



Consolidated Financial Statements as of and for the
Years Ended December 31, 2018 and 2017, and
Independent Auditors' Report

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INDEPENDENT AUDITORS' REPORT

To the Audit Committee of the Board of Trustees
Henry Ford Health System
Detroit, Michigan

We have audited the accompanying consolidated financial statements of Henry Ford Health System and affiliates (the "System"), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, 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 Consolidated Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated 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 Company'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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the System as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

March 14, 2019



**CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2018 AND 2017
(In thousands)**

	<u>2018</u>	<u>2017</u>
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 556,400	\$ 774,534
Short-term investments	1,141	546
Patient care receivables—net of allowance of \$95,521 in 2017 (Note 1)	391,083	334,926
Health care premium receivables	21,650	41,485
Due from third-party payors	21,183	55,815
Other current assets	246,989	217,338
Current portion of assets limited as to use	<u>46,654</u>	<u>45,509</u>
Total current assets	1,285,100	1,470,153
LONG-TERM INVESTMENTS	689,783	445,500
ASSETS LIMITED AS TO USE	893,206	1,009,027
JOINT VENTURE INVESTMENTS	24,970	24,854
INTANGIBLE AND OTHER ASSETS—Net	49,699	46,810
GOODWILL—Net of accumulated amortization of \$28,577 in 2018 and 2017	14,029	14,029
PROPERTY, PLANT, AND EQUIPMENT—Net	<u>1,499,475</u>	<u>1,448,566</u>
TOTAL ASSETS	<u>\$4,456,262</u>	<u>\$4,458,939</u>

(Continued)



**CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2018 AND 2017
(In thousands)**

	<u>2018</u>	<u>2017</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable	\$ 259,482	\$ 267,163
Due to third-party payors	46,572	37,523
Medical claims liability	176,241	197,124
Other liabilities and accrued expenses	304,401	345,456
Current portion of long-term obligations	17,128	17,383
Current portion of malpractice and general liability	32,602	37,465
Current portion of capital lease payable	<u>185</u>	<u>175</u>
Total current liabilities	836,611	902,289
DEFERRED COMPENSATION, POSTRETIREMENT, AND OTHER LIABILITIES	397,724	408,885
LONG-TERM OBLIGATIONS	986,099	1,006,805
MALPRACTICE AND GENERAL LIABILITY	97,752	88,049
LONG-TERM CAPITAL LEASE PAYABLE	<u>5,376</u>	<u>9,517</u>
Total liabilities	<u>2,323,562</u>	<u>2,415,545</u>
NET ASSETS:		
Without donor restrictions:		
Henry Ford Health System	1,882,921	1,785,322
Noncontrolling interests	<u>3,427</u>	<u>3,331</u>
Total net assets without donor restrictions	1,886,348	1,788,653
With donor restrictions	<u>246,352</u>	<u>254,741</u>
Total net assets	<u>2,132,700</u>	<u>2,043,394</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$4,456,262</u>	<u>\$4,458,939</u>

See notes to consolidated financial statements.

(Concluded)



**CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017
(In thousands)**

	<u>2018</u>	<u>2017</u>
REVENUE WITHOUT DONOR RESTRICTIONS:		
Patient service revenue		\$ 3,374,869
Less provision for bad debts		(99,815)
Net patient service revenue	\$ 3,581,749	3,275,054
Health care premiums	1,931,140	2,296,229
Investment (loss) income, net	(55,309)	95,751
Other income	396,234	309,972
Total revenue without donor restrictions	<u>5,853,814</u>	<u>5,977,006</u>
EXPENSES:		
Salaries, wages, and employee benefits	2,527,394	2,421,415
Health care provider expense	1,084,295	1,350,827
Supplies	981,677	944,101
Depreciation and amortization	204,961	189,017
General and other administrative	398,847	359,267
Other contracted services	316,276	315,429
Malpractice	44,748	36,187
Plant operations	57,903	56,223
Interest expense	31,693	32,932
Repairs and maintenance	66,748	71,803
Rent and lease	52,449	53,285
Total expenses	<u>5,766,991</u>	<u>5,830,486</u>
EXCESS OF REVENUE OVER EXPENSES BEFORE UNUSUAL ITEM	<u>86,823</u>	<u>146,520</u>
UNUSUAL ITEM:		
Net cumulative unrealized gains transferred to trading securities (Note 1)	-	59,216
Total unusual item	<u>-</u>	<u>59,216</u>
EXCESS OF REVENUE OVER EXPENSES FROM CONSOLIDATED OPERATIONS	86,823	205,736
LESS EXCESS OF REVENUE OVER EXPENSES ATTRIBUTABLE TO NONCONTROLLING INTERESTS	<u>1,957</u>	<u>2,057</u>
EXCESS OF REVENUE OVER EXPENSES ATTRIBUTABLE TO HENRY FORD HEALTH SYSTEM	<u>84,866</u>	<u>203,679</u>

(Continued)



**CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017**

(In thousands)

	<u>2018</u>	<u>2017</u>
NET ASSETS WITHOUT DONOR RESTRICTIONS:		
Excess of revenue over expenses from consolidated operations	\$ 86,823	\$ 205,736
Net cumulative unrealized gains transferred to trading securities (Note 1)	-	(59,216)
Change in net unrealized gains and losses on investments (Note 1)	-	22,558
Net assets released from restrictions for capital	9,545	8,862
Distributions to noncontrolling interests	(1,861)	(1,861)
Pension and other postretirement net adjustments	12,218	16,140
Purchase price adjustment to noncontrolling interest (Note 13)	(9,030)	-
	<u>97,695</u>	<u>192,219</u>
Increase in net assets without donor restrictions		
NET ASSETS WITH DONOR RESTRICTIONS:		
(Loss) income on restricted investments, net	(11,408)	11,949
Contributions and other	58,079	42,748
Net cumulative unrealized gains transferred to trading securities (Note 1)	-	(1,395)
Change in net unrealized gains and losses on investments (Note 1)	-	6,952
Net assets released from restrictions for operations	(45,515)	(40,599)
Net assets released from restrictions for capital	(9,545)	(8,862)
	<u>(8,389)</u>	<u>10,793</u>
(Decrease) increase in net assets with donor restrictions		
TOTAL INCREASE IN NET ASSETS	89,306	203,012
TOTAL NET ASSETS—Beginning of year	<u>2,043,394</u>	<u>1,840,382</u>
TOTAL NET ASSETS—End of year	<u>\$ 2,132,700</u>	<u>\$ 2,043,394</u>

See notes to consolidated financial statements.

(Concluded)



CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017
(In thousands)

	<u>2018</u>	<u>2017</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Increase in net assets	\$ 89,306	\$ 203,012
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Provision for bad debts	-	99,815
Depreciation and amortization	204,961	189,017
Pension and other postretirement net adjustments	(12,218)	(16,140)
Curtailment gain	-	(13,742)
Amortization of bond premium and financing costs	(4,965)	(4,840)
Loss on sale or disposal of assets	957	3,620
Goodwill impairment	-	170
Loss (income) on restricted investments	11,408	(11,949)
Restricted contributions and grants	(58,079)	(42,748)
Net realized and unrealized gains on investments—other than trading securities	-	(46,533)
Net realized and unrealized losses (gains) on investments—trading	94,957	(33,972)
Distributions to noncontrolling interests	1,861	1,861
Purchase price adjustment to noncontrolling interest	9,030	-
Proceeds from dissolution of trusts	(6,532)	-
Change in assets and liabilities:		
Patient and health care premium receivables	(36,322)	(151,681)
Other current assets	(29,651)	543
Assets limited as to use	4,483	(28,606)
Joint venture investments	(3,895)	(1,367)
Other assets	(5,966)	(2,635)
Accounts payable	(10,724)	23,511
Other liabilities	(34,510)	36,418
Due to/from third-party payors	43,681	(31,694)
Medical claims liability	(20,883)	2,800
Malpractice and general liability	8,840	(6,993)
Net cash provided by operating activities	<u>245,739</u>	<u>167,867</u>

(Continued)



**CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017
(In thousands)**

	<u>2018</u>	<u>2017</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property	\$ (263,620)	\$ (203,258)
Proceeds from the sale or maturity of available-for-sale investments	-	215,115
Purchase of available-for-sale investments	-	(254,257)
Proceeds from the sale or maturity of trading securities	912,363	162,360
Purchase of trading securities	<u>(1,147,714)</u>	<u>(154,261)</u>
Net cash used in investing activities	<u>(498,971)</u>	<u>(234,301)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on short-term borrowings	-	(24,167)
Payments on long-term obligations	(17,381)	(15,976)
Proceeds from long-term obligation	1,385	-
Payments on capital lease payable	(248)	(169)
Distributions to noncontrolling interests	(1,861)	(1,861)
Proceeds from dissolution of trusts	6,532	-
(Loss) income on restricted investments	(11,408)	11,949
Restricted contributions and grants	<u>58,079</u>	<u>42,748</u>
Net cash provided by financing activities	<u>35,098</u>	<u>12,524</u>
DECREASE IN CASH AND CASH EQUIVALENTS	(218,134)	(53,910)
CASH AND CASH EQUIVALENTS—Beginning of year	<u>774,534</u>	<u>828,444</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 556,400</u>	<u>\$ 774,534</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for interest, including amounts capitalized of \$3,870 and \$2,594 in 2018 and 2017, respectively	<u>\$ 41,811</u>	<u>\$ 43,041</u>
Amounts accrued in property, plant, and equipment—net	<u>\$ 13,333</u>	<u>\$ 19,320</u>
Unsettled investment trades	<u>\$ 359</u>	<u>\$ 996</u>
Unsettled investment purchases	<u>\$ 3,391</u>	<u>\$ 3,020</u>
Cash paid for taxes	<u>\$ 3,308</u>	<u>\$ 6,209</u>
New capital lease obligation for building	<u>\$ -</u>	<u>\$ 5,545</u>

See notes to consolidated financial statements.

(Concluded)



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017**

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Organization

Henry Ford Health System (the “Corporation”) and its affiliates (collectively, the “System”) constitute a comprehensive health care system offering health care to the people of southeastern and south-central Michigan. The System provides medical, surgical, psychiatric, and rehabilitative services in inpatient and outpatient settings; conducts research activities; and engages in the education and training of residents, nurses, and allied health professionals. The System includes one of the nation’s largest employed physician group practices. A significant portion of the System’s revenues are derived through its health maintenance organization (HMO) and its subsidiaries.

The Corporation is a Michigan not-for-profit corporation with several subsidiary corporations, the most significant of which are Henry Ford Wyandotte Hospital (Wyandotte), Henry Ford Macomb Hospital Corporation (Macomb), Henry Ford Allegiance Health Group and Associates (AHG), Health Alliance Plan (HAP), Henry Ford Health System Foundation (Foundation), and Onika Insurance Company, Ltd. (Onika).

Several subsidiaries also hold interests in other corporations. Amongst these are AHG’s sole membership interest in W. A. Foote Memorial Hospital d.b.a. Henry Ford Allegiance Health (Allegiance Health) and HAP’s holding in Administration Systems Research Corporation (ASR).

Joint venture interests include Foote Health Center Associates (62% ownership), Northwest Detroit Dialysis Centers (56.25% ownership), and Macomb Regional Dialysis Centers, L.L.C. (60% ownership), which are consolidated.

Basis of Presentation

The consolidated financial statements include the accounts of the System members as described above. The accounting and reporting policies of the System conform to accounting principles generally accepted in the United States of America (GAAP). All intercompany transactions have been eliminated. The preparation of the consolidated financial statements in conformity with GAAP requires that management make estimates and assumptions that affect the reported amounts. Actual results could differ from those estimates.

Revenue Recognition

On January 1, 2018, the System adopted the Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, (“ASU 2014-09”) using the modified retrospective method of application to all contracts. This ASU 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 principal of the revenue guidance 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 and services. The primary change was in the presentation of the provision for bad debts, which relates to self-pay patients and amounts due from patients with insurance for co-pays and deductibles. Under the ASU, the majority of what was previously classified as provision for bad debts is now reflected as implicit price concessions and therefore a direct deduction to patient service revenue. For the year ended December 31, 2018, the System recorded \$106,452,000 of implicit price concessions as a direct reduction of patient service revenue that would have been recorded as a provision for bad debts prior to the adoption of the ASU 2014-09. Other than this change in presentation, the adoption of this ASU did not have a significant impact to revenue recognized for the year ended December 31, 2018. This ASU does not apply to health care premiums, as they are accounted for under “Financial Services – Insurance (Topic 944).”

The System elected the practical expedient allowed under Accounting Standards Codification (ASC) 606-10-32-18 and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to the expectation that the period between the time of the service and the time the service is paid will be one year or less. The impact of any extended payment agreements with patients is not deemed material.

Net Patient Service Revenue and Patient Care Receivables

Net patient service revenue is reported at the amount that reflects the consideration to which the System expects to be entitled in exchange for providing patient care. These amounts are primarily due from patients and third-party payors, and include variable consideration for retroactive revenue adjustments due to a subsequent audit or review process. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by the System. Generally, performance obligations satisfied over time relate to patients receiving inpatient services. The System measures the performance obligation from the point of hospital admission through discharge. Revenue for performance obligations satisfied at a point in time is recognized when goods or services are provided, and the System does not believe it is required to provide additional goods or services to the patient. Generally, performance obligations satisfied at a point in time relate to outpatient services and pharmacy revenue.

Because the System’s performance obligations relate to contracts with a duration of less than one year, it has elected to apply the optional exemption provided in FASB ASC 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. These unsatisfied or partially unsatisfied performance obligations are primarily related to inpatient services and the related contracts are generally completed upon discharge, which generally occurs shortly after the end of the reporting period.

The System determines the transaction price based on contractual terms for all services covered by insurance or in accordance with the System’s policies with regards to uninsured patients. The System determines its estimate of implicit price concessions based on its historical collection experience with each class of patients using a portfolio approach as a practical expedient to account for patient contracts as a collective group rather than individually. The consolidated financial statement effects of using this practical expedient are not materially different from an individual contract approach.

Reimbursement from Third Party Payors

Reimbursement from most payors for inpatient and outpatient services vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Revenues under traditional Medicare and Medicaid programs, as well as Blue Cross, are based primarily on prospective payment systems. For Medicare, retrospectively determined non-claims based revenues, such as indirect medical education, direct graduate medical education, disproportionate share hospital payments, allied health education payments, organ acquisition, and bad debt expense reimbursement, are estimated using historical trends and current factors. These revenues are reported on Medicare cost reports, which are subject to audit by Medicare auditors and administrative and judicial review, prior to final settlement. These settlements can take several years to resolve. Because the laws, regulations, instructions, and rule interpretations governing Medicare reimbursement are complex and change frequently, the estimates recorded could change in subsequent periods. Medicaid revenues have the potential to be reduced based on an upper payment limit calculated through the Medicaid cost report, which is subject to review and adjustment by Medicaid auditors. Blue Cross revenues are also subject to a final settlement, where auditors reprice claims based on settlement rates. These represent the major payors included in patient care receivables at December 31, 2018 and 2017. Revenues associated with health care services provided by the System to members of its HMO are included in health care premiums in the consolidated statements of operations and changes in net assets.

Settlements with third-party payors for retroactive adjustments are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor, and the System's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as new information becomes available or as years are settled.

Generally, patients covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The System estimates the transaction price for these patients and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense. Bad debt expense for the year ended December 31, 2018, was not material to the consolidated financial statements.

Patient Financial Assistance

The System administers a patient financial assistance policy designed to provide financial assistance for uninsured patients as well as for insured patients with limited resources. For uninsured patients who meet the qualifications stipulated in the System's patient financial assistance policy, emergency and other medically necessary inpatient and outpatient services are provided at no cost. For uninsured patients who do not qualify for financial assistance, the System offers a discounted rate that does not exceed 115% of Medicare payment rates. Insured patients with limited financial resources may qualify for a discount on self-pay balances. In 2017, prior to the System adopting the new accounting standard for revenue recognition it maintained allowances primarily related to collectability of amounts due from self-pay patients. At December 31, 2017, the amount of allowances related to charity was \$15,993,000 and the amount related to bad debts was \$79,528,000.

Health Care Premiums

Premiums received in advance of the respective period of coverage are recognized as revenue ratably over the period of coverage. HAP has significant customer base concentrations in companies that are part of the automotive manufacturing industry and with Medicare beneficiaries.

Contributions

Contributions without donor restrictions are included in the consolidated statements of operations and changes in net assets when received. Gifts of cash and other assets that are received with donor stipulations are recorded as restricted contributions and included in the consolidated statements of operations and changes in net assets once the restrictions are satisfied.

Other Income

Other income includes assets released from restrictions, income from grants, income from contract pharmacy arrangements, administrative fees earned from HAP self-insured products, joint venture income, gift shop and cafeteria sales, parking garage fees, and other miscellaneous sources.

Performance Indicator

The consolidated statements of operations and changes in net assets include the excess of revenue over expenses from consolidated operations. Changes in net assets without donor restrictions, which are excluded from the excess of revenue over expenses from consolidated operations, consistent with industry practice, include net cumulative unrealized gains transferred to trading securities, change in net unrealized gains and losses on investments, net assets released from restrictions for capital, distributions to noncontrolling interests, pension and other postretirement net adjustments, and purchase price adjustment to noncontrolling interest. Certain income and expenses that are included in the performance indicator are separately presented as unusual items.

Net Asset Classifications

Net assets without donor restrictions—Net assets that are not subject to donor-imposed restrictions and may be expended for any purpose in performing the primary objectives of the System. These net assets may be used at the discretion of the System’s management and the board of directors. See Note 5 for information about the amounts and purposes of board designations of net assets without donor restrictions.

Net assets with donor restrictions—Net assets subject to stipulations imposed by donors and grantors. Some donor restrictions are temporary in nature and those restrictions will be met by the actions of the System or by the passage of time. Other donor restrictions are perpetual in nature and the donor has stipulated the funds be maintained by the System in perpetuity.

Donor restricted contributions are reported as increases in net assets with donor restrictions. When a restriction expires, net assets are reclassified from net assets with donor restrictions to net assets without donor restrictions in the consolidated statements of operations and changes in net assets as other income or net assets released from restrictions for capital.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and liquid short-term investments (e.g., money market funds) with an original maturity of 90 days or less. Cash equivalents are stated at fair value, which approximates cost.

Short-Term Investments

Short-term investments consist primarily of fixed-income instruments with original maturities greater than 90 days and less than one year. Short-term investments are stated at fair value, which approximates cost.

Other Current Assets

Other current assets consist primarily of inventories, which are stated at the lower of cost (first-in, first-out) or market, prepaid expenses, and miscellaneous receivables.

Assets Limited as to Use

Assets limited as to use are reported at their estimated fair value and include:

- Resources for which the board of directors of the System has designated specific future uses.
- Funds with donor restrictions that arise through specific contributions to the System.
- Funds held by trustee.
- Funds held to satisfy statutory reserve requirements.

The dollar amount of these assets to be used to satisfy current liabilities has been classified as a current asset.

Investments and Investment Income

Investments, inclusive of invested assets limited as to use, include marketable debt and equity securities. Investments in debt and equity securities with readily determinable fair values are measured at fair value in the consolidated balance sheets. Hedge funds, commingled funds, private equity, and other investments structured as limited liability corporations and partnerships are valued at net asset value (NAV), as a practical expedient, which is calculated using the most recent consolidated financial statements. The System has classified all investments as trading.

Investment (loss) income, net includes interest, dividends, realized gains and losses, and unrealized gains and losses. Realized gains and losses on sales of investments as well as unrealized gains and losses are calculated using the specific-identification method and are included in investment (loss) income, net or (loss) income on restricted investments, net.

During 2016, the System acquired AHG whose investments were classified as trading securities and the System initiated an asset liability management (ALM) analysis to determine its optimal investment allocation. The ALM analysis completed in 2017, resulted in the System shifting its investment allocation strategy away from minimally traded cash or similar safe-harbor investments toward a broadly diverse, actively managed investment structure with reasonable risk parameters. Because of this change, effective October 1, 2017, the System elected to transfer its investments previously accounted for as available-for-sale securities to trading securities. The System determined that the trading securities category is more appropriate based on its new investment strategies and policies and all System assets are now accounted for as trading securities. As a result, all unrealized gains and losses are included in the excess of revenue over expenses from consolidated operations.

This change resulted in the reclassification of net cumulative unrealized gains on investments previously classified as available-for-sale securities of \$59,216,000 from the statement of changes in net assets into the consolidated statements of operations as an unusual item. This amount includes net cumulative unrealized gains on investments as of December 31, 2016, of \$36,658,000 and unrealized gains on investments for the nine-month period ended September 30, 2017, of \$22,558,000. This change also resulted in the reclassification of net cumulative unrealized gains on investments with donor restrictions previously classified as available-for-sale securities of \$1,395,000 to (loss) income

on restricted investments, net. This amount includes net cumulative unrealized losses on investments as of December 31, 2016, of \$5,557,000 and unrealized gains on investments for the period ended September 30, 2017, of \$6,952,000.

Investment Risks

Investment securities are subject to various risks, such as interest rate, market, and credit. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in values in the near term could materially affect the amounts reported in the accompanying consolidated financial statements.

Fair Value of Financial Instruments

In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. This guidance revises accounting related to (1) the classification and measurement of investments in equity securities and (2) the presentation of certain fair value changes for financial liabilities measured at fair value. It also amends certain disclosure requirements associated with the fair value of financial instruments. This guidance is effective for the System in periods beginning after December 15, 2018. Early adoption is permitted. The System adopted the guidance as of January 1, 2018. The adoption affected the disclosures included in the consolidated financial statements for the year ended December 31, 2018 (Refer to Note 4).

Fair value of financial instruments has been determined using available information and appropriate valuation methodologies. The fair value of assets is based on quoted market prices, dealer quotes, and prices obtained from independent sources. The fair value of liabilities is based on a discounted cash flows analysis, using interest rates currently available for the issuance of debt with similar terms and remaining maturities. Considerable judgment is required in certain circumstances to develop the estimates of fair value, and they may not be indicative of the amounts, which could be realized in a current market exchange.

Derivative Financial Instruments

The System periodically utilizes various financial instruments (e.g., options and swaps) to limit interest rate risk and guarantee income. The System's policies generally prohibit trading in derivative financial instruments on a leveraged basis.

Intangible and Other Assets

Intangible and other assets for the years ended December 31, 2018 and 2017, consisted of the following (dollars in thousands):

	<u>Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>	<u>Useful Life (Years)</u>
December 31, 2018				
Definite-lived intangible assets:				
Customer relationships	\$ 15,660	\$ 6,679	\$ 8,981	8–22
Provider relations	22,164	5,255	16,909	10–25
Reinsurance escrow	19,361	-	19,361	
Other	<u>6,966</u>	<u>2,518</u>	<u>4,448</u>	
Total	<u>\$ 64,151</u>	<u>\$ 14,452</u>	<u>\$ 49,699</u>	
December 31, 2017				
Definite-lived intangible assets:				
Customer relationships	\$ 15,660	\$ 5,073	\$ 10,587	8–22
Provider relations	22,164	4,115	18,049	10–25
Reinsurance escrow	13,063	-	13,063	
Other	<u>7,298</u>	<u>2,187</u>	<u>5,111</u>	
Total	<u>\$ 58,185</u>	<u>\$ 11,375</u>	<u>\$ 46,810</u>	

Amortization expense on intangible assets was \$3,077,000 and \$3,208,000 for the years ended December 31, 2018 and 2017, respectively.

Estimated amortization expense on intangible assets for the next five years is as follows (in thousands):

Years Ending December 31:

2019	\$ 2,830
2020	2,781
2021	2,571
2022	2,360
2023	2,360

Goodwill

The System evaluates goodwill for impairment as of September 30 of each year, unless conditions arise that would require a more frequent evaluation. In assessing the recoverability of goodwill, management performs a qualitative or quantitative assessment to test for impairment annually. If it is determined, based on qualitative factors, that a quantitative impairment test is required, estimated future cash flows, and other factors are made to determine the fair value of the respective reporting unit. If these estimates or related projections change in the future, the System may be required to record impairment charges for goodwill at that time. Impairments, if any, are charged to earnings.

Information on changes in the carrying amounts of goodwill as of December 31, 2018 and 2017, is as follows (in thousands):

	<u>2018</u>	<u>2017</u>
As of January 1:		
Goodwill	\$ 45,451	\$ 45,451
Accumulated impairment loss	<u>(31,422)</u>	<u>(31,252)</u>
Total	14,029	14,199
Impairment loss	-	(170)
Total	<u>\$ 14,029</u>	<u>\$ 14,029</u>

Impairment

The System periodically, or when a triggering event occurs, evaluates the carrying value of its long-lived assets for impairment. This evaluation is based principally on the projected, undiscounted cash flows generated by the related assets.

Property, Plant, and Equipment

Property, plant, and equipment, which includes capitalized internal-use software, is recorded at cost or fair value at the date of acquisition. Depreciation is recorded on the straight-line method over the estimated useful lives of the assets. Estimated useful lives used in computing depreciation are generally 10 years for land improvements, 15 to 40 years for buildings and building improvements, and three to 15 years for equipment.

Expenditures for maintenance and repairs are recognized in operating results, unless they extend the useful life of the related asset. Costs incurred that extend the useful lives are capitalized and depreciated.

Medical Claims Liability

Medical claims liability consists of unpaid medical claims and other obligations resulting from the provision of health care services. It includes claims reported as of the consolidated balance sheets date and estimates, based upon historical claims experience, for claims incurred, but not reported (IBNR).

Management estimates the amount of the IBNR using standard actuarial developmental methodologies based upon, but not limited to, historical payment information and trends, denied claim activity, expected medical cost inflation, seasonality patterns, and changes in membership. This estimate includes a provision for potential adverse deviation, which considers multiple factors, including: known environmental and economic factors, changes in current payment patterns, potential high-cost cases, and the impact of new technology or pharmaceuticals on cost.

Management's IBNR best estimate is made on an accrual basis and adjusted in future periods based upon actual payment patterns and any changes in estimation factors. The reserve is adjusted as additional information becomes known and the current period includes adjustments related to prior-periods' estimates. The majority of the IBNR reserve balance held at the end of a reporting period is associated with the most recent months' incurred services, most of which have not been paid.

The IBNR estimation methodology has been consistently applied from period to period and there were no material changes in the amount of these reserves, or as a percent of reserve for claims and other settlements, between December 31, 2018 and 2017. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts estimated.

Deferred Compensation

Certain employees of the System participate in deferred compensation plans. The System has chosen to fund this liability using mutual funds and annuity or insurance contracts solely owned by the System. These assets are subject to the claims of the System's general creditors. Earnings related to the deferred compensation assets, including unrealized appreciation or depreciation, are included in investment income and changes in the corresponding liability are included in salaries, wages, and employee benefits in the consolidated statements of operations and changes in net assets. The asset and liability are recorded at fair market value. The System recorded a (reduction) charge to salaries, wages, and employee benefits expense of \$(8,048,000) and \$17,436,000 in 2018 and 2017, respectively, related to (losses) or earnings from the deferred compensation assets.

Tax Status

The System, except for HAP and Onika, consists of entities described under Internal Revenue Service (IRS) Code Section 501(c)(3) and, as such, are exempt from federal income taxes under IRS Code Section 501(a) and do not have private foundation status under IRS Code Sections 509(a)(1), 509(a)(2), or 509(a)(3). HAP is an entity described under IRS Code Section 501(c)(4) and, as such, is exempt from federal income taxes. The System's wholly owned insurance captive, Onika, operates in the Cayman Islands and is currently not subject to income taxes. The System does not have any material uncertain tax positions as of December 31, 2018 and 2017.

Adoption of New Accounting Standards

FASB ASU No. 2016-14, *Presentation of Financial Statements of Not-For-Profit Entities*, was adopted in 2018 and simplifies and improves how not-for-profit entities classify net assets as well as the information presented in financial statements and notes about liquidity, financial performance, and cash flows. The adoption of this guidance expanded certain footnote disclosures and changed the presentation to two classes of net assets versus the previously required three classes. The adoption did not have a material impact on the System's consolidated financial statements.

Forthcoming Accounting Standards

FASB ASU 2018-14. (Issued August 2018), *Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20)—Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans* – This amends ASC 715 and updates disclosure requirements to reflect most relevant information and applies to all employers that sponsor defined benefit pension or other postretirement plans. This guidance is effective for the System for annual periods ending after December 15, 2021. The System is evaluating the impact this guidance may have on the consolidated financial statements.

FASB ASU 2018-13 (issued July 2018), *Fair Value Measurement (Topic 820)—Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement* – Designed to improve the effectiveness of fair value measurement disclosures, this update modifies existing disclosure requirements on fair value measurements. Current guidance is reflected in *Topic 820, Fair Value Measurement, based on the concepts in FASB Concepts Statement, Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements, including the consideration of costs and benefits*. This guidance is effective for the System for annual periods beginning after December 15, 2019. The System is evaluating the impact this guidance may have on the consolidated financial statements.

FASB ASU2018-08 (issued June 2018), *Not-for-Profit Entities (Topic 958)* – Designed to clarify the scope and accounting guidance for contributions received and contributions made. This update clarifies and improves current guidance about whether a transfer of assets is a contribution or an exchange transaction. This guidance is effective for the System for annual periods beginning after

June 15, 2018. The adoption of this guidance is not expected to have a material impact on the System's consolidated financial statements.

FASB ASU 2017-07 (issued March 2017), *Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost* – This ASU requires the service cost component of net periodic benefit cost related to defined benefit pension and postretirement benefit plans to be reported in the same financial statement line as other compensation costs arising from services rendered during the period. The other components of net periodic benefit cost are required to be presented separately from service costs and outside of operating income in the consolidated statements of operations. Only the service cost component of net periodic benefit cost will be eligible for capitalization in assets. This guidance is effective for the System for periods beginning after December 15, 2018. The adoption of this guidance is not expected to have a material impact on the System's consolidated financial statements.

FASB ASU 2016-18 (issued February 2016), *Restricted Cash* – This ASU adds and clarifies guidance in the presentation of changes in restricted cash in the statement of cash flows requiring restricted cash to be included with cash and cash equivalents in the consolidated statements of cash flows. This guidance does not provide a definition of restricted cash. This guidance is effective for the System for periods beginning after December 15, 2018. The adoption of this guidance is not expected to have a material impact on the System's consolidated financial statements.

FASB ASU 2016-15 (issued February 2016), *Classification of Certain Cash Receipts and Cash Payments* – This guidance adds or clarifies guidance on the classification of certain cash receipts and payments in the consolidated statements of cash flows. This guidance is effective for the System for periods beginning after December 15, 2018. The adoption of this guidance is not expected to have a material impact on the System's consolidated financial statements.

FASB ASU 2016-02 (issued February 2016), *Leases (Topic 842)*, updated by FASB ASU No. 2018-10, (issued February 2018) *Codification Improvements to Topic 842, Leases* – This guidance was designed to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities in the balance sheet and disclosing key information about leasing arrangements. The main change in the new guidance is the requirement for all leases to be recognized in the balance sheet at the present value of lease payments. The System is adopting the optional transition method to apply the lease standard at the adoption date of January 1, 2019, and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Upon adoption, the System expects to record operating lease right-of-use assets and operating lease liabilities in the range of approximately \$180,000,000 to \$210,000,000, representing the present value of future lease payments under operating leases.

2. NET PATIENT SERVICE REVENUE

A substantial portion of net patient service revenue is paid by Medicare, Medicaid, and Blue Cross based upon contracted rates or under cost-reimbursement agreements in 2018 and 2017. Provisions for estimated retroactive adjustments under these agreements for current and prior years have been reflected in the accounts based upon the most current information available. Net patient service revenue of \$23,162,000 and \$16,348,000 related to prior-year settlements was recorded in 2018 and 2017, respectively. Patient service revenue, recognized from these major sources, as of December 31, 2018 and 2017, is as follows (dollars in thousands):

	<u>2018</u>		<u>2017</u>	
Medicare	\$ 1,496,597	42 %	\$ 1,425,488	42 %
Medicaid	597,952	17	560,457	17
Blue Cross	929,075	26	830,612	25
Self-pay	30,350	1	117,445	3
Commercial and other	<u>527,775</u>	<u>14</u>	<u>440,867</u>	<u>13</u>
Total	<u>\$ 3,581,749</u>	<u>100 %</u>	<u>\$ 3,374,869</u>	<u>100 %</u>

Patient service revenue includes implicit price concessions for 2018 and is before the provision for bad debts for 2017.

Letters of final settlements have not been received from Medicare for 2012 through 2018, from Medicaid for 2016 through 2018, or from Blue Cross for 2017 through 2018. The System is appealing various elements of Medicare final settlements dating back to 1999.

3. UNCOMPENSATED CARE AND COMMUNITY BENEFIT

The System demonstrates its exempt purpose by providing multiple services to support the health and well-being of the communities it serves. In addition to offering emergency services open to the public 24 hours a day, seven days a week, the System provides health care services without charge or at amounts less than its established rates to patients who meet the criteria of its patient financial assistance policy. Charity care is reported at estimated cost using a cost-to-charge ratio methodology. Other major community benefit commitments include participating in public programs under which reimbursement is less than the cost of providing care, maintaining research programs focused on improving health care, offering community education and outreach in the form of free or low-cost clinics and health screenings, education, and donations to support external community programs. The major components of Community Benefit for the years ended December 31, 2018 and 2017, are as follows (in thousands):

	<u>2018</u>	<u>2017</u>
Charity care at cost	\$ 35,598	\$ 11,081
Unpaid cost of Medicare, Medicaid, and other public programs	330,402	346,216
Implicit price concessions	90,202	-
Bad debt at estimated cost	<u>-</u>	<u>85,923</u>
 Total cost of uncompensated care	 456,202	 443,220
Research	68,934	59,293
Health professional education	85,537	80,610
Community health services and building activities	15,817	21,928
Subsidized health services	10,823	5,494
Community benefit operations and financial donations	<u>3,317</u>	<u>3,494</u>
 Total community benefit	 <u>\$ 640,630</u>	 <u>\$ 614,039</u>

Because of the adoption of ASU 2014-09 amounts previously reported as bad debt at estimated cost are now reflected as implicit price concessions.

The IRS requires the reported community benefit activities to be offset by external funding received. The System received \$55,193,000 and \$40,771,000 of external funding for research and \$2,536,000 and \$4,751,000 of external funding for community health services and building activities during the years ended December 31, 2018 and 2017, respectively.

The System's total cost of uncompensated care as a proportion of consolidated net patient revenue approximated 12.7% and 13.5% at December 31, 2018 and 2017, respectively.

4. INVESTMENTS AND FAIR VALUE MEASUREMENTS

Fair Value Measuring Hierarchy - The System assesses the inputs used to measure fair value using a three-level hierarchy based on the extent to which inputs used in measuring fair value are observable in the market. The fair value hierarchy is as follows:

Level 1—Quoted (unadjusted) prices for identical assets in active markets

Level 2—Other observable inputs, either directly or indirectly, including:

- Quoted prices for similar assets in active markets
- Quoted prices for identical or similar assets in nonactive markets (few transactions, limited information, noncurrent prices, high variability over time, etc.)
- Inputs other than quoted prices that are observable for the asset (interest rates, yield curves, volatilities, default rates, etc.)
- Inputs that are derived principally from or corroborated by other observable market data

Level 3—Unobservable inputs that cannot be corroborated by observable market data

Fair values of securities are based on quoted market prices, where available. The System obtains one price for each security, primarily from a third-party pricing service ("pricing service"), which generally uses Level 1 or Level 2 inputs for the determination of fair value. The pricing service normally derives

the security prices through recently reported trades for identical or similar securities, making adjustments through the reporting date based upon available observable market information. For securities not actively traded, the pricing service may use quoted market prices of comparable instruments or discounted cash flow analyses, incorporating inputs that are currently observable in the markets for similar securities. Inputs into the methodologies include, nonbinding broker quotes, benchmark yields, credit spreads, default rates, and prepayment speeds. The System assesses the reasonableness of the pricing information quarterly and has not historically made any adjustments.

When the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement is determined based on the lowest-level input that is significant to the fair value measurement in its entirety. The System's assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset.

Fair Value Measurement Methods - The following methods and assumptions are used to estimate the fair value of each class of financial instrument:

- *Cash Equivalents*—The carrying value approximates fair value as maturities are less than three months. Cash equivalents, comprised primarily of money markets are classified as Level 1.
- *Debt Securities*—The estimated fair values are based on quoted market prices and/or other market data for the same or comparable instruments and transactions in establishing the prices. Due to the nature of pricing fixed-income securities, management classifies the majority of debt securities as Level 2 investments.
- *Equity Securities*—The estimated fair values are based on quoted market prices and/or other market data for the same or comparable instruments and transactions in establishing the prices. Nonpublicly traded securities, which are primarily collective funds, are recorded at fair value based on NAV, which is calculated using the most recent fund financial statements. The funds in this class include bonds and other fixed-income instruments.
- *Hedge Funds*—Underlying assets in these funds may include equity and debt securities, commodities, currencies, and derivatives. These funds are valued at NAV, which is calculated using the most recent fund financial statements.
- *Private Equities*—The estimated fair values based on NAV, which is calculated using the most current financial statements issued by each fund. The value is adjusted for cash flows to and from the fund subsequent to the financial statement reporting date as well as other data available for the funds.
- *Derivatives*—The estimated fair values are based on quoted market prices and/or other market data for the same or comparable instruments and transactions in establishing the prices.
- *Grants and Pledges Receivable*—The fair value is estimated by management using the discounted cash flows method.
- *Long-Term Obligations*—The carrying value of the System's variable-rate bonds and other obligations approximates the fair value. The fair value of the System's fixed-rate bonds is estimated based upon prices obtained from a third-party service routinely relied upon by securities professionals to provide an approximate fair value of these types of securities.

The System's policy is to recognize transfers between all levels as of the beginning of the reporting period. There were no significant transfers between Levels 1, 2, and 3 during the years ended December 31, 2018 and 2017.

Fair Values - Information about the fair value of the System's financial assets and liabilities, according to the valuation techniques the System used to determine its fair values, as of December 31, 2018 and 2017, is as follows (in thousands):

	<u>2018</u>	<u>2017</u>
Assets measured at fair value:		
Level 1:		
Cash equivalents	\$ 617,956	\$ 878,387
Common stock	75,567	35,941
Collective equity funds:		
Asset allocation	190,167	200,204
Common stock	189,449	163,540
Debt securities	136,396	212,939
Fixed income	-	18,155
Derivative—asset	-	10,272
Subtotal—Level 1	<u>1,209,535</u>	<u>1,519,438</u>
Level 2:		
Debt securities:		
Asset-backed securities	11,924	37,649
Corporate debt securities	49,036	74,300
Government and agency debt securities	69,025	111,144
Nonagency mortgage-backed securities	3,616	6,263
Other debt securities	4,482	7,764
Grants and pledges receivable at fair value	<u>23,204</u>	<u>12,643</u>
Subtotal—level 2	161,287	249,763
Subtotal—assets at fair value	<u>1,370,822</u>	<u>1,769,201</u>
Investments measured at NAV	774,324	440,462
Private equities at cost—not measured at fair value—Level 3	<u>-</u>	<u>39,041</u>
Subtotal—assets recorded at cost or NAV	<u>774,324</u>	<u>479,503</u>
Cash	30,287	9,979
Other	<u>11,751</u>	<u>16,433</u>
Total	<u>\$ 2,187,184</u>	<u>\$ 2,275,116</u>
Asset classifications:		
Cash and cash equivalents	\$ 556,400	\$ 774,534
Short-term investments	1,141	546
Assets limited as to use	939,860	1,054,536
Long-term investments	<u>689,783</u>	<u>445,500</u>
Total	<u>\$ 2,187,184</u>	<u>\$ 2,275,116</u>

	<u>2018</u>	<u>2017</u>
Liability measured at fair value—Level 1—derivative	\$ <u>-</u>	\$ <u>10,256</u>
Liability not measured at fair value—Level 2—long-term obligations	\$ <u>1,052,210</u>	\$ <u>1,107,646</u>

The fair value measurements of certain investments calculated based on NAV, for the years ended December 31, 2018 and 2017, are as follows (in thousands) (there were approximately \$73,000,000 in unfunded commitments for private equity funds at year-end):

	<u>2018</u>	<u>Frequency</u>	<u>Notice Period</u>
Collective funds:			
Asset allocation	\$ 45,405	Monthly	7–10 days
Common stock	362,162	Daily, monthly	2–30 days
Debt securities	172,320	Daily, semimonthly, monthly	0–30 days
Hedge funds	134,253	Monthly, quarterly, annually	3–90 days
Private equities*	<u>60,184</u>	N/A	N/A
Total	<u>\$ 774,324</u>		
	<u>2017</u>	<u>Frequency</u>	<u>Notice Period</u>
Collective funds:			
Asset allocation	\$ 18,864	Monthly	9–30 days
Common stock	148,912	Daily, monthly	2–30 days
Debt securities	165,910	Daily, weekly, semimonthly, monthly	0–30 days
Hedge funds	<u>106,776</u>	Quarterly, annually	3–90 days
Total	<u>\$ 440,462</u>		

For purposes of NAV, the following investment category definitions are applied:

- Asset allocation investment funds consist of diversified portfolios of debt, equity, and other assets often providing the money manager with discretion as to the allocation across the various assets.
- Common stock investment funds invest substantially all their assets in the equity securities of publicly traded companies in the United States, developed international markets, and emerging international markets.
- Debt securities investment funds invest substantially all their assets in debt securities, including government and corporate bonds, both domestic and foreign.
- Hedge funds are investments funds that have advanced investment strategies with long, short, and derivative positions in domestic and foreign markets. Certain funds have provisions that limit access to the invested funds. These provisions include lockup terms that range up to three years from the subscription date.

- Private equities are investment vehicles typically organized as limited partnerships that are not publicly traded. Funds comprise a variety asset classes with advanced investment strategies, including growth equity, buyouts, venture capital, special situation, mezzanine, and secondary funds. Funds have reduced liquidity with a long-term investment horizon averaging 7-10 years and committed capital is drawn down over this life of the fund.

* As a result of adoption of ASU No. 2016-01 on January 1, 2018, private equities were recorded at fair value in 2018 and at cost in 2017. (Refer to Note 1.)

Bond Maturities - The bonds and notes are carried at fair value. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Holdings as of December 31, 2018, by contractual maturity, are listed as follows (in thousands):

Maturity	Estimated Fair Value
Due in one year or less	\$ 78,962
Due in one year through five years	30,635
Due in five years through 10 years	2,467
Due after 10 years	26,019
Total	\$ 138,083

Return on Investments - The total return on the investment portfolios for the years ended December 31, 2018 and 2017, consist of the following (in thousands):

	2018	2017
Trading securities:		
Interest and dividend income	\$ 28,240	\$ 44,607
Realized gains	53,183	21,220
Unrealized (losses) gains	(148,140)	12,752
Subtotal—trading securities	(66,717)	78,579
Available-for-sale securities:		
Interest and dividend income	-	10,703
Realized gains	-	17,023
Change in unrealized gains	-	29,510
Subtotal—available-for-sale securities	-	57,236
Total investment return	\$ (66,717)	\$ 135,815

Included in the above total return on investments are \$256,000 of impairment losses deemed other than temporary for the year ended December 31, 2017.

Effective October 1, 2017, the System elected to transfer its investments previously accounted for as available-for-sale securities to trading securities; therefore, total return on investments for 2017 for available-for-sale securities is for the nine months ended September 30, 2017. (Refer to Note 1.)

Investment (Loss) Income- Components of investment (loss) income for the years ended December 31, 2018 and 2017, is as follows (in thousands):

	<u>2018</u>	<u>2017</u>
Investment (loss) income, net:		
The Foundation	\$ (14,057)	\$ 31,754
Funds designated for malpractice and general liability	(1,471)	2,787
Funds designated for deferred compensation	(8,048)	17,436
Funds held under bond indenture agreements	1,143	3,004
Interest, dividends, and realized and unrealized (losses) gains from other unrestricted assets	<u>(32,876)</u>	<u>40,770</u>
Total investment (loss) income, net	(55,309)	95,751
Investment (loss) income on restricted investments	(11,408)	11,949
Available-for-sale unrealized gains	<u>-</u>	<u>28,115</u>
Total return on investment	<u>\$ (66,717)</u>	<u>\$ 135,815</u>

Investments Carried at Cost - The aggregate cost of the System's cost-method investments total \$39,041,000 as of December 31, 2017. Of the total cost-method investments, the System evaluated \$15,733,000 of investments for impairment as the estimated cost of the investments exceeded the fair value as of December 31, 2017. The System identified an unrealized loss of \$2,382,000 as of December 31, 2017. During 2017, the System elected to transfer its investments previously accounted for as available-for-sale securities to trading securities, therefore evaluating investments for impairment is not necessary and no impairment was recorded for the year ended December 31, 2018.

5. ASSETS LIMITED AS TO USE

Assets limited as to use as of December 31, 2018 and 2017, consist of the following (in thousands):

	<u>2018</u>	<u>2017</u>
Assets without donor restrictions:		
The Foundation	\$ 305,791	\$ 336,193
Funds held by trustee	4,652	4,512
Funds designated for malpractice and general liability	60,079	85,581
Funds designated for deferred compensation	146,771	154,078
HAP statutory funds	14,335	14,336
Funds board designated for research, education, and other	<u>161,880</u>	<u>205,095</u>
Total assets without donor restrictions	<u>693,508</u>	<u>799,795</u>
Assets with donor restrictions:		
Perpetual in nature	118,703	113,456
Purpose restricted	104,445	128,642
Grants and pledges receivable	<u>23,204</u>	<u>12,643</u>
Total assets with donor restrictions	<u>246,352</u>	<u>254,741</u>
Total assets limited as to use	939,860	1,054,536
Less requirements for current liabilities	<u>46,654</u>	<u>45,509</u>
Noncurrent assets limited as to use	<u>\$ 893,206</u>	<u>\$ 1,009,027</u>

Grants and pledges receivable and expected to be collected, as of December 31, 2018 and 2017, consist of the following (in thousands):

	<u>2018</u>	<u>2017</u>
Amounts expected to be collected in:		
Less than one year	\$ 14,051	\$ 8,045
One to five years	10,572	4,960
More than five years	<u>-</u>	<u>172</u>
Total grants and pledges expected to be collected	24,623	13,177
Unamortized discount	<u>(1,419)</u>	<u>(534)</u>
Total grants and pledges receivable with donor restrictions	<u>\$ 23,204</u>	<u>\$ 12,643</u>

All grants and pledges are deemed collectible.

Onika maintains a reserved deposit of \$11,391,000 and \$11,292,000 as of December 31, 2018 and 2017, respectively, under a reinsurance trust agreement and an agency agreement. These amounts are included above in funds designated for malpractice and general liability. The HAP statutory funds are maintained to fulfill regulatory requirements.

6. JOINT VENTURE INVESTMENTS

The System maintains investments in nine unconsolidated affiliates with ownership interests ranging from 20% to 55%. All unconsolidated affiliates are accounted for under the equity method.

The income related to the investments accounted for under the equity method, included in other income, was \$3,309,000 and \$2,299,000 for 2018 and 2017, respectively.

The summarized financial information for unconsolidated affiliates as of December 31, 2018 and 2017, consisted of the following (in thousands):

	<u>2018</u>	<u>2017</u>
Net revenues	\$ 147,974	\$ 123,570
Net income	4,778	4,757
Total assets	66,934	60,697
Net assets	50,874	44,538

7. PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment as of December 31, 2018 and 2017, consisted of the following (in thousands):

	<u>2018</u>	<u>2017</u>
Land and improvements	\$ 92,127	\$ 86,832
Building and improvements	1,621,576	1,529,649
Equipment	1,545,869	1,439,682
Construction in progress	<u>109,409</u>	<u>91,828</u>
Total	3,368,981	3,147,991
Less accumulated depreciation	<u>1,869,506</u>	<u>1,699,425</u>
Property, plant, and equipment—net	<u>\$ 1,499,475</u>	<u>\$ 1,448,566</u>

As of December 31, 2018 and 2017, the following assets recorded under capital leases are included above (in thousands):

	<u>2018</u>	<u>2017</u>
Land and improvements	\$ 614	\$ 614
Building and improvements	<u>10,799</u>	<u>13,296</u>
Total	11,413	13,910
Less accumulated amortization	<u>4,996</u>	<u>5,520</u>
Assets recorded under capital leases—net	<u>\$ 6,417</u>	<u>\$ 8,390</u>

Internal-use software is included above in equipment and construction in progress. The net book value was \$175,182,000 and \$201,858,000 at December 31, 2018 and 2017, respectively.

8. MEDICAL CLAIMS LIABILITY (REPORTED AND UNREPORTED)

Activity from HAP, included in medical claims liability, is summarized as follows (in thousands):

	<u>2018</u>	<u>2017</u>
Balance—beginning of year	\$ 234,092	\$ 222,110
Incurred related to:		
Current year	1,427,018	2,049,434
Prior year	<u>4,280</u>	<u>(25,017)</u>
Total incurred	<u>1,431,298</u>	<u>2,024,417</u>
Paid related to:		
Current year	1,231,515	1,809,392
Prior year	<u>233,554</u>	<u>203,043</u>
Total paid	<u>1,465,069</u>	<u>2,012,435</u>
Balance—end of year	<u>\$ 200,321</u>	<u>\$ 234,092</u>

Changes in actuarial estimates of claims unpaid reported as “incurred related to prior year” in the schedule above reflect revisions in estimates of medical cost trends and changes in claims processing patterns. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts provided.

9. MALPRACTICE AND GENERAL LIABILITY

The System provides professional and general liability insurance through a combination of self-insurance, claims-made coverage reinsured through Onika, and excess coverage purchased from commercial carriers and Caymich Insurance Company, Ltd. (Caymich). Caymich is an offshore captive insurance company domiciled in the Cayman Islands that provides pooled-risk coverage to its members. The System is a 43.52% and 34.86% member in Caymich at December 31, 2018 and 2017, respectively.

The System estimates a range of loss for known claims and unreported incidents and has recorded a liability based on its assessment of the most likely amount of loss in the range. The liability of \$130,354,000 and \$125,514,000 as of December 31, 2018 and 2017, respectively, has been discounted using a discount factor of 4% as of December 31, 2018 and 2017. Segregated funds included in assets limited as to use have been established to settle claims subject to self-insurance. (Losses) earnings related to these assets of \$(1,471,000) and \$2,787,000 are included in investment (loss) income in December 31, 2018 and 2017, respectively.

10. PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS

Retirement Income Plans - The System provides retirement benefits to substantially all its employees through a combination of qualified defined benefit programs and qualified defined contribution plans. Over several years, the System has been increasing benefit alignment across affiliates, with a focus on the defined contribution programs. The funding policy for all defined benefit plans meets or exceeds the minimum funding requirements required of the Employee Retirement Security Act of 1974. The following summarizes the status of programs at the System and its major affiliates:

System, other than HAP

Effective July 1, 2017, the Allegiance Health Group and Affiliates 403(b) plan was amended to modify the employer-matching formula, add an employer contribution, and provide AHG employees with transitional contributions. The new formula was effective for the first pay of 2018 for qualifying employees of AHG and for all newly hired employees of the System, other than employees of HAP and its affiliates. The primary benefit has a 6% employee contribution with a 3.5% employer match for wages. The plan also has a secondary account that provides for annual employer contributions from 1.25% to 2.75% of eligible wages.

Effective June 30, 2017, the System permanently froze the Allegiance Health Group and Affiliates retirement plan, resulting in a curtailment gain of \$8,408,000 recorded in salaries and wages and employee benefits in the consolidated statements of operations and changes in net assets.

System employees hired prior to 2018 (other than those of AHG and HAP) participate in a retirement savings plan which provides for a one-time employee election to participate. This plan requires employee and employer contributions of 2% and 2.5%, respectively, of base wages up to the social security wage limit. Contributions are 4% and 5% of base wages in excess of this limit for employees and employers, respectively. This plan has a secondary account that provides an annual employer contribution ranging from 1.25% to 2.75% of eligible wages.

Effective December 31, 2010, the System permanently froze the Henry Ford Health System pension plan, a cash balance formula defined benefit plan, and established the secondary account under the retirement savings plan as described above, to provide continuing benefits to all existing participants as well as newly hired employees. Newly hired employees after January 1, 2018, participate in the 403(b) program as described above. Information related to the expense, funding, and liability of this pension plan is provided below.

HAP

HAP maintains a 401(k) plan that provides benefits to qualifying employees with a primary and secondary benefit structure and formula similar to the System's 403(b) program described above.

Effective December 31, 2011, HAP permanently froze the final average pay benefit formula and adopted a cash balance formula in its defined benefit plan for all non-represented employees and for the UAW Local 600 Union Office/Nonexempt Bargaining unit participants hired on or after January 1, 2012, and for the UAW Local 600 Union Sales and Labor unit participants hired on or after April 1, 2012.

The cash balance benefit was frozen effective March 19, 2016, for participants in UAW Local 600 Union Office/Nonexempt Bargaining, effective December 23, 2017, for non-represented participants, resulting in a curtailment gain of \$5,334,000 recorded in salaries and wages and employee benefits in the consolidated statements of operations and changes in net assets. All impacted participants as well as new employees after January 1, 2018, are eligible for the secondary benefit in the HAP 401 (k) described above. Information related to the expense, funding, and liability of this pension plan is provided below.

All HAP non-represented active participants in the cash balance plan as of November 8, 2017, and age 50 or older, with at least 10 years of qualifying service were included in a Special Voluntary Retirement Program (SVRP) offer that provided for additional pay credits. The value of the additional pay credit for employees accepting the SVRP is recognized as a special termination benefit in 2017.

The expense related to the defined contribution plans was approximately \$80,915,000 and \$68,392,000 for 2018 and 2017, respectively.

Postretirement Health Care - The System also provides postretirement health care and life insurance benefits to certain employees who met minimum age and years of service requirements as of December 31, 2006. These employees are also required to meet certain eligibility requirements at the time of retirement. Benefits to employees may require employee contributions or be provided in the form of a fixed-dollar subsidy.

Retirement Program Investment Management - The System's primary investment objective for the pension plans is to ensure sufficient funds are available to meet the plan's benefit and expense obligations and to maintain compliance with regulatory funding requirements. The plans are managed with a long-term duration and liability investment perspective with the goal to achieve risk-adjusted returns on plan assets and plan liabilities.

In 1989, the System entered into a master retirement trust agreement. This master retirement trust agreement combined several trust agreements of the System's subsidiaries, including HAP, into a single trust agreement. All of the System's pension plan assets, excluding AHGs plan assets, are held by the master trust fund.

The allocation percentages of the fair value of total plan assets held as of the measurement dates, December 31, 2018 and 2017, for the plan assets held in the master trust as well as those held in the separate Allegiance trust are shown below:

Master Trust	Target	2018	2017
Cash and cash equivalents	2 %	2 %	1 %
Stock and stock funds	48	46	45
Bonds and bond funds	31	33	34
Global asset allocation	19	18	19
Other	-	1	1
Total	100 %	100 %	100 %
Allegiance Health Group and Affiliates	Target	2018	2017
Cash and cash equivalents	- %	1 %	- %
Stock and stock funds	44	43	45
Bond and bond funds	31	31	30
Global asset allocation	15	14	-
Other	10	11	25
Total	100 %	100 %	100 %

The following tables present information about the fair value of the total plan assets as of December 31, 2018 and 2017, according to the valuation techniques the System used to determine its fair values as described in Note 4 (in thousands):

Master Trust

	<u>2018</u>	<u>2017</u>
Assets measured at fair value:		
Level 1:		
Cash equivalents	\$ 7,214	\$ 4,014
Common stock	19,563	29,301
Collective equity funds:		
Asset allocation	27,970	92,884
Common stock	49,817	42,456
Debt securities	<u>47,733</u>	<u>77,750</u>
Subtotal—Level 1	152,297	246,405
Level 2		
Debt securities:		
Asset-backed securities	1,194	1,312
Corporate debt securities	4,409	4,043
Government and agency debt securities	3,304	4,454
Non-agency mortgage-backed securities	525	302
Other debt securities	<u>78</u>	<u>228</u>
Subtotal—Level 1	9,510	10,339
Level 3—Private equity	<u>-</u>	<u>5,346</u>
 Total investments measured at fair value	 161,807	 262,090
 Investments measured at NAV	 <u>247,085</u>	 <u>226,979</u>
 Total	 <u>\$ 408,892</u>	 <u>\$ 489,069</u>

The fair value reconciliation of the Level 3 assets for the years ended December 31, 2018 and 2017, is as follows (in thousands):

Master Trust

	<u>Level 3</u>
Ending balance—December 31, 2016	\$ 7,375
Total gains for the period included in changes in net assets	490
Purchases and settlements:	
Purchases	245
Settlements	<u>(2,764)</u>
Ending balance—December 31, 2017	5,346
Transfer to investments measured at NAV	<u>(5,346)</u>
Ending balance—December 31, 2018	<u>\$ -</u>

The following tables present information about the fair value of the total plan assets as of December 31, 2018 and 2017, according to the valuation techniques used to determine its fair values as described in Note 4 (in thousands):

<u>Allegiance Health Group and Affiliates</u>	<u>2018</u>	<u>2017</u>
Assets measured at fair value:		
Level 1:		
Cash and cash equivalents	\$ 1,018	\$ 1,158
Collective equity funds:		
Asset allocation	18,901	11,216
Common stock	56,692	72,286
Debt securities	26,352	27,532
Fixed income	-	7,230
Subtotal—Level 1	<u>102,963</u>	<u>119,422</u>
Level 3—Private equity	<u>-</u>	<u>1,953</u>
Total investments measured at fair value	102,963	121,375
Investments measured at NAV	<u>29,653</u>	<u>29,246</u>
Total	<u>\$ 132,616</u>	<u>\$ 150,621</u>

The fair value reconciliation of the Level 3 assets for the years ended December 31, 2018 and 2017, is as follows (in thousands):

<u>Allegiance Health Group and Affiliates</u>	<u>Level 3</u>
Ending balance—December 31, 2016	\$ 16,779
Total losses for the period included in changes in net assets	(44)
Transfer to investments measured at NAV	(13,593)
Settlements	<u>(1,189)</u>
Ending balance—December 31, 2017	1,953
Transfer to investments measured at NAV	<u>(1,953)</u>
Ending balance—December 31, 2018	<u>\$ -</u>

Projected Benefit Obligations - Information regarding the projected benefit obligation and assets of the pension and postretirement benefit plans for the System as of and for the years ended December 31, 2018 and 2017, is as follows (in thousands):

	Pension Benefits		Postretirement Benefits	
	2018	2017	2018	2017
Change in benefit obligation:				
Benefit obligation—beginning of year	\$ 800,757	\$ 794,841	\$ 64,837	\$ 65,871
Service cost	8,107	15,915	602	761
Interest cost	27,885	30,498	2,254	2,622
Actuarial (gain) loss	(51,092)	34,795	(10,174)	(446)
Benefits paid	(24,289)	(24,309)	(5,264)	(4,677)
Medicare Part D subsidy	-	-	651	703
Settlements	(55,473)	(43,058)	-	-
Curtailments	-	(8,575)	-	-
Special contractual termination benefits	-	650	-	-
Plan changes/other	-	-	(74)	3
Benefit obligation—end of year	<u>705,895</u>	<u>800,757</u>	<u>52,832</u>	<u>64,837</u>
Change in plan assets:				
Fair value of assets—beginning of year	639,690	591,167	-	-
Actual return on assets	(37,646)	84,751	-	-
Employer contributions	19,226	31,139	5,264	4,678
Benefits paid	(24,289)	(24,309)	(5,264)	(4,678)
Settlements	(55,473)	(43,058)	-	-
Fair value of assets—end of year	<u>541,508</u>	<u>639,690</u>	<u>-</u>	<u>-</u>
Amounts included in the consolidated balance sheets:				
Total accrued liability	<u>\$ 164,387</u>	<u>\$ 161,067</u>	<u>\$ 52,832</u>	<u>\$ 64,837</u>
Current liability	<u>\$ 1,451</u>	<u>\$ 1,482</u>	<u>\$ 4,110</u>	<u>\$ 4,327</u>
Long-term liability	<u>\$ 162,936</u>	<u>\$ 159,585</u>	<u>\$ 48,722</u>	<u>\$ 60,510</u>

Lump-sum settlements of \$55,473,000 and \$43,058,000 were made during the years ended December 31, 2018 and 2017, respectively. As a result of total lump-sum settlements exceeding the sum of service costs and interest costs, the System recognized a settlement loss of \$12,236,000 and \$6,738,000 during 2018 and 2017, respectively.

Pension and Postretirement Benefit Plan Expense - All previously unrecognized actuarial losses are reflected in the consolidated balance sheets. Pension and postretirement plan benefit items not yet recognized as a component of periodic pension and postretirement plan expense, but included within net assets without donor restrictions, as of and for the years ended December 31, 2018 and 2017, are as follows (in thousands):

	Pension Benefits		Postretirement Benefits	
	2018	2017	2018	2017
Unrecognized prior service cost	\$ 3,368	\$ 3,489	\$ -	\$ -
Unrecognized net actuarial loss (gain)	<u>138,731</u>	<u>140,845</u>	<u>(18,958)</u>	<u>(8,975)</u>
Total	<u>\$ 142,099</u>	<u>\$ 144,334</u>	<u>\$ (18,958)</u>	<u>\$ (8,975)</u>

An estimated \$121,000 in prior service cost and \$3,527,000 in net actuarial loss will be included as components of periodic pension plan expense in 2019. An estimated \$1,202,000 in net actuarial gain will be included as a component of period postretirement medical plan expense in 2019.

The accumulated benefit obligation was \$703,101,000 and \$796,374,000 as of December 31, 2018 and 2017, respectively.

Information regarding the net benefit cost of the pension and postretirement benefit plans for the System as of and for the years ended December 31, 2018 and 2017, is as follows (in thousands):

	Pension Benefits		Postretirement Benefits	
	2018	2017	2018	2017
Net pension benefit cost:				
Service cost	\$ 8,107	\$ 15,915	\$ 602	\$ 761
Interest cost	27,885	30,498	2,254	2,622
Expected return on assets	(42,832)	(43,651)	-	-
Amortization of prior service credit	121	(1,404)	-	(1,995)
Amortization of actuarial loss (gain)	19,264	9,950	(191)	(160)
Curtailement gains	-	(13,742)	-	-
Settlement cost	12,236	6,738	-	-
Special contractual termination benefits	-	650	-	-
Net benefit cost	<u>\$ 24,781</u>	<u>\$ 4,954</u>	<u>\$ 2,665</u>	<u>\$ 1,228</u>

Assumptions – Information on the assumptions were used to determine the benefit obligation and net benefit costs as of and for the years ended December 31, 2018 and 2017, is as follows:

	Pension Benefits		Postretirement Benefits	
	2018	2017	2018	2017
Discount rate—benefit obligation	3.75%-4.35%	2.75%-3.70%	4.30%	2.10%-3.65%
Discount rate—benefit cost	2.75%-3.70%	3.85%-4.15%	3.60%-3.65%	3.70%-4.15%
Expected return on plan assets	6.60%-6.98%	6.60%-6.98%	N/A	N/A

The qualified pension plan for union workers utilized 4% for the rate of compensation increase in estimating both the projected benefit obligation and the net benefit cost as of and for the years ended

December 31, 2018 and 2017. The HAP plan used an age-related scale in estimating both the projected benefit obligation and the net benefit cost for that plan as of and for the years ended December 31, 2018 and 2017.

The expected long-term rate of return on System plan assets is established based on management's expectations of asset returns for the investment mix in the plans, considering historical experience, current economic environment, and forecasted risk/reward assumptions. The expected returns of various asset categories are blended to derive one long-term assumption.

Trend Rates

Assumed health care cost trend rates have a significant effect on the amounts reported for the postretirement plans. The trend rates for 2019 are as follows:

Health care trend rates:	
Blue Cross Blue Shield of Michigan	6.6%
HAP full network	6.9%
HAP preferred network	10.2%
Prescription drug trend rate	6.9%
Ultimate health care and prescription drug trend rate	5.0%
Year in which ultimate trend rates reached	2033

A one-percentage-point change in assumed health care cost trends would have the following effects as of December 31, 2018:

	<u>One-Percentage-Point Increase</u>	<u>One-Percentage-Point Decrease</u>
Effect on postretirement benefit obligation	3.44%	(2.94)%
Effect on total of service cost and interest cost components	3.55%	(2.99)%

Expected Future Contributions - The System is expected to contribute \$10,570,000 to the pension plans and \$4,197,000 to the postretirement health care plans in 2019.

Expected Benefit Payments - As of December 31, 2018, the Systems expects to pay the following pension benefits and postretirement benefits, before deducting the Medicare Part D subsidy for each of the next five years and in the aggregate for the succeeding five years thereafter as follows (in thousands):

	<u>Pension Plans</u>	<u>Postretirement Plans</u>	<u>Postretirement Medicare Part D Subsidy</u>
Years ending December 31:			
2019	\$ 61,568	\$ 4,197	\$ (654)
2020	59,174	4,128	(665)
2021	60,156	4,047	(672)
2022	60,767	3,927	(673)
2023	57,315	4,476	(161)
Thereafter	241,557	20,346	(630)

11. LONG-TERM OBLIGATIONS

Long-term obligations as of December 31, 2018 and 2017, consisted of the following (in thousands):

	<u>2018</u>	<u>2017</u>
Revenue and refunding bonds Series 2016, fixed rate, maturing serially through 2042, interest rates of 3.00% to 5.00%; term due 2041, interest rate of 5.00%; term due 2046, interest rate of 4.00%	\$ 845,430	\$ 849,225
Taxable term loan, maturing 2021, variable interest rate, 3.16% at December 31, 2018	36,410	37,235
Tax-exempt loan, fixed interest rate of 2.07%, maturing 2020	22,550	33,479
Other obligations (interest rates from 4.44% to 4.82%)	3,976	4,423
Deferred issuance costs on bonds, net	(5,894)	(6,242)
Unamortized premium on bonds	<u>100,755</u>	<u>106,068</u>
Total	1,003,227	1,024,188
Less current portion	<u>17,128</u>	<u>17,383</u>
Total long-term obligations	<u>\$ 986,099</u>	<u>\$ 1,006,805</u>

The System's 2016 Master Indenture agreement created the Henry Ford Health System Credit Group (the "Credit Group"). The Credit Group is comprised of the Henry Ford Health System Obligated Group (the "Obligated Group"), Henry Ford Health System Designated Affiliates (the "Designated Affiliates"), and Henry Ford Health System Limited Designated Affiliates (the "Limited Designated Affiliates"). The Corporation, Wyandotte, Macomb, and Allegiance Health are members of the Obligated Group. HAP (excluding its subsidiaries) and the Foundation are Designated Affiliates. There are currently no Limited Designated Affiliates. The agreement contains financial covenants relating to permitted debt, permitted encumbrances, permitted dispositions of cash and other assets, permitted guarantees, and permitted mergers and reorganizations. The System has no knowledge of any default in the performance of the terms, covenants, provisions, or conditions of the 2016 Master Indenture.

The approximate principal requirements on long-term obligations for the next five years and thereafter are as follows (in thousands):

Years Ending December 31:

2019	\$ 17,128
2020	17,661
2021	17,830
2022	18,702
2023	20,649
Thereafter	816,396

The Corporation has various credit agreements, committed at several interest rate options, that it may borrow from summarized as follows (in thousands):

Borrowing Limit	Expiration Date	Loan Advances		Letters of Credit Commitments	
		2018	2017	2018	2017
\$ 100,000	April 18, 2019	-	-	-	\$ 8,128
75,000	April 19, 2020	-	-	-	-
50,000	April 30, 2021	-	-	-	-

The Corporation has received a 90 day extension under the same terms on the credit agreement that expires on April 18, 2019. The extension will permit negotiation of the replacement facility expected to be in place by July 2019.

12. CAPITAL LEASE OBLIGATIONS

The System has capital lease agreements for buildings. The capital lease obligations require payments in future years as follows (in thousands):

Years Ending December 31:

2019	\$ 421
2020	454
2021	454
2022	468
2023	476
Later years	<u>5,926</u>
Total minimum lease payments	8,199
Less interest (interest rates from 4.49% to 8.25%)	<u>2,638</u>
Obligations under capitalized leases, including \$185 due within one year	<u>\$ 5,561</u>

13. COMMITMENTS AND CONTINGENCIES

The System has entered into various operating lease agreements, which expire through 2037 and include varying renewal options. Rental expense under such leases was approximately \$52,449,000 and \$53,285,000 for the years ended December 31, 2018 and 2017, respectively.

The aggregate remaining lease payments required under operating leases with noncancelable terms in excess of one year as of December 31, 2018, approximate \$270,092,000. The approximate payment requirements under these leases for each of the five years, are as follows (in thousands):

Years Ending December 31:

2019	\$ 34,176
2020	29,751
2021	26,516
2022	22,278
2023	20,357

In connection with HAP's acquisition of ASR, ASR entered into an employment and stock transfer and redemption agreement (the "agreement") with a 33% non-controlling interest (NCI) holder. The NCI holder has exercised his right under this agreement requiring ASR to purchase his interests in ASR (the "Put Option"). The NCI holder disputes ASR's calculation of the price under the Put Option and is pursuing litigation to resolve the matter. During 2018 in connection with efforts to mediate this matter and based upon updated third party evaluations, HAP increased its recognized obligation under the Put Option by \$9,030,000 to \$36,754,000, of which \$18,423,000 remains outstanding and is reflected in accounts payable in the consolidated balance sheets. Although the parties continue to work toward a resolution of this matter, the ultimate outcome cannot be assessed at this time.

The System is also party to other lawsuits incidental to its operations and management believes that the ultimate outcome of these other contingencies will not have a material effect on the accompanying consolidated financial statements.

The health care industry is subject to numerous and complex laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, specifically those relating to the Medicare and Medicaid programs, can be subject to review and interpretation, as well as future regulatory enforcement actions, such as fines, penalties, and repayment of previously billed and collected revenues. Management believes that the System complies with current laws and regulations.

14. NET ASSETS WITHOUT DONOR RESTRICTIONS

Changes in consolidated net assets without donor restrictions attributable to the System and the noncontrolling interests for the years ended December 31, 2018 and 2017, are as follows (in thousands):

	<u>Henry Ford Health System</u>	<u>Noncontrolling Interests</u>	<u>Total</u>
Net assets without donor restrictions—December 31, 2016	\$ 1,593,299	\$ 3,135	\$ 1,596,434
Excess of revenue over expenses from consolidated operations	203,679	2,057	205,736
Net cumulative unrealized gains transferred to trading securities	(59,216)	-	(59,216)
Change in net unrealized gains and losses on investments	22,558	-	22,558
Net assets released from restrictions for capital	8,862	-	8,862
Distributions to noncontrolling interests	-	(1,861)	(1,861)
Pension and other postretirement net adjustments	16,140	-	16,140
	<u>192,023</u>	<u>196</u>	<u>192,219</u>
Net assets without donor restrictions—December 31, 2017	<u>1,785,322</u>	<u>3,331</u>	<u>1,788,653</u>
Excess of revenue over expenses from consolidated operations	84,866	1,957	86,823
Net assets released from restrictions for capital	9,545	-	9,545
Distributions to noncontrolling interests	-	(1,861)	(1,861)
Pension and other postretirement net adjustments	12,218	-	12,218
Purchase price adjustment to noncontrolling interest	(9,030)	-	(9,030)
	<u>97,599</u>	<u>96</u>	<u>97,695</u>
Net assets without donor restrictions—December 31, 2018	<u>\$ 1,882,921</u>	<u>\$ 3,427</u>	<u>\$ 1,886,348</u>

15. ENDOWMENTS

The System's endowments consist of various funds established for specific purposes that are either designated by the board and included in net assets without donor restrictions or designated by a donor and are included in net assets with donor restrictions. The assets are managed in a custodial account. The account is using the following targeted asset allocations:

	<u>Target</u>
Stock and stock funds	45 %
Private equities	20
Collective funds:	
Hedge funds	15
Debt securities	14
Liquid assets	<u>6</u>
Total	<u>100 %</u>

The annual spending appropriation from the endowments is determined by the average of the beginning balance for each of the three previous years multiplied by a 5% spending factor. The endowment corpus is maintained in perpetuity for donor-restricted endowments.

The composition of endowment net assets as of December 31, 2018 and 2017, and the changes in endowment net assets for the years ended December 31, 2018 and 2017, are summarized as follows (in thousands):

	Endowment Net Assets Designated by Board	Endowment Net Assets with Donor Restrictions	Total
Endowment net assets—December 31, 2016	\$ 303,730	\$ 106,064	\$ 409,794
Investment return, net	48,463	9,479	57,942
Contributions and other	-	3,377	3,377
Annual spending appropriation	<u>(16,000)</u>	<u>(4,797)</u>	<u>(20,797)</u>
Endowment net assets—December 31, 2017	336,193	114,123	450,316
Investment return, net	(14,902)	8,616	(6,286)
Contributions and other	-	6,876	6,876
Annual spending appropriation	<u>(15,500)</u>	<u>(5,358)</u>	<u>(20,858)</u>
Endowment net assets—December 31, 2018	<u>\$ 305,791</u>	<u>\$ 124,257</u>	<u>\$ 430,048</u>

16. INFORMATION ABOUT LIQUIDITY

The System's ALM strategy is designed to ensure liquidity across all operating units and meet all regulatory requirements. To accomplish this, separate cash funds are maintained for the System and for each of the regulated insurance subsidiaries (collectively "Operating Pools"). The Operating Pools allocation offers the potential for higher return consistent with reasonable risk while also ensuring adequate liquidity to meet the System's general expenditures, liabilities, and other obligations as they come due. In addition, as part of its liquidity management, the System invests cash in excess of daily requirements in various short-term investments, primarily government money market funds. As more fully described in Note 11, the System also has committed lines of credit for \$225,000,000, which it could draw upon in the event of an unanticipated liquidity level.

The Foundations' endowment investments are designated by the board and considered a quasi-endowment as described in further detail in Note 15. The System does not intend to spend from the Foundation's endowment other than the investment income appropriated for general expenditures, however, additional funds could be made available if necessary.

The Operating Pools, the Foundation endowment, and donor-restricted endowments contain a limited allocation of investments with lock-up provisions that would reduce the total investments that could be made available (see Note 4 for disclosures about these investments). The System carefully manages liquidity through other asset classes of investments.

The System's total financial assets as of December 31, 2018, reduced by amounts not available for general use within one year of the balance sheet date because of donor restrictions, internal designations, or certain investments with reduced liquidity are as follows (in thousands):

	<u>2018</u>
Total financial assets	\$ 2,621,100
Financial assets not available to be used in one year:	
Subject to contractual or donor imposed restrictions (Note 5)	(265,339)
Subject to board and other designations (Note 5)	(674,521)
Hedge funds subject to lock-up provisions (Note 4)	(5,725)
Private equity investments (Note 4)	<u>(11,650)</u>
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 1,663,865</u>

17. SUBSEQUENT EVENTS

Pursuant to FASB ASC Topic 855-10, *Subsequent Events—Overall*, the System has evaluated subsequent events through March 14, 2019, the date the consolidated financial statements were issued. Because of this evaluation, the System has no subsequent events to disclose.

The System expects to issue approximately \$250,000,000 of tax exempt bonds through the Michigan Finance Authority in the second quarter of 2019. The proceeds will be used to finance current construction projects, as well as refinance recent construction projects.

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