



# Annual Financial Report

As of and for the Years Ended December 31, 2019 and 2018

# TABLE OF CONTENTS

**Henry Ford Health System Overview** ..... 1

**System Highlights** ..... 3

**Management Discussion and Analysis** ..... 6

**Independent Auditors’ Report** ..... 13

**Consolidated Financial Statements**

    Consolidated Balance Sheets ..... 15

    Consolidated Statements of Operations and Changes in Net Assets..... 17

    Consolidated Statements of Cash Flows ..... 19

    Notes to Consolidated Financial Statements ..... 21



## HENRY FORD HEALTH SYSTEM OVERVIEW

### Organizational Overview

Henry Ford Health System, a Michigan nonprofit corporation, and its subsidiaries (collectively, the “System”) form a regional vertically integrated health care network made up of:

- Five acute care hospitals, two psychiatric hospitals, and one specialty hospital.
- Henry Ford Medical Group, one of the nation’s largest and longest existing physician group practices, with approximately 1,900 employed physicians and scientists, practicing in over 40 specialties.
- Health Alliance Plan of Michigan (“HAP”) and its subsidiaries, insurance plans, with more than three decades of integrated insurance operations, with approximately 530,000 covered lives and products in nearly every market segment.
- Comprehensive provider assets, including an extensive ambulatory network with medical and health centers, a substance abuse facility, behavioral health clinics, home-based care, pharmacy, eye care, and other retail-oriented services. In aggregate, the System has more than 250 care delivery locations, serving patients in southeast and south-central Michigan.

### Mission, Vision, and Values

The System’s mission is to improve people’s lives through excellence in the science and art of health care and healing. The System’s vision is to be the trusted partner in health, leading the nation in superior care and value — one person at a time. The System’s values, as depicted by the graphic below, support its mission and vision.

## OUR MISSION AND VALUES

We improve people’s lives through  
excellence in the science and art of health care and healing.  
Through Our Values of:



**Strategy**

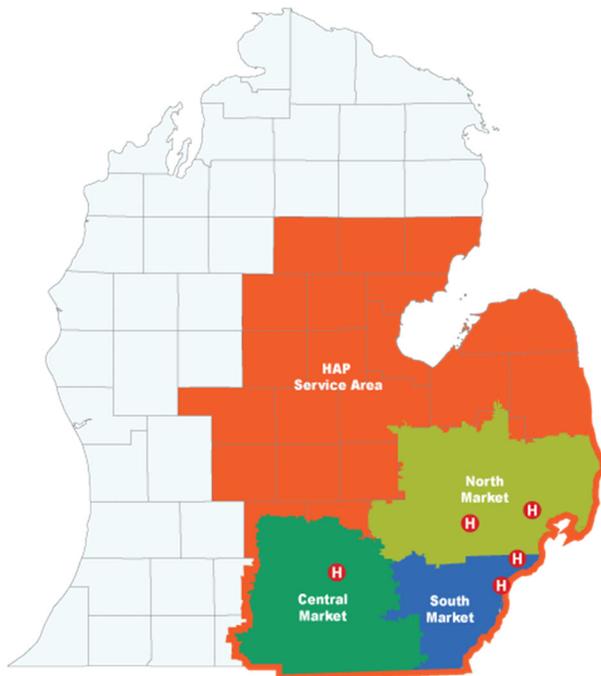
The System’s strategic plan “Path to True North 2023” (the “Plan”) drives the System’s continued success in the market place. In support of the organization’s mission, the plan focuses on three core outcomes:

- **Health of the Community** – Providing affordable and high-quality seamless care and coverage
- **Scale** – Sufficiency of competitive scale to achieve market impact and achieve national leadership positioning in select strategic services
- **Margin for Innovation** – Maintenance of a solid foundation to support national recognition as a leader in health delivery, sciences, and insurance innovation

In support of these objectives, the Plan outlines six strategic themes to leverage the System’s unique strategic advantages in the market as the only integrated system providing tertiary-quaternary care in an academic environment, a domestic health plan and other provider risk capabilities, and a regionally distributed footprint across south eastern and south-central Michigan. The graphic to the right depicts the Plan’s six strategic themes.



**Service Area**



The System defines its primary service area by major markets: the North Market, the South Market, and the Central Market. The North Market includes Oakland and Macomb Counties; the South Market includes Wayne County, which encompasses the city of Detroit, and the eastern half of Washtenaw County; and the Central Market includes Jackson County and portions of all surrounding counties. The map shows the System’s provider and health plan service area, as well as acute care facilities.

## SYSTEM HIGHLIGHTS

2019 was a transformative year for the System with new programs, new facilities, new partnerships, and new payment models. This transformation focused on consumerism and delivering sustainable growth. A few highlights from the year follow:

### Clinical Excellence and Innovations:

- For the second time in a row, all five System acute care hospitals earned an A grade for patient safety performance from The Leapfrog Group.
- First in the world to enroll a patient in the GBM AGILE trial for glioblastoma patients. Allowing rapid access to new therapies and hope, this trial is the first platform to test multiple therapies concurrently worldwide because of the international collaboration of clinicians.
- First double lung transplant on a patient whose lungs were damaged by vaping.
- First in Michigan and second in the world to perform an innovative, minimally invasive cancer treatment called Spinal Laser Interstitial Thermal Therapy, which destroys cancer cells adjacent to the spine without open surgery, reducing recovery time from weeks to days.
- Global Health Exchange recognized the System's supply chain management among the 50 Best Health Care Supply Chains in North America.

### Expanding Access:

- Opened Henry Ford Medical Center in Bloomfield Township and Henry Ford Pistons Performance Center in Detroit.
- Planned opening of two new Henry Ford destination medical centers in Royal Oak and Plymouth Township slated to open in 2020 and 2021.
- Expanded cancer care services across the System, including spearheading a comprehensive precision medicine and molecular tumor board for all cancer types, and the development of the Brigitte Harris Cancer Pavilion scheduled to open in 2020.

### Digital Advancements:

- Provided over 17,000 virtual patient visits, an increase of 123% from 2018, for patients in their home or in a more convenient clinic location.
- Enabled continuous vital monitoring for high-risk patients by providing nearly 50,000 remote patient monitoring telehealth encounters in patient homes.

- Launched new digital medical cost estimator designed to enhance the patient experience and provide out-of-pocket cost estimates for many common procedures.
- Launched Henry Ford Bill Pay to provide easy online access for patients to view and pay their balances, including flexible payment options. Over 72,000 patients have signed up, resulting in over 10,000 new payment plans and a 35% increase in online payments from the prior year.

#### **New Software Innovations:**

- Specialty pharmacists created DromosPTM, an innovative, cloud-based software application.
  - Automating patient therapy management, analytics, and workflow processes for specialty pharmacies.
  - Operational in a number of major health systems with more to launch in 2020.
- Continued strategic partnership for Precision Medicine with Syapse, the leading precision medicine software company. Responding to the Cancer Moonshot initiative, the System is committed to leading the data sharing movement to increase cancer care outcomes nationwide.

#### **Revolutionized Care Models:**

- Value-based arrangements now cover more than 650,000 lives. Arrangements include:
  - Direct-to-employer contract with General Motors
  - New partnership with BCBS of Michigan on their Blueprint for Affordability
  - Henry Ford Accountable Care Organization

#### **Other:**

- Awarded nearly \$90 million in funded research, ranking the System first in Michigan for National Institutes of Health research funding for non-university-based health care systems.
- Partnered with 13 leading US hospitals and health systems, together investing \$700 million to address social determinants of health with commitment to make local economic impact through hiring, purchasing, and investing.
- Licensed our intellectual property for the development of three international hospitals – one in Saudi Arabia which opened early in 2020 and two in India expected to open in 2020 and 2022 – expanding the System brand internationally.
- Acquired Trusted Health Plan Michigan, allowing the System to expand health care coverage options to Medicaid members in Wayne, Oakland, and Macomb counties.

**New Senior Leaders:**

- Dr. Steven Kalkanis was appointed CEO of Henry Ford Medical Group, and Senior VP and Chief Academic Officer for the System. Dr. Kalkanis is an internationally recognized neurosurgeon who is concurrently serving as the President of the Congress of Neurological Surgeons, the largest association of its kind.
- Dr. Michael Genord was appointed President and CEO of HAP. Dr. Genord served in many leadership roles, including Chief Medical Officer of HealthPlus and HAP as well as president and CEO of HAP Empowered Health Plan, a licensed HMO and wholly owned subsidiary of HAP.
- Laurie Doran was named HAP's CFO. During her 30-year career, she served as CFO of BMC HealthNet Plan and served in a variety of finance leadership roles at Harvard Pilgrim Health Care.

## MANAGEMENT DISCUSSION AND ANALYSIS

The Management Discussion and Analysis is intended to provide a high-level overview of the System's consolidated financial performance for the year ended December 31, 2019, with comparable prior-year information, including operational highlights. This document includes certain forward-looking comments based on management's beliefs; actual results could differ materially.

### Summary of Operating Results

The System reported consolidated operating income of \$138.6 million for the year ended December 31, 2019, on consolidated revenues of \$6.3 billion, providing an operating margin of 2.2%. Operating income before interest, depreciation, and amortization total \$380.6 million.

The System continued with its "System Redesign & Transformation" program, with the goal of achieving increased value by deploying projects targeting population health management, greater integration across the care continuum, improved access for customers, and enhanced corporate and support services.

### System Revenue

Total consolidated revenue without donor restrictions was \$6.3 billion for the year ended December 31, 2019, up \$387.6 million or 6.6% from the year ended December 31, 2018. The System recognized consolidated net patient service revenue of \$3.9 billion and consolidated health care premium revenue of \$1.9 billion for the year ended December 31, 2019. Consolidated revenues associated with health care services provided by the System to members of its capitated insurance products are included in health care premium revenue. Consolidated net patient service revenue reflects amounts recognized from all other payers and patients.

SYSTEM REVENUES (\$ in thousands)		
	<u>12/31/2019</u>	<u>12/31/2018</u>
Net patient service revenue:		
Gross net patient service revenue	\$ 4,628,357	\$ 4,302,683
Intercompany transactions eliminated	<u>(716,198)</u>	<u>(720,934)</u>
Total net patient service revenue	3,912,159	3,581,749
Health care premiums	1,938,804	1,931,140
Other revenue	<u>436,364</u>	<u>386,834</u>
Total revenue without donor restrictions	<u>\$ 6,287,327</u>	<u>\$ 5,899,723</u>

Consolidated net patient service revenue increased \$330.4 million or 9.2% for the year ended December 31, 2019, compared to the year ended December 31, 2018. This was primarily due to an increase and mix of outpatient activity, favorable rates, increased patient acuity, increased professional revenue, and expanded specialty and ambulatory pharmacy activities. This was partially offset by the slight decline in inpatient discharges.

Consolidated health care premium revenue was slightly favorable compared to the prior year despite the 2.8% decline in membership. The Centers for Medicare and Medicaid Services star rating payment to HAP was regained for 2019 and contributed to the stability of the revenue. The acquisition of Trusted provides expanded opportunity to increase Medicaid membership across the metropolitan Detroit marketplace.

HAP COVERED LIVES		
By Product	12/31/2019	12/31/2018
Self-Funded	179,330	191,410
Group Insured Commercial	154,741	162,290
Network Leasing	112,423	115,220
Medicare Advantage	70,607	63,418
Individual	7,165	8,464
Dual Eligible	4,718	4,624
Medicaid	4,171	3,276
<b>Total</b>	<b>533,155</b>	<b>548,702</b>

Consolidated other revenue increased \$49.5 million or 12.8% for the year ended December 31, 2019, compared to the year ended December 31, 2018. This was primarily due to increased contract pharmacy revenue and funding from the National Institutes of Health for the *All of Us* research program, which has the goal of advancing precision medicine.

### System Expense

Consolidated total expenses increased by \$400.3 million or 7.0%, for the year ended December 31, 2019, compared to the year ended December 31, 2018. Following are explanations for the most significant components.

SYSTEM EXPENSES (\$ in thousands)		
	12/31/2019	12/31/2018
Salaries, wages, and employee benefits	\$ 2,727,072	\$ 2,508,657
Health care provider expense	1,117,808	1,084,295
Supplies	1,100,467	981,677
General and other administrative	399,877	398,847
Other	803,329	774,778
<b>Total operating expenses</b>	<b>\$ 6,148,553</b>	<b>\$ 5,748,254</b>

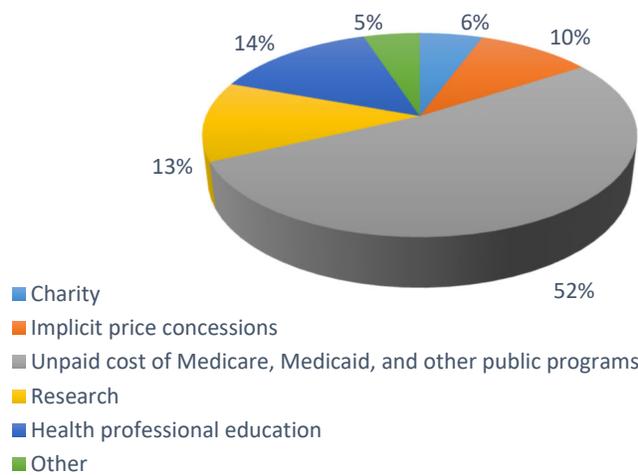
Consolidated salaries, wages, and employee benefits increased by \$218.4 million or 8.7% for the year ended December 31, 2019, compared to the year ended December 31, 2018. This was primarily due to the System’s wage program initiatives designed to address the competitive labor market combined with the impact of patient acuity on labor.

Consolidated health care provider expense increased by \$33.5 million or 3.1% for the year ended December 31, 2019, compared to the year ended December 31, 2018. This is primarily attributed to acuity of services provided to Medicare Advantage members aligning with their higher risk scores and premiums.

Consolidated supplies expense increased \$118.8 million or 12.1% for the year ended December 31, 2019, compared to the year ended December 31, 2018, driven by changes in the mix of patient services, increased patient acuity, and pharmacy expense related to expanded ambulatory and specialty pharmacy activities.

**Uncompensated Care and Community Benefits**

The System expended \$670.2 million on uncompensated care and community benefit for the year ended December 31, 2019, compared to \$640.6 million in the prior year. Uncompensated care represented \$455.3 million and \$456.2 million of these amounts in each respective year. Given its mission, the System also had substantial unreimbursed costs for health professional education, research, and other community services, which are also important components of overall community benefit expenditures.



**Nonoperating Items**

**Investment Performance**

The System maintains significant investments, including cash and cash equivalents, short-term investments, and long-term investments. Consolidated investment return, net recognized during the year ended 2019 was \$215.8 million compared to investment return, net of \$(45.9) million recognized during the year ended 2018. The increase in consolidated investment return is consistent with market returns on the underlying securities in these funds.

## Balance Sheet

As a result of the System's balance sheet management strategy to improve the efficiency of working capital and strong investment performance, total funds without restriction increased \$519.3 million over the prior year.

### Days Cash on Hand

Total System days cash at December 31, 2019, totaled 146.3 days compared to 122.6 days at December 31, 2018. This was primarily due to strong operating results, the bond issuance in May, and investment returns.

<b>DAYS CASH ON HAND</b>		
(\$ in thousands)		
	<u>12/31/2019</u>	<u>12/31/2018</u>
Cash, cash equivalents, and short-term investments	\$ 611,863	\$ 557,541
Long-term investments	1,223,054	689,783
Assets limited as to use:		
The Foundation	339,811	305,791
Funds designated for deferred compensation	177,577	146,771
Funds board-designated for research, education, and other	<u>28,797</u>	<u>161,880</u>
<b>Total funds without restrictions (A)</b>	<u>\$ 2,381,102</u>	<u>\$ 1,861,766</u>
<b>Total operating expenses<sup>(1)</sup> (excluding depreciation and amortization) (B)</b>	<u>\$ 5,941,564</u>	<u>\$ 5,543,293</u>
Days cash on hand (Calculation equals (A)/((B)/365))	<u>146.3</u>	<u>122.6</u>
Total funds without restrictions to total debt	<u>204.5 %</u>	<u>203.7 %</u>

<sup>(1)</sup>Total operating expenses for 2018 reflect current-year presentation of retirement benefit costs.

### Long-Term Obligations

On May 2, 2019, the System closed on the issuance of \$227.9 million in Series 2019A hospital revenue bonds ("Series 2019A Bonds") issued at a premium of \$22.1 million. The proceeds are being used for the purposes of financing or refinancing the construction, renovation, and equipping of the System's facilities. The System has received \$195.2 million of the proceeds for reimbursement of approved costs while \$56.0 million remains held in trust as of December 31, 2019.

On June 3, 2019, the System entered into two new \$100.0 million line-of-credit facilities, each of which expire on June 2, 2021. As a result on July 16, 2019, the System terminated a prior \$100.0 million line-of-credit facility and reduced the limit on a credit agreement from \$50.0 million to \$10.0 million on July 16, 2019, and will allow another credit agreement with a borrowing limit of \$75.0 million to expire on April 19, 2020.

<b>SYSTEM CAPITALIZATION</b> ( <b>\$ in thousands</b> )		
	<u>12/31/2019</u>	<u>12/31/2018</u>
Series 2016 Bonds <sup>(2)</sup>	\$ 840,770	\$ 845,430
Series 2019A Bonds <sup>(2)</sup>	227,910	-
Bank term loan	35,560	36,410
Tax-exempt note	11,392	22,550
Other obligations <sup>(3)</sup>	3,495	3,976
Financing lease payable	45,102	5,561
<b>Total debt<sup>(1)</sup></b>	<b><u>\$ 1,164,229</u></b>	<b><u>\$ 913,927</u></b>
<b>Total net assets without donor restrictions</b>	<b><u>\$ 2,232,739</u></b>	<b><u>\$ 1,886,348</u></b>
<b>Total capitalization</b>	<b><u>\$ 3,396,968</u></b>	<b><u>\$ 2,800,275</u></b>
<b>Total debt / total debt capitalization</b>	<b><u>34.3%</u></b>	<b><u>32.6%</u></b>

(1) Includes current portion of long-term debt

(2) Par amount of bonds outstanding. Does not include unamortized premium or deferred issuance costs on the bonds.

(3) Includes mortgages. HFHS has \$285.0 million under three credit agreements for short-term borrowing. The credit agreements are each secured by Obligations. As of December 31, 2019 and 2018, HFHS had no advances on the lines of credit and approximately \$10.0 million reserved for letters of credit, leaving \$275.0 million available for credit line draws.

**Debt Service Coverage Ratio**

<b>DEBT SERVICE COVERAGE RATIO</b>		
(\$ in thousands)		
	<u>12/31/2019</u>	<u>12/31/2018</u>
Excess of revenue over expenses before unusual items	\$ 354,503	\$ 86,823
Depreciation and amortization	206,989	204,961
Interest expense	34,977	31,693
Unrealized (gains) losses on securities	(150,801)	127,173
Pension settlement costs	<u>5,492</u>	<u>12,236</u>
Income available for debt service	<u>\$ 451,160</u>	<u>\$ 462,886</u>
Maximum annual debt service	<u>\$ 72,268</u>	<u>\$ 57,852</u>
Debt service coverage ratio <sup>(1)</sup>	<u>6.24</u>	<u>8.00</u>

<sup>(1)</sup>Based on Article III Section 3.12 of the Master Indenture

**Utilization**

<b>SYSTEM UTILIZATION STATISTICS</b>		
	<u>12/31/2019</u>	<u>12/31/2018</u>
Licensed beds (including skilled nursing facility beds)	2,468	2,468
Available beds	2,062	2,040
Discharges (excluding newborns)	110,047	110,222
Patient days (excluding newborns)	569,853	541,102
Length of stay	5.18	4.91
All payor case mix index	1.79	1.75
Inpatient emergency room visits	57,226	56,033
Outpatient emergency room visits	389,260	404,963
Inpatient surgeries	22,687	23,538
Outpatient surgeries	53,043	52,454
Observation cases	36,022	35,903
Total outpatient visits (including emergency room and surgeries)	7,536,383	7,280,334

# CONSOLIDATED FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018



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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, 2019 and 2018, 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 System'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 System'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, 2019 and 2018, 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.

**Change in Accounting Principle**

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2019, the System adopted Financial Accounting Standards Board Accounting Standards Update No. 2016-02, *Leases (Topic 842)*, using the modified retrospective method.

*Deloitte & Touche LLP*

March 13, 2020

**CONSOLIDATED BALANCE SHEETS**  
**AS OF DECEMBER 31, 2019 AND 2018**  
(In thousands)

	<u>2019</u>	<u>2018</u>
<b>ASSETS:</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 611,863	\$ 556,400
Short-term investments	-	1,141
Patient care receivables	429,900	391,083
Health care premium receivables	21,464	21,650
Due from third-party payors	20,261	21,183
Other current assets	258,087	246,989
Current portion of assets limited as to use	<u>108,546</u>	<u>46,654</u>
Total current assets	1,450,121	1,285,100
LONG-TERM INVESTMENTS	1,223,054	689,783
ASSETS LIMITED AS TO USE	835,077	893,206
JOINT VENTURE INVESTMENTS	23,663	24,970
INTANGIBLE AND OTHER ASSETS—Net	52,614	49,699
GOODWILL—Net of accumulated amortization of \$28,577 in 2019 and 2018	22,159	14,029
RIGHT OF USE—OPERATING LEASE ASSETS	198,559	-
RIGHT OF USE—FINANCING LEASE ASSETS	45,103	-
PROPERTY, PLANT, AND EQUIPMENT—Net	<u>1,607,201</u>	<u>1,499,475</u>
<b>TOTAL ASSETS</b>	<u>\$ 5,457,551</u>	<u>\$ 4,456,262</u>

(Continued)

**CONSOLIDATED BALANCE SHEETS**  
**AS OF DECEMBER 31, 2019 AND 2018**  
(In thousands)

	<u>2019</u>	<u>2018</u>
<b>LIABILITIES AND NET ASSETS:</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 348,814	\$ 259,482
Due to third-party payors	55,386	46,572
Medical claims liability	159,257	176,241
Other liabilities and accrued expenses	330,086	304,401
Current portion of long-term obligations	17,622	17,128
Current portion of malpractice and general liability	36,506	32,602
Current portion of operating lease liabilities	26,370	-
Current portion of financing lease liabilities	<u>3,518</u>	<u>185</u>
Total current liabilities	977,559	836,611
DEFERRED COMPENSATION, POSTRETIREMENT, AND OTHER LIABILITIES	430,928	397,724
LONG-TERM OBLIGATIONS	1,210,873	986,099
MALPRACTICE AND GENERAL LIABILITY	103,664	97,752
LONG-TERM OPERATING LEASE LIABILITIES	183,617	-
LONG-TERM FINANCING LEASE LIABILITIES	<u>41,584</u>	<u>5,376</u>
Total liabilities	<u>2,948,225</u>	<u>2,323,562</u>
<b>NET ASSETS:</b>		
Without donor restrictions:		
Henry Ford Health System	2,229,422	1,882,921
Noncontrolling interests	<u>3,317</u>	<u>3,427</u>
Total net assets without donor restrictions	2,232,739	1,886,348
With donor restrictions	<u>276,587</u>	<u>246,352</u>
Total net assets	<u>2,509,326</u>	<u>2,132,700</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u>\$ 5,457,551</u>	<u>\$ 4,456,262</u>

See notes to consolidated financial statements.

(Concluded)

**CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS  
FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018  
(In thousands)**

	<u>2019</u>	<u>2018</u>
<b>REVENUE WITHOUT DONOR RESTRICTIONS:</b>		
Net patient service revenue	\$ 3,912,159	\$ 3,581,749
Health care premiums	1,938,804	1,931,140
Other revenue	<u>436,364</u>	<u>386,834</u>
Total revenue without donor restrictions	<u>6,287,327</u>	<u>5,899,723</u>
<b>EXPENSES:</b>		
Salaries, wages, and employee benefits	2,727,072	2,508,657
Health care provider expense	1,117,808	1,084,295
Supplies	1,100,467	981,677
General and other administrative	399,877	398,847
Other contracted services	319,603	316,276
Depreciation and amortization	206,989	204,961
Repairs and maintenance	66,959	66,748
Plant operations	56,694	57,903
Rent and lease	58,775	52,449
Malpractice	59,332	44,748
Interest expense	<u>34,977</u>	<u>31,693</u>
Total expenses	<u>6,148,553</u>	<u>5,748,254</u>
<b>OPERATING INCOME</b>	138,774	151,469
<b>NONOPERATING ITEMS:</b>		
Investment return, net	215,821	(45,909)
Other components of net periodic pension cost	<u>(92)</u>	<u>(18,737)</u>
Total nonoperating items	<u>215,729</u>	<u>(64,646)</u>
<b>EXCESS OF REVENUE OVER EXPENSES</b>	<u>354,503</u>	<u>86,823</u>
<b>LESS EXCESS OF REVENUE OVER EXPENSES ATTRIBUTABLE TO NONCONTROLLING INTERESTS</b>	<u>1,973</u>	<u>1,957</u>
<b>EXCESS OF REVENUE OVER EXPENSES ATTRIBUTABLE TO HENRY FORD HEALTH SYSTEM</b>	<u>\$ 352,530</u>	<u>\$ 84,866</u>

(Continued)

**CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS  
FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018  
(In thousands)**

	<u>2019</u>	<u>2018</u>
<b>NET ASSETS WITHOUT DONOR RESTRICTIONS:</b>		
Excess of revenue over expenses from consolidated operations	\$ 354,503	\$ 86,823
Net assets released from restrictions for capital	16,305	9,545
Distributions to noncontrolling interests	(2,083)	(1,861)
Pension and other postretirement net adjustments	(7,373)	12,218
Purchase price adjustment to noncontrolling interest (Note 1)	<u>(14,961)</u>	<u>(9,030)</u>
Increase in net assets without donor restrictions	<u>346,391</u>	<u>97,695</u>
<b>NET ASSETS WITH DONOR RESTRICTIONS:</b>		
Return on restricted investments, net	32,781	(11,408)
Contributions and other	86,018	58,079
Net assets released from restrictions for operations	(72,259)	(45,515)
Net assets released from restrictions for capital	<u>(16,305)</u>	<u>(9,545)</u>
Increase (decrease) in net assets with donor restrictions	<u>30,235</u>	<u>(8,389)</u>
<b>TOTAL INCREASE IN NET ASSETS</b>	376,626	89,306
<b>TOTAL NET ASSETS—Beginning of year</b>	<u>2,132,700</u>	<u>2,043,394</u>
<b>TOTAL NET ASSETS—End of year</b>	<u>\$ 2,509,326</u>	<u>\$ 2,132,700</u>
See notes to consolidated financial statements.		(Concluded)

**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018**  
(In thousands)

	<u>2019</u>	<u>2018</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Increase in net assets	\$ 376,626	\$ 89,306
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	206,989	204,961
Pension and other postretirement net adjustments	7,373	(12,218)
Amortization of bond premium and deferred debt issue costs	(5,283)	(4,965)
Loss on sale or disposal of assets	8,086	957
Return on restricted investments	(32,781)	11,408
Restricted contributions and grants	(86,018)	(58,079)
Net realized and unrealized (gains) losses on investments	(223,718)	94,957
Distributions to noncontrolling interests	2,083	1,861
Purchase price adjustment to noncontrolling interest	14,961	9,030
Proceeds from dissolution of trusts	-	(6,532)
Change in assets and liabilities:		
Patient and health care premium receivables	(34,361)	(36,322)
Other current assets	(11,026)	(29,651)
Assets limited as to use	25,714	4,483
Joint venture investments	1,307	(3,895)
Other assets	(2,705)	(5,966)
Accounts payable	95,551	(10,724)
Other liabilities	37,193	(34,510)
Due to/from third-party payors	9,736	43,681
Medical claims liability	(21,137)	(20,883)
Malpractice and general liability	<u>9,816</u>	<u>8,840</u>
Net cash provided by operating activities	<u>378,406</u>	<u>245,739</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Additions to property	(317,442)	(263,620)
Proceeds from the sale or maturity of securities	470,571	912,363
Purchases of securities	(719,753)	(1,147,714)
Acquisition of THPM, net of cash received	<u>(13,516)</u>	<u>-</u>
Net cash used in investing activities	<u>(580,140)</u>	<u>(498,971)</u>

(Continued)

## CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018 (In thousands)

	<b>2019</b>	<b>2018</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from long-term obligations	\$ 195,244	\$ 1,385
Payments of long-term obligations	(17,147)	(17,381)
Payment of financing costs	(2,304)	-
Payments of finance lease liabilities	(2,756)	(248)
Distributions to noncontrolling interests	(2,083)	(1,861)
Payments to acquire noncontrolling interest	(32,556)	-
Return on restricted investments	32,781	(11,408)
Restricted contributions and grants	86,018	58,079
Proceeds from dissolution of trust	-	6,532
Net cash provided by financing activities	257,197	35,098
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	55,463	(218,134)
<b>CASH AND CASH EQUIVALENTS—Beginning of year</b>	556,400	774,534
<b>CASH AND CASH EQUIVALENTS—End of year</b>	\$ 611,863	\$ 556,400
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid during the year for interest, including amounts capitalized of \$5,798 and \$3,870 in 2019 and 2018, respectively	\$ 45,362	\$ 41,811
Amounts accrued in property, plant, and equipment—net	\$ 19,679	\$ 13,333
Unsettled investment trades	\$ 482	\$ 359
Unsettled investment purchases	\$ 570	\$ 3,391
Cash paid for taxes	\$ 8,493	\$ 3,308
See notes to consolidated financial statements.		(Concluded)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018 (Dollars in thousands)

### 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 (AHG), Health Alliance Plan of Michigan (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.

In connection with HAP’s acquisition of ASR, ASR entered into an employment and stock transfer and redemption agreement with a 33% noncontrolling interest (NCI) holder. In 2016, the NCI holder exercised his right under this agreement requiring ASR to purchase his interests in ASR. In 2019, HAP reached agreement with the NCI holder regarding the value of his interest. The final agreed-upon value of the interest has been paid to the NCI holder with the exception of \$828, which is expected to be paid in 2020.

On September 13, 2019, HAP finalized its acquisition of 100% ownership in Trusted Health Plan Michigan, Inc. (THPM) at an acquisition cost of \$22,500, which was paid in cash. The results of THPM have been included in the consolidated financial statements since the acquisition date. THPM is a 9,000 member Medicaid plan based in Detroit. As a result of the acquisition, the System will reenter a Michigan Medicaid HMO service area that includes Wayne, Oakland, and Macomb counties. The fair value of the assets acquired exceeded the liabilities assumed resulting in goodwill of \$8,130, which was recorded during the year ended December 31, 2019.

The fair value of identifiable assets acquired and liabilities assumed are preliminary as HAP is still in the process of finalizing third-party valuations of certain tangible and intangible assets and is still assessing the economic characteristics of certain assets acquired and liabilities assumed.

Summarized consolidated opening balance sheet information for THPM as of the acquisition date is shown below:

Cash and cash equivalents	\$ 8,984	Accounts payable	\$ 5,030
Health care premium receivables	4,270	Medical claims liability	4,153
Other current assets	72		
Assets limited as to use	1,000		
Intangible and other assets	9,120		
Goodwill	8,130		
Property, plant, and equipment	<u>107</u>		
Total assets acquired	<u>\$ 31,683</u>	Total liabilities assumed	<u>\$ 9,183</u>

The acquired intangible asset of \$9,120 is a Medicaid contract that will be amortized over its remaining useful life of 13 years.

The operating results of THPM for the period September 13, 2019, through December 31, 2019, included total revenue without donor restrictions of \$8,956, all of which is health care premiums, and a deficiency of revenue over expenses of \$702.

### ***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.

### ***Operating and Nonoperating Activities***

The System's mission is to improve people's lives through excellence in the science and art of health care and healing. The System provides a broad range of general and specialized health care services, including inpatient acute care, outpatient services, long-term care, and other health care services in pursuit of this mission. Activities directly associated with the furtherance of this purpose are considered to be operating activities. Other activities that are not central to the System's primary mission, including investment return, net are considered to be nonoperating.

### ***Reclassifications***

Certain amounts in prior periods' financial statements have been reclassified to conform to the current-year presentation. In the System's consolidated statement of operations and changes in net assets for the period ended December 31, 2018, \$45,909 of investment losses were reclassified from the operating income section to investment return, net within the nonoperating section. (Refer to Note 4).

### ***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 Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 606-10-50-14(a), *Revenue from Contracts with Customers*, 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 effects on the consolidated financial statements 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, 2019 and 2018. 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 years ended December 31, 2019 and 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.

#### ***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 as other revenue when received. Gifts of cash and other assets that are received with donor stipulations are included in the consolidated statements of operations and changes in net assets as contributions and other. Once the restrictions are satisfied, they are included in the consolidated statements of operations and changes in net assets as other revenue or net assets released from restrictions for capital.

### **Other Revenue**

Other revenue includes assets released from restrictions, income from grants, income from contract pharmacy arrangements, administrative fees earned from HAP self-insured products, net returns on malpractice and deferred compensation investments, joint venture income, gains and losses on sales of assets, 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 assets released from restrictions for capital, distributions to NCIs, pension and other postretirement net adjustments, and purchase price adjustment to NCI.

### **Net Asset Classifications**

*Net assets without donor restrictions*—Net assets that are not subject to donor-imposed restrictions. 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 with restrictions which 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 revenue 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 Return, net***

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 markets, 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 debt securities as trading.

Investment return, net includes interest, dividends, realized gains and losses, unrealized gains and losses, and expenses related to the management of the investments. 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 return, net or return on restricted investments, net.

### ***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***

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.

**Intangible and Other Assets**

Intangible and other assets as of December 31, 2019 and 2018, consisted of the following:

	<u>Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>	<u>Useful Life (Years)</u>
<b>December 31, 2019</b>				
Definite-lived intangible assets:				
Customer relationships	\$ 15,660	\$ 8,285	\$ 7,375	8–22
Provider relations	22,164	6,394	15,770	10–25
Medicaid contract	9,120	-	9,120	13
Reinsurance escrow	15,007	-	15,007	
Other	<u>7,945</u>	<u>2,603</u>	<u>5,342</u>	
Total	<u>\$ 69,896</u>	<u>\$ 17,282</u>	<u>\$ 52,614</u>	
<b>December 31, 2018</b>				
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>	

Amortization expense on intangible assets was \$2,830 and \$3,077 for the years ended December 31, 2019 and 2018, respectively.

Estimated amortization expense on intangible assets for the next five years is as follows:

**Years Ending December 31:**

2020	\$ 3,692
2021	3,272
2022	3,062
2023	3,062
2024	1,813

### 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, 2019 and 2018, is as follows:

	<u>2019</u>	<u>2018</u>
As of January 1:		
Goodwill	\$ 45,451	\$ 45,451
Accumulated impairment loss	<u>(31,422)</u>	<u>(31,422)</u>
Total	14,029	14,029
Goodwill acquired	<u>8,130</u>	<u>-</u>
Total	<u>\$ 22,159</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 3 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-period 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, 2019 and 2018. 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 other revenue 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 charge (reduction) to salaries, wages, and employee benefits expense of \$25,644 and \$(8,048) during the years ended December 31, 2019 and 2018, respectively, related to the return on the deferred compensation assets.

### **Tax Status**

The System, except for HAP, ASR, 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. ASR is a taxable entity. 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, 2019 and 2018.

### **Adoption of New Accounting Standards**

FASB Accounting Standards Update (ASU) No. 2018-08 (issued June 2018), *Not-for-Profit Entities (Topic 958)* – Adopted effective January 1, 2019, on a modified prospective basis without a material impact on the System's consolidated financial statements. 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 and provides additional guidance about how to determine whether a contribution is conditional.

FASB ASU No. 2016-02 (issued February 2016), *Leases (Topic 842)*—Adopted effective January 1, 2019, using the modified retrospective method. This guidance requires lessees to recognize a lease liability and a right-of-use (ROU) asset for all leases, with the exception of short-term leases with terms of 12 months or less. Under the modified retrospective method, the System's reporting for the comparative periods in the consolidated financial statements has not been restated and will continue to be reported in accordance with ASC Topic 840, *Leases*. No cumulative effect adjustments were required.

As permitted by ASU No. 2016-02, the System elected to apply the package of practical expedients allowing the System to not reassess (1) whether any expired or existing contracts are or contain leases, (2) the lease classification for any expired or existing leases, or (3) initial direct costs for any expired or existing leases. The System did not elect to apply the hindsight practical expedient which would have allowed the System to use hindsight when determining the lease term (i.e., evaluating the System's option to renew or terminate the lease or to purchase the underlying asset) and assess impairment of expired or existing leases. The System also elected to apply the short-term lease exception; therefore, the System will not record a ROU asset or corresponding lease liability for leases with a term of 12 months or less and instead will recognize a single lease cost allocated over the lease term, generally on a straight-line basis. The System elected the practical expedient to not separate lease components from nonlease components and instead account for both as a single lease component except for equipment agreements that contain a significant supplies component.

The System recorded approximately \$202,000 and \$209,000 of operating lease ROU assets and liabilities, respectively, and approximately \$7,600 of financing ROU assets and liabilities on January 1, 2019 upon adoption of this guidance.

FASB ASU No. 2017-07 (issued March 2017), *Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*—Adopted effective January 1, 2019, using the practical expedient that permits an employer to use the amounts disclosed in its pension and other postretirement benefit plan note for the prior comparative periods as the estimation basis for applying the retrospective presentation requirements. 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. As a result of adoption of FASB ASU No. 2017-07, \$18,737 for all components of net periodic benefit cost, except the service cost, for the System's pension and other postretirement benefit plans for the year ended December 31, 2018, has been reclassified from salaries, wages, and employee benefits to other components of net periodic pension cost within the nonoperating section of the consolidated statements of operations and changes in net assets.

FASB ASU No. 2016-18 (issued February 2016), *Restricted Cash*—Adopted effective January 1, 2019, without material impact on the System's consolidated financial statements. 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.

FASB ASU No. 2016-15 (issued February 2016), *Classification of Certain Cash Receipts and Cash Payments*—Adopted effective January 1, 2019, without a material impact on the System's consolidated financial statements. This guidance adds or clarifies guidance on the classification of certain cash receipts and payments in the consolidated statements of cash flows.

#### ***Forthcoming Accounting Standards***

FASB ASU No. 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, *Compensation Retirement—Benefits* 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 adoption of this guidance is limited to the annual disclosures and is not expected to have a material impact on the System's consolidated financial statements at December 31, 2021.

FASB ASU No. 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 adoption of this guidance is limited to the annual disclosures and is not expected to have a material impact on the System's consolidated financial statements at December 31, 2020.

FASB ASU No. 2016-13 (issued June 2016), *Financial Instruments—Credit Losses (Topic 326)—Measurement of Credit Losses on Financial Instruments*—Introduced a new model for recognizing credit losses on financial instruments based on an estimate of the current expected credit losses (CECL). The new CECL model generally calls for the immediate recognition of all expected credit losses and applies to financial instruments and other assets. This guidance replaces the current incurred loss model for measuring expected credit losses, requires expected losses on available-for-sale debt securities to be recognized through an allowance for credit losses rather than as reductions in the amortized cost of the securities, and provides for additional disclosure requirements. This guidance is effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021, with early adoption permitted. The System is evaluating the impact this guidance may have on the System's December 31, 2021, consolidated financial statements.

## 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 2019 and 2018. 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 \$49,279 and \$23,162 related to prior-year settlements was recorded during the years ended December 31, 2019 and 2018, respectively. The composition of net patient service revenue by payor for the years ended December 31, 2019 and 2018, is as follows:

	2019		2018	
Medicare	\$ 1,705,737	43 %	\$ 1,496,597	42 %
Medicaid	630,666	16	597,952	17
Blue Cross	1,045,659	27	929,075	26
Self-pay	28,965	1	30,350	1
Commercial and other	<u>501,132</u>	<u>13</u>	<u>527,775</u>	<u>14</u>
Total	<u>\$ 3,912,159</u>	<u>100 %</u>	<u>\$ 3,581,749</u>	<u>100 %</u>

Letters of final settlements have not been received from Medicare for 2012 through 2019, from Medicaid for 2016 through 2019, or from Blue Cross for 2019. 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, 2019 and 2018, are as follows:

	<u>2019</u>	<u>2018</u>
Charity care at cost	\$ 37,462	\$ 35,598
Unpaid cost of Medicare, Medicaid, and other public programs	349,493	330,402
Implicit price concessions	<u>68,338</u>	<u>90,202</u>
<b>Total cost of uncompensated care</b>	<b>455,293</b>	<b>456,202</b>
Research	85,021	68,934
Health professional education	96,300	85,537
Community health services and building activities	14,954	15,817
Subsidized health services	14,681	10,823
Community benefit operations and financial donations	<u>3,975</u>	<u>3,317</u>
<b>Total community benefit</b>	<b><u>\$ 670,224</u></b>	<b><u>\$ 640,630</u></b>

The IRS requires the reported community benefit activities to be offset by external funding received. The System received \$68,677 and \$55,193 of external funding for research and \$3,355 and \$2,536 of external funding for community health services and building activities during the years ended December 31, 2019 and 2018, respectively.

The System's total cost of uncompensated care as a proportion of consolidated net patient revenue approximated 11.6% and 12.7% at December 31, 2019 and 2018, 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 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 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 markets***—The estimated fair values are 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.

***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.

**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, 2019 and 2018, is as follows:

	<u>2019</u>	<u>2018</u>
Assets measured at fair value:		
Level 1:		
Cash equivalents	\$ 669,302	\$ 617,956
Common stock	26,593	75,567
Collective equity funds:		
Asset allocation	218,914	190,167
Common stock	180,260	189,449
Debt securities	<u>169,333</u>	<u>136,396</u>
Subtotal—Level 1	1,264,402	1,209,535
Level 2:		
Debt securities:		
Asset-backed securities	10,860	11,924
Corporate debt securities	59,088	49,036
Government and agency debt securities	60,769	69,025
Nonagency mortgage-backed securities	6,166	3,616
Other debt securities	4,587	4,482
Commercial paper	<u>55,984</u>	<u>-</u>
Total debt securities	197,454	138,083
Grants and pledges receivable at fair value	<u>26,152</u>	<u>23,204</u>
Subtotal—Level 2	223,606	161,287
Subtotal—assets at fair value	1,488,008	1,370,822
Investments measured at NAV	1,264,414	774,324
Cash	19,310	30,287
Other	<u>6,808</u>	<u>11,751</u>
Total	<u>\$ 2,778,540</u>	<u>\$ 2,187,184</u>
Asset classifications:		
Cash and cash equivalents	\$ 611,863	\$ 556,400
Short-term investments	-	1,141
Assets limited as to use	943,623	939,860
Long-term investments	<u>1,223,054</u>	<u>689,783</u>
Total	<u>\$ 2,778,540</u>	<u>\$ 2,187,184</u>
Liability not measured at fair value—Level 2—long-term obligations	<u>\$ 1,211,770</u>	<u>\$ 1,052,210</u>

**Investments at NAV**—The fair value measurements of certain investments calculated based on NAV, for the years ended December 31, 2019 and 2018, are as follows (there were approximately \$86,112 in unfunded commitments for private market investments at year-end):

	<u>2019</u>	<u>Frequency</u>	<u>Notice Period</u>
Collective funds:			
Asset allocation	\$ 52,705	Daily	2 days
Common stock	733,945	Daily, monthly	2–30 days
Debt securities	259,269	Daily, monthly, semimonthly	2–30 days
Hedge funds	126,455	Monthly, quarterly, annually	3–90 days
Private markets	<u>92,040</u>	N/A	N/A
Total	<u>\$ 1,264,414</u>		
	<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, monthly, semimonthly	0–30 days
Hedge funds	134,253	Monthly, quarterly, annually	3–90 days
Private markets	<u>60,184</u>	N/A	N/A
Total	<u>\$ 774,324</u>		

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

**Asset allocation**—Investment funds that consist of diversified portfolios of debt, equity, and other assets often providing the money manager with discretion as to the allocation of assets.

**Common stock**—Investment funds that 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 that invest substantially all their assets in debt securities, including government and corporate bonds, both domestic and foreign.

**Hedge funds**—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 markets**—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, secondary funds, private debt, real estate, and real assets. Funds have reduced liquidity with a long-term investment horizon averaging five to ten years and committed capital is drawn down over this life of the fund.

**Debt Maturities**—The debt securities 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, 2019, by contractual maturity, are listed as follows:

<b>Maturity</b>	<b>Estimated Fair Value</b>
Due in one year or less	\$ 57,009
Due in one year through five years	75,954
Due in five years through ten years	33,668
Due after ten years	<u>30,823</u>
 Total	 <u>\$ 197,454</u>

**Total Investments Return, net**—The total return on the investment portfolios for the years ended December 31, 2019 and 2018, consist of the following:

	<b>2019</b>	<b>2018</b>
Interest and dividend income	\$ 55,914	\$ 28,240
Realized gains	43,770	53,183
Unrealized gains (losses)	<u>179,948</u>	<u>(148,140)</u>
 Total investment return, net	 <u>\$ 279,632</u>	 <u>\$ (66,717)</u>

Total investment return, net for the years ended December 31, 2019 and 2018, consisted of the following:

	<b>2019</b>	<b>2018</b>
Included in other revenue:		
Funds designated for malpractice and general liability	\$ 5,174	\$ (1,471)
Funds designated for deferred compensation	25,644	(8,048)
Other miscellaneous interest	212	119
Included in nonoperating items:		
The Foundation	49,654	(14,057)
Interest, dividends, and realized and unrealized gains (losses) from other unrestricted assets	<u>166,167</u>	<u>(31,852)</u>
 Total	 246,851	 (55,309)
 Investment return, net on restricted investments	 <u>32,781</u>	 <u>(11,408)</u>
 Total investment return, net	 <u>\$ 279,632</u>	 <u>\$ (66,717)</u>

## 5. ASSETS LIMITED AS TO USE

Assets limited as to use as of December 31, 2019 and 2018, consisted of the following:

	<u>2019</u>	<u>2018</u>
Assets without donor restrictions:		
The Foundation	\$ 339,811	\$ 305,791
Funds held by trustee	61,797	4,652
Funds designated for malpractice and general liability	43,719	60,079
Funds designated for deferred compensation	177,577	146,771
HAP statutory funds	15,335	14,335
Funds board designated for research, education, and other	<u>28,797</u>	<u>161,880</u>
Total assets without donor restrictions	<u>667,036</u>	<u>693,508</u>
Assets with donor restrictions:		
Perpetual in nature	125,671	118,703
Purpose restricted	124,764	104,445
Grants and pledges receivable	<u>26,152</u>	<u>23,204</u>
Total assets with donor restrictions	<u>276,587</u>	<u>246,352</u>
Total assets limited as to use	943,623	939,860
Less requirements for current liabilities	<u>108,546</u>	<u>46,654</u>
Noncurrent assets limited as to use	<u>\$ 835,077</u>	<u>\$ 893,206</u>

Grants and pledges receivable are expected to be collected, and as of December 31, 2019 and 2018, consisted of the following:

	<u>2019</u>	<u>2018</u>
Amounts expected to be collected in:		
Less than one year	\$ 14,796	\$ 14,051
One to five years	8,139	10,572
More than five years	<u>5,000</u>	<u>-</u>
Total grants and pledges expected to be collected	27,935	24,623
Unamortized discount	<u>(1,783)</u>	<u>(1,419)</u>
Total grants and pledges receivable with donor restrictions	<u>\$ 26,152</u>	<u>\$ 23,204</u>

Onika had reserve deposits of \$12,096 and \$11,391 as of December 31, 2019 and 2018, 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 required by insurance regulations.

## 6. JOINT VENTURE INVESTMENTS

The System maintains investments in ten 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 revenue, was \$2,296 and \$3,309 for 2019 and 2018, respectively.

The summarized financial information for unconsolidated affiliates as of December 31, 2019 and 2018, consisted of the following:

	<u>2019</u>	<u>2018</u>
Net revenues	\$ 182,512	\$ 147,974
Net income	4,009	4,778
Total assets	130,722	66,934
Net assets	55,982	50,874

## 7. PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment as of December 31, 2019 and 2018, consisted of the following:

	<u>2019</u>	<u>2018</u>
Land and improvements	\$ 121,535	\$ 92,127
Building and improvements	1,692,031	1,621,576
Equipment	1,622,371	1,545,869
Construction in progress	<u>189,675</u>	<u>109,409</u>
Total	3,625,612	3,368,981
Less accumulated depreciation	<u>2,018,411</u>	<u>1,869,506</u>
Property, plant, and equipment—net	<u>\$ 1,607,201</u>	<u>\$ 1,499,475</u>

Internal use software is included above in equipment and construction in progress. The net book value was \$146,272 and \$175,182 at December 31, 2019 and 2018, respectively.

**8. MEDICAL CLAIMS LIABILITY (REPORTED AND UNREPORTED)**

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

	<u>2019</u>	<u>2018</u>
As of January 1	\$ 200,321	\$ 234,092
THPM acquisition	4,153	-
Incurred related to:		
Current year	1,682,873	1,427,018
Prior year	<u>(33,791)</u>	<u>4,280</u>
Total incurred	<u>1,649,082</u>	<u>1,431,298</u>
Paid related to:		
Current year	1,522,677	1,231,515
Prior year	<u>141,245</u>	<u>233,554</u>
Total paid	<u>1,663,922</u>	<u>1,465,069</u>
As of December 31	<u>\$ 189,634</u>	<u>\$ 200,321</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.

The provision for medical claims liabilities related to prior years decreased \$33,791 in 2019 primarily due to lower-than-anticipated losses in commercial and Medicare HMO business as well as higher-than-anticipated pharmacy rebates from prior years. In 2018, the provision for medical claims liabilities related to prior years increased \$4,280 primarily due to an underestimation of high-cost claims in the commercial and Medicare HMO business from 2017.

**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 44.90% and 43.52% member in Caymich at December 31, 2019 and 2018, 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 \$140,170 and \$130,354 as of December 31, 2019 and 2018, respectively, has been discounted using a discount

factor of 4%. Segregated funds included in assets limited as to use have been established to settle claims subject to self-insurance. Returns related to these assets of \$5,174 and \$(1,471) are included in other revenue in December 31, 2019 and 2018, 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 contribution and defined benefit plans. Over several years, the System has been increasing benefit alignment across affiliates, with a focus on the defined contribution plans. 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 expense related to the defined contribution plans was approximately \$86,836 and \$80,915 for 2019 and 2018, respectively. The following summarizes the status of plans at the System and its major affiliates:

### **System, other than HAP**

**Defined Contribution Plans**—Effective with the first pay in 2018, all employees of AHG as well as newly hired employees of the System (other than those of HAP) participate in a 403(b) plan with a two-tiered benefit structure. The primary benefit has a 6% employee contribution with a 3.5% employer match for eligible wages. The secondary benefit provides for annual employer contributions from 1.25% to 2.75% of eligible wages. 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.

**Defined Benefit Plans**—Effective December 31, 2010, the System permanently froze the Henry Ford Health System Pension Plan (“HFHS 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 employees hired up to the first pay in 2018. Effective June 30, 2017, the System permanently froze the Allegiance Health Retirement Plan (“AHG Plan”), a cash balance formula defined benefit plan. Employees of AHG are provided transitional credits until the end of 2020 through the 403(b) plan described above. On September 25, 2019, the board of directors of AHG and the board of trustees of Allegiance Health jointly agreed to accept the merger of the HFHS Plan into the AHG Plan effective December 31, 2019.

### **HAP**

**Defined Contribution Plan**—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.

**Defined Benefit Plans**—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 nonrepresented 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 and effective December 23, 2017, for nonrepresented participants. 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.

**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. The System targets an allocation of 0% - 10% for cash and cash equivalents, 38% - 58% for stock and stock funds, 21% - 41% for bond and bond funds, 0% -20% for global asset allocations, and 0% - 10% for other investments.

In connection with the merger of the HFHS Plan into AHG Plan the master retirement trust agreement and the AHG trust agreement were both amended to provide that the trust assets are available to pay benefits to all participants in the merged plan effective December 31, 2019.

The allocation percentages of the fair value of total plan assets held, as of the measurement dates, December 31, 2019, for the combined trust and December 31, 2018, for the master and AHG trusts are shown below:

	<b>Combined Trust 2019</b>	<b>Master Trust 2018</b>	<b>AHG Trust 2018</b>
Cash and cash equivalents	1 %	2 %	1 %
Stock and stock funds	50	46	43
Bonds and bond funds	31	33	31
Global asset allocation	15	18	14
Other	3	1	11
Total	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

The following tables present information about the fair value of the total plan assets as of December 31, 2019 and 2018, according to the valuation techniques the System used to determine its fair values as described in Note 4:

<b>Combined Trust</b>	<b>2019</b>	<b>2018</b>
Assets measured at fair value:		
Level 1:		
Cash equivalents	\$ 5,026	\$ 8,232
Common stock	-	19,563
Collective equity funds:		
Asset allocation	42,643	46,871
Common stock	94,598	106,509
Debt securities	<u>75,951</u>	<u>74,085</u>
Subtotal—Level 1	218,218	255,260
Level 2		
Debt securities:		
Asset-backed securities	1,146	1,194
Corporate debt securities	4,007	4,409
Government and agency debt securities	3,486	3,304
Non-agency mortgage-backed securities	1,022	525
Other debt securities	<u>203</u>	<u>78</u>
Subtotal—Level 2	<u>9,864</u>	<u>9,510</u>
Total investments measured at fair value	228,082	264,770
Investments measured at NAV	<u>356,225</u>	<u>276,738</u>
Total	<u>\$ 584,307</u>	<u>\$ 541,508</u>

Included in the table above as of December 31, 2018, the AHG trust had total plan assets of \$132,616 consisting of cash and cash equivalents of \$1,018, asset allocation funds of \$18,901, common stock of \$56,692, debt securities of \$26,352, and investments measured at NAV of \$29,653. All of the investments, excluding the NAV investments, were classified as Level 1 investments.

**Projected Benefit Obligations**—Information regarding the projected benefit obligation and assets of the defined benefit pension and postretirement benefit plans for the System as of and for the years ended December 31, 2019 and 2018, is as follows:

	Pension Benefits		Postretirement Benefits	
	2019	2018	2019	2018
Change in benefit obligation:				
Benefit obligation—beginning of year	\$ 705,895	\$ 800,757	\$ 52,832	\$ 64,837
Service cost	10,509	8,107	450	602
Interest cost	28,884	27,885	2,182	2,254
Actuarial loss (gain)	61,879	(51,092)	31,979	(10,174)
Benefits paid	(29,009)	(24,289)	(4,174)	(5,264)
Medicare Part D subsidy	-	-	700	651
Settlements	(32,921)	(55,473)	-	-
Plan changes/other	81	-	(26,476)	(74)
Benefit obligation—end of year	<u>745,318</u>	<u>705,895</u>	<u>57,493</u>	<u>52,832</u>
Change in plan assets:				
Fair value of assets—beginning of year	541,508	639,690	-	-
Actual return on assets	91,063	(37,646)	-	-
Employer contributions	13,666	19,226	4,174	5,264
Benefits paid	(29,009)	(24,289)	(4,174)	(5,264)
Settlements	(32,921)	(55,473)	-	-
Fair value of assets—end of year	<u>584,307</u>	<u>541,508</u>	<u>-</u>	<u>-</u>
Amounts included in the consolidated balance sheets:				
Total accrued liability	<u>\$ 161,011</u>	<u>\$ 164,387</u>	<u>\$ 57,493</u>	<u>\$ 52,832</u>
Current liability	<u>\$ 1,436</u>	<u>\$ 1,451</u>	<u>\$ 4,106</u>	<u>\$ 4,110</u>
Long-term liability	<u>\$ 159,575</u>	<u>\$ 162,936</u>	<u>\$ 53,387</u>	<u>\$ 48,722</u>

Lump-sum settlements of \$32,921 and \$55,473 were made during the years ended December 31, 2019 and 2018, 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 \$5,492 and \$12,236 during 2019 and 2018, respectively.

In 2019, with a July 1, 2020 effective date, the System implemented several changes to its postretirement plans that impact member cost sharing and plan offerings. The resulting reduction in postretirement benefit obligation was recognized as a plan change.

**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, 2019 and 2018, are as follows:

	Pension Benefits		Postretirement Benefits	
	2019	2018	2019	2018
Unrecognized prior service cost (credit)	\$ 3,328	\$ 3,368	\$ (26,475)	\$ -
Unrecognized net actuarial loss (gain)	<u>139,439</u>	<u>138,731</u>	<u>14,222</u>	<u>(18,958)</u>
Total	<u>\$ 142,767</u>	<u>\$ 142,099</u>	<u>\$ (12,253)</u>	<u>\$ (18,958)</u>

An estimated \$127 in prior service cost and \$9,466 in net actuarial loss will be included as components of periodic pension plan expense in 2020. An estimated \$8,919 in prior service credit and \$1,701 net actuarial loss will be included as a component of period postretirement medical plan expense in 2020.

The accumulated benefit obligation was \$742,144 and \$703,101 as of December 31, 2019 and 2018, 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, 2019 and 2018, is as follows:

	Pension Benefits		Postretirement Benefits	
	2019	2018	2019	2018
Components of net periodic benefit cost:				
Service cost	\$ 10,509	\$ 8,107	\$ 450	\$ 602
Interest cost	28,884	27,885	2,182	2,254
Expected return on assets	(38,912)	(42,832)	-	-
Amortization of prior service cost	121	121	-	-
Amortization of actuarial loss (gain)	3,527	19,264	(1,202)	(191)
Settlement cost	<u>5,492</u>	<u>12,236</u>	<u>-</u>	<u>-</u>
Net periodic benefit cost	<u>\$ 9,621</u>	<u>\$ 24,781</u>	<u>\$ 1,430</u>	<u>\$ 2,665</u>

**Assumptions**—Information on the assumptions that were used to determine the benefit obligation and net benefit costs as of and for the years ended December 31, 2019 and 2018, is as follows:

	Pension Benefits		Postretirement Benefits	
	2019	2018	2019	2018
Discount rate—benefit obligation	2.65%–3.30%	3.75%–4.35%	3.30%	4.30%
Discount rate—benefit cost	3.75%–4.35%	2.75%–3.70%	4.30%	3.60%–3.65%
Expected return on plan assets	6.70%–7.21%	6.60%–6.98%	N/A	N/A

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 2020 are as follows:

Health care trend rates:	
Blue Cross Blue Shield of Michigan	6.4%
HAP full network	6.6%
HAP preferred network	9.4%
Prescription drug trend rate	6.6%
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, 2019:

	<u>One-Percentage- Point Increase</u>	<u>One-Percentage- Point Decrease</u>
Effect on postretirement benefit obligation	1.31%	(1.15)%
Effect on total of service cost and interest cost components	3.01%	(2.56)%

**Expected Future Contributions**—The System is expected to contribute \$21,630 to the pension plans and \$4,173 to the postretirement health care plans in 2020.

**Expected Benefit Payments**—As of December 31, 2019, the System expects to pay the following pension benefits and postretirement benefits for each of the next five years and in the aggregate for the succeeding five years thereafter as follows:

	<u>Pension Plans</u>	<u>Postretirement Plans</u>
<b>Years Ending December 31:</b>		
2020	\$ 69,155	\$ 4,173
2021	64,540	4,202
2022	63,033	4,180
2023	59,748	4,151
2024	60,162	4,104
Thereafter	230,894	19,265

## 11. LONG-TERM OBLIGATIONS

Long-term obligations as of December 31, 2019 and 2018, consisted of the following:

<u>Obligation</u>	<u>Maturity</u>	<u>Rate</u>		<u>2019</u>	<u>2018</u>
Bonds Series 2016	2020 to 2046	Fixed	3.00%–5.00%	\$ 840,770	\$ 845,430
Bonds Series 2019A	2048 to 2050	Fixed	4.00%–5.00%	227,910	-
Taxable term loan	2021	Variable	2.53%	35,560	36,410
Tax-exempt loan	2020	Fixed	2.07%	11,392	22,550
Other obligations		Fixed	4.44%–4.82%	3,495	3,976
Deferred issuance costs, net				(7,807)	(5,894)
Unamortized bond premium				<u>117,175</u>	<u>100,755</u>
Total				1,228,495	1,003,227
Less current portion				<u>17,622</u>	<u>17,128</u>
Total long-term obligations				<u>\$ 1,210,873</u>	<u>\$ 986,099</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.

On May 2, 2019, the System issued \$227,910 in Series 2019A hospital revenue bonds, at a premium of \$22,094 with issuance costs of \$2,304. The System has received \$195,244 of the proceeds for reimbursement of approved costs while the remaining \$55,984 is held in trust as of December 31, 2019.

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

### Years Ending December 31:

2020	\$ 17,622
2021	51,628
2022	17,775
2023	19,694
2024	19,510
Thereafter	992,898

The System has various credit agreements that it may borrow from. On June 3, 2019, the System entered into two new \$100,000 line-of-credit facilities, each of which will expire on June 2, 2021. On July 16, 2019, the System terminated its prior \$100,000 line-of-credit facility and reduced the limit on a credit agreement from \$50,000 to \$10,000, which is limited to support letters of credit only. The System maintains an additional credit agreement with a borrowing limit of \$75,000, which will expire on April 19, 2020. The agreements as of December 31, 2019, are summarized as follows:

Borrowing Limit	Expiration Date	Loan Advances	Letters of Credit Commitments
		2019	2019
\$ 100,000	June 2, 2021	\$ -	\$ -
100,000	June 2, 2021	-	-
75,000	April 19, 2020	-	-
10,000	April 30, 2021	N/A	8,952
		2018	2018
\$ 100,000	April 18, 2019	\$ -	\$ -
75,000	April 19, 2020	-	-
50,000	April 30, 2021	-	-

## 12. LEASES

The System utilizes operating and finance leases for medical and office buildings, medical equipment, and various other equipment. The initial lease liability is calculated as the present value of fixed payments not yet paid and variable payments that are based on a market rate or an index (e.g., Consumer Price Index), measured at commencement. The ROU asset represents the lessee's right to use a specified asset for the lease term, and is measured at the lease liability amount, adjusted for lease prepayment, lease incentives received, and the lessee's initial direct costs. The lease agreements generally require the System to pay maintenance, repairs, property taxes, and insurance costs, which are variable amounts based on actual costs incurred during each applicable period. Such costs are not included in the determination of the ROU asset or lease liability. Most leases include options to renew the lease at the end of the initial term. These options are evaluated at the commencement of the lease, with only those that are reasonably certain of exercise included in determining the appropriate lease term. The System's lease agreements do not contain any material residual value guarantees or material restrictive covenants.

When readily determinable, the System uses the interest rate implicit in a lease to determine the present value of future lease payments. For leases where the implicit rate is not readily determinable, the System's incremental borrowing rate is utilized. The incremental borrowing rate is not a quoted rate and is derived by applying a spread over U.S. Treasury rates with a similar duration to the System's lease payments.

The components of lease cost and rent expense, included in general and other administrative expense depreciation and amortization expense, rent and lease expense, and interest expense for the year ended December 31, 2019, are as follows:

<b>Lease Cost:</b>	<b>2019</b>
Finance lease cost	
Amortization of ROU assets	\$ 2,974
Interest on lease liabilities	679
Operating lease cost	37,278
Short-term lease cost	16,051
Variable lease cost	<u>10,076</u>
 Total lease cost	 <u>\$ 67,058</u>

The System did not have any subleases as of December 31, 2019.

<b>Cash flow and other information:</b>	<b>2019</b>
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases <sup>(1)</sup>	\$ 34,849
Operating cash flows from finance leases	\$ 665
Financing cash flows from finance leases	\$ 2,756
 ROU assets obtained in exchange for new finance lease liabilities	 \$ 34,870
 ROU assets obtained in exchange for new operating lease liabilities	 \$ 27,623
 Weighted-average remaining lease term:	
Finance leases	17.6 years
Operating leases	9.1 years
 Weighted-average discount rate:	
Finance leases	3.8%
Operating leases	3.9%

<sup>(1)</sup> Included in the change in other liabilities in the consolidated statement of cash flows.

The schedule of maturity of lease liabilities for balances outstanding at December 31, 2019, is as follows:

Years Ending December 31:	Operating Leases	Finance Leases
2020	\$ 33,915	\$ 5,139
2021	30,197	4,696
2022	27,298	2,682
2023	25,679	2,733
2024	23,213	2,762
Thereafter	112,876	44,979
Total commitments	253,178	62,991
Less imputed interest	43,191	17,889
Present value of lease liabilities	\$ 209,987	\$ 45,102

The schedule of maturity of lease liabilities at December 31, 2018, is as follows:

Years Ending December 31:	Operating Leases	Finance Leases
2019	\$ 34,176	\$ 421
2020	29,751	454
2021	26,516	454
2022	22,278	468
2023	20,357	476
Thereafter	137,014	5,926
Total minimum lease payments	\$ 270,092	8,199
Less interest (interest rates from 4.49% to 8.25%)		2,638
Obligations capitalized leases, including \$185 due within one year		\$ 5,561

Assets recorded under capital lease obligations totaled \$11,413 as of December 31, 2018, and the related amortization totaled \$4,996.

As of December 31, 2019, the System has entered into a finance lease for a medical office building that has not yet commenced for approximately \$69,000. The lease is expected to commence in the 4th quarter of 2020.

### 13. COMMITMENTS AND CONTINGENCIES

The System is party to lawsuits incidental to its operations and management believes that the ultimate outcome of these 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 NCIs for the years ended December 31, 2019 and 2018, are as follows:

	<u>Henry Ford Health System</u>	<u>Noncontrolling Interests</u>	<u>Total</u>
Net assets without donor restrictions—December 31, 2017	\$ 1,785,322	\$ 3,331	\$ 1,788,653
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	<u>(9,030)</u>	<u>-</u>	<u>(9,030)</u>
Increase in net assets without donor restrictions	<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>
Excess of revenue over expenses from consolidated operations	352,530	1,973	354,503
Net assets released from restrictions for capital	16,305	-	16,305
Distributions to noncontrolling interests	-	(2,083)	(2,083)
Pension and other postretirement net adjustments	(7,373)	-	(7,373)
Purchase price adjustment to noncontrolling interest	<u>(14,961)</u>	<u>-</u>	<u>(14,961)</u>
Increase (decrease) in net assets without donor restrictions	<u>346,501</u>	<u>(110)</u>	<u>346,391</u>
Net assets without donor restrictions—December 31, 2019	<u>\$ 2,229,422</u>	<u>\$ 3,317</u>	<u>\$ 2,232,739</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 target allocation in this account is:

	<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 12 previous quarters 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, 2019 and 2018, and the changes in endowment net assets for the years ended December 31, 2019 and 2018, are summarized as follows:

	<u>Endowment Net Assets Designated by Board</u>	<u>Endowment Net Assets with Donor Restrictions</u>	<u>Total</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	305,791	124,257	430,048
Investment return, net	49,620	8,511	58,131
Contributions and other	-	3,023	3,023
Annual spending appropriation	<u>(15,600)</u>	<u>(5,631)</u>	<u>(21,231)</u>
Endowment net assets—December 31, 2019	<u>\$ 339,811</u>	<u>\$ 130,160</u>	<u>\$ 469,971</u>

## 16. INFORMATION ABOUT LIQUIDITY

The System's 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 asset allocations 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 \$285,000 in short-term credit facilities as of December 31, 2019, \$275,000 was available for credit line draws for liquidity events; the remaining \$10 million is reserved for letters of credit, which it could draw upon in the event of an unanticipated liquidity level.

The Foundation's 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, 2019 and 2018, reduced by amounts not available for general use within one year of the consolidated balance sheet date because of donor restrictions, internal designations, or certain investments with reduced liquidity are as follows:

	<u>2019</u>	<u>2018</u>
Total financial assets	\$ 3,250,165	\$ 2,621,100
Financial assets not available to be used in one year:		
Subject to contractual or donor imposed restrictions (Note 5)	(353,719)	(265,339)
Subject to board and other designations (Note 5)	(589,904)	(674,521)
Hedge funds subject to lock-up provisions (Note 4)	(15,023)	(5,725)
Private market investments (Note 4)	<u>(32,819)</u>	<u>(11,650)</u>
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 2,258,700</u>	<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 13, 2020, the date the consolidated financial statements were issued. As a result of this evaluation, the System has no subsequent events to disclose.



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