June 30, 2022 (excluding the existing G.O. Bonds, which are paid from *ad valorem* property taxes), as compared to available liquidity representing 45% of total outstanding debt as of June 30, 2021.

PH's days cash and investments on hand as of June 30, 2022 and 2021, was 108.9 and 136.5, respectively.

Economic and Other Factors

On June 24, 2015, PH's Board of Directors voted to transfer all services from Palomar Medical Center Downtown Campus ("PHDC") to other PH-owned facilities. Due to failing infrastructure and absent a seismic retrofit, the Board also voted to close the facility. An agreement to sell the PHDC real estate was executed and title transferred to the buyer on June 30, 2021. A net loss on the disposal of PHDC assets included in the sale in the amount of $16,197 was recorded at June 30, 2021.

The challenge of meeting constant capital needs and consumer demands becomes more difficult as the health care industry is highly dependent upon a number of factors that could have a significant effect on the operations and financial condition of PH. The healthcare industry is moving towards value-based care which requires improved efficiency and quality measures. As PH shifts towards these patient-centric drivers, inpatient utilization rates will lower with the decrease in readmission rates and improved continuum of care management.

Government payors continue to present reimbursement challenges for healthcare providers as the reimbursement rates are set annually with no ability for negotiation on rates and terms. Medicare continues to look for additional ways to cut medical costs by way of reimbursement modeling. Quality-based reimbursement methods incentivize health care providers to improve quality outcomes and patient experiences and penalize those who are not able to meet these measures. Contractually negotiated commercial payments, while based on an agreed-upon reimbursement methodology, are susceptible to shifts in demand, patterns of patient services, and are sensitive to a more competitive market.

On March 11, 2020, the World Health Organization officially declared COVID-19, the disease caused by the novel coronavirus, a pandemic. Soon afterward, PH (along with hospitals in the United States) temporarily cancelled elective surgical cases, resulting in a significant loss of net patient revenue for several months thereafter. The pandemic has resulted in PH incurring additional costs to maintain patient volume as well as to provide care to patients specifically affected by the virus. The duration and intensity of disruption from the pandemic is uncertain, and therefore the long-term impact, if any, cannot be predicted.

Union Contract

PH and two labor unions, the California Nurses Association (CNA) and the Caregivers Healthcare Employees Union (CHEU), reached agreements in June 2022. PH recently ratified new contracts with both bargaining units, in effect until May 31, 2025.

Finance contact – PH's financial statements are designed to present users with a general overview of PH's finances and to demonstrate PH's accountability. If you have any questions about the report or need additional financial information, please contact the Chief Financial Officer, PH, 2125 Citracado Pkwy., Suite 300, Escondido, California 92029.

Report of Independent Auditors

The Audit Committee
Palomar Health

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Palomar Health as of and for the years ended June 30, 2022 and 2021, which comprise the statements of net position as of June 30, 2022 and 2021, and the related statements of revenue, expenses and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the financial position of Palomar Health as of June 30, 2022 and 2021, and the changes in net position and 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), the California Code of Regulations, Title 2, Section 1131.2, *State Controller's Minimum Audit Requirement for California Special Districts,* and the standards applicable to financial audits contained in *Government Auditing Standards (Government Auditing Standards)*, issued by the Comptroller General of the United States. 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 Palomar Health 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.

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 from 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 Palomar Health's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

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 from 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 Palomar Health's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Palomar Health's ability to continue as a going concern for a reasonable period of time.

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

Emphasis of Matter

As discussed in Note 2 to the financial statements, during the year ended June 30, 2022, Palomar Health adopted the accounting requirements of Governmental Accounting Standards Board Statement No. 87, *Leases*. Our opinion is not modified with respect to this matter.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis, and schedule of changes in total Other Postemployment Benefits liability and related ratios, as listed in the table of contents, be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 20, 2022, on our consideration of Palomar Health'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 Palomar Health'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 Palomar Health's internal control over financial reporting and compliance.

Moss Adams LLP

Irvine, California
October 20, 2022

(Dollars in Thousands)

ASSETS AND DEFERRED OUTFLOW OF RESOURCES

	Years Ended June 30, 2022	2021 (As Restated)
CURRENT ASSETS		
Cash and cash equivalents	$ 31,864	$ 53,363
Investments	221,077	239,041
Patient accounts receivable, net of allowances for uncollectible accounts of $58,830 in 2022 and $42,482 in 2021	177,973	141,265
Other receivables	16,438	26,186
Supplies and inventories	12,764	12,685
Prepaid expenses and other	9,793	11,706
Estimated third-party payor settlements receivable	19,664	40,618
Restricted cash and investments, current	52,071	44,295
Total current assets	541,644	569,159
RESTRICTED NONCURRENT CASH AND INVESTMENTS		
Held by trustee under indenture agreements	51,711	80,490
Held by trustee under general obligation bonds indenture	51,886	43,913
Held in escrow for street improvements	6,545	9,028
Restricted by donor and other	353	352
Total restricted cash and investments	110,495	133,783
Less: amounts required to meet current obligations	52,071	44,295
Total restricted noncurrent cash and investments	58,424	89,488
CAPITAL ASSETS, net	978,401	969,786
LEASE RIGHT-OF-USE ASSETS	245,554	257,661
ESTIMATED THIRD-PARTY PAYOR SETTLEMENTS RECEIVABLE, net of current portion	32,172	-
OTHER ASSETS		
Prepaid debt insurance costs	7,491	8,100
Investment in and amounts due from affiliated entities	3,204	2,077
Leases receivable	35,180	37,876
Other	7,522	5,209
Total other assets	53,397	53,262
Total assets	1,909,592	1,939,356
DEFERRED OUTFLOW OF RESOURCES – loss on refunding of debt	50,800	53,564
Total assets and deferred outflow of resources	$ 1,960,392	$ 1,992,920

(Dollars in Thousands)

LIABILITIES, DEFERRED INFLOW OF RESOURCES, AND NET POSITION

	Years Ended June 30, 2022	Years Ended June 30, 2021 (As Restated)
CURRENT LIABILITIES		
Accounts payable	$ 70,523	$ 41,116
Accrued compensation and related liabilities	49,879	54,838
General obligation bonds, current	8,061	7,299
Other long-term debt, current	14,902	17,261
Lease obligation, current	10,417	6,640
Medicare accelerated payments, current	21,108	31,956
Other accrued liabilities	36,636	43,323
Accrued interest payable	21,425	19,562
Total current liabilities	232,951	221,995
WORKERS' COMPENSATION, net of current portion	5,371	4,072
MEDICARE ACCELERATED PAYMENTS, net of current portion	-	18,837
GENERAL OBLIGATION BONDS, net of current portion	651,741	654,782
OTHER LONG-TERM DEBT, net of current portion	614,174	632,062
LEASE OBLIGATION, net of current portion	250,278	258,065
FAIR VALUE OF INTEREST RATE SWAP	12,587	25,739
Total liabilities	1,767,102	1,815,552
DEFERRED INFLOW OF RESOURCES	44,228	47,580
Total liabilities and deferred inflow of resources	1,811,330	1,863,132
COMMITMENTS AND CONTINGENCIES (Note 16)		
NET POSITION		
Invested in capital assets, net of related debt	(234,199)	(173,322)
Restricted, expendable for		
Repayment of debt	31,727	25,295
Capital acquisitions	20,223	9,028
Other purposes	353	353
Unrestricted	330,958	268,434
Total net position	149,062	129,788
Total liabilities, deferred inflow of resources, and net position	$ 1,960,392	$ 1,992,920

See accompanying notes.

(Dollars in Thousands)

	Years Ended June 30, 2022	Years Ended June 30, 2021 (As Restated)
OPERATING REVENUE		
Patient service revenue, net of provision for uncollectible accounts of $77,259 in 2022 and $86,596 in 2021	$ 795,891	$ 728,947
Shared risk revenue	99,990	97,614
Other revenue	17,195	16,340
Total operating revenue	913,076	842,901
OPERATING EXPENSES		
Salaries, wages, and benefits	557,626	485,344
Professional fees	45,656	50,266
Supplies	116,720	110,158
Purchased services	81,425	82,336
Depreciation and amortization	53,150	52,594
Rent expense	9,966	20,814
Utilities	11,752	10,235
Other	24,588	22,561
Total operating expenses	900,883	834,308
INCOME FROM OPERATIONS	12,193	8,593
NON-OPERATING INCOME (EXPENSES)		
Investment loss	(5,490)	(267)
Unrealized gain on interest rate swap	13,152	9,445
Interest expense	(74,713)	(68,981)
Property tax revenue – unrestricted	20,184	19,319
Property tax revenue – restricted	44,402	39,851
Other, net	9,546	4,917
Total non-operating income (expenses), net	7,081	4,284
CHANGE IN NET POSITION	19,274	12,877
NET POSITION, beginning of year	129,788	116,911
NET POSITION, end of year	$ 149,062	$ 129,788

See accompanying notes.

Palomar Health
Statements of Cash Flows
(Dollars in Thousands)

	Years Ended June 30, 2022	Years Ended June 30, 2021
CASH FROM OPERATING ACTIVITIES		
Receipts from		
Patients, insurers, and other third-party payors	$ 847,955	$ 845,231
Other sources	26,943	11,762
Payments to		
Employees	(561,286)	(470,853)
Suppliers	(295,389)	(352,942)
Net cash provided by operating activities	18,223	33,198
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Receipt of district taxes	20,184	19,319
Federal grants	-	294
Net cash provided by noncapital financing activities	20,184	19,613
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	(45,721)	(20,212)
Interest payments on long-term debt	(72,850)	(43,449)
Proceeds from issuance of long-term debt	-	34,118
Principal repayment on long-term debt	(22,526)	(21,234)
Principal repayment on lease obligations	(246)	(2,424)
Interest payments on lease obligations	(10,990)	(6,261)
Proceeds from sale of capital assets	-	2,600
Receipt of property taxes restricted for debt service on general obligation bonds	44,402	39,851
Other	(656)	(154)
Net cash used in capital and related financing activities	(108,587)	(17,165)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(183,852)	(275,494)
Proceeds from sale of investments	225,104	281,130
Interest received on investments and notes receivable	3,373	(2,199)
Acquisitions	-	(8,047)
Other	4,056	-
Net cash used in investing activities	48,681	(4,610)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	(21,499)	31,036
CASH AND CASH EQUIVALENTS, beginning of year	53,363	22,327
CASH AND CASH EQUIVALENTS, end of year	$ 31,864	$ 53,363

See accompanying notes.

(Dollars in Thousands)

	Years Ended June 30, 2022	Years Ended June 30, 2021
RECONCILIATION OF INCOME FROM OPERATIONS TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Income from operations	$ 12,193	$ 8,593
Adjustments to reconcile income from operations to net cash provided by operating activities		
Depreciation and amortization	33,817	52,594
Amortization of lease right-of-use asset	19,333	
Provision for bad debts	77,278	86,274
Equity in losses (gains) of affiliates	(1,127)	532
Loss on disposal of fixed assets	638	3,408
Changes in assets and liabilities		
Patient accounts receivable	(113,986)	(113,598)
Other receivables	9,748	(3,643)
Supplies and inventories	(79)	(154)
Prepaid expenses and other	1,913	(4,805)
Estimated third-party payor settlements	(11,218)	277
Other, net	(2,313)	(621)
Accounts payable	32,058	4,226
Accrued compensation and related liabilities	(4,959)	14,491
Other accrued liabilities	(6,687)	(9,449)
Medicare accelerated payments	(29,685)	(4,809)
Workers' compensation	1,299	-
Deferred inflow of resources	-	(118)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 18,223	$ 33,198
NONCASH OPERATING ACTIVITIES		
Right-of-use assets obtained in exchange for lease obligations	$ 8,097	$ 7,691
NONCASH INVESTING AND CAPITAL AND FINANCING ACTIVITIES		
Capital expenditures included in accounts payable	$ 2,651	$ 569
Lease right-of-use assets acquired via lease obligations	$ 7,226	$ -

Note 1 – Operations and Reporting Entity

Organization – Palomar Health ("PH" or the "District"), a public health care district, is organized under the provisions of the Health and Safety Code of the state of California to provide and operate health care facilities. The accompanying financial statements include the accounts of the following commonly controlled divisions and related entities of PH. Unless otherwise indicated, the following are divisions of PH:

- Palomar Medical Center Escondido ("Escondido"), located in west Escondido, California, includes a 288-bed general acute care hospital, including tertiary services, trauma services, cardiovascular surgery, women's services, and retail pharmacy.

- Palomar Medical Center Poway ("Poway"), located in Poway, California, includes a 107-bed general acute care hospital and The Villas at Poway, a distinct part skilled nursing facility and sub-acute facility.

- Palomar Medical Center Downtown Campus ("PHDC") is located in east Escondido, California. The PHDC real estate was sold on June 30, 2021. Very limited operations were maintained at PHDC during the fiscal year ended June 30, 2021. All assets of PHDC were sold on June 30, 2021.

- Palomar Home Health Services, located in San Marcos, California.

- San Marcos Ambulatory Care Center, located in San Marcos, California, includes outpatient therapy.

- Jean McLaughlin Women's Center for Health and Healing, located on the Poway campus.

- Palomar Outpatient Behavioral Health, located in San Marcos, California.

- Palomar Health Development, Inc. ("Health Development"), a California nonprofit public benefit corporation organized and operated to seek grants to support research and other programs at PH's facilities. PH's reporting entity includes Health Development as a blended component unit because PH is the sole corporate member of Health Development and appoints all the members of Health Development board of directors.

- Arch Health Partners, Inc. ("Arch"), a tax exempt medical foundation established under Section 1206(l) of the California Health and Safety Code, with twenty-five clinics located in Escondido, Fallbrook, Poway, Murrieta, Ramona, San Diego, San Marcos, Temecula, and Valley Center, California, that provide primary and specialty care medical services, and add another component in effective health care delivery to residents within PH's community. In accordance with Governmental Accounting Standards Board (GASB) Codification Section 2100, *The Financial Reporting Entity*, for financial reporting purposes, PH's reporting entity includes Arch as a blended component unit as a result of the fiscal dependency of Arch on PH, and because PH is the sole corporate member of Arch. On December 1, 2020, Arch acquired the assets of ten clinics from Graybill Medical Group located within PH's service area. Those clinics were merged with the operations of Arch. Subsequent to the acquisition, Arch established a trade name for the combined operating entity, Palomar Health Medical Group ("PHMG").

Note 1 – Operations and Reporting Entity (continued)

- Pacific Accountable Care, LLC ("PAC"), a Medicare approved Accountable Care Organization (ACO) that has contracted with the Centers for Medicare & Medicaid Services ("CMS") as a participant in a Track 1 Medicare Shared Savings Program (MSSP) to provide coordinated high-quality care to Medicare patients at reduced cost. Arch's reporting entity includes PAC as a blended component unit because Arch is the sole member of PAC. See Note 9.

- Pacific Accountable Management, LLC ("PAM") and Pacific Accountable Management San Diego ("PAM-SD") operated as management service organizations (MSO). Operations for PAM and PAM-SD ceased in July 2018 when the MSO services were assumed by Arch. See Note 9.

Palomar Health Medical Group membership of Obligated Group – On August 31, 2017, PH, PHMG, and U.S. Bank National Association, as Master Trustee, entered into a Supplemental Master Indenture agreement providing for the addition of PHMG as a member of the Obligated Group created pursuant to the Master Indenture of Trust dated December 1, 2006. As such, PHMG became jointly and severally liable for the repayment of PH's revenue obligations and placed its collateral under control of a master trustee for the benefit of lenders and bondholders. In consideration of the agreement of PHMG to become an Obligated Group Member, PH agreed to the extinguishment of PHMG obligations. Related eliminations can be found in Note 18.

Note 2 – Summary of Significant Accounting Policies

Use of estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Basis of accounting and presentation – The accompanying financial statements have been prepared using the economic resource measurement focus and the accrual basis of accounting, in accordance with U.S. GAAP for healthcare organizations and the State Controller's Minimum Audit Requirements and Reporting Guidelines, and are presented in accordance with the reporting model as prescribed in GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. PH follows the business-type activities requirements of GASB Statements No. 34 and No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*.

Fiscal year – PH has adopted a fiscal year ending June 30. All references to years herein refer to the respective fiscal year.

Cash and cash equivalents – Cash and cash equivalents include highly liquid debt instruments with original maturities of three months or less and are intended for use in daily operations.

Notes to Financial Statements (Dollars in Thousands)

Note 2 – Summary of Significant Accounting Policies (continued)

Investments – Investments in debt, equity, and fixed income securities are carried at fair value, as determined by quoted market prices in the statements of net position. Investment income or loss is included in non-operating income, unless the income or loss is restricted by donor or law.

Supplies and inventories – Supplies and inventories are stated at the lower of cost (first-in, first-out) or market value.

Restricted cash and investments – Restricted cash and investments primarily include assets held by trustees under indenture agreements and designated assets set aside by the Board of Directors for future capital improvements over which the Board of Directors retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of PH have been classified as current assets in the accompanying statements of net position.

PH has entered into an agreement with the city of Escondido (the "City") to financially participate in street improvements near the site of Escondido. Under the agreement, PH was required to deposit $13,000 into an account jointly managed by PH and the City. PH's financial obligation is limited to the deposited amount plus any earned interest on the deposited funds. The balance of $6,545 and $9,028 as of June 30, 2022 and 2021, respectively, was included in restricted cash and investments in the accompanying statements of net position.

Capital assets – Capital asset acquisitions are recorded at cost. The capitalization threshold for individual item cost is $5 or greater and similar items that have cost less than $5 but have an aggregate cost of $20 or greater. Depreciation is computed using the straight-line method over the estimated useful life of each class of depreciable asset (the shorter of the estimated useful life or the lease term for leasehold improvements) as follows:

	Years
Land improvements	10–40
Buildings and building improvements	10–40
Leasehold improvements	3–25
Equipment	3–20

Gifts of long-lived assets, such as land, buildings, or equipment, are recorded at their fair market value and are reported in non-operating income. 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 for other purposes in net position. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Note 2 – Summary of Significant Accounting Policies (continued)

Capital assets are reviewed for impairment when events or changes in circumstances suggest that the service utility of the capital asset may have significantly and unexpectedly declined. Capital assets are considered impaired if both the decline in service utility of the capital asset is large in magnitude and the event or change in circumstance is outside the normal life cycle of the capital asset. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage; enactment or approval of laws or regulations or other changes in environmental factors; technological changes or evidence of obsolescence; changes in the manner or duration of use of a capital asset; and construction stoppage. The determination of the impairment loss is dependent upon the event or circumstance in which the impairment occurred. Impairment losses are recorded in the statements of revenue, expenses, and changes in net position. There was no impairment charge recorded during the years ended June 30, 2022 and 2021.

Compensated absences – PH policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits and are earned whether the employee is expected to realize the benefit as time off or in cash. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the statement of net position date plus an additional amount for compensation-related payments such as Social Security and Medicare taxes computed using rates in effect at that date.

Debt discounts, debt premiums, and debt issuance costs – Debt discounts and debt premiums are amortized by the effective interest method over the life of the related bonds. Debt issuance costs, except prepaid insurance costs, are expensed as incurred. Prepaid insurance costs are reported as an asset and recognized as an expense over the duration of the related debt.

Deferred outflows of resources – Deferred outflows of resources represent a consumption of net position that applies to future periods and so will not be recognized as an outflow of resources (expense) until that time. The deferred outflows of resources reported in the financial statements is loss on refunding of debt which is amortized over the shorter of the remaining life of the refunded bonds or the refunding debt as a component of interest expense (see Note 10).

Deferred inflows of resources – Deferred inflows of resources represent an increase in net position that applies to future periods and so will not be recognized as an inflow of resources (revenue) until that time. The deferred inflows of resources reported in the financial statements are unearned rental income that will be recognized as revenue over the life of the rental agreement, and changes in assumptions, and other inputs related to Other Post-Employment Benefits (OPEB) (see Note 15).

Goodwill – Goodwill represents the excess of the cost of an acquired entity over the net of the fair value of identifiable assets acquired and liabilities assumed as of the date of acquisition. PHMG amortizes goodwill over a 10-year period. In addition, PHMG has elected the option to not recognize and measure: a) customer-related intangible assets (unless they are capable of being sold or licensed independent from other assets of the business), and b) noncompetition agreements. Instead, the value of these intangibles is subsumed into goodwill.

Note 2 – Summary of Significant Accounting Policies (continued)

PHMG evaluates the carrying value of goodwill as one reporting unit for impairment by comparing the carrying value to its fair value. If the fair value is less than the carrying value, goodwill is potentially impaired. PHMG evaluates goodwill whenever events or changes in circumstances suggest that the carrying amount of goodwill may be impaired. PHMG determined that there was no goodwill impairment for the year ended June 30, 2022.

Interest rate swaps – PH has entered into variable-to-fixed interest rate swaps, which are reflected at fair value in the statements of net position. The fair value of the interest rate swaps will fluctuate based generally on changes in market rates of interest. Unrealized gains or losses resulting from changes in fair value are reported as interest expense in non-operating income (expenses) in the statements of revenue, expenses, and changes in net position. Interest cost on variable interest rate debt is reported based on the fixed interest rate paid by PH under the interest rate swaps and is also recorded as interest expense.

As of June 30, 2022 and 2021, the interest rate swaps were recorded as a liability of $12,587 and $25,739, respectively.

Net position – Net position of PH is classified in three broad components: net investment in capital assets, restricted (distinguishing between major categories of restrictions), and unrestricted. Net investment in capital assets consists of capital assets, net of accumulated depreciation, and is reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Net position restricted for repayment of debt includes amounts deposited with trustees as required by bond indentures (see Note 10). Net position restricted for capital acquisitions relates to amounts restricted to acquire capital assets. Net position restricted for other purposes relates to noncapital net position that must be used for a particular purpose, as specified by contributors or others external to PH. Unrestricted net position represents the remaining net position that does not meet the definition of net investment in capital assets or restricted.

Risk management – PH is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than medical malpractice and workers' compensation claims. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

PH is self-insured for a portion of its exposure to risk of loss from workers' compensation and malpractice claims. Annual estimated provisions are accrued based on actuarially determined amounts or management's estimate and include an estimate of the ultimate costs for both reported claims and claims incurred but not yet reported.

Statements of revenue, expenses, and changes in net position – All revenue and expenses directly related to the delivery of health care services are included in operating revenue and expenses in the statements of revenue, expenses, and changes in net position. Non-operating income (expenses) consists of those revenue and expenses that result from non-exchange transactions, financing (interest expense and changes in the fair value of interest rate swaps), and investment income.

Note 2 – Summary of Significant Accounting Policies (continued)

Net patient service revenue – PH has agreements with third-party payors that provide for payments to PH at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and daily rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including a provision for bad debts and estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis during the year the related services are rendered and adjusted in future years, as final settlements are determined.

Shared risk revenue – PH and its affiliated medical groups have agreements with various third-party payors to provide medical services to subscribing participants. Under some of these agreements, PH and its affiliated medical groups receive monthly capitation payments based on the number of members for each payor, regardless of services actually performed by PH. Under these agreements, after deduction of costs incurred by providers outside these agreements for care provided to subscribing participants, PH participates in shared risk pools with medical groups, through which it earns reimbursement or pays additional amounts to the medical groups. In conjunction with the shared risk pools, PH estimates incurred but not reported (IBNR) claims for medical services provided to patients. IBNR of $3,655 and $3,958 are included in other accrued liabilities in the accompanying statements of net position as of June 30, 2022 and 2021, respectively.

Activity in PH’s liability for IBNR claims for medical services provided to patients as of and for the years ended June 30, 2022 and 2021, is summarized as follows (in thousands):

	2022	2021
BALANCE, beginning of the year	$ 3,957	$ 7,579
Current year claims incurred and changes in estimates	39,296	33,026
Claims and expenses paid	(39,598)	(36,648)
BALANCE, end of the year	$ 3,655	$ 3,957

Charity care – PH provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are not reported as revenue in the accompanying financial statements.

Note 2 – Summary of Significant Accounting Policies (continued)

Property taxes – PH receives financial support from property taxes. Property taxes are levied by the County of San Diego on behalf of PH to finance PH's activities. Amounts levied for General Obligation Bonds (G.O. Bonds) are based on assessed property values and are set annually by the Board of Directors. Property tax revenue for the years ended June 30, 2022 and 2021, consists of the following (in thousands):

	2022	2021
To support operations – unrestricted use	$ 20,184	$ 19,319
For debt service on G.O. Bonds – restricted use	44,402	39,851
	$ 64,586	$ 59,170

Grants and contributions – PH receives grants from various governmental agencies and private organizations. PH also receives contributions from Palomar Health Foundation and Health Development. Revenues from grants and contributions are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or capital acquisitions. These amounts, when recognized upon meeting all requirements, are reported as components of the statements of revenues, expenses, and changes in net position.

Income taxes – PH is a governmental subdivision of the state of California and is exempt from federal income and state franchise taxes. PHMG and PAC are exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC) and Section 23701(d) of the California Revenue and Taxation Code. PAM and PAM-SD, which are limited liability companies (LLCs), are classified as partnerships for federal and state income tax purposes and, as such, are exempt from federal income and state franchise taxes. Accordingly, no provision for income taxes has been included in the accompanying financial statements.

Change in accounting principle and restatement – In 2022, PH implemented GASB Statement No. 87, *Leases*. GASB 87 enhances the relevance and consistency of information of PH's leasing activities. It establishes requirements for lease accounting based on the principle that leases are financings of the right to use an underlying asset. A lessee is required to recognize a lease liability and an intangible right to use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources. These changes were incorporated in PH's 2022 financial statements and had an effect on the beginning net position of PH. PH recognized $77,121 in a lease liability at July 1, 2020, due to the implementation of GASB 87; however, this entire amount was offset by an intangible right to use lease asset.

Note 2 – Summary of Significant Accounting Policies (continued)

The implementation of GASB 87 had the following effect on net position as reported June 30, 2021 (in thousands):

Net position at June 30, 2021, as previously reported	$ 135,548
GASB 87 Leases	(5,760)
Net position at June 30, 2021, as restated	$ 129,788

Recent accounting pronouncements – In June 2018, the GASB issued Statement No. 89, *Accounting for Interest Cost Before the End of a Construction Period.* This statement requires that interest costs incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest costs incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund. PH adopted this statement effective July 1, 2021.

In May 2020, the GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements* (GASB 96). GASB 96 provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). GASB 96 (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. To the extent relevant, the standards for SBITAs are based on the standards established in Statement No. 87, *Leases*, as amended. The requirements of GASB 96 are effective for fiscal years beginning after June 15, 2022, and all reporting periods thereafter. PH is reviewing the impact of the adoption of GASB 96 for the fiscal year ending June 30, 2023.

In June 2022, the GASB issued Statement No. 101, *Compensated Absences* (GASB 101). GASB 101 requires that liabilities for compensated absences be recognized for (1) leave that has not been used, and (2) leave that has been used but not yet paid in cash or settled through noncash means. A liability should be recognized for leave that has not been used if (a) the leave is attributable to services already rendered, (b) the leave accumulates, and (c) the leave is more likely than not to be used for time off or otherwise paid in cash or settled through noncash means. This statement requires that a liability for certain types of compensated absences—including parental leave, military leave, and jury duty leave—not be recognized until the leave commences. This statement also requires that a liability for specific types of compensated absences not be recognized until the leave is used. The requirements of this GASB 101 are effective for fiscal years beginning after December 15, 2023, and all reporting periods thereafter. PH is reviewing the impact of the adoption of GASB 101 for the fiscal year ending June 30, 2025.

Note 2 – Summary of Significant Accounting Policies (continued)

Leases - PH recognizes lease contracts or equivalents that have a term exceeding one year and the cumulative future payments on the contract exceed $7,500 that meet the definition of an other than short-term lease. PH uses a discount rate that is explicitly stated or implicit in the contract. When a readily determinable discount rate is not available, the discount rate is determined using PH's incremental borrowing rate at start of the lease for a similar asset type and term length to the contract. Short-term lease payments are expensed when incurred.

Reclassifications – Certain reclassifications have been made to the prior year amounts to conform to the current year presentation.

Note 3 – Net Patient Service Revenue, Third-Party Reimbursement Programs, and Non-Operating Revenue

Net patient service revenue – PH renders services to certain patients under contractual arrangements with the Medicare and Medi-Cal programs and various health maintenance and preferred provider organizations. The Medicare program generally pays a prospectively determined fee-for-services (FFS) rendered to Medicare patients. Additionally, Medicare reimburses PH for certain inpatient services (primarily mental health unit services) on the basis of costs incurred. The Medi-Cal program provides for payment on a prospectively negotiated contractual rate per day, percentage of charges for services rendered, or capitated payment arrangement.

Revenue from the Medicare and Medi-Cal programs inclusive of risk (capitated) and non-risk managed care programs accounted for approximately 45% and 53% of PH's net patient service revenue for the years ended June 30, 2022 and 2021, respectively.

Third-party cost reports for the Medicare program have been settled through the year ended June 30, 2018, for Escondido and through the year ended June 30, 2019, for Poway, with the exception of PMC Escondido's fiscal years 2011 and 2013 reports which are pending administrative review by CMS. The cost reports for the Medi-Cal program have been settled through the year ended June 30, 2018, for Escondido, and through the year ended June 30, 2020, for Poway. Results of cost report settlements as well as estimates for settlements of all years through 2021 have been reflected in the accompanying financial statements. As of June 30, 2022 and 2021, estimated third-party settlements resulted in a receivable of $51,837 and $40,618, respectively. Amounts expected to be received or paid beyond June 30, 2023, are classified as noncurrent in the accompanying statements of net position.

Laws and regulations governing Medicare and Medi-Cal programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. During the years ended June 30, 2022 and 2021, PH settled various prior-year cost reports and appeal issues. These settlements and normal estimation differences between subsequent cash collections on patient accounts receivable resulted in no additional revenues for the year ended June 30, 2022, and approximately $745 of additional revenues for the year ended June 30, 2021, which are included in net patient service revenue in the accompanying statements of revenue, expenses, and changes in net position.

Note 3 – Net Patient Service Revenue, Third-Party Reimbursement Programs, and Non-Operating Revenue (continued)

Third-party reimbursement programs – *Public Hospital Redesign and Incentives in Medi-Cal (PRIME) and Quality Incentive Pool (QIP)* – During the period July 1, 2020 through December 31, 2020, and for the year ended June 30, 2020, PH participated in the PRIME program. The program was approved via the California Section 1115(a) demonstration waiver, titled “California’s Medi-Cal 2020 Demonstration.” The PRIME program incentivized public hospitals to identify critical objectives to improve delivery of care for Medi-Cal beneficiaries. PRIME was effective beginning January 1, 2016, and was a five-year program. The program had both reporting metrics and performance metrics. Revenue was recognized based on approval from CMS for the achievement of reporting metrics and when metrics were achieved for the performance metrics component.

California replaced PRIME by implementing the QIP program for district/municipal hospitals beginning January 1, 2021 through December 31, 2023. The State of California (the “State”) will direct Medi-Cal Managed Care Plans (“MCPs”) to make QIP payments tied to performance on designated performance measures in categories such as, but not limited to, primary care access and preventive care, acute and chronic care, behavioral health, maternal health, patient safety, and overuse/appropriateness of care. This program supports the State’s quality strategy by promoting access and value-based payment, increasing the amount of funding tied to quality outcomes, while at the same time further aligning state, MCPs, and district/municipal hospital goals. This payment arrangement moves California towards value-based alternative payment models.

Additionally, QIP expands upon the PRIME program. California is maintaining and continuing the momentum achieved with district/municipal hospitals on improvements in the quality of care delivered to Medi-Cal beneficiaries. Intergovernmental transfers (IGTs) provide the non-federal share of funding and total funding is based on performance of meeting the identified metrics.

Nondesignated Public Hospital Bridge Loan Program (NDPH Program) - The NDPH Program enables the California Health Facilities Financing Authority to issue up to a total of $40 million in zero interest working capital loans to eligible nondesignated public hospitals that are affected by financial delays associated with the transition from the PRIME Program to the QIP Program. These loans are secured by PH’s Medi-Cal reimbursements and are required to be repaid within two years of their issuance date. PH received two separate loans totaling $6,808 during the year ended June 30, 2022. Payments, including 1% administration fee of $3,481 and $3,396 are due on February 3, 2024 and April 1, 2024, respectively, and are classified within noncurrent estimated third party settlements as of June 30, 2022.

Medi-Cal managed care rate range IGT – The Affordable Care Act (ACA) recognized the formation and maintenance of a network of primary care providers to service Medi-Cal Managed Care plans which require funding assistance. IGT is a payment methodology to partially fund the gap between what Medi-Cal Managed Care plans pay and the full cost of providing the service.

PH was notified that fiscal 2021 IGT payments would be delayed until early 2023 based on a requirement of CMS. As a result, amounts estimated to be received of $33,502 beyond June 30, 2023, are classified as noncurrent liabilities in the accompanying statement of net position as of June 30, 2022.

Note 3 – Net Patient Service Revenue, Third-Party Reimbursement Programs, and Non-Operating Revenue (continued)

Senate Bill 239 quality assurance fee (QAF) supplemental payment – A state-legislated supplemental program that distributes funds to hospitals based on the volume of care to Medi-Cal funded patients. The intention is to strengthen the ability of hospitals to meet the increased demand resulting from implementing programs, service, and capital required by ACA.

PH was notified that fiscal 2021 QAF payments would be delayed until early 2023 based on a requirement of CMS. As a result, amounts estimated to be received of $5,547 beyond June 30, 2023, are classified as noncurrent liabilities in the accompanying statement of net position as of June 30, 2022.

QAF managed care funds – part of the hospital QAF – Under the California Hospital Fee Program, PH receives net supplemental funds under a managed care methodology.

Assembly Bill 113 Medi-Cal rate stabilization – A state-legislated program which provides a cost supplement for Medi-Cal Managed Care Seniors and Persons with Disabilities.

Assembly Bill 915 outpatient supplemental payment – This bill provides for the payment of a supplemental reimbursement to acute care hospitals owned by certain public entities that provide outpatient services to Medi-Cal beneficiaries. The state legislated a supplemental reimbursement for uncompensated Medi-Cal FFS outpatients. PH receives 50% of reported uncompensated costs.

Medi-Cal DSH – The Disproportionate Share Hospital (DSH) Program reimburses hospitals for some of the uncompensated care costs associated with furnishing inpatient hospital services to Medi-Cal beneficiaries and uninsured individuals.

The following table summarizes amounts recognized as net patient service revenue from the various state supplemental funding programs and transfer agreements available to PH for the years ended June 30, 2022 and 2021, respectively (in thousands):

	2022	2021
PRIME/QIP	$ 18,039	$ 12,951
Managed care rate range IGT	28,329	15,460
QAF	10,891	13,412
Medi-Cal rate stabilization	1,131	2,781
Outpatient supplemental payment	4,620	6,543
Medi-Cal DSH	(2,883)	1,591
Totals	$ 60,127	$ 52,738

With respect to the above described programs, revenue is recognized when management is reasonably assured all performance and satisfaction of obligations have been met, the amount of revenue is available, and has been considered in estimating the amount of revenue to be recognized.

Note 3 – Net Patient Service Revenue, Third-Party Reimbursement Programs, and Non-Operating Revenue (continued)

The state of California Government Code (the “Government Code”) authorizes PH to invest unrestricted and board-designated assets in obligations of the U.S. Treasury and certain U.S. government agencies, obligations of the state of California and local government entities bankers’ acceptances, commercial paper, certificates of deposit, repurchase agreements, and mortgage securities. Certain of these investments may be purchased only in limited amounts and limited maturity dates, as defined in the Government Code. PH’s bond indenture agreements authorize trustee-held assets to be invested in obligations of the U.S. Treasury and certain U.S. government agencies, repurchase agreements, and obligations of financial institutions meeting certain criteria defined in the indentures.

The California State Treasury makes available the Local Agency Investment Fund (LAIF) through which local governments may pool investments. Each governmental entity may invest up to $75,000 of unrestricted monies in the fund and an unlimited amount of qualified bond proceeds. PH had invested $73,355 and $73,216 of unrestricted funds in this fund as of June 30, 2022 and 2021, respectively. PH also had invested $6,545 and $9,028 in jointly managed funds under an escrow agreement with the City of Escondido as of June 30, 2022 and 2021, respectively. Investments in the LAIF are highly liquid, as deposits can be converted to cash within 24 hours without loss of interest. PH is a voluntary participant in the LAIF. The fair value of PH’s investment in this pool is reported in the accompanying statements of net position at amounts based upon PH’s pro rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis and therefore is excluded from the fair value hierarchy.

Note 4 – Cash and Cash Equivalents and Investments

As of June 30, 2022 and 2021, PH had the following investments (in thousands):

	2022	2021
Investments – current	$ 221,077	$ 239,041
Restricted cash and investments – current	52,071	44,295
Restricted cash and investments – noncurrent	58,424	89,488
Total	$ 331,572	$ 372,824

Note 4 – Cash and Cash Equivalents and Investments (continued)

As of June 30, 2022 and 2021, PH had investments by type and maturity as follows (in thousands):

	2022		
		Investment Maturities (in Years)	
Investment Type	Fair Value	Less Than 1	1–5
External investment pool – LAIF	$ 79,900	$ 79,900	$ -
U.S. government bonds	38,816	4,296	34,520
U.S. treasury bills	25,988	2,463	23,525
Corporate bonds	68,807	12,145	56,662
Money market mutual funds	118,061	118,061	-
Total	$ 331,572	$ 216,865	$ 114,707

	2021		
		Investment Maturities (in Years)	
Investment Type	Fair Value	Less Than 1	1–5
External investment pool – LAIF	$ 82,244	$ 82,244	$ -
U.S. government bonds	29,342	2,091	27,251
U.S. treasury bills	58,392	10,930	47,462
Corporate bonds	35,604	3,726	31,878
Money market mutual funds	167,242	167,242	-
Total	$ 372,824	$ 266,233	$ 106,591

GASB Statement No. 72, *Fair Value Measurement and Application,* defines fair value as the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability.

The fair value should be calculated based on assumptions that market participants would use in pricing the asset or liability, not on assumptions specific to the entity. In addition, the fair value of liabilities should include consideration of non-performance risk.

Note 4 – Cash and Cash Equivalents and Investments (continued)

In addition to defining fair value, this guidance expands the disclosure requirements around fair value and establishes a fair value hierarchy for valuation inputs. The hierarchy prioritizes the inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels, which are determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the measurement date.

Level 2 – Pricing inputs are based on quoted market prices for similar instruments in active markets, quoted prices for identical or similar instruments in inactive markets, 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. Financial assets and liabilities in this category generally include asset-backed securities, corporate bonds and loans, municipal bonds, and interest rate swap instruments.

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

Marketable securities and financial instruments – Where quoted market prices are available in an active market, securities or instruments are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated using pricing models, quoted prices of securities or instruments with similar characteristics, or discounted cash flows. These securities or instruments are classified within Level 2 of the valuation hierarchy. In certain cases, where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the valuation hierarchy.

Note 4 – Cash and Cash Equivalents and Investments (continued)

The following table summarizes PH's assets and liabilities measured at fair value on a recurring basis as of June 30, 2022 and 2021 (in thousands):

	2022			
	Total	Level 1	Level 2	Level 3
Investments				
Money market mutual funds	$ 118,061	$ 118,061	$ -	$ -
U.S. government bonds	38,816	-	38,816	-
U.S. treasury bills	25,988	25,988	-	-
Corporate bonds	68,807	-	68,807	-
	251,672	$ 144,049	$ 107,623	$ -
Investments not subject to the fair value hierarchy				
State investment pool – LAIF	79,900			
Total investments	$ 331,572			
Liabilities				
Interest rate swap	$ (12,587)	$ -	$ (12,587)	$ -

	2021			
	Total	Level 1	Level 2	Level 3
Investments				
Money market mutual funds	$ 167,242	$ 167,242	$ -	$ -
U.S. government bonds	29,342	-	29,342	-
U.S. treasury bills	58,392	58,392	-	-
Corporate bonds	35,604	-	35,604	-
	290,580	$ 225,634	$ 64,946	$ -
Investments not subject to the fair value hierarchy				
State investment pool – LAIF	82,244			
Total investments	$ 372,824			
Liabilities				
Interest rate swap	$ (25,739)	$ -	$ (25,739)	$ -

There are many factors affecting the value of investments. Some, such as interest rate risk, credit risk, concentration of credit risk, and custodial credit risk, may affect both equity and fixed income securities.

Equity and debt securities respond to such factors as economic conditions, individual company earnings performance, and market liquidity while fixed income securities are particularly sensitive to credit risks and changes in interest rates.

Note 4 – Cash and Cash Equivalents and Investments (continued)

Interest rate risk – Interest rate risk is the risk that the value of fixed income securities will decline due to increasing interest rates. The terms of a debt investment may cause its fair value to be highly sensitive to interest rate changes. As a means of limiting exposure to fair value losses arising from increasing interest rates, PH's investment policy, as per statutory requirements, limits the term of any investment to a maturity not exceeding five years.

Credit risk – Fixed income securities are subject to credit risk, which is the chance that an issuer will fail to pay interest or principal in a timely manner or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline. Certain fixed income securities, including obligations of the U.S. government or those explicitly guaranteed by the U.S. government, are not considered to have credit risk. State law limits PH's investment in commercial paper, corporate bonds, and bond mutual funds with an "A" rating issued by nationally recognized statistical rating organizations. PH has no investment policy that would further limit investment choices. As of June 30, 2022 and 2021, PH's investments, excluding U.S. government obligations, consisted of the following: corporate bond investments rated "A" or better by Standard & Poor's (S&P) and Moody's Investors Service (Moody's), U.S. Government Agency investments rated "AAA" by Fitch, and PH's investments in the LAIF, which were not rated.

Concentration of credit risk – Concentration of credit risk is the risk associated with a lack of diversification, such as having substantial investments in a few individual issuers, thereby exposing PH to greater risks resulting from adverse economic, political, regulatory, geographic, or credit developments. Amounts invested in the LAIF are not considered subject to concentration of credit risk. In accordance with state law, no more than 5% of total investments may be invested in the securities of any one issuer, except obligations of the U.S. government, no more than 10% may be invested in any one mutual fund, and no more than 30% may be invested in bankers' acceptances of any one commercial bank.

Investments in any one issuer (other than U.S. treasury securities and external investment pools) that represent 5% or more of the total investments as of June 30, 2022 and 2021, were as follows (in thousands):

		2022		2021	
Investment	Investment Type	Fair Value	Percentage of Total Investments	Fair Value	Percentage of Total Investments
Federal National Mortgage Association	Federal Agency Securities	$ -	0%	$ 17,851	5%
U.S. Bank, Trustee	First American Govt Oblig Fund CL D	$ 19,049	6%	$ 36,058	10%
Wells Fargo Advantage Government Money Market	U.S. Government Money Market Funds	$ -	0%	$ 52,941	14%
Fidelity Investments	FIMM-Treasury Port Instl CL 2644	$ -	0%	$ 36,602	10%
Computershare Corporate Trust Services	Allspring Government Money Market Service	$ 43,229	13%	$ -	0%

Custodial credit risk – investments – All of PH's investments are insured or registered or held by PH's agent in the agent's nominee name, with subsidiary records listing PH as the legal owner. For these reasons, PH is not exposed to custodial credit risk for its investments.

Note 4 – Cash and Cash Equivalents and Investments (continued)

Custodial credit risk – deposits – Custodial credit risk is the risk that in the event of a bank failure, PH's deposits may not be returned to it. PH does not have a policy for custodial credit risk. As of June 30, 2022 and 2021, PH's bank balances totaled $34,516 and $52,270, respectively, and were not exposed to custodial credit risk, as the uninsured deposits are with financial institutions that are individually required by state law to have government deposits collateralized at a rate of 110% of the deposits. Such collateral is considered to be held in PH's name. PHMG maintains bank deposit accounts that are insured by the Federal Deposit Insurance Corporation (FDIC) up to a limit of $250 per depositor. PHMG had cash balances of $3,282 and $4,713 that were above the insured limit as of June 30, 2022 and 2021, respectively.

Investment income (loss) – Investment income (loss) for the years ended June 30 consisted of the following (in thousands):

	2022	2021
Interest, dividends, and realized gains on sale of investments	$ 2,262	$ 2,447
Net increase in fair value of investments	(7,752)	(2,714)
Total	$ (5,490)	$ (267)

Note 5 – Concentrations of Credit Risk

PH grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of gross receivables from patients and third-party payors as of June 30, 2022 and 2021, was as follows:

	2022	2021
Medicare	16%	13%
Medi-Cal	7%	11%
HMO/PPO/commercial*	68%	69%
Self Pay	7%	5%
Others	2%	2%
Total	100%	100%

* In addition to various commercial insurance plans, this category includes Medi-Cal HMOs and Medicare Advantage HMOs.

Note 6 – Capital Assets

A summary of changes in capital assets for the years ended June 30, 2022 and 2021, is as follows (in thousands):

	Balance as of June 30, 2021 (As restated)	Additions	Disposals	Transfers	Balance as of June 30, 2022
Land improvements	$ 76,870	$ 151	$ -	$ 111	$ 77,132
Buildings and leasehold improvements	1,068,730	364	-	16,591	1,085,685
Equipment	297,366	4,152	(2,807)	8,476	307,187
Land	54,846	-	-	-	54,846
Construction in progress	40,061	51,433	(718)	(25,178)	65,598
	1,537,873	56,100	(3,525)	-	1,590,448
Less: accumulated depreciation and amortization	(568,087)	(46,743)	2,783	-	(612,047)
Capital assets, net	$ 969,786	$ 9,357	$ (742)	$ -	$ 978,401

	Balance as of June 30, 2020 (As restated)	Additions	Disposals	Transfers	Balance as of June 30, 2021 (As restated)
Land improvements	$ 80,342	$ -	$ (3,472)	$ -	$ 76,870
Buildings and leasehold improvements	1,152,652	1,494	(94,339)	8,923	1,068,730
Equipment	313,259	4,235	(23,219)	3,091	297,366
Land	60,715	-	(5,869)	-	54,846
Construction in progress	33,455	19,008	(388)	(12,014)	40,061
	1,640,423	24,737	(127,287)	-	1,537,873
Less: accumulated depreciation and amortization	(633,439)	(44,301)	109,653	-	(568,087)
Capital assets, net	$ 1,006,984	$ (19,564)	$ (17,634)	$ -	$ 969,786

Construction commitments outstanding as of June 30, 2022, were $36,592.

Note 7 – Lease Right-of-Use Assets

A summary of changes in lease right-of-use assets for both PH and PHMG for the year ended June 30, 2022, is as follows (in thousands):

	Balance as of June 30, 2021 (As restated)	Additions	Disposals	Balance as of June 30, 2022	Amounts due within one year
Lease right of use assets					
Building	$ 263,052	$ 3,751	$ (75)	$ 266,728	
Furniture, fixtures, and equipment	9,532	3,475	(15)	12,992	
Total lease right of use assets	272,584	7,226	(90)	279,720	
Less accumulated amortization					
Building	(12,371)	(16,679)	76	(28,974)	
Furniture, fixtures, and equipment	(2,552)	(2,655)	15	(5,192)	
Total accumulated amortization	(14,923)	(19,334)	91	(34,166)	
Net lease right of use assets	$ 257,661	$ (12,108)	$ 1	$ 245,554	
Lease liabilities	$ 264,705	$ 8,035	$ (12,045)	$ 260,695	$ 10,417

PH lease-related expense included in rent expense on the statements of revenue, expenses, and changes in net position for the years ended June 30, 2022 and 2021, is as follows (in thousands):

	2022	2021
Amortization expense by class of underlying asset		
Medical equipment	$ 924	$ 912
Building	10,326	6,847
Equipment	1,549	1,398
Total amortization expense	12,799	9,157
Interest on lease liabilities	10,990	6,566
Total lease related expense	$ 23,789	$ 15,723

Note 7 – Lease Right-of-Use Assets (continued)

PHMG lease-related expense included in rent expense on the statements of revenue, expenses, and changes in net position for the years ended June 30, 2022 and 2021, is as follows (in thousands):

	2022	2021
Finance lease expense		
Amortization of ROU assets	$ 42	$ -
Interest on lease liabilities	4	-
Operating lease expense	7,382	7,471
Variable and short-term lease expense	2,126	271
Total lease related expense	$ 9,554	$ 7,742

The District evaluated the lease right-of-use assets for impairment and determined there was no impairment for the year ended June 30, 2022. See Note 12 for related lease obligations.

Note 8 – Investment in and Amounts Due from Affiliated Entities

During fiscal year 2007, PH entered into a partnership agreement with PDP Pomerado, LLC in exchange for a ground lease agreement. During fiscal year 2010, the partnership with PDP Pomerado, LLC was terminated and the ground lease agreement was transferred to NHP/PMP Pomerado, LLC. In conjunction with the termination of the partnership, PDP Pomerado, LLC was dissolved and its assets were liquidated. PH received proceeds of $6,279 for its interest in PDP Pomerado, LLC, which was recorded as unearned revenue as it was attributed to the difference in contractual lease payments and the fair value of lease payments. Unamortized unearned revenue of $6,691 and $6,797 included in deferred inflow of resources in the accompanying statements of net position as of June 30, 2022 and 2021, respectively, is recognized as income over the remaining term of the ground lease agreement, which expires in April 2061, and has two ten-year options to renew at $1 per year. The renewal is considered inevitable.

In October 2017, PH entered into an Investment Interests Purchase Agreement, whereby Arch conveyed 100% of its interest in PHS-PAM Holdings, Inc. (“PHS-PAM”) to PH. PH purchased 1,000 or 100% of the issued and outstanding shares of PHS-PAM, which owns 50% of PAM and 50% of PAM-SD. The remaining 50% ownership interests in PAM and PAM-SD are held by Arch and/or its subsidiaries. PH paid $2,500 via PHS-PAM for its 50% interest in PAM-SD. This investment was eliminated in the financial statements.

PH’s investment in affiliated entities, which are generally accounted for under the equity method because PH does not control the entities, was $6,904 and $5,777 as of June 30, 2022 and 2021, respectively. The total income from PH’s investment in affiliates was $326 and $397 for the years ended June 30, 2022 and 2021, respectively, and is included in other, net on the statements of changes in net position.

Note 9 – Related Organizations

Palomar Health Foundation – Palomar Health Foundation (the "Foundation") is a charitable nonprofit organization created to provide assistance and support for PH. The Foundation is a separately governed organization. Its financial position, results of operations, and cash flows are not included in the accompanying financial statements. The Foundation provides a funding source for various programs on behalf of PH. Funding for these programs provided by the Foundation totaled $1,191 and $2,726 for the years ended June 30, 2022 and 2021, respectively.

PH has entered into a management services agreement (MSA) with the Foundation, whereby PH provides administrative support to the Foundation. Support provided to the Foundation totaled $1,479 and $1,631 for the years ended June 30, 2022 and 2021, respectively. Under the MSA, PH provided a credit line to the Foundation of $8,000 with interest at 2.5% above LIBOR. The credit line expired June 30, 2021, and is being renegotiated. There were no amounts outstanding on the line of credit as of June 30, 2022 or 2021. An audited summary of the Foundation's assets, liabilities, and net assets as of June 30, 2022 and 2021, was as follows (in thousands):

	2022	2021
Assets	$ 7,332	$ 6,834
Liabilities	$ 1,557	$ 963
Net assets	5,775	5,871
Total liabilities and net assets	$ 7,332	$ 6,834

PIMG, Inc. – In April 2010, Arch entered into a 25-year professional services agreement with PIMG, Inc. ("PIMG") under which PIMG provides professional medical services to patients seeking services from and enrolled with Arch. For the years ended June 30, 2022 and 2021, PIMG provided professional services to Arch in the amounts of $13,114 and $11,126, respectively. Any amounts advanced are to be repaid upon Arch's request and do not bear interest. There are outstanding amounts in the amount of $704 and $775 as of June 30, 2022 and 2021, respectively.

Pacific Accountable Care, LLC (PAC) – In April 2016, Arch formed PAC, a partnership with Medicare FFS participants, to develop an ACO with the intent to manage, coordinate, and promote accountability for the quality, patient safety, cost, and overall care of 12,000 Medicare patients with Arch as the sole member. In January 2017, CMS awarded PAC a Track 1 MSSP contract for calendar years January 1, 2017 through December 31, 2019. PAC is eligible for payments from CMS if able to achieve medical cost savings as compared to predetermined benchmarks. As a Track 1 MSSP, PAC has no risk with CMS for any increase in medical cost. For fiscal year 2018, PAC recorded a receivable of $3,946 for its share of the 2017/2018 plan year savings with a related payable of $921 due to the CMS approved physicians participating in the PAC ACO. There are no outstanding amounts as of June 30, 2022 or 2021.

Pacific Accountable Management, LLC (PAM) and Pacific Accountable Management San Diego, LLC (PAM-SD) – PAM and PAM-SD operated as MSOs and provided administrative and billing services to Arch during the year ended June 30, 2018. PH and Arch collectively hold 100% of PAM and PAM-SD and closed operations for both entities in July 2018.

Note 10 – Long-Term Debt

The following is a summary of long-term debt transactions for PH for the years ended June 30, 2022 and 2021 (in thousands):

	Balance June 30, 2021 (As Restated)	Additions	Reductions	Balance June 30, 2022	Amounts Due within One Year
General Obligation Bonds					
Series 2016A General Obligation Bonds	$ 48,984	$ -	(2,408)	$ 46,576	$ 1,980
Series 2016B General Obligation Bonds	178,246	-	(1,023)	177,223	-
Series 2010A General Obligation Bonds	65,473	-	(30)	65,443	-
Series 2009A General Obligation Bonds	108,913	-	(877)	108,036	954
Series 2007A General Obligation Bonds	40,359	-	(4,894)	35,465	5,127
Accrued interest on capital appreciation bonds	231,339	8,473	-	239,812	12,753
Total General Obligation Bonds	673,314	8,473	(9,232)	672,555	20,814
Other long-term debt					
Series 2017 Refunding Revenue Bonds	166,670	-	(659)	166,011	-
Series 2017 Certificates of Participation	58,216	-	(1,151)	57,065	1,144
Series 2016 Refunding Revenue Bonds	248,510	-	(7,601)	240,909	6,555
Series 2006 Certificates of Participation	137,400	-	(6,484)	130,916	6,725
Series 2021 Certificates of Participation	33,785	-	(801)	32,984	-
Notes payable	3,885	-	(3,408)	477	478
Long-term debt – Crisis Stabilization Unit	857	-	(143)	714	-
Total other long-term debt	649,323	-	(20,247)	629,076	14,902
Total long-term debt	$ 1,322,637	$ 8,473	$ (29,479)	$ 1,301,631	$ 35,716

	Balance June 30, 2020 (As Restated)	Additions	Reductions	Balance June 30, 2021 (As Restated)	Amounts Due within One Year
General Obligation Bonds					
Series 2016A General Obligation Bonds	$ 51,276	$ -	$ (2,292)	$ 48,984	$ 1,835
Series 2016B General Obligation Bonds	179,268	-	(1,022)	178,246	-
Series 2010A General Obligation Bonds	65,504	-	(31)	65,473	-
Series 2009A General Obligation Bonds	109,455	-	(542)	108,913	665
Series 2007A General Obligation Bonds	44,917	-	(4,558)	40,359	4,799
Accrued interest on capital appreciation bonds	224,776	7,070	(507)	231,339	11,233
Total General Obligation Bonds	675,196	7,070	(8,952)	673,314	18,532
Other long-term debt					
Series 2017 Refunding Revenue Bonds	167,329	-	(659)	166,670	-
Series 2017 Certificates of Participation	59,319	-	(1,103)	58,216	1,085
Series 2016 Refunding Revenue Bonds	255,825	-	(7,315)	248,510	6,270
Series 2006 Certificates of Participation	143,655	-	(6,255)	137,400	6,500
Series 2021 Certificates of Participation	-	33,785	-	33,785	-
Notes payable	4,844	-	(959)	3,885	3,406
Long-term debt – Crisis Stabilization Unit	1,000	-	(143)	857	-
Total other long-term debt	631,972	33,785	(16,434)	649,323	17,261
Total long-term debt	$ 1,307,168	$ 40,855	$ (25,386)	$ 1,322,637	$ 35,793

Note 10 – Long-Term Debt (continued)

The terms and due dates of PH's long-term debt as of June 30, 2022 and 2021, are as follows:

- Series 2021 Certificates of Participation ("2021 COP") bear interest at 5.00%, with interest payments due semiannually. Principal payments are due in fiscal year 2027. The 2021 COP are net of unamortized original issue premium of $5,071 as of June 30, 2021, and are collateralized by PH revenues as defined in the indenture agreement. The cost of the insurance premium is being amortized over the life of the bonds.

- Series 2017 Refunding Revenue Bonds ("Series 2017 Bonds") bear interest at 5.00%, with interest payments due semiannually. Principal payments are due in annual amounts ranging from $15,785 in fiscal year 2041 to $22,405 in fiscal year 2048. The Series 2017 Bonds are net of unamortized original issue premium of $14,551 and $15,210 as of June 30, 2022 and 2021, respectively, and are collateralized by PH revenues as defined in the indenture agreement. The net unamortized loss on refunding is $16,591 and $17,341 as of June 30, 2022 and 2021, respectively, and is included as deferred outflow of resources and amortized. As an alternative to maintaining a cash reserve to fund principal and interest payments in the event of default, PH purchased a Municipal Bond Debt Service Reserve Insurance policy with a policy limit of $11,827. The cost of the insurance premium is being amortized over the life of the bonds.

- Series 2017 Certificates of Participation ("2017 COP") bear interest at rates between 4.00% to 5.00%, with interest payments due semiannually. Principal payments are due in annual amounts ranging from $1,085 in fiscal year 2021 to $3,450 in fiscal year 2048. The 2017 COP are net of unamortized original issue premium of $1,005 and $1,072 as of June 30, 2022 and 2021, respectively, and are collateralized by PH revenues as defined in the indenture agreement. As an alternative to maintaining a cash reserve to fund principal and interest payments in the event of default, PH purchased a Municipal Bond Debt Service Reserve Insurance policy with a policy limit of $3,522. The cost of the insurance premium is being amortized over the life of the bonds.

- Series 2016 Refunding Revenue Bonds ("Series 2016 Revenue Bonds") bear interest at rates between 3.00% to 5.00%, with interest payments due semiannually. Principal payments are due in annual amounts ranging from $6,270 in fiscal year 2021 to $27,440 in fiscal year 2040. The Series 2016 Revenue Bonds are net of unamortized original issue premium of $23,059 and $24,389 as of June 30, 2022 and 2021, respectively, and are collateralized by PH revenues as defined in the indenture agreement. The net unamortized loss on refunding is $31,191 and $32,990 as of June 30, 2022 and 2021, respectively, and is included as deferred outflow of resources and amortized.

- Series 2016A General Obligation Bonds ("Series 2016A G.O. Bonds") bear interest at rates between 2.00% to 5.00%, with interest payments due semiannually. Principal payments are due in annual amounts ranging from $1,835 in fiscal year 2021 to $4,345 in fiscal year 2035. The Series 2016A G.O. Bonds are net of unamortized original issue premium of $6,916 and $7,488 as of June 30, 2022 and 2021, respectively.

Note 10 – Long-Term Debt (continued)

- Series 2016B General Obligation Bonds ("Series 2016B G.O. Bonds") bear interest at rates between 2.00% to 5.00%, with interest payments due semiannually. Principal payments are due in annual amounts ranging from $13,310 in fiscal year 2028 to $19,305 in fiscal year 2038. The Series 2016B G.O. Bonds are net of unamortized original issue premium of $14,388 and $15,410 as of June 30, 2022 and 2021, respectively. The net unamortized loss on refunding is $3,018 and $3,233 as of June 30, 2022 and 2021, respectively, and is included as deferred outflow of resources and amortized.

- Series 2010 Certificates of Participation ("2010 COP") were advance refunded on December 11, 2017, with proceeds from the issuance of the Series 2017 Bonds. Additional 2010 COP reserves were deposited in an escrow trust account held with the escrow agent to provide for all future debt service payments. As a result, the 2010 COP are considered to be defeased and the liability for these bonds has been removed from the statements of net position. PH refunded the Series 2010 COP to reduce its total debt service payments over the next 16 years and to obtain an economic gain of $16,678.

- Series 2010A General Obligation Bonds ("Series 2010A G.O. Bonds") accreted interest compounded at rates between 6.84% to 7.85% on $64,917 Capital Appreciation Bonds ("CABs") with the first payment to bondholders due on August 1, 2034. Accreted interest compounds at 6.75% on $49,999 Convertible CABs with the first payment to bondholders also due on August 1, 2034. Principal payments are due in annual amounts ranging from $1,476 in fiscal year 2038 to $33,159 in fiscal year 2041. The Series 2010A G.O. Bonds are net of unamortized premium of $526 and $557 as of June 30, 2022 and 2021, respectively.

- Series 2009 Certificates of Participation ("2009 COP") were advance refunded on October 20, 2016, with proceeds from the issuance of the Series 2016 Revenue Bonds. Additional 2009 COP reserves were deposited in an escrow trust account held with the escrow agent to provide for all future debt service payments. As a result, the 2009 COP is considered to be defeased and the liability for these bonds has been removed from the statements of net position. PH refunded the Series 2009 COP to reduce its total debt service payments over the next 23 years by $48,600 and to obtain an economic gain of $33,200.

- Series 2009A General Obligation Bonds ("Series 2009 G.O. Bonds") accreted interest compounded at rates between 6.84% to 9.00% on $50,001 CABs with the first payment to bondholders on August 1, 2019. Accreted interest compounded at 7.00% on $59,999 Convertible CABs with the first payment to bondholders on August 1, 2033. Principal payments are due in annual amounts ranging from $664 in fiscal year 2021 to $18,868 in fiscal year 2039. The Series 2009 G.O. Bonds are net of unamortized premium of $2,427 and $2,640 as of June 30, 2022 and 2021, respectively.

Note 10 – Long-Term Debt (continued)

- Series 2007A General Obligation Bonds ("Series 2007A G.O. Bonds") are compounded at interest rates between 3.67% to 4.92% on $66,083 CABs with the first payment paid to bondholders on August 1, 2011. Principal payments are due in annual amounts ranging from $4,799 in fiscal 2021 to $6,585 in fiscal 2027. The Series 2007A G.O. Bonds are net of unamortized premium of $257 and $352 as of June 30, 2022 and 2021, respectively. A portion of the Series 2007A G.O. Bonds, the current interest bonds, was advance refunded on October 27, 2016, with proceeds from the issuance of the Series 2016B G.O. Bonds. As a result, the Series 2007A G.O. current interest bonds are considered to be defeased and the liability for these bonds has been removed from the statements of net position. PH refunded the 2007A G.O. Bonds to reduce its total debt service payments over the next 21 years by $50,200 and to obtain an economic gain of $38,200.

- Series 2006 Certificates of Participation ("2006 COP") were issued as auction rate securities, whereby the interest rate for each series is generally determined during successive seven-day auction periods (a portion of the Series 20016 COP refunded the Series 1993 Insured Refunding Revenue Bonds). In addition, PH entered into an interest rate swap agreement with Citibank, N.A., New York, with respect to the 2006 COP in a notional amount of $180,000 (the "Swap Agreement") (see Note 11). Interest on the 2006 COP is accrued at 3.22%, which is the fixed rate to be paid by PH under the Swap Agreement; interest payments are due semiannually and principal payments are due annually in amounts ranging from $6,275 in fiscal year 2021 to $12,350 in fiscal year 2037. The 2006 COP are net of unamortized loss on refunding of $10 and $25 as of June 30, 2022 and 2021, respectively, and are collateralized by PH revenues as defined in the indenture agreement.

All the G.O. Bonds represent the general obligation of PH in an amount sufficient to service the obligation, and PH has the power and is obligated to cause to be levied and collected by the County of San Diego annual *ad valorem* taxes upon all property within PH's boundaries subject to taxation by PH for payment of the principal and interest on the bonds when due. However, PH is legally required to repay the G.O. Bonds if collected *ad valorem* taxes are insufficient.

PH is required to maintain certain debt covenants (Days Cash on Hand, Maximum Annual Debt Service Coverage, and Cushion Ratio) under its indenture agreements for the COP. The covenants stipulate that in the event of underachievement, the insurers may require PH to call in mutually agreed-upon consultants to perform mutually agreed-upon scope of services to assist PH in achieving the covenants.

The estimated fair value of PH's long-term debt was approximately $1,338,000 and $1,554,000 as of June 30, 2022 and 2021, respectively, based on quotations from independent third parties.

During the year ended June 30, 2020, Arch applied for and received a Paycheck Protection Loan from a bank in the amount of $2,487. Arch received full forgiveness of the loan during the year ended June 30, 2022, and has recognized a gain on debt forgiveness of $2,487 which is included in other nonoperating income in the accompanying statement of revenue, expenses, and changes in net position.

Note 10 – Long-Term Debt (continued)

Estimated future principal and interest payments on long-term debt as of June 30, 2022, are as follows (in thousands):

	Principal	Interest	Total
Years Ending June 30,			
2023	$ 22,630	$ 56,746	$ 79,376
2024	23,972	57,971	81,943
2025	25,303	59,315	84,618
2026	26,675	60,825	87,500
2027	28,014	62,579	90,593
2028–2032	231,055	298,320	529,375
2033–2037	267,027	272,160	539,187
2038–2042	231,428	200,256	431,684
2043–2047	111,995	20,440	132,435
2048	25,855	629	26,484
Sub-total	993,954	1,089,241	2,083,195
Net premium on bonds	67,865	-	67,865
Accrued interest on capital appreciation bonds	239,812	-	239,812
Total	$ 1,301,631	$ 1,089,241	$ 2,390,872

Note 11 – Interest Rate Swap

In 2006, PH entered into the Swap Agreement as a means to lower its borrowing costs on the 2006 COP (see Note 10) when compared against fixed-rate bonds at the time of issuance. The Swap Agreement was effective December 28, 2006, with an initial notional amount of $180,000 for the 2006 COP and terminates on November 1, 2036, simultaneously with the maturity of the 2006 COP.

Under the Swap Agreement, PH pays the swap provider amounts based on a fixed interest rate of 3.218%, and the swap provider pays to PH amounts based on 56% of the British Banker's Association 30-day London Interbank Offered Rate (LIBOR), plus 0.230% (1.454% and 0.087% as of June 30, 2022 and 2021, respectively).

Notes to Financial Statements (Dollars in Thousands)

Note 11 – Interest Rate Swap (continued)

The significant terms of the Swap Agreement are as follows:

Corresponding bond series	Series 2006 Certificate of Participation bonds
Swap type	Fixed income
Initial notional amount	$ 180,000
Notional amount as of June 30, 2022	$ 130,925
Notional amount as of June 30, 2021	$ 137,425
Effective date	December 28, 2006
Termination date	November 1, 2036
Final bond maturity	November 1, 2036
PH pays	3.218 %
Cash payments remitted by PH for year ended June 30, 2022	$ 3,832
PH receives	56% of 30-day LIBOR + 0.23%
Swap fair value as of June 30, 2022	$ (12,587)
Change in fair value for the year ended June 30, 2022	$ 13,152
Classification	Liability

Fair value – As of June 30, 2022 and 2021, the swap had a negative fair value of $12,587 and $25,739, respectively, developed by a mark-to-market pricing service using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap. The negative fair value of the swap is reported in the accompanying statements of net position as a long-term liability. The change in the fair value of the swap is reported in the accompanying statements of revenue, expenses, and changes in net position as unrealized gain on interest rate swap.

Credit risk – PH seeks to limit its counterparty risk by contracting only with highly rated entities. As of June 30, 2022, the counterparty of the interest rate swap was rated “Aa3” by Moody’s, “A+” by S&P, and “A+” by Fitch Ratings (Fitch). To mitigate the potential for credit risk, under the terms of the Swap Agreement, if the counterparty’s credit quality falls below (1) Moody’s rating of Baa2, (2) S&P’s rating of BBB, or (3) Fitch’s rating of BBB, the fair value of the swap will be collateralized by the counterparty with cash and/or treasury securities.

Basis risk – PH is exposed to basis risk on its Swap Agreement because the variable rate payments received by PH on the instruments are based on a rate or index other than the interest rate paid on its variable rate debt.

Note 11 – Interest Rate Swap (continued)

Termination risk – The swap uses the International Swaps & Derivatives Association Master Agreement (the "Master Agreement"), which includes standard termination events such as failure to pay and bankruptcy. The Master Agreement also includes an "additional termination event." The Master Agreement can be terminated if, at any time, a relevant credit rating with respect to a party declines below the termination level or is withdrawn, or if any party has no relevant rating but was previously rated by such rating agency. The termination levels are (1) Moody's rating of Baa2, (2) S&P rating of BBB, and (3) Fitch rating of BBB.

The negative swap fair value in the accompanying statements of net position approximates the termination payment that would be owed by PH to the swap counterparty if the swap was terminated. The payments from PH to the swap counterparty are insured by Assured Guaranty. This insurance provides protection to the swap counterparty in the event PH fails to make payments due under the swap. Under the terms of the Swap Agreement, an "insurer event" will occur if both Moody's and S&P's ratings for Assured Guaranty fall below the A category. If an insurer event happens, PH would be required to post collateral by a first priority perfected security interest in the gross revenues of PH. Assured Guaranty was rated A1 by Moody's with a stable outlook effective March 2022.

Note 12 – Leases

The future principal and interest lease payments as of June 30, 2022, for PH were as follows (in thousands):

	Principal	Interest
Years Ending June 30,		
2023	$ 10,417	$ 11,040
2024	8,775	10,607
2025	5,293	10,370
2026	5,166	10,148
2027	5,597	9,916
2028 - 2032	29,545	45,864
2033 - 2037	44,014	38,195
2038 - 2042	63,329	26,591
2043 - 2047	52,660	12,960
2048 - 2052	35,899	3,247
	$ 260,695	$ 178,938

Note 12 – Leases (continued)

As of June 30, 2022, future minimum lease payments under non-cancelable operating and finance leases for PHMG are as follows (in thousands):

	Finance	Operating
Years Ending June 30,		
2023	$ 24	$ 7,249
2024	-	5,527
2025	-	3,906
2026	-	3,563
2027	-	667
Thereafter	-	3,273
Total minimum lease payments	24	24,185
Less: imputed interest	-	2,436
Total lease obligations	24	21,749
Less: lease obligation, current	24	6,459
Lease obligation, net	$ -	$ 15,290
Weighted-average remaining lease term (in years)	0.50	4.81
Weighted-average discount rate	4.34%	4.34%

Note 12 – Leases (continued)

PH lease-related revenue included in other non-operating income on the statements of revenue, expenses and changes in net position for the years ended June 30, 2022 and 2021, is as follows (in thousands):

	Principal	Interest
Years Ending June 30,		
2023	$ 311	$ 1,212
2024	279	1,169
2025	507	967
2026	515	945
2027	537	923
2028 - 2032	3,174	4,358
2033 - 2037	3,782	3,728
2038 - 2042	5,426	2,922
2043 - 2047	659	2,280
2048 - 2052	35	2,475
2053 - 2057	44	2,617
2058 - 2062	54	2,858
2063 - 2067	67	3,025
2068 - 2072	83	3,312
2073 - 2077	104	3,507
2078 - 2082	129	3,845
2083 - 2087	160	4,073
2088 - 2092	198	4,470
2093 - 2097	246	4,733
2098 - 2102	305	5,197
2103 - 2107	3,798	2,077
2108 - 2112	5,282	571
	$ 25,695	$ 61,264

The future principal and interest lease receipts as of June 30, 2022 for PH, were as follows (in thousands):

	2022	2021
Lease revenue		
Office space	$ 1,013	$ 377
Land	125	102
Total lease revenue	1,138	479
Interest revenue	1,146	695
Total lease related revenue	$ 2,284	$ 1,174

Note 13 – Deferred Annuity Contracts

PH offers its employees a deferred compensation plan, which has an employer-match component created in accordance with IRC Section 457. Employees who elect to participate in the plan make contributions through a reduction in salary. All participating employees manage their contribution and investment choices through a funding agency selected by PH.

Effective July 2006, PH began providing an employer match to the employee deferred compensation plan. Under the plan and subject to a cap of 2% on the amount of compensation deferred, PH matches up to 50% of the employee's contribution, based on a variety of factors including length of employment. Prior to July 2006, contributions to the deferred compensation plan were made only by employees who chose to participate. During the years ended June 30, 2022 and 2021, PH made matching contributions of $3,200 and $3,300, respectively.

The investments of PH's IRC Section 457 plan and earnings thereon are held in trust for the exclusive benefit of the plan participants and their beneficiaries. The IRC Section 457 plan and earnings are not subject to claims of PH's general creditors. Accordingly, the accompanying statements of net position do not include the funds deposited with financial institutions pursuant to deferred annuity contracts.

Note 14 – Retirement Plan

PH sponsors a defined contribution retirement plan under which benefits are limited to amounts accumulated from total contributions by PH and by participating employees, plus earnings thereon. Generally, all employees with one year of service are eligible to participate. For the years ended June 30, 2022 and 2021, contributions under the retirement plan by PH were 6% of covered employees' basic compensation. Contributions are funded as accrued. Total PH contributions expensed for the years ended June 30, 2022 and 2021, were $19,482 and $20,286, respectively.

Note 15 – Postemployment Healthcare Plan

The District accounts for its postemployment healthcare plan under GASB Codification Section P50, *Postemployment Benefits Other Than Pensions – Reporting for Benefits Provided Through Trusts That Meet Specified Criteria – Defined Benefit*.

Plan description and funding policy – PH's Postemployment Healthcare Plan (the "Plan") is a single-employer defined benefit healthcare plan administered by Discovery Benefits. The Plan provides medical and dental insurance benefits to qualified postemployment participants on a gap coverage basis. Coverage is limited to those employees who have provided 10 years of consecutive service, are below the age of 65, and do not receive coverage from other sources. The contribution requirements of the Plan members and PH are established and may be amended by the Board of Directors. The required contribution is based on estimated pay-as-you-go financing requirements.

Notes to Financial Statements (Dollars in Thousands)

Note 15 – Postemployment Healthcare Plan (continued)

Employees covered by benefit terms – As of the current and prior valuation dates, the following employees were covered by the Plan:

	July 1, 2020	July 1, 2018
Inactive employees currently receiving benefit payments	4	8
Active employees	3,498	3,634
Total	3,502	3,642

Total OPEB liability – PH's total OPEB liability of $1,242 was measured as of June 30, 2022 and was determined by an actuarial valuation as of that date.

Actuarial assumptions and other inputs – The total OPEB liability in the June 30, 2022 actuarial valuation is determined using the following actuarial assumptions and other inputs, applied to all periods included in the measurement, unless otherwise specified. The actuarial assumptions used in the June 30, 2022 valuation were based on the results of an actuarial experience study for the period June 30, 2021 to June 30, 2022.

Inflation	2.50%
Salary increases	3.00%–18.50%, including inflation
Discount rate	2.16%
Healthcare cost trend rates	7.0% for 2021, 6.75% for 2022, and decreasing to an ultimate rate of 4% in 2033

The discount rate was based on Bond Buyer 20-Bond General Obligation Index. Mortality rates were based on the RP-2000. Combined mortality table rates projected with mortality improvement scale BB.

Note 15 – Postemployment Healthcare Plan (continued)

Changes in the OPEB liability for the years ended June 30 were as follows (in thousands):

	2022	2021
Total OPEB liability – prior measurement date	$ 1,403	$ 1,404
Changes in total OPEB liability		
(a) Service cost	85	91
(b) Interest on the total OPEB liability	32	30
(c) Changes on benefit terms	-	-
(d) Differences between expected and actual experience	(93)	(139)
(e) Changes of assumptions or other inputs	(133)	54
(f) Benefit payments	(52)	(37)
Total OPEB liability – current measurement date	$ 1,242	$ 1,403
Covered-employee payroll	$ 228,047	$ 257,890
Total OPEB liability as a % of covered-employee payroll	0.50%	0.50%
Key information		
Valuation date	July 1, 2020	July 1, 2020
Reporting date	June 30, 2022	June 30, 2021
Measurement date	June 30, 2022	June 30, 2021
Discount rate as of the measurement date	3.54%	2.16%
Municipal bond index rate	3.54%	2.16%
Municipal bond index date	June 30, 2022	June 30, 2021

Sensitivity of the net OPEB liability to changes in the discount rate – The following presents PH's total OPEB liability using the final discount rate of 3.54% and preliminary discount rate of 2.21% for June 30, 2022 and 2021 measurement dates, respectively, as well as what the total OPEB liabilities would be if they were calculated using a discount rate that is one percentage point lower or one percentage point higher than the current rate (in thousands).

	June 30, 2022			June 30, 2021		
	1% Decrease 2.54%	Discount Rate 3.54%	1% Increase 4.54%	1% Decrease 1.16%	Discount Rate 2.16%	1% Increase 3.16%
Net OPEB liability	$ 1,336	$ 1,242	$ 1,156	$ 1,517	$ 1,403	$ 1,299

Note 15 – Postemployment Healthcare Plan (continued)

Sensitivity of the net OPEB liability to changes in the healthcare trend rates – The following presents PH's total OPEB liability using the current health trend rates, as well as what the total OPEB liability would be if it were calculated using healthcare trend rates that are one percentage point lower or one percentage point higher than the current healthcare trend rates (in thousands).

	June 30, 2022 (FYE 2023 trend and later)			June 30, 2021 (FYE 2022 trend and later)		
	1% Decrease 5.50% to 3.00%	Current 6.50% to 4.00%	1% Increase 7.50% to 5.00%	1% Decrease 5.75% to 3.00%	Current 6.75% to 4.00%	1% Increase 7.75% to 5.00%
Net OPEB liability	$ 1,135	$ 1,242	$ 1,364	$ 1,270	$ 1,403	$ 1,557

OPEB expense and deferred outflows of resources and deferred inflows of resources related to OPEB – For the fiscal year ended June 30, 2022, PH recognized OPEB expense of $70. As of June 30, 2022, the deferred outflows of resources and deferred inflows of resources related to OPEB are as follows (in thousands):

	June 30, 2022			June 30, 2021		
	Deferred Outflows of Resources	Deferred Inflows of Resources	Net Amount	Deferred Outflows of Resources	Deferred Inflows of Resources	Net Amount
Differences between expected and actual experience	$ -	$ (152)	$ (152)	$ -	$ (123)	$ (123)
Changes of assumptions and other inputs	68	(102)	(34)	116	(1)	115
Total	$ 68	$ (254)	$ (186)	$ 116	$ (124)	$ (8)

Amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows (in thousands):

Years Ending June 30,	
2023	$ (44)
2024	(64)
2025	(61)
2025	(18)
	$ (187)

Note 16– Commitments and Contingencies

Legal matters – The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, specifically those relating to the Medicare and Medi-Cal programs, is subject to government review and interpretation, as well as regulatory actions. Claims for payment for services rendered to Medicare and Medi-Cal beneficiaries must meet applicable billing laws and regulations, which, among other things, require that the services are medically necessary, accurately coded, and sufficiently documented in the beneficiaries' medical records. Allegations concerning possible violations of regulations can result in the imposition of significant fines and penalties, as well as significant repayment of previously billed and collected revenues for patient services.

PH has ongoing efforts to comply with laws and regulations, to assess its prior compliance, and the potential impact of noncompliance. PH with its ongoing compliance program will continue to monitor, investigate, and correct any potential areas of noncompliance. No regulatory action has been asserted against PH to date, although such action could occur in the future.

PH is a party to certain other legal actions arising in the ordinary course of business. In the opinion of PH management, the liability, if any, under these claims is adequately covered by insurance. PH is insured for medical malpractice under a claims-made and reported policy.

PH is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; natural disasters; and employee health and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters.

PH filed civil litigation against a third-party payor claiming breach of contract regarding payment denial of numerous healthcare service claims. PH had previously fully reserved the patient receivable balances for those claims to zero. The parties negotiated a settlement agreement in May 2021.

Coronavirus 2019 pandemic – On March 11, 2020, the World Health Organization officially declared COVID-19, the disease caused by the novel coronavirus, a pandemic. Soon afterward, PH (along with hospitals in the United States) cancelled elective surgical cases, resulting in a significant loss of net patient revenue. The pandemic has resulted in PH incurring additional costs to maintain patient volume as well as to provide care to patients specifically affected by the virus. The duration and intensity of disruption from the pandemic is uncertain, and therefore the long-term impact, if any, cannot be predicted. In response, Congress passed legislation to provide financial support to hospitals.

In April 2020, PH applied for and received advances from Medicare under the Medicare Accelerated Payment Program, administered by CMS, of $55,602. This amount is treated as a loan bearing no interest. Medicare began recouping the loan in April 2021 by withholding 25.00% of Medicare patient claim payments and applying withheld amounts against the outstanding loan balance. Recoupment at the 25.00% rate will continue for eleven months, then at the rate of 50.00% of Medicare patient claim payments for the subsequent six months. At the end of the six-month period, Medicare will issue a letter for any remaining loan balance. As of June 30, 2022 and 2021, the outstanding balance is $21,108 and $50,973, respectively, of which $21,108 and $31,956, respectively, is classified as current liabilities.

Note 16 – Commitments and Contingencies (continued)

During April, May, and June 2020, PH received funds under the Provider Relief Fund, administered by the U.S. Department of Health & Human Services (HHS), under the Coronavirus Aid, Relief, and Economic Security (CARES) Act of $21,349. PH was required to and did timely sign attestations agreeing to the terms and conditions of payment. Those terms and conditions include measures to prevent fraud and misuse. Documentation is required to ensure that these funds are to be used for healthcare-related expenses or lost revenue attributable to coronavirus, limitations of out-of-pocket payments from certain patients, and the acceptance of several other reporting and compliance requirements. Also anti-fraud monitoring and auditing will be done by HHS and the Office of the Inspector General. Management is currently assessing the compliance requirements of these funds.

Workers' compensation program – Effective July 1, 2016, PH has contracted with Safety National Casualty Corporation to provide workers' compensation insurance coverage. PH is self-insured for the first $1,000 of each occurrence with a maximum limit of indemnity per occurrence of $1,000. As of June 30, 2022 and 2021, estimated claims liabilities for workers' compensation recorded were $8,679 and $7,300, respectively.

Activity in PH's workers' compensation claims liability during the years ended June 30, 2022 and 2021, is summarized as follows (in thousands):

	2022	2021
BALANCE, beginning of the year	$ 7,300	$ 6,523
Current year claims incurred and changes in estimates for claims incurred in the prior year	5,027	4,936
Claims and expenses paid	(3,649)	(4,159)
BALANCE, end of year	8,678	7,300
Less: current portion, included in other accrued liabilities	(3,307)	(3,228)
BALANCE, end of year, less current portion	$ 5,371	$ 4,072

Employee medical plan – Effective January 1, 2021, PH implemented a self-insured medical plan for eligible employees and dependents as part of its employee benefits program. The self-insured program replaced a fully indemnified medical insurance plan through a health maintenance organization. PH carries a stop loss insurance policy for medical claims exceeding $400 individually and $500 in the aggregate. As of June 30, 2022 and 2021, the estimated claims liability recorded was $4,399 and $3,217, respectively, and is included in accrued compensation and related liabilities on the statements of net position.

Note 16 – Commitments and Contingencies (continued)

Comprehensive liability insurance coverage – PH is insured for comprehensive liability (professional liability, bodily injury and property damage liability, personal injury, advertising injury and discrimination liability, and employee benefit liability) under a claims-made policy with the California Nurses Association (CNA), which covers asserted claims and incidents reported. PH is self-insured for the first $1,000 for each claim and $7,000 in aggregate. PH's comprehensive liability insurance was renewed effective July 1, 2022, and the current policy expires on July 1, 2023. PH has reserves for estimated claims through 2015, including an estimate of IBNR. Such reserves remained unchanged at $2,463 from previous year and are recorded as other accrued liabilities in the accompanying statements of net position.

Activity in PH's comprehensive liability insurance coverage liability during the years ended June 30, 2022 and 2021, is summarized as follows (in thousands):

	2022	2021
BALANCE, beginning of the year	$ 5,082	$ 3,947
Current year claims incurred and changes in estimates	(20)	1,135
BALANCE, end of the year	$ 5,062	$ 5,082

Seismic compliance – California Senate Bill (SB) 1953 requires hospital acute care buildings to meet more stringent seismic guidelines by 2020. The California Office of Statewide Health Planning & Development (OSHPD) assigns structural performance category (SPC) ratings to each acute care hospital facility in the state. As of June 17, 2021, the Escondido facility was assigned SPC-5 and Poway campus buildings were assigned SPC-4 and SPC-5 ratings. As such, they may be used to provide in patient care beyond January 1, 2030.

Note 17 – Condensed Combining Information

A summary of the condensed combining information for PH and PHMG as of June 30, 2022, is as follows (in thousands):

ASSETS AND DEFERRED OUTFLOW OF RESOURCES

	CONDENSED COMBINING STATEMENT OF NET POSITION AS OF JUNE 30, 2022				
	PH	PHMG	PAM, PAM-SD, and PAC	Eliminations	Total
Current assets	$ 532,088	$ 29,789	$ 2,812	$ (23,045)	$ 541,644
Capital assets, net	973,282	5,119	-	-	978,401
Operating lease right of use asset, net	239,259	20,773	-	(14,478)	245,554
Noncurrent assets	144,553	7,598	-	(8,158)	143,993
Total assets	1,889,182	63,279	2,812	(45,681)	1,909,592
Deferred outflow of resources	50,800	-	-	-	50,800
Total assets and deferred outflow of resources	$ 1,939,982	$ 63,279	$ 2,812	$ (45,681)	$ 1,960,392
LIABILITIES, DEFERRED INFLOW OF RESOURCES, AND NET POSITION					
Current liabilities	$ 212,758	$ 44,462	$ 4,260	$ (28,529)	$ 232,951
Long-term liabilities	1,531,116	18,790	-	(15,755)	1,534,151
Total liabilities	1,743,874	63,252	4,260	(44,284)	1,767,102
Deferred inflow of resources	44,228	-	-	-	44,228
Total liabilities and deferred inflow of resources	1,788,102	63,252	4,260	(44,284)	1,811,330
Net investment in capital assets	(238,347)	4,114	-	34	(234,199)
Restricted	52,303	-	-	-	52,303
Unrestricted	337,924	(4,087)	(1,448)	(1,431)	330,958
Total net position	151,880	27	(1,448)	(1,397)	149,062
Total liabilities, deferred inflow of resources, and net position	$ 1,939,982	$ 63,279	$ 2,812	$ (45,681)	$ 1,960,392

PH is the sole corporate member of PHMG and PHMG is dependent upon PH for financial support. PHMG received $31,589 and $30,420 in financial support for the years ended June 30, 2022 and 2021, respectively, including capital contributions of $2,579 and $642 for the years ended June 30, 2022 and 2021, respectively.

Subsequent to June 30, 2022, PHMG has received an additional $10,005 of financial support.

Notes to Financial Statements (Dollars in Thousands)

Note 17 – Condensed Combining Information (continued)

CONDENSED COMBINING STATEMENT OF REVENUE, EXPENSES, AND CHANGES IN NET POSITION

FOR THE YEAR ENDED JUNE 30, 2022

	PH	PHMG	PAM, PAM-SD, and PAC	Elimination	Total
OPERATING REVENUE					
Net patient service revenue	$ 725,527	$ 65,643	$ 4,721	$ -	$ 795,891
Shared risk revenue	65,353	41,489	-	(6,852)	99,990
Other revenue	9,232	7,608	-	355	17,195
PH program revenue	-	9,318	-	(9,318)	-
Total operating revenue	800,112	124,058	4,721	(15,815)	913,076
OPERATING EXPENSES	707,774	158,530	2,251	(20,822)	847,733
DEPRECIATION AND AMORTIZATION	50,267	2,883	-	-	53,150
Total operating expenses	758,041	161,413	2,251	(20,822)	900,883
INCOME (LOSS) FROM OPERATIONS	42,071	(37,355)	2,470	5,007	12,193
NON-OPERATING INCOME (EXPENSE)					
Investment income (loss)	(5,493)	3	-	-	(5,490)
Unrealized gain on interest rate swap	13,152	-	-	-	13,152
Interest expense	(74,654)	(174)	-	115	(74,713)
Property tax revenue	64,586	-	-	-	64,586
Interfund support	(31,589)	31,589	-	-	-
Other, net	11,608	2,472	(1,852)	(2,682)	9,546
Total nonoperating (expense) income, net	(22,390)	33,890	(1,852)	(2,567)	7,081
CHANGE IN NET POSITION	19,681	(3,465)	618	2,440	19,274
NET POSITION, beginning of year	132,199	3,492	(2,066)	(3,837)	129,788
NET POSITION, end of year	$ 151,880	$ 27	$ (1,448)	$ (1,397)	$ 149,062

Notes to Financial Statements (Dollars in Thousands)

Note 17 – Condensed Combining Information (continued)

CONDENSED COMBINING STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2022

	PH	PHMG	PAM, PAM-SD, and PAC	Elimination	Total
CASH FLOWS FROM					
Operating activities	$ 53,744	$ (33,100)	$ (2,421)	$ -	$ 18,223
Noncapital financing activities	(14,546)	34,730	-	-	20,184
Capital and related financing activities	(105,825)	(5,502)	2,740	-	(108,587)
Investing activities	48,681	-	-	-	48,681
NET INCREASE (DECREASE) IN CASH EQUIVALENTS	(17,946)	(3,872)	319	-	(21,499)
CASH AND CASH EQUIVALENTS, beginning of year	48,943	4,352	68	-	53,363
CASH AND CASH EQUIVALENTS, end of year	$ 30,997	$ 480	$ 387	$ -	$ 31,864

Note 17 – Condensed Combining Information (continued)

A summary of the condensed combining information for PH and PHMG as of June 30, 2021, is as follows (in thousands):

ASSETS AND DEFERRED OUTFLOW OF RESOURCES

	CONDENSED COMBINING STATEMENT OF NET POSITION AS OF JUNE 30, 2021				
	PH	PHMG	PAM, PAM-SD, and PAC	Eliminations	Total
Current assets	$ 558,388	$ 21,267	$ 2,354	$ (12,850)	$ 569,159
Capital assets, net	964,610	5,176	-	-	969,786
Operating lease right of use asset, net	248,787	23,352	-	(14,478)	257,661
Noncurrent assets	145,623	5,285	-	(8,158)	142,750
Total assets	1,917,408	55,080	2,354	(35,486)	1,939,356
Deferred outflow of resources	53,564	-	-	-	53,564
Total assets and deferred outflow of resources	$ 1,970,972	$ 55,080	$ 2,354	$ (35,486)	$ 1,992,920

LIABILITIES, DEFERRED INFLOW OF RESOURCES, AND NET POSITION

	PH	PHMG	PAM, PAM-SD, and PAC	Eliminations	Total
Current liabilities	$ 193,157	$ 40,313	$ 4,420	$ (15,895)	$ 221,995
Long-term liabilities	1,598,036	11,275	-	(15,754)	1,593,557
Total liabilities	1,791,193	51,588	4,420	(31,649)	1,815,552
Deferred inflow of resources	47,580	-	-	-	47,580
Total liabilities and deferred inflow of resources	1,838,773	51,588	4,420	(31,649)	1,863,132
Net investment in capital assets	(201,829)	28,507	-	-	(173,322)
Restricted	34,676	-	-	-	34,676
Unrestricted	299,352	(25,015)	(2,066)	(3,837)	268,434
Total net position	132,199	3,492	(2,066)	(3,837)	129,788
Total liabilities, deferred inflow of resources, and net position	$ 1,970,972	$ 55,080	$ 2,354	$ (35,486)	$ 1,992,920

Notes to Financial Statements (Dollars in Thousands)

Note 17 – Condensed Combining Information (continued)

CONDENSED COMBINING STATEMENT OF REVENUE, EXPENSES, AND CHANGES IN NET POSITION

FOR THE YEAR ENDED JUNE 30, 2021

	PH	PHMG	PAM, PAM-SD, and PAC	Elimination	Total
OPERATING REVENUE					
Net patient service revenue	$ 688,110	$ 40,837	$ -	$ -	$ 728,947
Shared risk revenue	69,289	32,103	-	(3,778)	97,614
Other revenue	9,900	6,295	-	145	16,340
PH program revenue	-	4,326	-	(4,326)	-
Total operating revenue	767,299	83,561	-	(7,959)	842,901
OPERATING EXPENSES	684,576	104,901	614	(8,377)	781,714
DEPRECIATION AND AMORTIZATION	50,453	2,141	-	-	52,594
Total operating expenses	735,029	107,042	614	(8,377)	834,308
INCOME (LOSS) FROM OPERATIONS	32,270	(23,481)	(614)	418	8,593
NON-OPERATING INCOME (EXPENSE)					
Investment income	(267)	-	-	-	(267)
Unrealized gain on interest rate swap	9,445	-	-	-	9,445
Interest expense	(68,899)	(82)	-	-	(68,981)
Property tax revenue	59,170	-	-	-	59,170
Interfund support	(30,420)	30,241	-	-	(179)
Other, net	4,771	195	130	-	5,096
Total nonoperating (expense) income, net	(26,200)	30,354	130	-	4,284
CHANGE IN NET POSITION	6,070	6,873	(484)	418	12,877
NET POSITION, beginning of year	126,129	(3,381)	(1,582)	(4,255)	116,911
NET POSITION, end of year	$ 132,199	$ 3,492	$ (2,066)	$ (3,837)	$ 129,788

Notes to Financial Statements (Dollars in Thousands)

Note 17 – Condensed Combining Information (continued)

CONDENSED COMBINING STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2021

	PH	PHMG	PAM, PAM-SD, and PAC	Elimination	Total
CASH FLOWS FROM					
Operating activities	$ 58,630	$ (25,276)	$ (156)	$ -	$ 33,198
Noncapital financing activities	19,613	-	-	-	19,613
Capital and related financing activities	(42,482)	25,187	130	-	(17,165)
Investing activities	(5,944)	1,334	-	-	(4,610)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	29,817	1,245	(26)	-	31,036
CASH AND CASH EQUIVALENTS, beginning of year	19,126	3,107	94	-	22,327
CASH AND CASH EQUIVALENTS, end of year	$ 48,943	$ 4,352	$ 68	$ -	$ 53,363

Required Supplementary Information

Palomar Health

Schedule of Changes in the Net OPEB Liability and Related Ratios – Last 10 Fiscal Years (Shown in Thousands)

	Fiscal Year End Reporting Periods										
	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012
1. Total OPEB liability – prior measurement date	$ 1,403	$ 1,404	$ 1,230	$ 1,193	$ 1,176	$ 1,190	n/a	n/a	n/a	n/a	n/a
2. Changes in total OPEB liability											
(a) Service cost	85	91	67	69	60	72	n/a	n/a	n/a	n/a	n/a
(b) Interest on the total OPEB liability	32	30	44	46	43	35	n/a	n/a	n/a	n/a	n/a
(c) Changes on benefit terms	-	-	-		-	-	n/a	n/a	n/a	n/a	n/a
(d) Differences between expected and actual experience	(93)	(139)	-	(48)	-	-	n/a	n/a	n/a	n/a	n/a
(e) Changes of assumptions or other inputs	(133)	54	120	34	(24)	(63)	n/a	n/a	n/a	n/a	n/a
(f) Benefit payments	(52)	(37)	(57)	(64)	(62)	(58)	n/a	n/a	n/a	n/a	n/a
(g) Total	$ 1,242	$ 1,403	$ 1,404	$ 1,230	$ 1,193	$ -	$ -	$ -	$ -	$ -	$ -
3. Total OPEB liability – current measurement date	$ 1,242	$ 1,403	$ 1,404	$ 1,230	$ 1,193	$ 1,176	$ 1,190	$ -	$ -	$ -	$ -
4. Estimated covered-employee payroll	$ 228,047	$ 257,890	$ 227,447	$ 258,493	$ 209,718	240492	n/a	n/a	n/a	n/a	n/a
5. Total OPEB liability as a % of covered-employee payroll	0.50%	0.50%	0.62%	0.48%	0.60%	0.005	n/a	n/a	n/a	n/a	n/a
Key information											
Valuation date	7/1/2020	July 1, 2020	July 1, 2019	July 1, 2018	July 1, 2016	July 1, 2016	July 1, 2016	n/a	n/a	n/a	n/a
Reporting date	June 30, 2022	June 30, 2021	June 30, 2020	June 30, 2019	June 30, 2018	June 30, 2017	n/a	n/a	n/a	n/a	n/a
Measurement date	June 30, 2022	June 30, 2021	June 30, 2020	June 30, 2019	June 30, 2018	June 30, 2017	June 30, 2016	n/a	n/a	n/a	n/a
Discount rate as of the measurement date	3.54%	2.16%	2.21%	3.48%	3.87%	3.58%	0.0285	n/a	n/a	n/a	n/a
Bond index rate	3.54%	2.16%	2.21%	3.48%	3.87%	3.58%	0.0285	n/a	n/a	n/a	n/a
Bond index date	June 30, 2022	June 30, 2021	June 30, 2020	June 11, 2019	June 30, 2018	June 30, 2017	June 30, 2016	n/a	n/a	n/a	n/a

Notes: PH has no assets that are accumulated in a trust to pay related benefits that meet the criteria in paragraph 4 of Statement 75.

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*

The Audit Committee
Palomar Health

We have audited, in accordance with the 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, the financial statements of Palomar Health, which comprise the statement of net position as of June 30, 2022, and the related statement of revenue, expenses, and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 20, 2022.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Palomar Health'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Palomar Health's internal control. Accordingly, we do not express an opinion on the effectiveness of Palomar Health'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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We identified certain deficiencies in internal control, described below as items 2022-001 and 2022-002, that we consider to be significant deficiencies.

Finding 2022-001: Significant Deficiency in Timely Completion of Account Reconciliation Preparation and Review

Observation: Due to Palomar Health's employee turnover in the accounting and finance departments during the current year under audit, account reconciliation preparation and review were not performed timely. We also noted on some reconciliations that the preparer and reviewer were the same personnel. This resulted in several adjusting and reclassifying entries required to be recorded during the year under audit to properly reflect account balances. This deficiency creates a risk where account balances do not properly reconcile to the subledger or supporting documentation. Discrepancies may not be identified nor resolved in a timely manner.

Recommendation: We recommend that management prepare account reconciliations on a timely basis and ensure they are independently reviewed by someone other than the preparer. If there are any resource constraints, we recommend the review and approval of reconciliations be documented through the use of a monthly closing process checklist.

Management's Response: Management concurs with the auditors' assessment. Policies are in place requiring reconciliations to be prepared on a timely basis with independent review and approval of the reconciliation and any related accounting entries. Management is adding a reconciliation checklist to the monthly closing schedule which includes verification that the reconciliations were prepared, signed, and dated by the preparer and signed then dated by an independent reviewer. The CFO or VP of Finance will be responsible for reviewing the completed checklist as part of the closing process, documenting the review by signing and dating the completed checklist.

Finding 2022-002: Significant Deficiency in Consolidation Process

Observation: During our audit, we noted that intercompany accounts were not reconciled timely. Elimination entries provided were incomplete or inaccurate which required various adjustments and additional elimination entries to properly reflect financial results of Palomar Health and its blended component units. This deficiency creates a risk that the financial statements may not be complete and accurate.

Recommendation: We recommend that management formalize the financial statement preparation process to ensure intercompany accounts are properly flagged as such and appropriately reflected as eliminating adjustments in the financial statements. Intercompany balances should be reconciled monthly to ensure balances net to zero at the entity-wide level.

Management's Response: Management concurs with the auditors' assessment. Management is changing the process for intercompany eliminating adjustments to facilitate a more structured closing process. Intercompany eliminating adjustments will be added to the month-end closing checklist with certain specified requirements including ensuring balances net to zero. The CFO or VP of Finance will be responsible for reviewing the completed checklist as part of the closing process, documenting the review by signing and dating the completed checklist.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether Palomar Health's financial statements are free from 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 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.

Moss Adams LLP

Irvine, California
October 20, 2022