KPMG

SEATTLE CANCER CARE ALLIANCE

Financial Statements

June 30, 2017 and 2016

(With Independent Auditors' Report Thereon)

KPMG LLP
Suite 2900
1918 Eighth Avenue
Seattle, WA 98101

Independent Auditors' Report

The Board of Directors
Seattle Cancer Care Alliance:

Report on the Financial Statements

We have audited the accompanying financial statements of Seattle Cancer Care Alliance (the Company), which comprise the balance sheets as of June 30, 2017 and 2016, and the related statements of operations and changes in unrestricted net assets, changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Seattle Cancer Care Alliance as of June 30, 2017 and 2016, and the results of its operations and changes in net assets and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Seattle, Washington
October 12, 2017

SEATTLE CANCER CARE ALLIANCE

Balance Sheets

June 30, 2017 and 2016

Assets		**2017**	**2016**
Current assets:			
Cash and cash equivalents	$	40,607,000	27,270,000
Short-term investments		309,010,000	287,818,000
Patient accounts receivable, net of allowance for doubtful accounts of $1,563,000 and $1,581,000 in 2017 and 2016, respectively		62,954,000	61,157,000
Due from related parties		1,788,000	3,801,000
Other receivables		6,783,000	7,576,000
Current portion of assets whose use is limited		24,000	17,000
Supplies inventory, at cost		8,778,000	7,677,000
Prepaid expenses		3,902,000	3,828,000
Total current assets		433,846,000	399,144,000
Noncurrent portion of assets whose use is limited		6,469,000	5,435,000
Property, plant, and equipment, net of accumulated depreciation		137,306,000	128,581,000
Intangible assets, net of accumulated amortization of $20,374,000 and $19,147,000 in 2017 and 2016, respectively		7,323,000	8,550,000
Other assets		8,186,000	14,194,000
Total assets	$	593,130,000	555,904,000
Liabilities and Net Assets			
Current liabilities:			
Current portion of long-term debt	$	2,742,000	2,658,000
Accounts payable and accrued expenses		28,689,000	34,053,000
Due to related parties		15,276,000	11,692,000
Third-party payor settlements payable		1,783,000	4,981,000
Accrued interest payable		1,356,000	1,385,000
Total current liabilities		49,846,000	54,769,000
Long-term debt, net of current portion		103,203,000	106,846,000
Other long-term liabilities		812,000	809,000
Total liabilities		153,861,000	162,424,000
Commitments and contingencies			
Net assets:			
Unrestricted		432,800,000	388,045,000
Temporarily restricted		3,173,000	2,239,000
Permanently restricted		3,296,000	3,196,000
Total net assets		439,269,000	393,480,000
Total liabilities and net assets	$	593,130,000	555,904,000

See accompanying notes to financial statements.

SEATTLE CANCER CARE ALLIANCE

Statements of Operations and Changes in Unrestricted Net Assets

Years ended June 30, 2017 and 2016

	2017	2016
Operating revenues:		
Patient service revenue (net of contractual allowances and discounts)	$ 517,696,000	496,470,000
Provision for bad debts	(1,613,000)	(1,969,000)
Net patient service revenue less provision for bad debts	516,083,000	494,501,000
Other operating revenue	30,402,000	29,403,000
Net assets released from restriction used for operations	1,678,000	1,310,000
Total operating revenues	548,163,000	525,214,000
Operating expenses:		
Salaries, wages, and benefits	134,133,000	119,778,000
Purchased services	168,141,000	155,475,000
Supplies	164,456,000	146,754,000
Depreciation and amortization	22,308,000	21,380,000
Interest	3,342,000	3,306,000
Other	34,462,000	26,997,000
Total operating expenses	526,842,000	473,690,000
Net income from operations	21,321,000	51,524,000
Nonoperating income:		
Investment income	21,201,000	2,820,000
Other income, net	2,233,000	677,000
Excess of revenues over expenses	44,755,000	55,021,000
Change in unrestricted net assets	44,755,000	55,021,000
Unrestricted net assets, beginning of year	388,045,000	333,024,000
Unrestricted net assets, end of year	$ 432,800,000	388,045,000

See accompanying notes to financial statements.

SEATTLE CANCER CARE ALLIANCE

Statements of Changes in Net Assets

Years ended June 30, 2017 and 2016

		Unrestricted	Temporarily restricted	Permanently restricted	Total
Balance, June 30, 2015	$	333,024,000	1,812,000	986,000	335,822,000
Excess of revenues over expenses		55,021,000	—	—	55,021,000
Restricted contributions, grants, and other		—	1,737,000	2,210,000	3,947,000
Net assets released from restriction for operations		—	(1,310,000)	—	(1,310,000)
Change in net assets		55,021,000	427,000	2,210,000	57,658,000
Balance, June 30, 2016		388,045,000	2,239,000	3,196,000	393,480,000
Excess of revenues over expenses		44,755,000	—	—	44,755,000
Restricted contributions, grants, and other		—	2,612,000	100,000	2,712,000
Net assets released from restriction for operations		—	(1,678,000)	—	(1,678,000)
Change in net assets		44,755,000	934,000	100,000	45,789,000
Balance, June 30, 2017	$	432,800,000	3,173,000	3,296,000	439,269,000

See accompanying notes to financial statements.

SEATTLE CANCER CARE ALLIANCE

Statements of Cash Flows

Years ended June 30, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Change in net assets	$ 45,789,000	57,658,000
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Net realized and change in unrealized (gains) and losses on investments	(14,314,000)	6,119,000
Loss on disposal of assets	77,000	10,000
Depreciation and amortization	22,308,000	21,380,000
Amortization of premium on issuance of long-term debt	(977,000)	(1,073,000)
Donation of unrestricted financial assets	—	(205,000)
Receipt of endowment investments	(100,000)	(2,210,000)
Provision for bad debts	1,613,000	1,969,000
(Increase) decrease in:		
Patient accounts receivable	(3,410,000)	(7,090,000)
Due from related parties	2,013,000	1,947,000
Other receivables	793,000	(3,171,000)
Supplies inventory	(1,101,000)	(912,000)
Prepaid expenses	(74,000)	(716,000)
Assets whose use is limited	(941,000)	(427,000)
Other long-term assets	1,046,000	(1,778,000)
Increase (decrease) in:		
Accounts payable and accrued expenses	(4,269,000)	(7,739,000)
Due to related parties	3,584,000	(20,246,000)
Third-party payor settlements payable	(3,198,000)	2,174,000
Accrued interest payable	(29,000)	(32,000)
Other long-term liabilities	3,000	(189,000)
Net cash provided by operating activities	48,813,000	45,469,000
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(25,946,000)	(13,778,000)
Proceeds from sale of property, plant, and equipment	6,000	6,000
Net purchases of trading securities	(6,878,000)	(44,901,000)
Net cash used in investing activities	(32,818,000)	(58,673,000)
Cash flows from financing activities:		
Principal payments on long-term debt	(2,658,000)	(2,522,000)
Net cash used in financing activities	(2,658,000)	(2,522,000)
Net increase (decrease) in cash and cash equivalents	13,337,000	(15,726,000)
Cash and cash equivalents at beginning of year	27,270,000	42,996,000
Cash and cash equivalents at end of year	$ 40,607,000	27,270,000
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest	$ 4,334,000	4,397,000
Supplemental disclosure of noncash activity:		
Purchase of property, plant, and equipment included in accounts payable	$ 4,054,000	5,149,000

See accompanying notes to financial statements.

(1) Organization

Seattle Cancer Care Alliance (SCCA) is a nonprofit corporation organized in 1998 by Seattle Children's Hospital, the University of Washington Medicine (UW Medicine), and Fred Hutchinson Cancer Research Center (FHCRC) for the purpose of developing and offering a comprehensive program of integrated cancer care services. SCCA operates a 20-bed licensed hospital inside the University of Washington Medical Center (UWMC), a member organization of UW Medicine, and operates ambulatory cancer care service facilities. In addition to providing inpatient and outpatient cancer care services, SCCA provides programmatic direction to the adult inpatient cancer services provided by UWMC and the pediatric inpatient and outpatient cancer services provided by Seattle Children's Hospital. Members of SCCA share equally in the results of operations.

(2) Summary of Significant Accounting Policies

(a) 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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(b) Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with original maturities of three months or less at the date of purchase. SCCA maintains cash balances that may exceed federally insured limits. SCCA does not believe that this results in any significant credit risk. As of June 30, 2017 and 2016, cash equivalents were $13,501,000 and $13,496,000, respectively.

(c) Supplies Inventory

Inventory, consisting principally of surgical, medical, and pharmaceutical supplies, is carried at the lower of cost (first-in, first-out method) or net realizable value.

(d) Assets Whose Use is Limited

These assets consist of funds held under the terms of SCCA's trust indenture and restricted net assets. Amounts required to meet current liabilities have been reclassified as current assets in the balance sheets as of June 30, 2017 and 2016. These funds have been invested in various money market funds.

(e) Investments

Investments consist principally of U.S. government obligations, corporate bonds, collateralized mortgage obligations, and equity mutual funds that are stated at fair market value. All investment transactions are traded and valued in U.S. dollars. Management classifies investments expected to mature or be sold within the following year and not restricted for other purposes as short-term investments. SCCA has designated all investments as trading securities unless otherwise indicated.

Investment income or loss is included in the excess of revenue over expenses unless the income or loss is restricted by donor or law.

(Continued)

(f) Property, Plant, and Equipment

Property, plant, and equipment are stated at cost, net of accumulated depreciation. Improvements and replacements of plant and equipment are capitalized, and repairs and maintenance are expensed. The cost and related accumulated depreciation of property, plant, and equipment sold or retired are removed from the accounts and the resulting gain or loss is recognized.

(g) Intangible Assets

Intangible assets are stated at the value assigned to them upon contribution to SCCA, and are subject to amortization. Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In 2017 and 2016, there were no impairment charges on intangible assets.

(h) Deferred Financing Costs

Costs incurred to secure financing are presented as a direct deduction from the carrying amount of debt and are amortized on a straight-line basis over the earlier of life of the debt or the initial bank loan tender term for private issue debt.

(i) Temporarily and Permanently Restricted Net Assets

Gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. Temporarily restricted net assets are those whose use by SCCA has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by SCCA in perpetuity. When restricted funds to be used for operations are expended for their restricted purposes, these amounts are reflected in unrestricted net assets as net assets released from restrictions for operations and are included in operating revenues. Donor-restricted contributions whose restrictions are met in the same reporting period are reported as unrestricted support. When restricted funds are expended for the acquisition of property, plant, and equipment, these amounts are reflected in unrestricted net assets as net assets released from restriction used for capital acquisitions.

(j) Depreciation

Depreciation is computed using the straight-line method, which allocates the cost of depreciable assets over the following estimated useful lives:

Land improvements	2–25 Years
Buildings and fixed equipment	3–40 Years
Major movable and minor equipment	2–20 Years
Leasehold improvements	2–10 Years

(Continued)

(k) Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amount from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive agreements are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Net patient service revenue is recognized in the period in which the services are performed.

(l) Allowance for Doubtful Accounts

The allowance for doubtful accounts represents management's best estimate of probable losses inherent in the patient accounts receivable balance. This estimate is based on known, troubled accounts and historical experience. Activity in the allowance for doubtful accounts was as follows for the years ended:

		2017	2016
Balance as of beginning of year	$	1,581,000	1,284,000
Provision for bad debts		1,613,000	1,969,000
Write-offs		(1,631,000)	(1,672,000)
Balance as of end of year	$	1,563,000	1,581,000

(m) Investment Income

Investment income includes (1) interest, dividends, and realized gains and losses on SCCA's cash equivalents, short-term investments, and assets whose use is limited, (2) changes in unrealized gains and losses on trading securities, and (3) investment management expense.

(n) Excess of Revenues over Expenses

The statements of operations and changes in unrestricted net assets include excess of revenues over expenses. Changes in unrestricted net assets that are excluded from excess of revenues over expenses include changes in unrealized gains and losses on investments of other-than-trading securities, and capital acquisitions related to grants and contributions of long-lived assets (including assets acquired using contributions, which by donor restriction were to be used for the purposes of acquiring such assets).

(o) Taxes

SCCA has obtained a determination letter from the Internal Revenue Service indicating that it is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code, except for unrelated business income tax. SCCA recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

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On November 1, 2013, SCCA filed a claim with the Washington State Department of Revenue requesting a refund of Washington State business and occupation and sales/use taxes paid by SCCA during the period of January 1, 2009 through June 30, 2013, asserting that it qualified as a comprehensive cancer center exempt from business and occupation and sales/uses taxes under the provisions of RCW 82.04.4265, RCW 82.08.808, and RCW 82.12.080. The Department of Revenue denied SCCA's refund request in January 2015 and SCCA subsequently filed an administrative appeal. During the period SCCA's refund request was under consideration by the Department of Revenue, SCCA accrued but did not pay business and occupation and sales/use taxes. In July 2016, SCCA and the Department of Revenue entered into a closing agreement resolving the outstanding issues relating to SCCA's refund request. Under the terms of the closing agreement, the Department of Revenue denied SCCA's refund request for the period of January 1, 2009, through June 30, 2013, but accepted the amount SCCA claimed was exempt from taxes for the tax periods beginning July 1, 2013, and recognized SCCA's status as comprehensive cancer center exempt from business and occupation and sales/uses taxes effective August 1, 2016. As a result, SCCA released approximately $12,799,000 in accrued liabilities for business and occupation and sales/use taxes for the tax periods beginning July 1, 2013, which was included in other operating expenses in 2016. In 2016, SCCA recorded an associated estimated Medicare cost report liability of $2,500,000 in third-party payor settlements payable. SCCA released $1,900,000 in 2017 to settle this liability through June 30, 2014, which leaves a remaining balance of $600,000 for associated estimated Medicare cost report liability for the tax period ended June 30, 2015.

(p) Recently Adopted or Newly Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, to clarify the principles for recognizing revenue and to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and International Financial Reporting Standards. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in the ASU can be applied either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the update recognized at the date of the initial application along with additional disclosures. SCCA is currently evaluating the impact of ASU No. 2014-09, including the methods of implementation, which is effective for the fiscal year beginning on July 1, 2018.

In April 2015, the FASB issued ASU No. 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. ASU No. 2015-03 requires debt issuance costs related to a recognized debt liability to be presented on the balance sheet as a deduction from the carrying amount of the debt, consistent with debt discounts. This standard is effective for SCCA's fiscal year 2017 financial statements. The retrospective application of ASU No. 2015-03 resulted in decreases in assets and long-term debt of $661,000 as of June 30, 2016.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which requires lessees to recognize a lease liability and a right-of-use asset for all lease obligations with exception to short-term leases. The lease liability will represent the lessee's obligation to make lease payments arising from the lease measured on a discounted basis and the right-of-use asset will represent the lessee's right to use or control the use of a specified asset for a lease term. The lease guidance also simplifies accounting for sale-leaseback transactions. SCCA is currently evaluating the impact of ASU No. 2016-02, which is effective for the fiscal year beginning on July 1, 2019 with retrospective application to the earliest presented period.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, to reduce diversity in reporting practice, reduce complexity, and enhance understandability of not-for-profit financial statements. This ASU contains the following key aspects: (A) reduces the number of net asset classes presented from three to two: with donor restrictions and without donor restrictions; (B) requires all not-for-profit entities to present expenses by their functional and their natural classifications in one location in the financial statements; (C) requires NFPs to provide quantitative and qualitative information about management of liquid resources and availability of financial assets to meet cash needs within one year of the balance sheet date; and (D) retains the option to present operating cash flows in the statement of cash flows using either the direct or indirect method. SCCA is currently evaluating the impact of ASU No. 2016-14, including the methods of implementation, which is effective for the fiscal year beginning July 1, 2018.

(q) Reclassifications

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

(3) Fair Value Measurements

(a) Fair Value of Financial Instruments

The following methods and assumptions were used by SCCA in estimating the fair value of its financial instruments:

Cash and Cash Equivalents – The carrying amount reported in the balance sheets for cash and cash equivalents approximates its fair value.

Short-Term Investments and Assets Whose Use is Limited – Investments in fixed-income securities and equity securities with a readily determinable fair value are based on quoted market prices, if available, or estimated using quoted market prices for similar securities.

(b) Fair Value Hierarchy

In accordance with Accounting Standards Codification (ASC) Topic 820*, Fair Value Measurement*, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 – Valuation is based upon quoted prices for identical assets in active markets.
- Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and independent pricing models or other model-based valuation techniques, such as present value of future cash flows and adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss assumptions for which all significant assumptions are observable in the market.
- Level 3 – Inputs are unobservable inputs for the asset or liability. SCCA does not own any Level 3 financial assets or liabilities.

The level in the fair value hierarchy within which a fair value measurement falls, in its entirety, is based on the lowest-level input that is significant to the fair value measurement.

The following table presents assets that are measured at fair value on a recurring basis (including items that are required to be measured at fair value) at June 30, 2017:

		Fair value measurements at reporting date using	
	June 30, 2017	**Quoted prices in active markets for identical assets (Level 1)**	**Significant other observable inputs (Level 2)**
Assets:			
Short-term investments:			
U.S. Treasury notes and bills	$ 47,289,000	47,289,000	—
Equity mutual funds:			
Domestic	76,112,000	76,112,000	—
International (U.S. dollar denominated)	53,914,000	53,914,000	—
U.S. government agency bonds	3,028,000	—	3,028,000
Corporate debt securities:			
Domestic – financial services	22,904,000	—	22,904,000
Domestic – utilities	15,009,000	—	15,009,000
Domestic – consumer goods	9,096,000	—	9,096,000
Domestic – other	12,550,000	—	12,550,000
International (U.S. dollar denominated)	22,596,000	—	22,596,000
U.S. mortgage-backed securities – residential	17,156,000	—	17,156,000
Collateralized debt securities	28,489,000	—	28,489,000
Municipal bonds	867,000	—	867,000
Total short-term investments	$ 309,010,000	177,315,000	131,695,000
Trustee-held funds	$ 6,493,000	6,493,000	—

The following table presents assets that are measured at fair value on a recurring basis (including items that are required to be measured at fair value) at June 30, 2016:

		Fair value measurements at reporting date using	
	June 30, 2016	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)
Assets:			
Short-term investments:			
U.S. Treasury notes and bills	$ 55,187,000	55,187,000	—
Equity mutual funds:			
Domestic	64,821,000	64,821,000	—
International (U.S. dollar denominated)	44,124,000	44,124,000	—
U.S. government agency bonds	3,551,000	—	3,551,000
Corporate debt securities:			
Domestic – financial services	19,786,000	—	19,786,000
Domestic – utilities	13,453,000	—	13,453,000
Domestic – consumer goods	7,474,000	—	7,474,000
Domestic – other	12,192,000	—	12,192,000
International (U.S. dollar denominated)	19,767,000	—	19,767,000
U.S. mortgage-backed securities – residential	18,040,000	—	18,040,000
Collateralized debt securities	26,956,000	—	26,956,000
Municipal bonds	2,467,000	—	2,467,000
Total short-term investments	$ 287,818,000	164,132,000	123,686,000
Trustee-held funds	$ 5,452,000	5,452,000	—

There were no transfers into or out of Level 1 or Level 2 financial instruments during the years ended June 30, 2017 or 2016.

The financial statements as of and for the years ended June 30, 2017 and 2016 do not contain any nonrecurring fair value measurements relating to assets or liabilities that require disclosure under the provisions of ASC Topic 820.

(4) Investment Income

Investment income comprises the following for the years ended June 30:

		2017	2016
Investment income:			
Interest and dividend income	$	7,334,000	9,552,000
Changes in net unrealized gains (losses) on trading securities		17,832,000	(5,994,000)
Realized losses on investments, net		(3,518,000)	(125,000)
Investment management expense		(447,000)	(613,000)
Total investment income	$	21,201,000	2,820,000

(5) Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at June 30:

		2017	2016
Patient housing	$	100,000	115,000
Research		1,617,000	1,011,000
Specific clinics or treatment programs		275,000	387,000
Supportive care services		506,000	443,000
Other		675,000	283,000
	$	3,173,000	2,239,000

(6) Net Assets Released from Restriction

Net assets were released from restriction for the following purposes for the years ended June 30:

		2017	2016
Patient housing	$	70,000	18,000
Research		1,260,000	979,000
Specific clinics or treatment programs		152,000	103,000
Supportive care services		165,000	210,000
Other		31,000	—
	$	1,678,000	1,310,000

(7) Property, Plant, and Equipment

Property, plant, and equipment consist of the following as of June 30:

		2017	2016
Land and improvements	$	28,166,000	28,166,000
Buildings and fixed equipment		141,877,000	132,289,000
Major movable and minor equipment		87,128,000	80,167,000
Leasehold improvement		8,484,000	8,484,000
Construction in progress		12,464,000	4,920,000
		278,119,000	254,026,000
Less accumulated depreciation		(140,813,000)	(125,445,000)
	$	137,306,000	128,581,000

Depreciation expense for the fiscal years ended June 30, 2017 and 2016 amounted to approximately $16,043,000 and $14,862,000, respectively. No interest was capitalized during the years ended June 30, 2017 or 2016.

(8) Intangible Assets

Intangible assets consist of the value assigned to a ground lease and contributed outpatient businesses. The ground lease was contributed by FHCRC. It relates to land upon which the SCCA's South Lake Union outpatient facility was constructed and has a term of 99 years. The outpatient businesses were contributed by FHCRC and by UWMC with the designation that SCCA be a site of practice for certain oncology-related outpatient activities.

Amortization expense for intangible assets is calculated using the straight-line method and for the fiscal years ended June 30, 2017 and 2016 amounted to $1,227,000 and $1,255,000, respectively. The unamortized balance of the intangible assets consists of the following as of June 30:

		2017	2016	Amortization period
Ground lease	$	3,006,000	3,011,000	99 Years
Outpatient businesses		4,317,000	5,539,000	20 Years
	$	7,323,000	8,550,000	

The estimated amortization expense for the next five years related to these intangible assets is as follows:

2018	$	1,241,000
2019		1,241,000
2020		1,241,000
2021		739,000
2022		36,000
Thereafter		2,825,000
	$	7,323,000

(9) Long-Term Debt

Long-term debt consists of the following as of June 30:

		2017	2016
Washington Health Care Facility Authority, Fixed Rate Demand Revenue Bonds, Series 2014, at an average fixed interest rate of 4.52% and 4.48% for the years ended June 30, 2017 and 2016, respectively, maturing on March 1, 2038, net of unamortized bond premium of $7,664,000, and at increasing principal amounts of $2,270,000 to $22,225,000	$	88,114,000	91,251,000
Washington Health Care Facility Authority, Weekly Rate Demand Revenue Bonds, Series 2010, at an average variable interest rate of 1.26% and 1.00% for the years ended June 30, 2017 and 2016, respectively, maturing on February 1, 2038, and at increasing principal amounts of $472,000 to $1,371,000		18,416,000	18,914,000
		106,530,000	110,165,000
Less current portion		(2,742,000)	(2,658,000)
Less deferred financing costs		(585,000)	(661,000)
Long-term debt, net	$	103,203,000	106,846,000

The maturities by year of the long-term debt obligations are as follows:

2018	$	2,742,000
2019		2,974,000
2020		3,074,000
2021		3,219,000
2022		3,365,000
Thereafter		83,492,000
		98,866,000
Plus unamortized net premiums		7,664,000
	$	106,530,000

(a) Washington Health Care Facility Authority, Revenue Bonds, Series 2014

In fiscal year 2015, SCCA borrowed the proceeds of the Washington Health Care Facility Authority's $86,950,000 Revenue Bonds, Series 2014 (the 2014 Bonds). The bonds are issued for the purpose of providing the funds necessary to advance refund and defease all of the Washington Health Care Facility Authority, Revenue Bonds, Series 2008, and pay certain costs in connection with the issuance of the 2014 Bonds. Principal is paid upon maturity of the bond and interest is paid semiannually. SCCA has the option to redeem outstanding bonds prior to their maturity dates, provided certain conditions are met.

Under SCCA's master trust, SCCA is subject to certain covenants, including a requirement to maintain a minimum debt service coverage ratio of 1.10 to 1.00.

SCCA has pledged as collateral its gross receivables. Payments on the 2014 Bonds will be made solely by SCCA; the member organizations do not guaranty any of SCCA's financial obligations, including repayment of the 2014 Bonds.

(b) Washington Health Care Facility Authority, Weekly Rate Demand Revenue Bonds, Series 2010

In fiscal year 2011, SCCA borrowed the proceeds of the Washington Health Care Facility Authority's $21,415,000 Variable Rate Revenue Bonds, Series 2010 (the 2010 Bonds) to provide a portion of the funds necessary to refund bonds issued to fund the Seattle Cancer Care Alliance House and to pay a portion of the costs of issuing the 2010 Bonds. The initial interest rate was calculated as 65% of the sum of LIBOR plus 1.88% effective November 1, 2012 or LIBOR plus 2.15% prior to November 2012. Effective December 1, 2014, the interest rate was renegotiated as 65.01% of the sum of the one-month LIBOR plus 1.20%.

Upon issuance, SCCA entered into a private placement agreement with KeyBank National Association (Key), which was in effect as of June 30, 2012. Under the agreement, the initial bank tender date was November 1, 2013, and has since been extended to November 18, 2024. Unless the tender date is extended to a later date, the bonds could be tendered for repayment on November 18, 2024.

Under the terms of the credit agreement with Key, SCCA is subject to certain covenants, including a requirement to maintain a minimum debt service coverage ratio of 1.10 to 1.00, long-term indebtedness to sum of long-term indebtedness plus unrestricted net assets to not exceed 0.70 to 1.00, and 75 days of cash on hand.

Obligations issued under the master indenture, including the obligation issued to secure the 2010 Bonds, are secured by a pledge of SCCA’s gross receivables. Payments on the 2010 Bonds will be made solely by SCCA; the member organizations do not guaranty any of SCCA’s financial obligations, including repayment of the 2010 Bonds.

(c) Line of Credit

SCCA entered into a line of credit in the amount of $3,000,000 with an expiration date of December 1, 2017. SCCA shall pay interest on the outstanding principal balance of this line of credit at the rate per annum equal to the daily LIBOR plus 2.5%. No funds have been drawn on this line of credit for the years ended June 30, 2017 or 2016.

(10) Patient Service Revenue

SCCA has agreements with third-party payors that provide for payments to SCCA at amounts different from its established rates. Gross patient service revenues were billed to the following payors for the years ended June 30, 2017 and 2016:

	2017	2016
Commercial	52 %	54 %
Medicare	35	35
Medicaid	11	10
Other	2	1
Total	100 %	100 %

Outstanding gross patient accounts receivable are as follows as of June 30, 2017 and 2016:

	2017	2016
Commercial	59 %	58 %
Medicare	26	28
Medicaid	12	10
Other	3	4
Total	100 %	100 %

Net patient service revenue consists of the following for the years ended June 30:

		2017	2016
Gross patient service revenue	$	927,981,000	869,815,000
Deductions from gross patient service revenue		(410,285,000)	(373,345,000)
Patient service revenue, net		517,696,000	496,470,000
Provision for bad debts		(1,613,000)	(1,969,000)
Net patient service revenue less provision for bad debts	$	516,083,000	494,501,000

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

(a) Medicare

Medicare pays for inpatient hospital services under the prospective payment system (PPS) unless the provider is statutorily exempt from PPS (Exempt Hospital). PPS hospitals are paid a predetermined flat rate for inpatient care that is based on the patient’s diagnosis at discharge while Exempt Hospitals are paid based on the “reasonable cost” of the services provided subject to an annual rate of increase limit. Exempt Hospitals receive an interim payment based on a percentage of charges submitted that is adjusted based on the filed cost report. Certain types of cancer hospitals are currently included among the Exempt Hospitals. SCCA’s inpatient facility has been recognized by Medicare as an Exempt Hospital.

Medicare has historically paid for outpatient services on the basis of the cost of or a portion of the cost of providing the services. The Balanced Budget Act of 1997 required a phased in prospective payment system for outpatient services (OP PPS). The Centers for Medicare and Medicaid Services (CMS), an agency of the United States Department of Health and Human Services, issued regulations implementing OP PPS, which became effective as of August 1, 2000. Before the effective date of OP PPS, the Balanced Budget Refinement Act of 1999 established a “hold harmless” provision for cancer hospitals ensuring that they would be supplemented for certain covered services incurred under OP PPS. Under the hold harmless provision, if the amount of payment the cancer hospital would receive under OP PPS is less than what it would have received before OP PPS’ implementation, the amount of payment due to the cancer hospital will be increased by the amount of such difference. As an Exempt Hospital, SCCA qualifies for payment under the hold harmless provision.

The Budget Control Act of 2011 requires automatic spending reductions beginning April 1, 2013 to reduce the federal deficit, including Medicare spending reductions of up to 2% for a fiscal year, with a uniform percentage reduction across all Medicare programs. In 2013, the CMS notified SCCA that Medicare fee-for-service claims with dates of service or dates of discharge on or after April 1, 2013 will incur a 2% reduction in Medicare payments.

Adjustments from finalizations from prior-year cost reports and other third-party settlement estimates resulted in an increase of net patient service revenues of approximately $254,000 in 2017 and $583,000 in 2016.

(b) Medicaid

SCCA is paid for services provided to Medicaid patients under the state's fee schedule, which is based on a modification of Medicare's prospective payment systems for inpatient and outpatient care. In 2009, the State of Washington enacted a safety net assessment program involving Washington State hospitals to increase funding from other sources and obtain additional federal funds to support increased payments to providers for Medicaid services.

(c) Commercial Case Rate Contracts

For certain commercial payors, SCCA has negotiated a single payment (case rate) for a defined period of care (case rate period) related to providing a bone marrow or stem cell transplant. All of SCCA's case rate contracts specify a minimum and maximum payment calculation based on a review of actual gross charges provided during the case rate period. In addition to the case rate payments, the case rate contracts also specify negotiated fee-for-service rates for services performed outside of the case rate period. Case rate contracts extend to SCCA related parties. SCCA serves as the collection agent for the case rate payments. All case rate payments are remitted to SCCA, which in turn remits payment to each respective related party for its proportionate share of services rendered. Any liability to related parties has been accrued in accounts payable and accrued expenses at June 30, 2017 and 2016.

(d) Financial Assistance

SCCA provides care to patients who meet certain criteria under its financial assistance policy without charge or at amounts less than its established rates. Because SCCA does not pursue collection of amounts determined to qualify as financial assistance, they are not reported as revenue. Approximately $6,691,000 and $6,888,000 in gross charges were provided for financial assistance in 2017 and 2016, respectively. The estimated net cost of financial assistance provided was approximately $3,796,000 and $3,751,000 in 2017 and 2016, respectively. The net cost of financial assistance was calculated using a percentage of cost to charges, which was 57% in 2017 and 54% in 2016. The number of financial assistance patients served was 1,929 in 2017 and 2,220 in 2016.

(e) Bad Debt

For patients that do not qualify for financial assistance, SCCA recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a portion of SCCA's patients will be unable or unwilling to pay for the services provided. Thus, SCCA records a provision for bad debts related to patients in the period the services are provided.

(11) Related Party Transactions

Members of SCCA share equally in the capital contributions and in the results of operations. The initial capital contributions of the members were based on a contribution schedule in accordance with the Members Agreement dated June 15, 1998. Contributions in 1998 consisted of cash payments, contributed equipment, a ground lease, and the fair value of existing businesses. The fair value of existing businesses

(Continued)

was recorded as intangible assets at the time that the related programs were transferred to the SCCA. No contributions have been made since fiscal year 2001.

(a) Outpatient and Other Services

SCCA and its member organizations have entered into various affiliate agreements in order to optimize the use of clinical and support functions available from member organizations. Certain affiliate agreements relate to support functions, including human resources, information technology, and cover the cost of staff, purchased services, and supplies, including pharmaceuticals and medical supplies. Affiliate agreements are based upon negotiated fixed monthly amounts or other specified terms and conditions for each prescribed service. Such amounts are renegotiated annually. In addition, SCCA leases out lab space to UW Medicine under a noncancelable operating lease and leases space and equipment under several operating lease agreements from its member organizations. SCCA purchased support functions from affiliates totaling $242,213,000 and $220,563,000 in fiscal years 2017 and 2016, respectively, which are included in purchased services and supplies on the statements of operations and changes in unrestricted net assets. SCCA sold support functions to member organizations in the amount of $22,059,000 and $16,928,000 in fiscal years 2017 and 2016, respectively, which are included in other operating revenue on the statements of operations and changes in unrestricted net assets.

(b) Inpatient Services

Under the Pediatric and Adult Inpatient Services Agreement, SCCA operates certain ambulatory cancer care services and facilities, and obtains inpatient services from Seattle Children’s Hospital for pediatric patients and UWMC for adult patients. SCCA provides programmatic direction for the inpatient cancer services at UWMC and Seattle Children’s Hospital as set forth in the respective agreements. UWMC and Seattle Children’s Hospital make their personnel and facilities available to FHCRC, as set forth in the respective agreements, to enable FHCRC to meet its requirements in connection with pediatric and adult cancer research and obtain certain research and related services. The Pediatric and Adult Inpatient Services Agreement was amended and restated effective July 1, 2014.

In addition, SCCA operates a 20-bed adult inpatient unit within UWMC’s facility. SCCA has received notification from the fiscal intermediary that this inpatient unit is designated as a hospital within a hospital. Therefore, gross revenues for these inpatient services are recorded by SCCA, which provides medical oversight and management for the inpatient unit. UWMC provides patient care services to SCCA, including necessary personnel, equipment, and ancillary services. SCCA pays UWMC for services provided to SCCA inpatients based upon the agreement. SCCA recognized $43,376,000 and $40,610,000 of expenses related to these services in fiscal years 2017 and 2016, respectively, which are included in purchased services in the statements of operations and changes in unrestricted net assets.

SCCA also makes its personnel and facilities available to FHCRC, to enable FHCRC to meet its requirements in connection with adult cancer research. SCCA purchases from FHCRC certain research and development support, data collection and analysis, physician assistant services, consulting services, and license rights to use the FHCRC name in connection with the inpatient cancer services program. SCCA incurred $7,170,000 and $6,556,000 in expenses related to these services in fiscal years 2017 and 2016, respectively, which are included in purchased services in the statements of operations and changes in unrestricted net assets.

(Continued)

(c) Due from/Due to Related Parties

SCCA has amounts due from or due to related parties for the various transactions described above, which are as follows as of June 30:

	2017		2016	
	Due from related parties	**Due to related parties**	**Due from related parties**	**Due to related parties**
FHCRC	$ 36,000	2,026,000	62,000	668,000
Seattle Children's Hospital	193,000	—	215,000	9,000
University of Washington	1,559,000	13,250,000	3,524,000	11,015,000
	$ 1,788,000	15,276,000	3,801,000	11,692,000

(12) Commitments and Contingencies

(a) Operating Leases

SCCA leases equipment and office space under operating leases expiring at various dates through December 2022. Total rental expense in fiscal years 2017 and 2016 for all operating leases was approximately $5,964,000 and $5,552,000, respectively, and is included in other expenses.

The following is a schedule, by year, of future minimum lease payments under operating leases as of June 30, 2017, which have initial or remaining lease terms in excess of one year:

2018	$ 4,928,000
2019	4,719,000
2020	4,363,000
2021	4,420,000
2022	4,036,000
Thereafter	1,960,000
	$ 24,426,000

(b) Litigation

SCCA is involved in litigation and regulatory investigations arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on SCCA's future financial position or results from operations.

(c) Regulatory Environment

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, governmental healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government agencies are actively conducting investigations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that SCCA is in compliance with the fraud and abuse regulations as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions known or unasserted at this time.

(13) Professional Liability

SCCA maintains professional liability insurance coverage on a claims-made basis through commercial insurance carriers. The policies in effect for fiscal years 2017 and 2016 have a $1,000,000 limit per occurrence, and a limit in the aggregate of $3,000,000. SCCA has purchased $40,000,000 of excess coverage.

SCCA has recorded a liability that represents an estimate for the ultimate settlement for claims incurred but not reported. At June 30, 2017 and 2016, the professional liability was estimated at approximately $811,000 and $809,000, respectively, and is included in other long-term liabilities in the accompanying balance sheets.

(14) Retirement Plans

SCCA has a defined contribution plan for its paid employees. Employees are generally eligible after one year and 1,000 hours of service. SCCA contributes 7% of each eligible employee’s compensation up to the Social Security wage base limit and 12% on compensation above the limit. SCCA also has a Supplemental Executive Retirement Plan for eligible members of the executive team. Contributions for the years ended June 30, 2017 and 2016 were $5,887,000 and $6,146,000, respectively, and are presented in salaries, wages, and benefits in the statements of operations and changes in unrestricted net assets.

(15) Subsequent Events

SCCA has performed an evaluation of subsequent events through October 12, 2017 which is the date these financial statements were issued.