

CONSOLIDATED FINANCIAL STATEMENTS AND  
SUPPLEMENTARY INFORMATION

The Cleveland Clinic Foundation  
d.b.a. Cleveland Clinic Health System  
Years Ended December 31, 2017 and 2016  
With Report of Independent Auditors

Ernst & Young LLP



Building a better  
working world

Cleveland Clinic Health System  
Consolidated Financial Statements  
and Supplementary Information  
Years Ended December 31, 2017 and 2016

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Ernst & Young LLP  
Suite 1800  
950 Main Avenue  
Cleveland, OH 44113-7214

Tel: +1 216 861 5000  
Fax: +1 216 583 2013  
ey.com

## Report of Independent Auditors

The Board of Directors  
The Cleveland Clinic Foundation

We have audited the accompanying consolidated financial statements of The Cleveland Clinic Foundation and controlled affiliates, d.b.a. Cleveland Clinic Health System, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in conformity 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 of material misstatement, whether due to fraud or error.

### **Auditor's 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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 consolidated financial position of The Cleveland Clinic Foundation and controlled affiliates, d.b.a. Cleveland Clinic Health System, at December 31, 2017 and 2016, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

March 27, 2018

# Cleveland Clinic Health System

## Consolidated Balance Sheets (In Thousands)

	<b>December 31</b>	
	<b>2017</b>	<b>2016</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 241,227	\$ 520,628
Patient receivables, net of allowances for uncollectible accounts of \$194,159 in 2017 and \$186,241 in 2016	1,012,903	1,059,171
Investments for current use	154,971	52,126
Other current assets	374,726	396,892
Total current assets	1,783,827	2,028,817
Investments:		
Long-term investments	7,729,697	6,476,259
Funds held by trustees	69,234	75,892
Assets held for self-insurance	159,802	128,128
Donor-restricted assets	717,410	612,221
	8,676,143	7,292,500
Property, plant, and equipment, net	4,699,697	4,512,078
Other assets:		
Pledges receivable, net	151,019	150,709
Trusts and interests in foundations	80,643	67,219
Other noncurrent assets	475,010	410,007
	706,672	627,935
Total assets	\$ 15,866,339	\$ 14,461,330

	<b>December 31</b>	
	<b>2017</b>	<b>2016</b>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 503,691	\$ 482,427
Compensation and amounts withheld from payroll	345,446	322,493
Current portion of long-term debt	457,813	81,739
Variable rate debt classified as current	573,270	527,115
Other current liabilities	438,662	462,561
Total current liabilities	<u>2,318,882</u>	<u>1,876,335</u>
Long-term debt:		
Hospital revenue bonds	2,861,438	2,926,949
Notes payable and capital leases	134,840	516,719
	<u>2,996,278</u>	<u>3,443,668</u>
Other liabilities:		
Professional and general liability insurance reserves	147,327	146,109
Accrued retirement benefits	492,833	478,874
Other noncurrent liabilities	567,566	490,545
	<u>1,207,726</u>	<u>1,115,528</u>
Total liabilities	<u>6,522,886</u>	<u>6,435,531</u>
Net assets:		
Unrestricted	8,346,649	7,088,209
Temporarily restricted	662,189	627,426
Permanently restricted	334,615	310,164
Total net assets	<u>9,343,453</u>	<u>8,025,799</u>
Total liabilities and net assets	<u><u>\$ 15,866,339</u></u>	<u><u>\$ 14,461,330</u></u>

*See accompanying notes.*

Cleveland Clinic Health System

Consolidated Statements of Operations  
and Changes in Net Assets  
(In Thousands)

**Operations**

	<b>Year Ended December 31</b>	
	<b>2017</b>	<b>2016</b>
<b>Unrestricted revenues</b>		
Net patient service revenue	\$ 7,794,551	\$ 7,551,066
Provision for uncollectible accounts	(296,469)	(301,694)
Net patient service revenue less provision for uncollectible accounts	7,498,082	7,249,372
Other	908,920	787,835
Total unrestricted revenues	<u>8,407,002</u>	<u>8,037,207</u>
<b>Expenses</b>		
Salaries, wages, and benefits	4,565,140	4,430,982
Supplies	793,365	749,073
Pharmaceuticals	957,045	862,697
Purchased services and other fees	533,045	506,107
Administrative services	198,863	196,958
Facilities	334,371	343,377
Insurance	61,060	66,746
	<u>7,442,889</u>	<u>7,155,940</u>
Operating income before interest, depreciation, and amortization expenses	964,113	881,267
Interest	140,824	136,105
Depreciation and amortization	487,240	476,305
Operating income before special charges	<u>336,049</u>	<u>268,857</u>
Special charges – <i>Note 19</i>	5,491	25,618
Operating income	<u>330,558</u>	<u>243,239</u>
<b>Nonoperating gains and losses</b>		
Investment return	896,139	404,191
Derivative losses	(2,305)	(22,824)
Other, net	(74,078)	(111,099)
Net nonoperating gains	<u>819,756</u>	<u>270,268</u>
Excess of revenues over expenses	<u>1,150,314</u>	<u>513,507</u>

(continued on next page)

## Changes in Net Assets

	Net Assets			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Balances at January 1, 2016	\$ 6,627,406	\$ 586,276	\$ 295,316	\$ 7,508,998
Excess of revenues over expenses	513,507	–	–	513,507
Donated capital and assets released from restrictions for capital purposes	23,448	(22,683)	–	765
Gifts and bequests	–	84,256	16,939	101,195
Net investment income	–	24,451	–	24,451
Net assets released from restrictions used for operations included in other unrestricted revenues	–	(45,292)	–	(45,292)
Retirement benefits adjustment	(17,789)	–	–	(17,789)
Change in interests in foundations	–	432	–	432
Change in value of perpetual trusts	–	–	(2,091)	(2,091)
Foreign currency translation	(59,181)	–	–	(59,181)
Other	818	(14)	–	804
Increase in net assets	460,803	41,150	14,848	516,801
Balances at December 31, 2016	7,088,209	627,426	310,164	8,025,799
Excess of revenues over expenses	<b>1,150,314</b>	–	–	<b>1,150,314</b>
Donated capital and assets released from restrictions for capital purposes	<b>81,871</b>	<b>(81,871)</b>	–	–
Gifts and bequests	–	<b>98,555</b>	<b>22,116</b>	<b>120,671</b>
Net investment income	–	<b>55,112</b>	–	<b>55,112</b>
Net assets released from restrictions used for operations included in other unrestricted revenues	–	<b>(41,675)</b>	–	<b>(41,675)</b>
Retirement benefits adjustment	<b>(3,373)</b>	–	–	<b>(3,373)</b>
Change in interests in foundations	–	<b>5,047</b>	–	<b>5,047</b>
Change in value of perpetual trusts	–	–	<b>2,335</b>	<b>2,335</b>
Foreign currency translation	<b>29,301</b>	–	–	<b>29,301</b>
Other	<b>327</b>	<b>(405)</b>	–	<b>(78)</b>
Increase in net assets	<b>1,258,440</b>	<b>34,763</b>	<b>24,451</b>	<b>1,317,654</b>
Balances at December 31, 2017	<b>\$ 8,346,649</b>	<b>\$ 662,189</b>	<b>\$ 334,615</b>	<b>\$ 9,343,453</b>

See accompanying notes.

# Cleveland Clinic Health System

## Consolidated Statements of Cash Flows (In Thousands)

	Year Ended December 31	
	2017	2016
<b>Operating activities and net nonoperating gains and losses</b>		
Increase in net assets	\$ 1,317,654	\$ 516,801
Adjustments to reconcile increase in net assets to net cash provided by operating activities and net nonoperating gains and losses:		
Loss on extinguishment of debt	46,159	3,925
Retirement benefits adjustment	3,373	17,789
Net realized and unrealized gains on investments	(897,841)	(382,146)
Depreciation and amortization	490,663	491,292
Provision for uncollectible accounts	296,469	301,694
Foreign currency translation (gain) loss	(29,301)	59,181
Donated capital	-	(765)
Restricted gifts, bequests, investment income, and other	(183,165)	(123,987)
Amortization of bond premiums and debt issuance costs	(3,106)	(1,657)
Net gain in value of derivatives	(26,509)	(8,835)
Changes in operating assets and liabilities:		
Patient receivables	(250,201)	(410,561)
Other current assets	10,173	31,113
Other noncurrent assets	(66,487)	(58,559)
Accounts payable and other current liabilities	16,404	91,924
Other liabilities	92,395	8,928
Net cash provided by operating activities and net nonoperating gains and losses	816,680	536,137
<b>Financing activities</b>		
Proceeds from long-term borrowings	1,118,137	502,448
Payments for advance refunding and redemption of long-term debt	(1,110,120)	(148,260)
Principal payments on long-term debt	(84,257)	(127,011)
Debt issuance costs	(8,173)	(949)
Change in pledges receivable, trusts, and interests in foundations	(1,206)	(10,203)
Restricted gifts, bequests, investment income, and other	183,165	123,987
Net cash provided by financing activities	97,546	340,012
<b>Investing activities</b>		
Expenditures for property, plant, and equipment	(607,720)	(664,703)
Proceeds from sale of property, plant, and equipment	1,486	1,585
Net change in cash equivalents reported in long-term investments	(362,513)	146,064
Purchases of investments	(2,441,368)	(2,757,671)
Sales of investments	2,215,234	2,671,903
Net cash used in investing activities	(1,194,881)	(602,822)
Effect of exchange rate changes on cash	1,254	(2,279)
(Decrease) increase in cash and cash equivalents	(279,401)	271,048
Cash and cash equivalents at beginning of year	520,628	249,580
Cash and cash equivalents at end of year	\$ 241,227	\$ 520,628
<b>Supplemental disclosure of noncash activity</b>		
Assets acquired through capital leases and other financing agreements	\$ 28,062	\$ 15,479
Accounts payable accruals for property, plant, and equipment	\$ 82,206	\$ 68,340

See accompanying notes.

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements

December 31, 2017 and 2016

### **1. Organization and Consolidation**

The Cleveland Clinic Foundation (Foundation) is a nonprofit, tax-exempt, Ohio corporation organized and operated to provide medical and hospital care, medical research, and education. The accompanying consolidated financial statements include the accounts of the Foundation and its controlled affiliates, d.b.a. Cleveland Clinic Health System (System).

The System is the leading provider of healthcare services in northeast Ohio. The System operates 13 hospitals with approximately 3,800 staffed beds. Twelve of the hospitals are operated in the Northeast Ohio area, anchored by the Foundation. The System operates 21 outpatient Family Health Centers, 10 ambulatory surgery centers, as well as numerous physician offices located throughout a seven-county area of northeast Ohio, and specialized cancer centers in Sandusky and Mansfield, Ohio. In addition, the System operates a hospital and a clinic in Weston, Florida, health and wellness centers in West Palm Beach, Florida and Toronto, Canada, and a specialized neurological clinical center in Las Vegas, Nevada. Pursuant to agreements, the System also provides management services for Ashtabula County Medical Center, located in Ashtabula, Ohio, with approximately 180 staffed beds, and Cleveland Clinic Abu Dhabi, a multispecialty hospital offering critical and acute care services that is part of Mubadala Development Company's network of healthcare facilities located in Abu Dhabi, United Arab Emirates with approximately 364 staffed beds.

All significant intercompany balances and transactions have been eliminated in consolidation.

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### 2. Accounting Policies

#### Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance, and requires significantly expanded disclosures about revenue recognition. The core principle of the revenue model is that an entity recognizes 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 guidance in ASU 2014-09, including subsequent amendments, is effective for the System as of January 1, 2018.

The System adopted ASU 2014-09 on January 1, 2018 using the modified retrospective method of transition. The System's process for implementation began with a preliminary evaluation of ASU 2014-09 and considered subsequent interpretations by the FASB Transition Resource Group for Revenue Recognition and the American Institute of Certified Public Accountants. The System performed an analysis of revenue streams and transactions under ASU 2014-09. In particular, for net patient service revenue, the System performed an analysis into the application of the portfolio approach as a practical expedient to group patient contracts with similar characteristics, such that revenue for a given portfolio would not be materially different than if it were evaluated on a contract-by-contract basis. Upon adoption, the majority of what is currently classified as provision for uncollectible accounts and presented as a reduction to net patient service revenue on the consolidated statements of operations and changes in net assets will be treated as a price concession that reduces the transaction price, which is reported as net patient service revenue. The new standard also requires enhanced disclosures related to the disaggregation of revenue and significant judgments made in measurement and recognition. The impact of adopting ASU 2014-09 is not material to total unrestricted revenues, excess of revenues over expenses or unrestricted net assets.

In February 2016, the FASB issued ASU 2016-02, *Leases*. This ASU requires lessees to recognize assets and liabilities on the balance sheet for leases with lease terms greater than twelve months. The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. This amends current guidance that requires only capital leases to be recognized on the lessee balance sheet. ASU 2016-02 will also require additional disclosures on the amount, timing and uncertainty of cash flows arising from leases. The guidance is effective for the System for reporting periods beginning after December 15, 2018 with early adoption permitted. The System is currently evaluating the impact that ASU 2016-02 will have on its consolidated financial statements and will adopt the provisions upon the effective date.

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### **2. Accounting Policies (continued)**

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements for Not-for-Profit Entities*. This standard intends to make certain improvements to the current reporting requirements for not-for-profit entities. This standard sets forth changes to net asset classification requirements and the information presented about a not-for-profit entity's liquidity, financial performance and cash flows. ASU 2016-14 is effective for the System for annual reporting periods beginning after December 15, 2017, and interim periods beginning after December 15, 2018. The System is currently evaluating the impact that ASU 2016-14 will have on its consolidated financial statements and will adopt the provisions upon the effective date.

#### **Use of Estimates**

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

#### **Net Patient Service Revenue and Patient Receivables**

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others, including retroactive adjustments under payment agreements with third-party payors. The System has agreements with third-party payors that generally provide for payments to the System at amounts different from its established rates. For uninsured patients who do not qualify for charity care, the System recognizes revenue based on established rates, subject to certain discounts as determined by the System. An estimated provision for uncollectible accounts is recorded that results in net patient service revenue being reported at the net amount expected to be received. The System has determined, based on an assessment at the consolidated entity level, that patient service revenue is primarily recorded prior to assessing the patient's ability to pay and as such, the entire provision for uncollectible accounts related to patient service revenue is recorded as a deduction from patient service revenue.

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### **2. Accounting Policies (continued)**

Patient receivables are reduced by an allowance for uncollectible accounts. The allowance for uncollectible accounts is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in healthcare coverage, major payor sources and other collection indicators. Periodically throughout the year, management assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience by payor category. The results of this review are then used to make modifications to the provision for uncollectible accounts to establish an appropriate allowance for uncollectible receivables. After satisfaction of amounts due from insurance, the System follows established guidelines for placing certain past-due patient balances with collection agencies, subject to the terms of certain restrictions on collection efforts as determined by the System.

The System is paid a prospectively determined rate for the majority of inpatient acute care and outpatient, skilled nursing, and rehabilitation services provided (principally Medicare, Medicaid, and certain insurers). These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Payments for capital are received on a prospective basis for Medicare and on a cost reimbursement methodology for Medicaid. Payments are received on a prospective basis for the System's medical education costs, subject to certain limits. The System is paid for cost reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare Administrative Contractor. Provision for estimated retroactive adjustments, if any, resulting from regulatory matters or other adjustments under payment agreements are estimated in the period the related services are provided. The System recorded an increase in net patient service revenue of \$5.9 million and \$12.0 million in 2017 and 2016, respectively, related to changes in estimates.

In 2014, the Provider Reimbursement Review Board provided a favorable decision to the System regarding the graduate medical education program for Weston Hospital. The decision requires the Centers for Medicare and Medicaid Services (CMS) to reimburse Weston Hospital on its annual cost reports for graduate medical education under new program regulations, which includes all years since the hospital opened in 2001. The System recorded an increase in net patient service revenue of \$7.5 million in 2016 related to changes in estimates.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation as well as significant regulatory action, and, in the normal course of business, the System is subject to contractual reviews and audits, including audits initiated by the Medicare Recovery Audit Contractor program. As a result, there is at least a reasonable possibility that recorded estimates will change in the near term. The System believes it is in compliance with applicable laws and regulations governing the Medicare and Medicaid programs and that adequate provisions have been made for any adjustments that may result from final settlements.

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### **2. Accounting Policies (continued)**

As part of integration efforts involving Akron General Health System (Akron General) and through review of contractual relationships between Akron General and some of its independent physician practice groups, the System identified possible violations to the Federal Anti-Kickback Statute and Limitations on Certain Physician Referrals regulation (commonly referred to as the “Stark Law”), which may have resulted in false claims to federal and/or state health care programs and may result in liability under the Federal Anti-Kickback Statute, Stark Law, False Claims Act and/or other laws and regulations. Akron General is cooperating with the appropriate government authorities on such possible violations.

There is a probable liability associated with the matters described above, which may put at risk federal reimbursements related to services provided to patients at Akron General by the practice groups, and potential fines and penalties that could be assessed. It is not possible to estimate the ultimate amount of the liability at this time.

### **Charity Care**

The System provides care to patients who do not have the ability to pay and who qualify for charity care pursuant to established policies of the System. Charity care is defined as services for which patients have the obligation and willingness to pay but do not have the ability to do so. The System does not report charity care as net patient service revenue. The cost of charity care provided in 2017 and 2016 approximated \$91 million and \$87 million, respectively. The System estimated these costs by calculating a ratio of cost to gross charges and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients.

The System participates in the Hospital Care Assurance Program (HCAP). Ohio created HCAP to financially support those hospitals that service a disproportionate share of low-income patients unable to pay for care. HCAP funds basic, medically necessary hospital services for patients whose family income is at or below the federal poverty level, which includes Medicaid patients and patients without health insurance. The System recorded HCAP expenses of \$8.3 million and revenues of \$3.1 million for the years ended December 31, 2017 and 2016, respectively, which are included in net patient service revenue.

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### **2. Accounting Policies (continued)**

#### **Management Service Agreements**

The System has management service agreements with regional, national and international organizations to provide advisory services for various healthcare ventures. The scope of these services range from managing current healthcare operations that are designed to improve clinical quality, innovation, patient care, medical education and research at other healthcare organizations and educational institutions to managing the construction, training, organizational infrastructure, and operational management of healthcare entities. The System recognizes revenues related to management service agreements on a pro rata basis over the term of the agreements as services are provided. Payments received in advance are recorded as deferred revenue until the services have been provided. The System has recorded deferred revenue related to management service agreements, included in other current liabilities, of \$15.7 million and \$13.6 million at December 31, 2017 and 2016, respectively. Revenue related to management service agreements for 2017 and 2016 was \$113.9 million and \$99.5 million, respectively, and is included in other unrestricted revenues.

#### **Cash and Cash Equivalents**

The System considers all highly liquid investments with original maturities of three months or less when purchased to be cash equivalents. Cash equivalents are recorded at fair value in the consolidated balance sheets and exclude amounts included in long-term investments and investments for current use.

#### **Inventories**

Inventories (primarily supplies and pharmaceuticals) are stated at an average cost or the lower of cost (first-in, first-out method) or market and are recorded in other current assets.

#### **Property, Plant, and Equipment**

Property, plant, and equipment purchased by the System are recorded at cost. Donated property, plant, and equipment are recorded at fair value at the date of donation. Expenditures that substantially increase the useful lives of existing assets are capitalized. Routine maintenance and repairs are expensed as incurred. Depreciation, including amortization of capital leased assets, is computed by the straight-line method using the estimated useful lives of individual assets. Buildings are assigned useful lives ranging from five years to forty years. Equipment is assigned

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### **2. Accounting Policies (continued)**

a useful life ranging from three to twenty years. Interest cost incurred on borrowed funds during the period of construction of capital assets and interest income on unexpended project funds are capitalized as a component of the cost of acquiring those assets. The System records costs and legal obligations associated with long-lived asset retirements. Assets acquired through capital lease arrangements are excluded from the consolidated statements of cash flows.

#### **Impairment of Long-Lived Assets**

The System evaluates the recoverability of long-lived assets and the related estimated remaining lives when indicators of impairment are present. For purposes of impairment analysis, assets are grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. The System records an impairment charge or changes the useful life if events or changes in circumstances indicate that the carrying amount may not be recoverable or the useful life has changed.

#### **Investments and Investment Income**

Investments in equity securities with readily determinable fair values and all investments in debt securities are recorded at fair value in the consolidated balance sheets. Investments, excluding alternative investments, are primarily classified as trading. Investment transactions are recorded on a settlement date basis. Realized gains and losses are determined using the average cost method.

Commingled investment funds are valued using, as a practical expedient, the net asset value as provided by the respective investment companies and partnerships. There are no significant redemption restrictions on the commingled investment funds.

Investments in alternative investments, which include hedge funds, private equity/venture funds and real estate funds, are primarily limited partnerships that invest in marketable securities, privately held securities, real estate, and derivative products and are reported using the equity method of accounting based on net asset value information provided by the respective partnership or third-party fund administrators. Investments held by the partnerships consist of marketable securities as well as securities that do not have readily determinable values. The values of the securities held by the limited partnerships that do not have readily determinable values are determined by the general partner and are based on historical cost, appraisals, or other valuation estimates that require varying degrees of judgment. There is inherent uncertainty in such

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### **2. Accounting Policies (continued)**

valuations, and the estimated fair values may differ from the values that would have been used had a ready market for the securities existed. Generally, the equity method investment balance of the System's holdings in alternative investments reflects net contributions to the partnerships and the System's share of realized and unrealized investment income and expenses. The investments may individually expose the System to securities lending, short sales, and trading in futures and forward contract options and other derivative products. The System's risk is limited to its carrying value. The financial statements of the limited partnerships are audited annually.

Alternative investments can be divested only at specified times in accordance with terms of the partnership agreements. Hedge fund redemptions typically contain restrictions that allow for a portion of the withdrawal proceeds to be held back from distribution while the underlying investments are liquidated. These redemptions are subject to lock-up provisions that are generally imposed upon initial investment in the fund. Private equity/venture funds and real estate funds are generally closed-end funds and have significant redemption restrictions that prohibit redemptions during the fund's life.

Investment return, including equity method income on alternative investments, is reported as nonoperating gains and losses, except for earnings on funds held by bond trustees and interest and dividends earned on assets held for self-insurance, which are included in other unrestricted revenues. Donor-restricted investment return on temporarily and permanently restricted investments is included in temporarily restricted net assets.

Certain of the System's assets and liabilities are exposed to various risks, such as interest rate, market, and credit risks.

### **Fair Value Measurements**

Fair value measurements are 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.

Authoritative guidance provides an option to elect fair value as an alternative measurement for selected financial assets and liabilities not previously recorded at fair value. The System did not elect fair value accounting for any assets or liabilities that are not currently required to be measured at fair value.

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### **2. Accounting Policies (continued)**

The framework for measuring fair value is comprised of a three-level hierarchy based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

### **Goodwill and Other Intangibles**

Goodwill has resulted from business combinations, primarily physician practice acquisitions, and is based on the purchase price in excess of the fair values of assets acquired and liabilities assumed at the acquisition date. Annually, or when indicators of impairment exist, the System evaluates goodwill for impairment to determine whether there are events or circumstances that indicate it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The System considers assets to be impaired and writes them down to fair value if the expected undiscounted cash flows are less than the carrying amounts.

Intangible assets other than goodwill are recorded at fair value in the period of acquisition. Intangible assets with finite lives, which consist primarily of patient medical records, non-compete agreements and leasehold interests, are amortized over their estimated useful lives, ranging from two to five years, with a weighted-average amortization period of approximately three years.

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### **2. Accounting Policies (continued)**

#### **Derivative Instruments**

The System's derivative financial instruments consist of interest rate swaps and foreign currency forward contracts (Note 12), which are recognized as assets or liabilities in the consolidated balance sheets at fair value.

The System accounts for changes in the fair value of derivative instruments depending on whether they are designated and qualified as part of a hedging relationship and further, on the type of hedging relationship. The System has not designated any derivative instruments as hedges. Accordingly, the changes in fair value of derivative instruments and the related cash payments are recorded in derivative losses in the consolidated statements of operations and changes in net assets.

#### **Foreign Currency Translation**

The statements of operations of foreign subsidiaries whose functional currencies are other than the U.S. dollar are translated into U.S. dollars using average exchange rates for the period. The assets and liabilities of foreign subsidiaries whose functional currencies are other than the U.S. dollar are translated into U.S. dollars using exchange rates as of the balance sheet date. The U.S. dollar effects that arise from translating the net assets of these subsidiaries at changing rates are recorded as foreign currency translation gains and losses in the consolidated statements of operations and changes in net assets. Cumulative foreign currency translation losses included in unrestricted net assets were \$42.1 million and \$71.4 million at December 31, 2017 and 2016, respectively.

#### **Debt Issuance Costs**

Debt issuance costs are amortized over the period the obligation is outstanding using the straight-line method, which approximates the interest method.

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### **2. Accounting Policies (continued)**

#### **Contributions**

Unconditional donor pledges to give cash, marketable securities, and other assets are reported at fair value at the date the pledge is made to the extent estimated to be collectible by the System. Conditional donor promises to give and indications of intentions to give are not recognized until the condition is satisfied. Pledges received with donor restrictions that limit the use of the donated assets are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are transferred to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as other unrestricted revenues if the purpose relates to operations or reported as a change in unrestricted net assets if the purpose relates to capital.

No amounts have been reflected in the consolidated financial statements for donated services. The System pays for most services requiring specific expertise. However, many individuals volunteer their time and perform a variety of tasks that assist the System with various programs.

#### **Grants**

Grant revenue is recognized in the period it is earned based on when the applicable project expenses are incurred and project milestones are achieved. Grant payments received in advance of related project expenses are deferred until the expenditure has been incurred and recorded as deferred revenue and included in other current liabilities. The System recorded research grant revenue, included in other unrestricted revenues, of \$195.7 million and \$189.2 million in 2017 and 2016, respectively.

#### **Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are used to differentiate resources, the use of which is restricted by donors or grantors to a specific time period or purpose, from resources on which no restrictions have been placed or that arise from the general operations of the System. Temporarily restricted gifts and bequests are recorded as an addition to temporarily restricted net assets in the period received. Permanently restricted net assets consist of amounts held in perpetuity or for terms designated by donors, including the fair value of several perpetual trusts for which the System is an income beneficiary. Earnings on permanently restricted net assets are recorded as investment income in temporarily restricted net assets and subsequently used in accordance with the donor's designation. Temporarily and permanently restricted net assets are primarily restricted for research, education, and strategic capital projects.

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 2. Accounting Policies (continued)

##### Excess of Revenues Over Expenses

The consolidated statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments classified as nontrading, retirement benefits adjustments, foreign currency translation gains and losses, contributions of long-lived assets (including assets acquired using grants or contributions that by donor restriction were to be used for the purpose of acquiring such assets), and transfers of net assets to maintain donor-restricted endowment funds at the level required by donor stipulations or law.

#### 3. Net Patient Service Revenue and Patient Receivables

Net patient service revenue before the provision for uncollectible accounts by major payor source for the years ended December 31, 2017 and 2016, are as follows (in thousands):

	2017		2016	
Medicare	\$ 2,584,950	33%	\$ 2,521,242	33%
Medicaid	646,934	8	572,130	8
Managed care and commercial	4,400,325	57	4,288,570	57
Self-pay	162,342	2	169,124	2
	\$ 7,794,551	100%	\$ 7,551,066	100%

The System records an estimated provision for uncollectible accounts in the year of service for self-pay accounts receivable, which includes patient receivables associated with self-pay patients and deductible and copayment balances for which third-party coverage provides for a portion of the services provided. The System's allowance for doubtful accounts was 16% and 15% of accounts receivable at December 31, 2017 and 2016, respectively. Write-offs on self-pay accounts receivable decreased \$83.5 million in 2017 compared to 2016. The System does not maintain a material allowance for uncollectible accounts for third-party payors.

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 3. Net Patient Service Revenue and Patient Receivables (continued)

The System's concentration of credit risk relating to patient receivables is limited due to the diversity of patients and payors. Patient receivables consist of amounts due from government programs, commercial insurance companies, other group insurance programs, and private pay patients. Patient receivables due from Medicare, Medicaid, and one commercial payor account for approximately 27%, 9%, and 23% at December 31, 2017, and 29%, 8%, and 23% at December 31, 2016, respectively, of the System's total patient receivables. Revenues from the Medicare and Medicaid programs and one commercial payor account for approximately 33%, 8%, and 17% for 2017, and 33%, 8%, and 17% for 2016, respectively, of the System's net patient service revenue. Excluding these payors, no one payor represents more than 10% of the System's patient receivables or net patient service revenue.

#### 4. Cash, Cash Equivalents, and Investments

The composition of cash, cash equivalents, and investments at December 31, 2017 and 2016, is as follows (in thousands):

	<b>2017</b>	<b>2016</b>
Cash and cash equivalents	<b>\$ 770,654</b>	\$ 687,410
Fixed income securities:		
U.S. treasuries	<b>1,075,486</b>	963,715
U.S. government agencies	<b>18,964</b>	20,270
U.S. corporate	<b>83,383</b>	167,025
U.S. government agencies asset-backed securities	<b>25,139</b>	25,102
Corporate asset-backed securities	<b>4,895</b>	2,829
Foreign	<b>21,267</b>	44,759
Fixed income mutual funds	<b>391,971</b>	222,670
Commingled fixed income funds	<b>791,372</b>	663,154
Common and preferred stocks:		
U.S.	<b>475,141</b>	422,947
Foreign	<b>297,573</b>	267,061
Equity mutual funds	<b>262,991</b>	381,686
Commingled equity funds	<b>2,029,255</b>	1,591,389
Commingled commodity funds	<b>127,690</b>	122,297
Alternative investments:		
Hedge funds	<b>1,142,932</b>	1,134,136
Private equity/venture funds	<b>854,632</b>	696,786
Real estate	<b>483,996</b>	452,018
Pending purchases of investments	<b>215,000</b>	-
Total cash, cash equivalents, and investments	<b><u>\$ 9,072,341</u></b>	<b><u>\$ 7,865,254</u></b>

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 4. Cash, Cash Equivalents, and Investments (continued)

Pending purchases of investments of \$215.0 million at December 31, 2017 were invested as hedge funds on January 1, 2018.

Investments are primarily maintained in a master trust fund administered using a bank as trustee. The management of the majority of the System's investments is conducted by numerous external investment management organizations that are monitored by the System. There were 138 investment managers at December 31, 2017 focusing on various investment strategies, including equity investments, fixed income investments, commodities and alternative investments. The alternative investments have separate administrators and custodian arrangements. Alternative investments also include five holdings in which the System invests directly.

Total investment return is comprised of the following for the years ended December 31, 2017 and 2016 (in thousands):

	<b>2017</b>	<b>2016</b>
Other unrestricted revenues:		
Interest income and dividends	\$ <b>2,909</b>	\$ 2,750
Nonoperating gains, net:		
Interest income and dividends	<b>70,135</b>	61,430
Net realized gains on sales of investments	<b>177,901</b>	157,358
Net change in unrealized gains on investments	<b>518,861</b>	100,079
Equity method income on alternative investments	<b>152,178</b>	104,184
Investment management fees	<b>(22,936)</b>	(18,860)
	<b>896,139</b>	404,191
Other changes in net assets:		
Investment income on restricted investments and other	<b>54,250</b>	24,771
Total investment return	<b>\$ 953,298</b>	\$ 431,712

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 5. Other Current Assets and Liabilities and Other Noncurrent Assets and Liabilities

Other current and noncurrent assets at December 31, 2017 and 2016, consist of the following (in thousands):

	2017	2016
Current:		
Inventories	\$ 143,437	\$ 133,074
Prepaid expenses	57,010	52,989
Pledges receivable, current ( <i>Note 9</i> )	45,657	58,188
Research receivables	36,143	36,390
Estimated amounts due from third-party payors	9,397	41,162
Other	83,082	75,089
Total other current assets	\$ 374,726	\$ 396,892
Noncurrent:		
Deferred compensation plan assets	\$ 206,085	\$ 162,820
Goodwill and other intangible assets	101,999	92,574
Note receivable	37,204	37,455
Investments in affiliates	33,921	37,244
Other	95,801	79,914
Total other noncurrent assets	\$ 475,010	\$ 410,007

Other current and noncurrent liabilities at December 31, 2017 and 2016 consist of the following (in thousands):

	2017	2016
Current:		
Research deferred revenue	\$ 67,492	\$ 71,885
Interest payable	52,236	64,141
Current portion of professional and general liability insurance reserves ( <i>Note 13</i> )	51,051	52,125
Estimated amounts due to third-party payors	40,053	45,000
Management contracts and other deferred revenue	38,026	38,602
Employee benefit related liabilities	29,211	34,384
Current portion of pledges payable	15,460	306
Foreign currency forward contracts ( <i>Note 12</i> )	—	11,076
Other	145,133	145,042
Total other current liabilities	\$ 438,662	\$ 462,561

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 5. Other Current Assets and Liabilities and Other Noncurrent Assets and Liabilities (continued)

	<b>2017</b>	<b>2016</b>
Noncurrent:		
Employee benefit related liabilities	<b>\$ 256,797</b>	\$ 216,666
Interest rate swap liabilities ( <i>Note 12</i> )	<b>123,989</b>	139,422
Pledge liabilities	<b>20,328</b>	34,134
Estimated amounts due to third-party payors	<b>18,665</b>	24,523
Gift annuity liabilities	<b>12,120</b>	11,114
Accrued income tax liabilities ( <i>Note 15</i> )	<b>606</b>	2,258
Other	<b>135,061</b>	62,428
Total other noncurrent liabilities	<b>\$ 567,566</b>	\$ 490,545

#### 6. Goodwill and Other Intangible Assets

The System recorded goodwill of \$10.9 million and \$4.1 million in 2017 and 2016, respectively, related to the acquisitions of various physician practices. Goodwill is recorded in other noncurrent assets in the consolidated balance sheets.

The changes in the carrying amount of goodwill for the years ended December 31, 2017 and 2016 are as follows (in thousands):

	<b>Year Ended December 31</b>	
	<b>2017</b>	<b>2016</b>
Balance, beginning of year	<b>\$ 58,497</b>	\$ 54,411
Goodwill acquired	<b>10,923</b>	4,086
Balance, end of year	<b>\$ 69,420</b>	\$ 58,497

The System acquired other intangible assets of \$0.2 million and \$0.4 million in 2017 and 2016, respectively, related to the acquisitions of various physician practices. Other intangible assets are recorded in other noncurrent assets in the consolidated balance sheets.

Cleveland Clinic Health System

Notes to Consolidated Financial Statements (continued)

**6. Goodwill and Other Intangible Assets (continued)**

Other intangible assets at December 31, 2017 and 2016 consist of the following (in thousands):

	<b>2017</b>		<b>2016</b>	
	<b>Historical Cost</b>	<b>Accumulated Amortization</b>	<b>Historical Cost</b>	<b>Accumulated Amortization</b>
Trade name	\$ 31,700	\$ –	\$ 31,700	\$ –
Finite-lived intangible assets	<b>6,261</b>	<b>5,382</b>	6,643	4,266
<b>Total</b>	<b>\$ 37,961</b>	<b>\$ 5,382</b>	<b>\$ 38,343</b>	<b>\$ 4,266</b>

Amortization related to finite-lived intangible assets was \$1.7 million and \$2.3 million in 2017 and 2016, respectively, and is included in depreciation and amortization in the consolidated statements of operations and changes in net assets. Future amortization is as follows (in thousands): 2018 – \$602; 2019 – \$219; and 2020 – \$58.

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 7. Fair Value Measurements

The following tables present the financial instruments measured at fair value on a recurring basis as of December 31, 2017 and 2016, based on the valuation hierarchy (in thousands):

<b>December 31, 2017</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets</b>				
Cash and investments:				
Cash and cash equivalents	\$ 770,609	\$ 45	\$ –	\$ 770,654
Fixed income securities:				
U.S. treasuries	1,075,486	–	–	1,075,486
U.S. government agencies	–	18,964	–	18,964
U.S. corporate	–	83,383	–	83,383
U.S. government agencies asset-backed securities	–	25,139	–	25,139
Corporate asset-backed securities	–	4,895	–	4,895
Foreign	–	21,267	–	21,267
Fixed income mutual funds	391,971	–	–	391,971
Common and preferred stocks:				
U.S.	473,420	1,721	–	475,141
Foreign	296,025	1,548	–	297,573
Equity mutual funds	262,991	–	–	262,991
Total cash and investments	3,270,502	156,962	–	3,427,464
Perpetual and charitable trusts	–	53,728	–	53,728
Total assets at fair value	<u>\$ 3,270,502</u>	<u>\$ 210,690</u>	<u>\$ –</u>	<u>\$ 3,481,192</u>
<b>Liabilities</b>				
Interest rate swaps	\$ –	\$ 123,989	\$ –	\$ 123,989
Total liabilities at fair value	<u>\$ –</u>	<u>\$ 123,989</u>	<u>\$ –</u>	<u>\$ 123,989</u>

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 7. Fair Value Measurements (continued)

December 31, 2016	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Cash and investments:				
Cash and cash equivalents	\$ 687,410	\$ —	\$ —	\$ 687,410
Fixed income securities:				
U.S. treasuries	963,715	—	—	963,715
U.S. government agencies	—	20,270	—	20,270
U.S. corporate	—	167,025	—	167,025
U.S. government agencies asset-backed securities	—	25,102	—	25,102
Corporate asset-backed securities	—	2,829	—	2,829
Foreign	—	44,759	—	44,759
Fixed income mutual funds	222,670	—	—	222,670
Common and preferred stocks:				
U.S.	420,744	2,203	—	422,947
Foreign	265,689	1,372	—	267,061
Equity mutual funds	381,686	—	—	381,686
Total cash and investments	2,941,914	263,560	—	3,205,474
Perpetual and charitable trusts	—	45,350	—	45,350
Total assets at fair value	<u>\$ 2,941,914</u>	<u>\$ 308,910</u>	<u>\$ —</u>	<u>\$ 3,250,824</u>
<b>Liabilities</b>				
Interest rate swaps	\$ —	\$ 139,422	\$ —	\$ 139,422
Foreign currency forward contracts	—	11,076	—	11,076
Total liabilities at fair value	<u>\$ —</u>	<u>\$ 150,498</u>	<u>\$ —</u>	<u>\$ 150,498</u>

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 7. Fair Value Measurements (continued)

Financial instruments at December 31, 2017 and 2016 are reflected in the consolidated balance sheets as follows (in thousands):

	<b>2017</b>	<b>2016</b>
Cash, cash equivalents, and investments measured at fair value	<b>\$ 3,427,464</b>	\$ 3,205,474
Commingled funds measured at net asset value	<b>2,948,317</b>	2,376,840
Alternative investments accounted for under the equity method	<b>2,481,560</b>	2,282,940
Pending purchases of investments	<b>215,000</b>	–
Total cash, cash equivalents, and investments	<b>\$ 9,072,341</b>	\$ 7,865,254
Perpetual and charitable trusts measured at fair value	<b>\$ 53,728</b>	\$ 45,350
Interests in foundations	<b>26,915</b>	21,869
Trusts and interests in foundations	<b>\$ 80,643</b>	\$ 67,219

Interest rate swaps and forward currency forward contracts (Note 12) are reported in other current and noncurrent liabilities in the consolidated balance sheets.

The following is a description of the System's valuation methodologies for assets and liabilities measured at fair value. Fair value for Level 1 is based upon quoted market prices. Fair value for Level 2 is determined as follows:

Investments classified as Level 2 are primarily determined using techniques that are consistent with the market approach. Valuations are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs, which include broker/dealer quotes, reported/comparable trades, and benchmark yields, are obtained from various sources, including market participants, dealers, and brokers.

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### **7. Fair Value Measurements (continued)**

The fair value of perpetual and charitable trusts in which the System receives periodic payments from the trust is determined based on the present value of expected cash flows to be received from the trust using discount rates ranging from 2.5% to 5.0%, which are based on Treasury yield curve interest rates or the assumed yield of the trust assets. The fair value of charitable trusts in which the System is a remainder beneficiary is based on the System's beneficial interest in the investments held in the trust, which are measured at fair value.

The fair value of interest rate swaps is determined based on the present value of expected future cash flows using discount rates appropriate with the risks involved. The valuations include a credit spread adjustment to market interest rate curves to appropriately reflect nonperformance risk. The credit spread adjustment is derived from other comparably rated entities' bonds recently priced in the market. The System manages credit risk based on the net portfolio exposure with each counterparty.

The fair value of foreign currency forward contracts is based on the difference between the contracted forward rate and current market foreign currency exchange rates. A credit spread adjustment is included in the valuations to appropriately reflect nonperformance risk. The credit spread adjustment is derived from other comparably rated entities' bonds recently priced in the market.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the System believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 8. Property, Plant, and Equipment

Property, plant, and equipment at December 31, 2017 and 2016 consist of the following (in thousands):

	<b>2017</b>	<b>2016</b>
Land and improvements	\$ 406,463	\$ 390,669
Buildings	5,657,283	5,350,756
Leasehold improvements	30,832	30,609
Equipment	1,671,465	1,599,562
Computer hardware and software	855,524	797,300
Construction-in-progress	754,564	611,587
Leased facilities and equipment	158,785	150,561
	<b>9,534,916</b>	8,931,044
Accumulated depreciation and amortization	<b>(4,835,219)</b>	(4,418,966)
	<b>\$ 4,699,697</b>	\$ 4,512,078

Included in the preceding table is unamortized computer software of \$193.2 million and \$188.3 million at December 31, 2017 and 2016, respectively. Amortization of computer software totaled \$47.9 million and \$48.9 million in 2017 and 2016, respectively. Amortization of computer software for the five years subsequent to December 31, 2017, is as follows (in millions): 2018 – \$42.8; 2019 – \$33.8; 2020 – \$25.5; 2021 – \$22.5; and 2022 – \$21.1.

Accumulated amortization of leased facilities and equipment was \$70.4 million and \$58.8 million at December 31, 2017 and 2016, respectively.

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 9. Pledges Receivable

Outstanding pledges receivable from various corporations, foundations, and individuals at December 31, 2017 and 2016, are as follows (in thousands):

	<b>2017</b>	<b>2016</b>
Pledges due:		
In less than one year	\$ <b>61,439</b>	\$ 72,117
In one to five years	<b>115,638</b>	108,075
In more than five years	<b>81,429</b>	88,540
	<b>258,506</b>	268,732
Allowance for uncollectible pledges and discounting	<b>(61,830)</b>	(59,835)
Current portion (net of allowance for uncollectible pledges of \$15.6 million in 2017 and \$13.9 million in 2016)	<b>(45,657)</b>	(58,188)
	<b>\$ 151,019</b>	\$ 150,709

#### 10. Notes Payable and Capital Leases

Notes payable and capital leases at December 31, 2017 and 2016 consist of the following (in thousands):

	<b>2017</b>	<b>2016</b>
Notes payable with interest rates up to 5.0%	\$ <b>376,521</b>	\$ 381,308
Revolving credit facility	<b>60,000</b>	60,000
Capital leases for facilities and equipment	<b>93,986</b>	96,435
City of Lakewood lease	<b>513</b>	1,565
	<b>531,020</b>	539,308
Unamortized debt issuance costs	<b>(387)</b>	(620)
Less current portion	<b>(395,793)</b>	(21,969)
Total notes payable and capital leases	<b>\$ 134,840</b>	\$ 516,719

In 2015, the System executed a \$375.0 million term loan agreement with a financial institution. The proceeds of the term loan were used to finance the System's international business strategy. The term loan matures in 2018 and bears interest at a variable rate based on the London Interbank Offered Rate (LIBOR) plus an applicable spread. The interest rate on the term loan ranged from 1.11% to 1.85% in 2017 (average rate 1.59%) and from 0.73% to 1.11% in 2016 (average rate 0.99%).

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### 10. Notes Payable and Capital Leases (continued)

In 2016, the System entered into a \$300 million revolving credit facility with multiple financial institutions. The revolving credit facility expires in 2019 with provisions allowing the System to extend the term for one-year periods. The facility allows the System to enter into short-term loans that automatically renew throughout the term of the facility. At December 31, 2017, the System has the intent and the ability to refinance the short-term loans beyond one year. The revolving credit facility bears interest at a variable rate based on the London Interbank Offered Rate (LIBOR) plus an applicable spread. Amounts outstanding on the revolving credit facility as of December 31, 2017 and 2016 totaled \$60.0 million. The proceeds were used to pay the full outstanding amount on a line of credit executed in January 2016 and terminated in September 2016. The interest rate on the revolving credit facility ranged from 1.52% to 2.09% in 2017 (average rate 1.70%) and from 1.38% to 1.53% in 2016 (average rate 1.40%).

Maturities of the notes payable and revolving credit facility for the five years subsequent to December 31, 2017, are as follows (in thousands): 2018 – \$376,495; 2019 – \$60,026; 2020 – \$0; 2021 – \$0; and 2022 – \$0.

Future minimum capital lease payments, including total interest of \$18.5 million, are as follows (in thousands): 2018 – \$23,128; 2019 – \$22,819; 2020 – \$16,102; 2021 – \$12,189; and 2022 – \$10,071; and thereafter – \$28,193. Assets acquired through capital lease arrangements are included in property, plant, and equipment.

The City of Lakewood, Ohio (the City) leases real and personal property to Lakewood Hospital Association (LHA) for the purpose of enabling the operation of certain healthcare services at Lakewood Hospital. In connection with executing an Amended Lease with the City, LHA had agreed to make additional payments to the City. In 2015, the Amended Lease was further amended to shorten the lease term and to reduce the total payments due under the lease. The payments under the current lease as amended range in annual amounts up to \$1.2 million through 2018, or until certain provisions in the lease are satisfied. The net present value of the additional payments discounted at an interest rate of 6% is \$0.5 million and \$1.6 million at December 31, 2017 and 2016, respectively. LHA has approximately \$29 million of net assets, included in the System's unrestricted net assets at December 31, 2016, available for use under the terms of the current lease but unavailable to other members of the System.

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### 11. Bonds

Bonds at December 31, 2017 and 2016 consist of the following (in thousands):

	Interest Rate(s)	Final Maturity	Amount Outstanding at December 31	
			2017	2016
Series 2017A	0.83% to 3.48%	2043	\$ 818,775	\$ —
Series 2017B	1.56% to 3.70%	2043	169,255	—
Series 2017C	2.24%	2032	9,305	—
Series 2016, Private Placement	3.35%	2046	325,000	325,000
Series 2016, Term Loan	Variable rate	2026	16,270	17,370
Series 2014	4.86%	2114	400,000	400,000
Series 2014A CP Notes	Variable rate	2044	70,955	70,955
Series 2013A	3.62% to 4.04%	2042	73,150	73,150
Series 2013B	Variable rate	2039	201,160	201,160
Series 2013, Keep Memory Alive	Variable rate	2037	61,165	63,135
Series 2012A	1.54% to 4.07%	2039	451,135	460,080
Series 2011A	2.79% to 4.83%	2032	160,605	172,030
Series 2011B	2.94%	2031	27,785	29,120
Series 2011C	3.40% to 4.72%	2032	157,945	170,995
Series 2009A	5.58%	2039	—	305,400
Series 2009B	3.99% to 4.21%	2039	31,640	366,215
Series 2008A	4.39%	2043	7,930	409,740
Series 2008B	Variable rate	2043	327,575	369,250
Series 2003C	Variable rate	2035	41,905	41,905
Series 2002	Variable rate	2032	—	9,635
			<b>3,351,555</b>	3,485,140
Net unamortized premium			167,451	51,287
Unamortized debt issuance costs			(22,278)	(22,593)
Current portion			(62,020)	(59,770)
Long-term variable rate debt classified as current			(573,270)	(527,115)
			<b>\$ 2,861,438</b>	<b>\$ 2,926,949</b>

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### 11. Bonds (continued)

The majority of the System's outstanding revenue bonds are limited obligations of various issuing authorities payable solely by the System pursuant to loan agreements between the borrowing entities and the issuing authorities. Under various financing agreements, the System must meet certain operating and financial performance covenants. The Series 2016 private placement, the Series 2016 term loan and the Series 2014 bonds are issued directly by the Foundation. The Series 2013 Keep Memory Alive bonds are issued directly by Keep Memory Alive, a non-obligated affiliate of the System.

In August 2017, pursuant to certain agreements between the System and the State of Ohio (State) acting by and through the Ohio Higher Education Facility Commission, the State issued \$818.8 million of fixed-rate Hospital Refunding Revenue Bonds (Series 2017A Bonds) and \$169.3 million of fixed-rate Taxable Hospital Refunding Revenue Bonds (Series 2017B Bonds) for the benefit of the System. Proceeds from the sale of the Series 2017A Bonds and Series 2017B Bonds were used to refund all or a portion of the outstanding Series 2008A, 2008B, 2009A, 2009B and 2012A Bonds and to pay the cost of issuance. The System recorded a loss on extinguishment of debt of \$46.2 million related to this transaction, which is recorded in other nonoperating gains and losses in the consolidated statements of operations and changes in net assets.

In December 2017, pursuant to certain agreements between the System and the State of Ohio (State) acting by and through the Ohio Higher Education Facility Commission, the State issued \$9.3 million of Hospital Refunding Revenue Bonds (Series 2017C Bonds) for the benefit of the System. Proceeds from the sale of the Series 2017C Bonds were used to refund all of the outstanding Series 2002 Bonds. The Series 2017C Bonds were purchased by a financial institution and are scheduled to be tendered to the System on December 1, 2027. During this term, the bonds bear interest at 2.24% plus an applicable credit spread. The tender date may be extended subject to the consent of the financial institution.

In January 2016, the System entered into a line of credit with a financial institution totaling \$60.0 million. The System drew the full amount on the line of credit and also issued \$100.0 million of Taxable Hospital Revenue Commercial Paper Notes (Series 2014A CP Notes). The proceeds from the draw on the line of credit and a portion of the proceeds from the issuance of the Series 2014A CP Notes were used to defease the Series 2012 Akron Bonds and redeem the Series 2012 taxable Akron Bonds, the Series 2014A Akron Bonds and the Series 2014B Akron Bonds. The System recorded a loss on extinguishment of debt of \$3.9 million in 2016 related to this transaction, which is recorded in other nonoperating gains and losses in the consolidated statements of operations and changes in net assets.

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### **11. Bonds (continued)**

The Series 2014A CP Notes may be issued from time to time in a maximum outstanding face amount of \$100 million. At December 31, 2017 and 2016, the System has \$71.0 million of outstanding Series 2014A CP Notes.

In August 2016, the System issued private placement debt totaling \$325.0 million that was purchased by a financial institution. The private placement debt matures in 2046 and bears interest at a fixed rate of 3.35%. The proceeds of the private placement debt were used for the general corporate purposes of the Foundation.

In November 2016, the System entered into a loan agreement with a financial institution totaling \$17.4 million. The loan matures in 2026 and bears interest at a variable rate based on the LIBOR index rate plus an applicable spread. The proceeds of the loan were used to pay a portion of the outstanding Series 2014A CP Notes.

Certain of the System's current outstanding bonds bear interest at a variable rate. During 2017 and 2016, the rates for the System's variable rate bonds ranged from 0.47% to 2.18% (average rate 0.91%) and 0.01% to 1.78% (average rate 0.45%), respectively.

Certain variable rate revenue bonds are secured by irrevocable direct pay letters of credit and standby bond purchase agreements totaling \$354.2 million at December 31, 2017. Bonds are classified as current in the consolidated balance sheets if they are supported by lines of credit or standby bond purchase agreements that expire within one year, require repayment of a remarketing draw within one year or contain a subjective clause that, if declared by the lender, could cause immediate repayment of the bonds.

The System provides self-liquidity on the Series 2003C Bonds, certain sub-series of the Series 2008B Bonds and the Series 2014A CP Notes. These bonds are classified as current liabilities in the consolidated balance sheets.

During the term of agreements with the issuing authorities, the System is required to make specified deposits with trustees to fund principal and interest payments when due. Also, unexpended bond proceeds are held by the trustee and released to the System for approved requisition requests for capital projects. There were no unexpended bond proceeds at December 31, 2017 and 2016. The current portion of the funds held by trustees, which consists of deposits with the trustees to fund current principal and interest payments, was \$103.9 million at December 31, 2017 and is included in investments for current use. There was no current portion of funds held by trustees at December 31, 2016.

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### **11. Bonds (continued)**

The System is subject to certain restrictive covenants, including provisions relating to certain debt ratios, days cash on hand, and other matters. The System was in compliance with these covenants at December 31, 2017 and 2016.

Combined current aggregate scheduled maturities, assuming the remarketing of the variable rate demand bonds, for the five years subsequent to December 31, 2017, are as follows (in thousands): 2018 – \$62,020; 2019 – \$64,035; 2020 – \$66,020; 2021 – \$68,870; and 2022 – \$71,825.

Total interest paid approximated \$153.4 million and \$134.4 million in 2017 and 2016, respectively. Capitalized interest cost approximated \$0.6 million and \$1.1 million in 2017 and 2016, respectively.

### **12. Derivative Instruments**

The System has entered into various derivative financial instruments to manage interest rate risk and foreign currency exposures.

The System's objective with respect to interest rate risk is to manage the risk of rising interest rates on the System's variable rate debt and certain variable rate operating lease payments. Consistent with its interest rate risk management objective, the System entered into various interest rate swap agreements with a total outstanding notional amount of \$615.0 million and \$633.1 million at December 31, 2017 and 2016, respectively. During the term of these transactions, the System pays interest at a fixed rate and receives interest at a variable rate based on the London Interbank Offered Rate (LIBOR) or the Securities Industry and Financial Markets Association Index (SIFMA). The swap agreements are not designated as hedging instruments. Net interest paid or received under the swap agreements is included in derivative losses in the consolidated statements of operations and changes in net assets.

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 12. Derivative Instruments (continued)

The following table summarizes the System's interest rate swap agreements (in thousands):

Swap Type	Expiration Date	System Pays	System Receives	Notional Amount at December 31	
				2017	2016
Fixed	2021	3.21%	68% of LIBOR	\$ 31,725	\$ 33,265
Fixed	2024	3.42%	68% of LIBOR	27,200	27,800
Fixed	2027	3.56%	68% of LIBOR	124,303	128,333
Fixed	2028	5.12%	100% of LIBOR	37,730	38,800
Fixed	2028	3.51%	68% of LIBOR	29,125	29,965
Fixed	2030	5.07%	100% of LIBOR	59,075	60,825
Fixed	2030	5.06%	100% of LIBOR	59,050	60,800
Fixed	2031	3.04%	68% of LIBOR	49,850	52,625
Fixed	2032	4.32%	79% of LIBOR	2,279	2,361
Fixed	2032	4.33%	70% of LIBOR	4,557	4,723
Fixed	2032	3.78%	70% of LIBOR	2,279	2,361
Fixed	2036	4.90%	100% of LIBOR	49,700	49,725
Fixed	2036	4.90%	100% of LIBOR	76,950	78,350
Fixed	2037	4.62%	100% of SIFMA	61,165	63,135
				<b>\$ 614,988</b>	<b>\$ 633,068</b>

The System is exposed to fluctuations in various foreign currencies against its functional currency, the U.S. dollar (USD). The System uses foreign currency derivatives including currency forward contracts and currency options to manage its exposure to fluctuations in the USD – British Pound (GBP) exchange rate. Currency forward contracts involve fixing the USD – GBP exchange rate for delivery of a specified amount of foreign currency on a specified date. The currency forward contracts are typically cash settled in USD for their fair value at or close to their settlement date. The System has also used currency option contracts to manage its foreign currency exchange risk.

In June 2016, the System entered into five foreign currency contracts, expiring between September 2016 and September 2017, with a total outstanding notional amount of \$150 million. At December 31, 2017, the System has no outstanding foreign currency forward contracts. At December 31, 2016, the System had three outstanding foreign currency forward contracts with a total notional amount of \$75 million. The foreign currency contracts are not designated as hedging instruments.

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 12. Derivative Instruments (continued)

The following table summarizes the location and fair value for the System's derivative instruments (in thousands):

	<b>Derivatives Liability</b>			
	<b>December 31, 2017</b>		<b>December 31, 2016</b>	
	<b>Balance Sheet Location</b>	<b>Fair Value</b>	<b>Balance Sheet Location</b>	<b>Fair Value</b>
<b>Derivatives not designated as hedging instruments</b>				
Interest rate swap agreements	Other noncurrent liabilities	<b>\$ 123,989</b>	Other noncurrent liabilities	\$ 139,422
Foreign currency contracts		\$ –	Other current liabilities	\$ 11,076

The following table summarizes the location and amounts of derivative losses on the System's interest rate swap agreements (in thousands):

	<b>Location of Loss Recognized</b>	<b>Year Ended December 31</b>	
		<b>2017</b>	<b>2016</b>
<b>Derivatives not designated as hedging instruments</b>			
Interest rate swap agreements	Derivative losses	<b>\$ (5,309)</b>	\$ (4,539)
Foreign currency contracts	Derivative gains (losses)	<b>\$ 3,004</b>	\$ (18,285)

The System has used various derivative contracts in connection with certain prior obligations and investments. Although minimum credit ratings are required for counterparties, this does not eliminate the risk that a counterparty may fail to honor its obligations. Derivative contracts are subject to periodic "mark-to-market" valuations. A derivative contract may, at any time, have a positive or negative value to the System. In the event that the negative value reaches certain thresholds established in the derivative contracts, the System is required to post collateral, which could adversely affect its liquidity. At December 31, 2017 and 2016, the System posted \$69.2 million and \$75.6 million, respectively, of collateral with counterparties that is included in funds held by trustees in the consolidated balance sheets. In addition, if the System were to choose to terminate a derivative contract or if a derivative contract were terminated pursuant to an event of default or a termination event as described in the derivative contract, the System could be required to pay a termination payment to the counterparty.

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### **13. Professional and General Liability Insurance**

The System manages its professional and general liability insurance program through a captive insurance arrangement.

In the ordinary course of business, professional and general liability claims have been asserted against the System by various claimants. These claims are in various stages of processing or, in certain instances, are in litigation. In addition, there are known incidents, and there also may be unknown incidents, which may result in the assertion of additional claims. The System has accrued its best estimate of both asserted and unasserted claims based on actuarially determined amounts. These estimates are subject to the effects of trends in loss severity and frequency, and ultimate settlement of professional and general liability claims may vary significantly from the estimated amounts.

The System's professional and general liability insurance reserves of \$198.4 million and \$198.2 million at December 31, 2017 and 2016, respectively, are recorded as current and noncurrent liabilities and include discounted estimates of the ultimate costs for both asserted claims and unasserted claims. Asserted claims for the System's reserves were discounted at 2.25% and 1.75% at December 31, 2017 and 2016, respectively. Unasserted claims were discounted at 2.50% and 2.25% at December 31, 2017 and 2016, respectively. Through the captive insurance subsidiary, the System has set aside investments of \$210.9 million (\$51.1 million included in investments for current use) and \$180.3 million (\$52.1 million included in investments for current use) at December 31, 2017 and 2016, respectively, of which \$37.6 million and \$37.0 million at December 31, 2017 and 2016, respectively, are restricted in accordance with reinsurance trust agreements related to coverage of the Florida operations and other reinsurance programs provided by the captive insurance subsidiary.

Cleveland Clinic Health System

Notes to Consolidated Financial Statements (continued)

**13. Professional and General Liability Insurance (continued)**

Activity in the professional and general liability insurance reserves is summarized as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Balance at beginning of year	\$ 198,234	\$ 191,840
Incurred related to:		
Current period	65,901	65,512
Prior period	(14,288)	(13,985)
Total incurred	<u>51,613</u>	<u>51,527</u>
Paid related to:		
Current period	5,219	6,862
Prior period	44,828	37,710
Total paid	<u>50,047</u>	<u>44,572</u>
	1,566	6,955
(Decrease) increase in unasserted claims	(1,414)	1,671
Decrease in reinsurance recoverable	(8)	(2,232)
Balance at end of year	<u>\$ 198,378</u>	<u>\$ 198,234</u>

The foregoing reconciliation shows \$14.3 million and \$14.0 million of favorable development in 2017 and 2016, respectively, due to changes in actuarial estimates as a result of lower claim activity, closed claims, and expedited settlement of claims, which has reduced claim expenses and resulted in more favorable settlements. The System utilizes a combination of actual and industry statistics to estimate loss and loss adjustment expense reserves.

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### **14. Pensions and Other Postretirement Benefits**

The System maintains four defined benefit pension plans, including two plans related to Akron General. The CCHS Retirement Plan is a tax-qualified defined benefit pension plan that provides benefits to substantially all employees of the System, except those employed by Akron General. All benefit accruals under the CCHS Retirement Plan ceased as of December 31, 2012. Akron General has a tax-qualified defined benefit plan covering substantially all of its employees that were hired before 2004 who meet certain eligibility requirements. In 2009, Akron General ceased benefit accruals for substantially all nonunion employees, with benefit accruals for remaining employees ceasing at various intervals through December 31, 2017. The benefits for the System's tax-qualified defined benefit pension plans are provided based on age, years of service, and compensation. The System's policy for its tax-qualified defined benefit pension plans is to fund at least the minimum amounts required by the Employee Retirement Income Security Act. The System also maintains two unfunded, nonqualified defined benefit supplemental retirement plans, which cover certain professional staff and administrative employees.

The System sponsors two noncontributory, defined contribution plans, and three contributory, defined contribution plans. The Cleveland Clinic Investment Pension Plan (IPP) is a noncontributory, defined contribution plan, which covers substantially all of the System's employees, except employees covered by the Cleveland Clinic Cash Balance Plan and those employed by Akron General. The System's contribution to the IPP for participants is based upon a percentage of employee compensation that is based on years of service. The Cleveland Clinic Cash Balance Plan (CBP) is a noncontributory, defined contribution plan that covers certain professional and administrative employees not covered by the IPP. The System's contribution to the CBP is a percentage of employee compensation that is determined according to age. The System also sponsors three tax-qualified contributory, defined contribution plans, including two plans related to Akron General, which cover substantially all employees. The plans permit employees to make pre-tax employee deferrals and to become entitled to certain employer matching contributions that are based on employee contributions.

The System provides healthcare benefits upon retirement for substantially all of its employees who meet certain minimum age and years of service provisions at retirement. The System's healthcare plans generally provide for cost sharing, in the form of retiree contributions, deductibles, and coinsurance. The System's policy is to fund the annual cost of healthcare benefits from the general assets of the System. The estimated cost of these postretirement benefits is actuarially determined and accrued over the employees' service periods.

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### **14. Pensions and Other Postretirement Benefits (continued)**

The mortality tables used to calculate the defined benefit obligation for the System's defined benefit and postretirement health benefit plans are based on the RP-2014 "Employees" table unadjusted, with generational projection for non-annuitants and the RP-2014 "Healthy Annuitants" table unadjusted, with generational projection for annuitants. In 2016, the System updated the generational mortality projections scale from Scale MP-2015 to Scale MP-2016. In 2017, the System updated the generational mortality projections scale from Scale MP-2016 to Scale MP-2017. The System believes that the updated mortality rates are the best estimate of future experience.

The System expects to make contributions of \$8.9 million to the defined benefit pension plans in 2018. Pension benefit payments over the next ten years are estimated as follows: 2018 – \$112.6 million; 2019 – \$116.1 million; 2020 – \$116.6 million; 2021 – \$120.5 million; 2022 – \$117.4 million; and in the aggregate for the five years thereafter – \$560.1 million.

The System expects to make contributions of \$4.1 million to other postretirement benefit plans in 2018. Other postretirement benefit payments over the next ten years, net of the average annual Medicare Part D subsidy of approximately \$2.3 million, are estimated as follows: 2018 – \$4.1 million; 2019 – \$4.0 million; 2020 – \$3.9 million; 2021 – \$3.7 million; 2022 – \$3.4 million; and in the aggregate for the five years thereafter – \$11.9 million.

No plan assets are expected to be returned to the employer during 2018.

The System is required to recognize the funded status, which is the difference between the fair value of plan assets and the projected benefit obligations, of its pension and other postretirement benefit plans in the consolidated balance sheets, with a corresponding adjustment to unrestricted net assets. Amounts recorded in unrestricted net assets consist of actuarial gains and losses and prior service credits and costs. Actuarial gains and losses recorded in unrestricted net assets outside of the corridor, which is 10% of the greater of the projected benefit obligation or the fair value of the plan assets, will be recognized as a component of net periodic benefit cost immediately in the current period. Prior service credits and costs will be amortized over future periods, pursuant to the System's accounting policy.

Unrecognized prior service credits and costs are amortized on a straight-line basis over the estimated life of the plan participants. In 2018, the System is expected to amortize \$2.9 million of unrecognized prior service credits in net periodic benefit costs.

Cleveland Clinic Health System

Notes to Consolidated Financial Statements (continued)

**14. Pensions and Other Postretirement Benefits (continued)**

Included in unrestricted net assets at December 31, 2017 and 2016 are the following amounts that have not yet been recognized in net periodic benefit cost (in thousands):

	Defined Benefit Pension Plans		Other Postretirement Benefits	
	2017	2016	2017	2016
Unrecognized actuarial losses (gains)	\$ 173,279	\$ 168,337	\$ (9,553)	\$ (9,890)
Unrecognized prior service credit	(15,621)	(12,763)	(7,994)	(8,946)
Total	<u>\$ 157,658</u>	<u>\$ 155,574</u>	<u>\$ (17,547)</u>	<u>\$ (18,836)</u>

Unrecognized actuarial losses (gains) included in unrestricted net assets represent amounts within the corridor that do not require recognition in net periodic benefit cost for each respective year.

Changes in plan assets and benefit obligations recognized in unrestricted net assets for the years ended December 31, 2017 and 2016 are as follows (in thousands):

	Defined Benefit Pension Plans		Other Postretirement Benefits	
	2017	2016	2017	2016
Current year actuarial (loss) gain	\$ (45,990)	\$ (130,527)	\$ 5,674	\$ 6,482
Recognition of actuarial loss (gain) in excess of corridor	41,048	108,526	(6,011)	(4,407)
Current year prior service credit	4,538	—	—	4,355
Amortization of prior service credit	(1,680)	(1,681)	(952)	(537)
Total	<u>\$ (2,084)</u>	<u>\$ (23,682)</u>	<u>\$ (1,289)</u>	<u>\$ 5,893</u>

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 14. Pensions and Other Postretirement Benefits (continued)

The following table sets forth the funded status of the System's pensions and other postretirement benefit plans and the amounts recognized in the System's December 31, 2017 and 2016 consolidated balance sheets (in thousands):

	Defined Benefit Pension Plans		Other Postretirement Benefits	
	2017	2016	2017	2016
Change in projected benefit obligation:				
Projected benefit obligation at beginning of year	\$ 1,736,681	\$ 1,649,131	\$ 98,900	\$ 111,309
Service cost	196	2,178	1,313	1,681
Interest cost	71,493	76,074	4,273	5,368
Actuarial loss (gain)	89,403	98,362	(5,674)	(6,482)
Participant contributions	-	-	13,437	12,186
Plan amendments	(4,538)	-	-	(4,357)
Curtailement	(62)	-	-	-
Settlement payments	(68,248)	-	-	-
Benefits paid	(39,482)	(89,064)	(17,606)	(21,928)
Federal subsidy	-	-	890	1,123
Projected benefit obligation at end of year	<b>1,785,443</b>	1,736,681	<b>95,533</b>	98,900
Change in plan assets:				
Fair value of plan assets at beginning of year	1,342,970	1,255,431	-	-
Actual return on plan assets	128,022	47,291	-	-
Participant contributions	-	-	13,437	12,186
System contributions	11,897	129,312	4,169	9,742
Benefits paid	(107,730)	(89,064)	(17,606)	(21,928)
Fair value of plan assets at end of year	<b>1,375,159</b>	1,342,970	-	-
Accrued retirement benefits	<b>\$ (410,284)</b>	<b>\$ (393,711)</b>	<b>\$ (95,533)</b>	<b>\$ (98,900)</b>
Current liabilities	<b>\$ (8,882)</b>	<b>\$ (9,263)</b>	<b>\$ (4,102)</b>	<b>\$ (4,474)</b>
Noncurrent liabilities	<b>(401,402)</b>	<b>(384,448)</b>	<b>(91,431)</b>	<b>(94,426)</b>
Net liability recognized in consolidated balance sheets	<b>\$ (410,284)</b>	<b>\$ (393,711)</b>	<b>\$ (95,533)</b>	<b>\$ (98,900)</b>

The accumulated benefit obligation for all defined benefit pension plans was \$1.8 billion and \$1.7 billion at December 31, 2017 and 2016, respectively.

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 14. Pensions and Other Postretirement Benefits (continued)

The CCHS Retirement Plan paid \$68.2 million in lump-sum payments in accordance with plan terms in 2017, which exceeded the sum of the service cost and interest cost components of net periodic benefit cost for the year. As a result, the System recorded a settlement charge of \$7.6 million for the year ended December 31, 2017. There were no settlement charges for the year ended December 31, 2016.

In 2017, the System amended the Akron General primary defined benefit pension plan to offer a lump sum option to all non-bargained active and terminated vested participants, effective January 1, 2018. As a result of this amendment, the projected benefit obligation decreased \$4.5 million in 2017.

The components of net periodic benefit cost (credit) are as follows (in thousands):

	<b>Defined Benefit Pension Plans</b>		<b>Other Postretirement Benefits</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Components of net periodic benefit cost:				
Service cost	\$ 196	\$ 2,178	\$ 1,313	\$ 1,681
Interest cost	71,493	76,074	4,273	5,368
Expected return on plan assets	(84,670)	(79,456)	-	-
Recognition of actuarial loss (gain) in excess of corridor	33,471	108,526	(6,011)	(4,407)
Settlement charge	7,577	-	-	-
Amortization of unrecognized prior service credit	(1,680)	(1,681)	(952)	(537)
Net periodic benefit cost (credit)	<b>26,387</b>	105,641	<b>(1,377)</b>	2,105
Defined contribution plans	<b>224,769</b>	217,941	-	-
Total	<b>\$ 251,156</b>	\$ 323,582	<b>\$ (1,377)</b>	\$ 2,105

The service cost component of net periodic benefit cost (credit) is included in salaries, wages, and benefits in the consolidated statements of operations and changes in net assets. The components of net periodic benefit cost (credit) other than the service cost component are included in other nonoperating gains and losses in the consolidated statements of operations and changes in net assets.

Cleveland Clinic Health System

Notes to Consolidated Financial Statements (continued)

**14. Pensions and Other Postretirement Benefits (continued)**

Weighted-average assumptions used to determine pension and postretirement benefit obligations and net periodic benefit cost are as follows:

	Defined Benefit Pension Plans		Other Postretirement Benefits	
	2017	2016	2017	2016
Weighted-average assumptions:				
Discount rates:				
Used for benefit obligations	<b>3.74%</b>	4.24%	<b>3.83%</b>	4.36%
Used for net periodic benefit cost	<b>4.24%</b>	4.74%	<b>4.36%</b>	4.86%
Expected rate of return on plan assets	<b>6.53%</b>	6.56%	–	–
Rate of compensation increase:				
Used for benefit obligations	<b>2.25%</b>	2.25%	–	–
Used for net periodic benefit cost	<b>2.25%</b>	2.25%	–	–

The System uses a direct cost approach to estimate its postretirement benefit obligation for healthcare services provided by the System (internally provided services). Healthcare services provided by non-System entities (externally provided services) are based on the System's historical cost experience.

The annual assumed healthcare cost trend rates for the next year and the assumed trend thereafter is as follows:

	2017	2016
Internally provided services:		
Initial rate	<b>6.00%</b>	5.50%
Ultimate rate	<b>4.50%</b>	4.50%
Year ultimate reached	<b>2024</b>	2021
Externally provided services:		
Initial rate	<b>7.00%</b>	6.50%
Ultimate rate	<b>5.50%</b>	5.50%
Year ultimate reached	<b>2024</b>	2021

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 14. Pensions and Other Postretirement Benefits (continued)

A one-percentage-point increase or decrease in the healthcare cost trend rate would have increased or decreased service and interest costs in 2017 by \$2.4 million and \$1.4 million, respectively, and service and interest costs in 2016 by \$2.5 million and \$1.7 million, respectively.

The System's weighted-average asset allocation of pension plan assets at December 31, 2017 and 2016, by asset category, are as follows:

<b>Asset category</b>	<b>Percentage of Plan Assets</b>		
	<b>2017</b>	<b>2016</b>	<b>Target Allocation</b>
Interest-bearing cash	<b>6.4%</b>	7.0%	0%–10%
Fixed income securities	<b>45.8</b>	47.0	40%–80%
Common and preferred stocks	<b>31.1</b>	31.1	17%–37%
Alternative investments	<b>16.7</b>	14.9	3%–23%
Total	<b>100.0%</b>	100.0%	

The System's investment strategy for its pension assets balances the liquidity needs of the pension plans with the long-term return goals necessary to satisfy future pension obligations. The target allocation ranges of the investment pool to various asset classes are designed to diversify the portfolio in a way that achieves an efficient trade-off between long-term return and risk while providing adequate liquidity to meet near-term expenses and obligations.

The System's weighted-average pension portfolio return assumption of 6.53% and 6.56% in 2017 and 2016, respectively, is based on the targeted assumed rate of return through its asset mix at the beginning of each year, which is designed to mitigate short-term return volatility and achieve an efficient trade-off between return and risk. Expected returns and risk for each asset class are formed using a global capital asset pricing model framework in which the expected return is the compensation earned from taking risk. Forward-looking adjustments are made to expected return, volatility, and correlation estimates as well. Additionally, constraints such as permissible asset classes, portfolio guidelines, and liquidity considerations are included in the model.

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 14. Pensions and Other Postretirement Benefits (continued)

In 2015, the System updated its investment strategy and modified the target allocations of pension plan assets in the CCHS Retirement Plan based on the current funded status of the plan. Coincident with this update, the System reduced the asset allocation for common and preferred stocks with a corresponding increase in fixed income securities. The updated investment strategy was implemented because of the funded status of the pension plan and the anticipation that such changes in investment strategy will result in lower volatility of future changes in funded status. Once the new investment strategy is fully implemented, it is anticipated that the duration of the investment assets will match the liabilities of the pension plan over time. Additional revisions in asset allocations and expected rate of return on plan assets may occur based on future changes in the funded status of the pension plans.

The following tables present the financial instruments in the System's defined benefit pension plans measured at fair value on a recurring basis as of December 31, 2017 and 2016, based on the valuation hierarchy (in thousands):

<b>December 31, 2017</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets</b>				
Cash and investments:				
Cash and cash equivalents	\$ 87,571	\$ 5	\$ –	\$ 87,576
Fixed income securities:				
U.S. treasuries	360,138	–	–	360,138
U.S. government agencies	–	5,045	–	5,045
U.S. corporate	–	62,672	–	62,672
Foreign	–	7,513	–	7,513
Fixed income mutual funds	73,016	–	–	73,016
Common and preferred stocks:				
U.S.	69,804	–	–	69,804
Foreign	20,342	654	–	20,996
Equity mutual funds	92,189	–	–	92,189
<b>Total assets at fair value</b>	<b>\$ 703,060</b>	<b>\$ 75,889</b>	<b>\$ –</b>	<b>\$ 778,949</b>

Cleveland Clinic Health System

Notes to Consolidated Financial Statements (continued)

**14. Pensions and Other Postretirement Benefits (continued)**

<b>December 31, 2016</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets</b>				
Cash and investments:				
Cash and cash equivalents	\$ 94,013	\$ 2	\$ –	\$ 94,015
Fixed income securities:				
U.S. treasuries	303,857	–	–	303,857
U.S. government agencies	–	4,431	–	4,431
U.S. corporate	–	83,201	–	83,201
Foreign	–	12,280	–	12,280
Fixed income mutual funds	77,615	–	–	77,615
Common and preferred stocks:				
U.S.	70,524	421	–	70,945
Foreign	27,406	719	–	28,125
Equity mutual funds	78,630	–	–	78,630
Total assets at fair value	<u>\$ 652,045</u>	<u>\$ 101,054</u>	<u>\$ –</u>	<u>\$ 753,099</u>

Total plan assets in the System's defined benefit pension plans at December 31, 2017 and 2016 are comprised of the following (in thousands):

	<b>2017</b>	<b>2016</b>
Plan assets measured at fair value	<b>\$ 778,949</b>	\$ 753,099
Commingled fixed-income funds measured at net asset value	<b>121,580</b>	149,065
Commingled equity funds measured at net asset value	<b>245,509</b>	240,453
Alternative investments measured at net asset value	<b>196,121</b>	200,353
Pending purchases of alternative investments	<b>33,000</b>	–
Total fair value of plan assets at end of year	<u><b>\$ 1,375,159</b></u>	<u>\$ 1,342,970</u>

Fair value methodologies for Level 1 and Level 2 are consistent with the inputs described in Note 7.

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### **14. Pensions and Other Postretirement Benefits (continued)**

Fixed income securities include debt obligations of the U.S. government and various agencies, U.S. corporations, and other fixed income instruments such as mortgage-backed and asset-backed securities. The composition of these securities represents an expected return and risk profile that is commensurate with broadly defined fixed income indexes such as the Barclays Capital U.S. Aggregate Index. Additionally, investments include mutual funds and commingled fixed-income funds that may also invest in opportunistic as well as non-U.S. and high-yield debt instruments. Commingled fixed-income funds are valued using net asset value as a practical expedient.

Common and preferred stocks include investments of publicly traded common stocks of both U.S. and international corporations, the majority of which represent actively traded and liquid securities that are traded on many of the world's major exchanges and include large-, mid-, and small-capitalization securities. The composition of these securities represents an expected return and risk profile that is commensurate with broadly defined equity indexes such as the Russell 3000 Index and the Morgan Stanley Capital International (MSCI) All Country World ex-U.S. Index. Investments also include equity mutual funds and commingled equity funds whose underlying assets may include publicly traded equity securities. Commingled equity funds are valued using net asset value as a practical expedient.

Alternative investments include hedge funds and private equity funds that are valued using net asset value as a practical expedient. Hedge funds are meant to provide returns between those expected from stocks and fixed income investments with commensurate levels of risk and lower correlation relative to traditional investments. Included in this category are investments that are well diversified across various strategies and may consist of absolute return funds, long/short funds, and other opportunistic/multi-strategy funds. The underlying investments in such funds may include publicly traded and privately held equity and debt instruments issued by U.S. and international corporations as well as various derivatives based on these securities. Hedge fund redemptions typically contain restrictions that allow for a portion of the withdrawal proceeds to be held back from distribution while the underlying investments are liquidated. Private equity investments make up a smaller portion of the alternative investments and generally consist of limited partnerships formed to invest in equity and debt investments in operating companies that are not publicly traded. Investment strategies in this category may include buyouts, distressed debt, and venture capital. Private equity funds are closed-end funds and have significant redemption restrictions that prohibit redemptions during the fund's life.

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### 15. Income Taxes

The Foundation and most of its controlled affiliates are tax-exempt organizations as described in Section 501(c)(3) of the Internal Revenue Code. These organizations are subject to income tax on any income from unrelated business activities. The System also owns or controls certain taxable affiliates.

The System files income tax returns in the U.S. federal jurisdiction and in various state and foreign jurisdictions. With few exceptions, the System is no longer subject to U.S. federal, state, and local or non-U.S. income tax examinations by tax authorities for years before 2013.

At December 31, 2017 and 2016, the liability for uncertainty in income taxes was \$0.6 million and \$2.3 million, respectively. The System does not expect a significant increase or decrease in unrecognized tax benefits within the next 12 months. The System recognizes interest and penalties accrued related to the liability for unrecognized tax benefits in the consolidated statements of operations and changes in net assets.

The System has gross net operating losses available for federal income tax purposes of \$121.7 million and \$121.5 million at December 31, 2017 and 2016, respectively. These losses expire in varying amounts from 2018 through 2037. A deferred tax asset of \$25.6 million and \$41.3 million relating to the net operating losses has been recorded at December 31, 2017 and 2016, respectively. A valuation allowance of \$25.5 million and \$41.3 million has been recorded at December 31, 2017 and 2016, respectively, related to the net operating loss carryforwards due to the uncertainty regarding their use.

The Tax Cuts and Jobs Act (Act) was enacted on December 22, 2017. The Act reduces the U.S. federal corporate tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that was previously tax deferred and creates new taxes on certain foreign sourced earnings. For tax-exempt entities, the Act also requires organizations to categorize certain fringe benefit expenses as a source of unrelated business income, pay an excise tax on remuneration above certain thresholds that is paid to executives by the organization, and report income or loss from unrelated business activities on an activity-by-activity basis, among other provisions. At December 31, 2017, the System has made a reasonable estimate of the tax effects of the enactment of the Act. As a result, a tax benefit of \$6.2 million was recorded for the remeasurement of the deferred tax balances at the new tax rate. Certain regulatory guidance provides for a measurement period of up to one year during which the accounting for the tax effects of the Act may be completed. The System may record further adjustments in future periods upon obtaining, preparing, or analyzing additional information about facts and circumstances that existed as of the date of enactment that would have affected the income tax effects initially reported. The System will continue to revise and refine the calculations as additional IRS guidance is issued.

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### 16. Commitments and Contingent Liabilities

The System leases various equipment and facilities under operating lease arrangements. Total rental expense in 2017 and 2016 was \$66.2 million and \$73.6 million, respectively. Minimum operating lease payments over the next five years are as follows (in thousands): 2018 – \$49,542; 2019 – \$36,418; 2020 – \$31,199; 2021 – \$27,880; and 2022 – \$24,344.

Included in the System's operating lease payments are the following off-balance-sheet financing agreements:

In 2003, the System entered into an operating lease agreement for the purpose of leasing a genetics and stem cell research building (Stem Cell Building Lease). Under the terms of the Stem Cell Building Lease, the System began to lease the facility upon the issuance of the certificate of occupancy in December 2004 and is required to lease the facility for 29 years. At December 31, 2017, total remaining minimum operating lease payments were \$27.2 million.

In 2006, the System entered into an operating lease agreement for the purpose of leasing a parking garage and service center building (Service Center Lease). Under the terms of the Service Center Lease, the System began to lease the facility upon issuance of a certificate of occupancy in October 2008 and is required to lease the facility for 21 years with an option (by the System) to extend the lease an additional five years. At December 31, 2017, total remaining minimum operating lease payments were \$71.3 million.

In 2007, the System entered into two operating lease agreements to lease an office complex comprised of five buildings primarily used for administrative services, totaling approximately 707,000 square feet. The System is required to lease the facilities for 22 years with an option (by the System) to extend the leases an additional five years. At December 31, 2017, total remaining minimum operating lease payments were \$37.4 million.

At December 31, 2017, the System has commitments for construction and other related capital contracts of \$485.5 million and letters of credit of \$0.7 million. Guarantees of mortgage loans made by banks to certain staff members are \$18.5 million at December 31, 2017. In addition, the System has remaining commitments to invest approximately \$635.4 million in alternative investments at December 31, 2017. The largest commitment at December 31, 2017, to any one alternative strategy manager is \$81.0 million. These investments are expected to occur over the next three to five years. No amounts have been recorded in the consolidated balance sheets for these commitments and guarantees.

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### **16. Commitments and Contingent Liabilities (continued)**

Pledge liabilities to various foundations and other entities at December 31, 2017 are as follows (in thousands): 2018 – \$15,642; 2019 – \$500; 2020 – \$4,800; 2021 – \$500; 2022 – \$4,600; and thereafter – \$13,700. The unamortized discount on pledge liabilities at December 31, 2017 was \$4.0 million. Pledge liabilities are recorded in other current liabilities and other noncurrent liabilities in the consolidated balance sheets.

#### **17. Endowment**

The System's endowment consists of approximately 323 individual donor-restricted funds established for a variety of purposes. Net assets associated with endowment funds are classified and reported based on donor-imposed restrictions.

#### **Interpretation of Relevant Law**

In 2009, the Uniform Prudent Management of Institutional Funds Act (UPMIFA) was enacted to update and replace Ohio's previous law, the Uniform Management of Institutional Funds Act. The System has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. As a result of this interpretation, the System classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the System in a manner consistent with the standard for expenditure prescribed by UPMIFA. In accordance with UPMIFA, the System considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

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

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### **17. Endowment (continued)**

#### **Funds With Deficiencies**

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires the System to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets were \$0.1 million and \$0.6 million as of December 31, 2017 and 2016, respectively.

#### **Return Objectives and Risk Parameters**

The System has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity. Under this policy, the endowment assets are invested in a highly diversified portfolio of U.S. and non-U.S. publicly traded equities, alternative investments, and fixed income securities structured to achieve an optimal balance between return and risk. The System expects its endowment funds, over time, to provide an average rate of return of approximately 7.5% annually. Actual returns in any given year may vary from this amount.

#### **Strategies Employed for Achieving Objectives**

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

#### **Spending Policy and How the Investment Objectives Relate to Spending Policy**

The System has a policy of appropriating for distribution each year up to 5% of its endowment fund's average fair value over the prior three years through the calendar year-end preceding the fiscal year in which the distribution is planned. In establishing this policy, the System considered the long-term expected return on its endowment. Accordingly, over the long term, the System expects the current spending policy to allow its endowment to grow at an average of 2.5% annually. This is consistent with the System's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

## Cleveland Clinic Health System

### Notes to Consolidated Financial Statements (continued)

#### 17. Endowment (continued)

##### Changes in Endowment Net Assets

The following table summarizes the changes in endowment net assets for the years ended December 31, 2017 and 2016 (in thousands):

	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Endowment net assets, January 1, 2016	\$ 38,787	\$ 260,310	\$ 299,097
Investment income	1,245	–	1,245
Net appreciation	14,521	–	14,521
Contributions	–	16,979	16,979
Appropriation of endowment assets for expenditure	(7,290)	–	(7,290)
Endowment net assets, December 31, 2016	47,263	277,289	324,552
Investment income	<b>2,251</b>	–	<b>2,251</b>
Net appreciation	<b>38,172</b>	–	<b>38,172</b>
Contributions	–	<b>22,160</b>	<b>22,160</b>
Appropriation of endowment assets for expenditure	<b>(5,325)</b>	–	<b>(5,325)</b>
Endowment net assets, December 31, 2017	<b>\$ 82,361</b>	<b>\$ 299,449</b>	<b>\$ 381,810</b>

#### 18. Functional Expenses

The System provides healthcare services and education and performs research. Expenses related to these functions were as follows (in thousands):

	<b>2017</b>	<b>2016</b>
Healthcare services	<b>\$ 6,464,006</b>	\$ 6,240,880
Research	<b>228,789</b>	220,137
Medical education	<b>334,563</b>	333,354
General and administrative	<b>959,399</b>	894,707
Non-healthcare services	<b>89,687</b>	104,890
	<b>\$ 8,076,444</b>	<b>\$ 7,793,968</b>

# Cleveland Clinic Health System

## Notes to Consolidated Financial Statements (continued)

### **19. Special Charges**

The System incurred and recorded special charges of \$5.5 million and \$25.6 million in 2017 and 2016, respectively. Special charges includes \$5.5 million and \$17.8 million in 2017 and 2016, respectively, of accelerated depreciation expense and other costs related to LHA. The Foundation, LHA and the City of Lakewood entered into an agreement in December 2015 that outlines the transition of healthcare services in the City of Lakewood. Participation in the agreement by the City of Lakewood was authorized by an ordinance adopted by Lakewood City Council. Under the terms of the agreement, the Foundation and LHA will make contributions over the next 16 years for the creation of a new health and wellness community foundation to be used to address community health and wellness needs in the City of Lakewood. In addition, the Foundation will construct, own and operate an approximately 62,000-square-foot family health center expected to open in 2018 that will be located adjacent to the current site of the hospital. LHA ceased inpatient operations at the hospital in February 2016, while the current emergency department and several outpatient services at the hospital will continue until the opening of the new family health center and emergency department. The cessation of inpatient services at the hospital is not considered a discontinued operation since the System provides inpatient hospital services at the Foundation and its subsidiary hospitals in the Northeast Ohio area. Special charges in 2016 also include \$7.8 million of statutory compensation costs related to the termination of tenant leases at the System's London building that is being converted from office space to a healthcare facility.

### **20. Subsequent Events**

The System evaluated events and transactions occurring subsequent to December 31, 2017 through March 27, 2018, the date the consolidated financial statements were issued. During this period, there were no subsequent events requiring recognition in the consolidated financial statements, and there were no nonrecognized subsequent events requiring disclosure.

# Supplementary Information



Ernst & Young LLP  
Suite 1800  
950 Main Avenue  
Cleveland, OH 44113-7214

Tel: +1 216 861 5000  
Fax: +1 216 583 2013  
ey.com

## Report of Independent Auditors on Supplementary Information

The Board of Directors  
The Cleveland Clinic Foundation

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The following consolidating balance sheets, statements of operations and changes in net assets, and statements of cash flows are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

*Ernst & Young LLP*

March 27, 2018

# Cleveland Clinic Health System

## Consolidating Balance Sheet

December 31, 2017

(In Thousands)

	<b>Obligated Group</b>	<b>Non-Obligated Group</b>	<b>Consolidating Adjustments and Eliminations</b>	<b>Consolidated</b>
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$ 27,644	\$ 213,583	\$ –	\$ 241,227
Patient receivables, net	904,105	142,450	(33,652)	1,012,903
Due from affiliates	55,942	50	(55,992)	–
Investments for current use	103,920	51,051	–	154,971
Other current assets	310,960	64,134	(368)	374,726
Total current assets	<u>1,402,571</u>	<u>471,268</u>	<u>(90,012)</u>	<u>1,783,827</u>
Investments:				
Long-term investments	7,289,000	440,697	–	7,729,697
Funds held by trustees	69,234	–	–	69,234
Assets held for self-insurance	–	159,802	–	159,802
Donor-restricted assets	685,292	32,118	–	717,410
	<u>8,043,526</u>	<u>632,617</u>	<u>–</u>	<u>8,676,143</u>
Property, plant, and equipment, net	3,819,800	879,897	–	4,699,697
Other assets:				
Pledges receivable, net	150,690	329	–	151,019
Trusts and interests in foundations	71,866	8,777	–	80,643
Other noncurrent assets	566,548	60,388	(151,926)	475,010
	<u>789,104</u>	<u>69,494</u>	<u>(151,926)</u>	<u>706,672</u>
Total assets	<u><u>\$ 14,055,001</u></u>	<u><u>\$ 2,053,276</u></u>	<u><u>\$ (241,938)</u></u>	<u><u>\$ 15,866,339</u></u>

	<b>Obligated Group</b>	<b>Non-Obligated Group</b>	<b>Consolidating Adjustments and Eliminations</b>	<b>Consolidated</b>
<b>Liabilities and net assets</b>				
Current liabilities:				
Accounts payable	\$ 432,859	\$ 71,024	\$ (192)	\$ 503,691
Compensation and amounts withheld from payroll	311,159	34,287	–	345,446
Current portion of long-term debt	77,208	380,677	(72)	457,813
Variable rate debt classified as current	514,396	58,874	–	573,270
Due to affiliates	50	55,942	(55,992)	–
Other current liabilities	358,475	116,352	(36,165)	438,662
<b>Total current liabilities</b>	<b>1,694,147</b>	<b>717,156</b>	<b>(92,421)</b>	<b>2,318,882</b>
Long-term debt:				
Hospital revenue bonds	2,861,438	–	–	2,861,438
Notes payable and capital leases	110,675	171,562	(147,397)	134,840
	2,972,113	171,562	(147,397)	2,996,278
Other liabilities:				
Professional and general liability insurance reserves	55,875	91,452	–	147,327
Accrued retirement benefits	453,710	39,123	–	492,833
Other noncurrent liabilities	526,814	40,752	–	567,566
	1,036,399	171,327	–	1,207,726
<b>Total liabilities</b>	<b>5,702,659</b>	<b>1,060,045</b>	<b>(239,818)</b>	<b>6,522,886</b>
Net assets:				
Unrestricted	7,397,798	950,971	(2,120)	8,346,649
Temporarily restricted	638,208	23,981	–	662,189
Permanently restricted	316,336	18,279	–	334,615
<b>Total net assets</b>	<b>8,352,342</b>	<b>993,231</b>	<b>(2,120)</b>	<b>9,343,453</b>
<b>Total liabilities and net assets</b>	<b>\$ 14,055,001</b>	<b>\$ 2,053,276</b>	<b>\$ (241,938)</b>	<b>\$ 15,866,339</b>

*See accompanying note.*

# Cleveland Clinic Health System

## Consolidating Balance Sheet

December 31, 2016

(In Thousands)

	<b>Obligated Group</b>	<b>Non-Obligated Group</b>	<b>Consolidating Adjustments and Eliminations</b>	<b>Consolidated</b>
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$ 303,102	\$ 217,526	\$ –	\$ 520,628
Patient receivables, net	980,244	105,228	(26,301)	1,059,171
Due from affiliates	4,091	28	(4,119)	–
Investments for current use	–	52,126	–	52,126
Other current assets	315,649	83,554	(2,311)	396,892
Total current assets	1,603,086	458,462	(32,731)	2,028,817
Investments:				
Long-term investments	6,090,613	385,646	–	6,476,259
Funds held by trustees	75,892	–	–	75,892
Assets held for self-insurance	–	128,128	–	128,128
Donor-restricted assets	572,982	39,239	–	612,221
	6,739,487	553,013	–	7,292,500
Property, plant, and equipment, net	3,678,818	833,260	–	4,512,078
Other assets:				
Pledges receivable, net	149,889	820	–	150,709
Trusts and interests in foundations	59,069	8,150	–	67,219
Other noncurrent assets	514,693	51,138	(155,824)	410,007
	723,651	60,108	(155,824)	627,935
Total assets	<u>\$ 12,745,042</u>	<u>\$ 1,904,843</u>	<u>\$ (188,555)</u>	<u>\$ 14,461,330</u>

	<b>Obligated Group</b>	<b>Non-Obligated Group</b>	<b>Consolidating Adjustments and Eliminations</b>	<b>Consolidated</b>
<b>Liabilities and net assets</b>				
Current liabilities:				
Accounts payable	\$ 409,700	\$ 75,037	\$ (2,310)	\$ 482,427
Compensation and amounts withheld from payroll	291,384	31,109	–	322,493
Current portion of long-term debt	75,918	5,893	(72)	81,739
Variable rate debt classified as current	466,203	60,912	–	527,115
Due to affiliates	28	4,091	(4,119)	–
Other current liabilities	388,227	100,636	(26,302)	462,561
<b>Total current liabilities</b>	<b>1,631,460</b>	<b>277,678</b>	<b>(32,803)</b>	<b>1,876,335</b>
Long-term debt:				
Hospital revenue bonds	2,926,949	–	–	2,926,949
Notes payable and capital leases	121,896	547,127	(152,304)	516,719
	3,048,845	547,127	(152,304)	3,443,668
Other liabilities:				
Professional and general liability insurance reserves	57,290	88,819	–	146,109
Accrued retirement benefits	429,965	48,909	–	478,874
Other noncurrent liabilities	434,093	56,452	–	490,545
	921,348	194,180	–	1,115,528
<b>Total liabilities</b>	<b>5,601,653</b>	<b>1,018,985</b>	<b>(185,107)</b>	<b>6,435,531</b>
Net assets:				
Unrestricted	6,253,358	838,299	(3,448)	7,088,209
Temporarily restricted	597,449	29,977	–	627,426
Permanently restricted	292,582	17,582	–	310,164
<b>Total net assets</b>	<b>7,143,389</b>	<b>885,858</b>	<b>(3,448)</b>	<b>8,025,799</b>
<b>Total liabilities and net assets</b>	<b>\$ 12,745,042</b>	<b>\$ 1,904,843</b>	<b>\$ (188,555)</b>	<b>\$ 14,461,330</b>

*See accompanying note.*

# Cleveland Clinic Health System

## Consolidating Statements of Operations and Changes in Net Assets

Year Ended December 31, 2017  
(In Thousands)

### Operations

	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
<b>Unrestricted revenues</b>				
Net patient service revenue	\$ 7,151,809	\$ 916,179	\$ (273,437)	\$ 7,794,551
Provision for uncollectible accounts	(240,971)	(55,498)	-	(296,469)
Net patient service revenue less provision for uncollectible accounts	6,910,838	860,681	(273,437)	7,498,082
Other	769,719	302,217	(163,016)	908,920
Total unrestricted revenues	7,680,557	1,162,898	(436,453)	8,407,002
<b>Expenses</b>				
Salaries, wages, and benefits	4,291,356	587,955	(314,171)	4,565,140
Supplies	693,166	101,572	(1,373)	793,365
Pharmaceuticals	872,841	84,204	-	957,045
Purchased services and other fees	435,791	126,802	(29,548)	533,045
Administrative services	151,282	70,462	(22,881)	198,863
Facilities	269,428	68,627	(3,684)	334,371
Insurance	66,917	58,839	(64,696)	61,060
	6,780,781	1,098,461	(436,353)	7,442,889
Operating income before interest, depreciation, and amortization expenses	899,776	64,437	(100)	964,113
Interest	128,956	11,868	-	140,824
Depreciation and amortization	424,771	62,569	(100)	487,240
Operating income (loss) before special charges	346,049	(10,000)	-	336,049
Special charges	-	5,491	-	5,491
Operating income (loss)	346,049	(15,491)	-	330,558
<b>Nonoperating gains and losses</b>				
Investment return	830,497	65,642	-	896,139
Derivative gains (losses)	44	(2,349)	-	(2,305)
Other, net	(70,802)	(3,276)	-	(74,078)
Net nonoperating gains	759,739	60,017	-	819,756
Excess of revenues over expenses	1,105,788	44,526	-	1,150,314

# Cleveland Clinic Health System

## Consolidating Statements of Operations and Changes in Net Assets

Year Ended December 31, 2016  
(In Thousands)

### Operations

	<b>Obligated Group</b>	<b>Non-Obligated Group</b>	<b>Consolidating Adjustments and Eliminations</b>	<b>Consolidated</b>
<b>Unrestricted revenues</b>				
Net patient service revenue	\$ 6,887,704	\$ 923,407	\$ (260,045)	\$ 7,551,066
Provision for uncollectible accounts	(263,904)	(37,790)	-	(301,694)
Net patient service revenue less provision for uncollectible accounts	6,623,800	885,617	(260,045)	7,249,372
Other	641,776	307,632	(161,573)	787,835
Total unrestricted revenues	7,265,576	1,193,249	(421,618)	8,037,207
<b>Expenses</b>				
Salaries, wages, and benefits	4,126,743	576,451	(272,212)	4,430,982
Supplies	646,496	103,608	(1,031)	749,073
Pharmaceuticals	791,831	70,866	-	862,697
Purchased services and other fees	408,744	140,171	(42,808)	506,107
Administrative services	155,122	68,448	(26,612)	196,958
Facilities	276,000	71,361	(3,984)	343,377
Insurance	67,628	74,089	(74,971)	66,746
	6,472,564	1,104,994	(421,618)	7,155,940
Operating income before interest, depreciation, and amortization expenses	793,012	88,255	-	881,267
Interest	126,401	9,704	-	136,105
Depreciation and amortization	405,832	70,473	-	476,305
Operating income before special charges	260,779	8,078	-	268,857
Special charges	968	24,650	-	25,618
Operating income (loss)	259,811	(16,572)	-	243,239
<b>Nonoperating gains and losses</b>				
Investment return	375,676	28,515	-	404,191
Derivative losses	(20,130)	(2,694)	-	(22,824)
Other, net	(103,704)	(7,395)	-	(111,099)
Net nonoperating gains	251,842	18,426	-	270,268
Excess of revenues over expenses	511,653	1,854	-	513,507

# Cleveland Clinic Health System

## Consolidating Statements of Operations and Changes in Net Assets (continued)

*(In Thousands)*

	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Total net assets at January 1, 2016	\$ 6,676,176	\$ 836,270	\$ (3,448)	\$ 7,508,998
Excess of revenues over expenses	511,653	1,854	-	513,507
Donated capital, excluding assets released from restrictions for capital purposes of \$22,683	724	41	-	765
Restricted gifts and bequests	97,207	3,988	-	101,195
Restricted net investment income	22,755	1,696	-	24,451
Net assets released from restrictions used for operations included in other unrestricted revenues	(40,895)	(4,397)	-	(45,292)
Retirement benefits adjustment	(6,835)	(10,954)	-	(17,789)
Transfers (to) from affiliates	(116,453)	116,453	-	-
Change in restricted net assets related to interest in foundations	432	-	-	432
Change in restricted net assets related to value of perpetual trusts	(1,318)	(773)	-	(2,091)
Foreign currency translation loss	(73)	(59,108)	-	(59,181)
Other	16	788	-	804
Increase in total net assets	<u>467,213</u>	<u>49,588</u>	<u>-</u>	<u>516,801</u>
Total net assets at December 31, 2016	7,143,389	885,858	(3,448)	8,025,799
Excess of revenues over expenses	<b>1,105,788</b>	<b>44,526</b>	-	<b>1,150,314</b>
Restricted gifts and bequests	<b>118,562</b>	<b>2,109</b>	-	<b>120,671</b>
Restricted net investment income	<b>51,721</b>	<b>3,391</b>	-	<b>55,112</b>
Net assets released from restrictions used for operations included in other unrestricted revenues	<b>(38,081)</b>	<b>(3,594)</b>	-	<b>(41,675)</b>
Retirement benefits adjustment	<b>(7,257)</b>	<b>3,884</b>	-	<b>(3,373)</b>
Transfers (to) from affiliates	<b>(27,471)</b>	<b>27,471</b>	-	-
Change in restricted net assets related to interest in foundations	<b>5,047</b>	-	-	<b>5,047</b>
Change in restricted net assets related to value of perpetual trusts	<b>1,717</b>	<b>618</b>	-	<b>2,335</b>
Foreign currency translation gain	-	<b>29,301</b>	-	<b>29,301</b>
Other	<b>(1,073)</b>	<b>(333)</b>	<b>1,328</b>	<b>(78)</b>
Increase in total net assets	<u><b>1,208,953</b></u>	<u><b>107,373</b></u>	<u><b>1,328</b></u>	<u><b>1,317,654</b></u>
Total net assets at December 31, 2017	<u><b>\$ 8,352,342</b></u>	<u><b>\$ 993,231</b></u>	<u><b>\$ (2,120)</b></u>	<u><b>\$ 9,343,453</b></u>

See accompanying note.

Cleveland Clinic Health System  
Consolidating Statement of Cash Flows

Year Ended December 31, 2017  
(In Thousands)

	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
<b>Operating activities and net nonoperating gains and losses</b>				
Increase in total net assets	\$ 1,208,953	\$ 107,373	\$ 1,328	\$ 1,317,654
Adjustments to reconcile increase in total net assets to net cash provided by operating activities and net nonoperating gains and losses:				
Loss on extinguishment of debt	46,159	-	-	46,159
Retirement benefits adjustment	7,257	(3,884)	-	3,373
Net realized and unrealized gains on investments	(832,374)	(65,467)	-	(897,841)
Depreciation and amortization	424,771	65,992	(100)	490,663
Provision for uncollectible accounts	240,971	55,498	-	296,469
Foreign currency translation gain	-	(29,301)	-	(29,301)
Donated capital	-	-	-	-
Restricted gifts, bequests, investment income, and other	(177,047)	(6,118)	-	(183,165)
Transfers to (from) affiliates	27,471	(27,471)	-	-
Amortization of bond premiums and debt issuance costs	(3,118)	12	-	(3,106)
Net gain in value of derivatives	(26,509)	-	-	(26,509)
Changes in operating assets and liabilities:				
Patient receivables	(164,832)	(92,720)	7,351	(250,201)
Other current assets	(59,278)	19,521	49,930	10,173
Other noncurrent assets	(53,297)	(9,392)	(3,798)	(66,487)
Accounts payable and other current liabilities	5,764	70,258	(59,618)	16,404
Other liabilities	111,364	(18,969)	-	92,395
Net cash provided by operating activities and net nonoperating gains and losses	756,255	65,332	(4,907)	816,680
<b>Financing activities</b>				
Proceeds from long-term borrowings	1,118,137	2,710	(2,710)	1,118,137
Payments for advance refunding and redemption of long-term debt	(1,110,120)	-	-	(1,110,120)
Principal payments on long-term debt	(86,096)	(5,778)	7,617	(84,257)
Debt issuance costs	(8,173)	-	-	(8,173)
Change in pledges receivables, trusts and interests in foundations	(1,482)	276	-	(1,206)
Restricted gifts, bequests, investment income, and other	177,047	6,118	-	183,165
Net cash provided by financing activities	89,313	3,326	4,907	97,546
<b>Investing activities</b>				
Expenditures for property, plant, and equipment	(519,040)	(88,680)	-	(607,720)
Proceeds from sale of property, plant, and equipment	1,070	416	-	1,486
Net change in cash equivalents reported in long-term investments	(394,195)	31,682	-	(362,513)
Purchases of investments	(2,226,802)	(214,566)	-	(2,441,368)
Sales of investments	2,045,412	169,822	-	2,215,234
Transfers (to) from affiliates	(27,471)	27,471	-	-
Net cash used in investing activities	(1,121,026)	(73,855)	-	(1,194,881)
Effect of exchange rate changes on cash	-	1,254	-	1,254
Decrease in cash and cash equivalents	(275,458)	(3,943)	-	(279,401)
Cash and cash equivalents at beginning of year	303,102	217,526	-	520,628
Cash and cash equivalents at end of year	\$ 27,644	\$ 213,583	\$ -	\$ 241,227

See accompanying note.

Cleveland Clinic Health System  
Consolidating Statement of Cash Flows

Year Ended December 31, 2016  
(In Thousands)

	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
<b>Operating activities and net nonoperating gains and losses</b>				
Increase in total net assets	\$ 467,213	\$ 49,588	\$ -	\$ 516,801
Adjustments to reconcile increase in total net assets to net cash provided by operating activities and net nonoperating gains and losses:				
Loss on extinguishment of debt	-	3,925	-	3,925
Retirement benefits adjustment	6,835	10,954	-	17,789
Net realized and unrealized gains on investments	(356,893)	(25,253)	-	(382,146)
Depreciation and amortization	405,832	85,460	-	491,292
Provision for uncollectible accounts	263,904	37,790	-	301,694
Foreign currency translation loss	73	59,108	-	59,181
Donated capital	(724)	(41)	-	(765)
Restricted gifts, bequests, investment income, and other	(119,076)	(4,911)	-	(123,987)
Transfers to (from) affiliates	116,453	(116,453)	-	-
Amortization of bond premiums and debt issuance costs	(1,670)	13	-	(1,657)
Net gain in value of derivatives	(1,954)	(6,881)	-	(8,835)
Changes in operating assets and liabilities:				
Patient receivables	(364,728)	(48,474)	2,641	(410,561)
Other current assets	45,182	(17,099)	3,030	31,113
Other noncurrent assets	(191,171)	29,839	102,773	(58,559)
Accounts payable and other current liabilities	98,026	(431)	(5,671)	91,924
Other liabilities	23,621	(14,693)	-	8,928
Net cash provided by operating activities and net nonoperating gains and losses	390,923	42,441	102,773	536,137
<b>Financing activities</b>				
Proceeds from long-term borrowings	502,370	145,711	(145,633)	502,448
Payments for advance refunding and redemption of long-term debt	-	(148,260)	-	(148,260)
Principal payments on long-term debt	(143,228)	(26,643)	42,860	(127,011)
Debt issuance costs	(949)	-	-	(949)
Change in pledges receivables, trusts and interests in foundations	(11,510)	1,307	-	(10,203)
Restricted gifts, bequests, investment income, and other	119,076	4,911	-	123,987
Net cash provided by (used in) financing activities	465,759	(22,974)	(102,773)	340,012
<b>Investing activities</b>				
Expenditures for property, plant, and equipment	(614,364)	(50,339)	-	(664,703)
Proceeds from sale of property, plant, and equipment	1,585	-	-	1,585
Net change in cash equivalents reported in long-term investments	91,241	54,823	-	146,064
Purchases of investments	(2,375,754)	(381,917)	-	(2,757,671)
Sales of investments	2,351,802	320,101	-	2,671,903
Transfers (to) from affiliates	(116,453)	116,453	-	-
Net cash (used in) provided by investing activities	(661,943)	59,121	-	(602,822)
Effect of exchange rate changes on cash	(73)	(2,206)	-	(2,279)
Increase in cash and cash equivalents	194,666	76,382	-	271,048
Cash and cash equivalents at beginning of year	108,436	141,144	-	249,580
Cash and cash equivalents at end of year	<u>\$ 303,102</u>	<u>\$ 217,526</u>	<u>\$ -</u>	<u>\$ 520,628</u>

See accompanying note.

# Cleveland Clinic Health System

## Note to Consolidating Financial Statements

December 31, 2017 and 2016

### **1. Presentation of Consolidating Financial Statements**

The accompanying financial statement information presents consolidating financial statement information for the Obligated Group (as defined herein) and certain controlled affiliates of The Cleveland Clinic Foundation (collectively referred to as the Non-Obligated Group), which have no liability under the Master Trust Indenture (Indenture), amended and restated as of April 1, 2003 (as supplemented, the Indenture), between The Cleveland Clinic Foundation and The Huntington National Bank, as successor Master Trustee. The Cleveland Clinic Foundation, Cleveland Clinic Avon Hospital, Cleveland Clinic Health System – East Region, Fairview Hospital, Lutheran Hospital, Marymount Hospital, Inc., Medina Hospital, Cleveland Clinic Florida (a nonprofit corporation) and Cleveland Clinic Florida Health System Nonprofit Corporation are the sole members of the Obligated Group under the Indenture.

With respect to the Obligated Group, certain properties and interests are considered to be Excluded Property under the Indenture. In addition, the provisions of the Indenture provide that additional property may be categorized as Excluded Property upon satisfaction of various financial tests. As such, these properties and interests are not subject to the restrictions contained in the Indenture and, under the Indenture, are not subject to the restriction on liens and other encumbrances that may be placed on property of the Obligated Group. Furthermore, the revenues derived from the Excluded Property are not subject to the restrictions contained in the Indenture until they are received and commingled with other revenues of the Obligated Group. The accompanying financial statement information is presented by legal entity and no adjustment has been made for the Excluded Property.

In 2017, concurrently with the issuance of the Series 2017A and Series 2017B Bonds, Cleveland Clinic Avon Hospital became a member of the Obligated Group. Cleveland Clinic Avon Hospital is reported as a member of the Obligated Group for all periods presented in the accompanying consolidating financial statements.

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