

CONSOLIDATED FINANCIAL STATEMENTS

NorthShore University HealthSystem
Years Ended September 30, 2018 and 2017
With Report of Independent Auditors

Ernst & Young LLP



Building a better
working world

NorthShore University HealthSystem

Consolidated Financial Statements

Years Ended September 30, 2018 and 2017

Contents

Report of Independent Auditors.....1

Consolidated Financial Statements

Consolidated Balance Sheets3

Consolidated Statements of Operations and Changes in Net Assets5

Consolidated Statements of Cash Flows.....7

Notes to Consolidated Financial Statements.....8



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Report of Independent Auditors

The Board of Directors
NorthShore University HealthSystem

We have audited the accompanying consolidated financial statements of NorthShore University HealthSystem and its affiliates (collectively, the Corporation), which comprise the consolidated balance sheets as of September 30, 2018 and 2017, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of NorthShore University HealthSystem and its affiliates at September 30, 2018 and 2017, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

February 4, 2019

NorthShore University HealthSystem

Consolidated Balance Sheets (Dollars in Thousands)

	September 30	
	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 52,699	\$ 59,460
Other short-term investments	1,240	1,150
Internally designated investments, current portion	52,605	50,705
Patient accounts receivable, less allowances for uncollectible and charity accounts (2018 – \$107,253; 2017 – \$113,937)	261,570	330,838
Inventories, prepaid expenses, and other	87,942	75,275
Total current assets	456,056	517,428
Investments available for general use	1,875,690	1,695,893
Investments limited as to use	222,758	206,691
Property and equipment:		
Land and improvements	107,331	107,473
Buildings	1,600,879	1,490,024
Equipment and furniture	426,920	442,733
Construction-in-progress	68,280	165,255
	2,203,410	2,205,485
Less accumulated depreciation	1,075,189	1,113,888
Total property and equipment, net	1,128,221	1,091,597
Other noncurrent assets	254,587	239,240
Total assets	\$ 3,937,312	\$ 3,750,849

NorthShore University HealthSystem

Consolidated Balance Sheets (continued)

(Dollars in Thousands)

	September 30	
	2018	2017
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 88,651	\$ 79,632
Accrued expenses	201,006	184,528
Current portion of self-insurance	41,500	40,000
Due to third-party payors	119,829	106,992
Current maturities of long-term debt	11,193	10,793
Total current liabilities	<u>462,179</u>	<u>421,945</u>
Noncurrent liabilities:		
Long-term debt, less current maturities	312,917	323,979
Employee retirement and deferred compensation plans	124,034	126,630
Accrued self-insurance and other	195,647	233,518
Total noncurrent liabilities	<u>632,598</u>	<u>684,127</u>
Net assets:		
Unrestricted	2,625,580	2,442,811
Temporarily restricted	139,561	124,873
Permanently restricted	77,394	77,093
Total net assets	<u>2,842,535</u>	<u>2,644,777</u>
Total liabilities and net assets	<u><u>\$ 3,937,312</u></u>	<u><u>\$ 3,750,849</u></u>

See accompanying notes.

NorthShore University HealthSystem

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

	Year Ended September 30	
	2018	2017
Unrestricted revenues and other support		
Net patient service and premium revenue	\$ 2,063,902	\$ 2,022,627
Provision for uncollectible accounts	(51,642)	(48,807)
Net patient service and premium revenue	<u>2,012,260</u>	<u>1,973,820</u>
Investment earnings supporting current activities	78,000	45,000
Net assets released from restrictions used for operations	14,836	12,850
Other revenue	48,616	49,319
Total unrestricted revenues and other support	<u>2,153,712</u>	<u>2,080,989</u>
Expenses		
Salaries and benefits	1,156,576	1,103,517
Supplies, services, and other	723,675	699,289
Depreciation and amortization	67,075	109,673
Insurance	21,850	32,457
Medicaid assessment	45,362	43,636
Interest	8,722	7,452
Total expenses	<u>2,023,260</u>	<u>1,996,024</u>
Income from operations	130,452	84,965
Nonoperating income		
Dividend and interest income	36,556	32,350
Net realized gains on investments	116,861	54,463
Net unrealized gains on investments	11,418	126,512
Transfer of investment earnings supporting current activities	(78,000)	(45,000)
Other, net	(52,370)	(46,245)
Total nonoperating income	<u>34,465</u>	<u>122,080</u>
Revenues, gains, and other support in excess of expenses	<u>164,917</u>	<u>207,045</u>

Continued on next page.

NorthShore University HealthSystem

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

	Year Ended September 30	
	2018	2017
Unrestricted net assets		
Revenue, gains, and other support in excess of expenses	\$ 164,917	\$ 207,045
Pension-related changes other than net periodic costs	17,832	10,898
Net assets released from restrictions used for capital	274	100
Other transfers, net	(254)	(1,096)
Increase in unrestricted net assets	182,769	216,947
Temporarily restricted net assets		
Contributions and other	8,473	8,035
Net realized gains on investments	6,918	2,059
Net unrealized gains on investments	14,407	15,572
Net assets released from restrictions	(15,110)	(12,950)
Increase in temporarily restricted net assets	14,688	12,716
Permanently restricted net assets		
Contributions	301	236
Increase in permanently restricted net assets	301	236
Increase in net assets	197,758	229,899
Net assets at beginning of year	2,644,777	2,414,878
Net assets at end of year	\$ 2,842,535	\$ 2,644,777

See accompanying notes.

NorthShore University HealthSystem

Consolidated Statements of Cash Flows

(Dollars in Thousands)

	Year Ended September 30	
	2018	2017
Operating activities		
Increase in net assets	\$ 197,758	\$ 229,899
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Change in net unrealized gains on investments	(25,825)	(142,084)
Change in trading portfolio investments, net	(170,039)	(6,773)
Restricted contributions	(8,774)	(8,271)
Depreciation and amortization	67,075	109,673
Bond premium amortization	(88)	(88)
Pension-related changes other than net periodic cost	(17,832)	(10,898)
Provision for uncollectible accounts	51,642	48,807
Changes in operating assets and liabilities:		
Patient accounts receivable	15,998	(63,447)
Other current assets	(14,657)	1,444
Noncurrent assets and liabilities	(37,872)	(21,726)
Accounts payable and accrued expenses	26,997	21,656
Due from (to) third-party payors	14,465	(6,344)
Net cash provided by operating activities	<u>98,848</u>	<u>151,848</u>
Investing activities		
Investments in property and equipment, net	(103,678)	(147,863)
Net cash used in investing activities	<u>(103,678)</u>	<u>(147,863)</u>
Financing activities		
Restricted contributions	8,774	8,271
Payments of long-term debt	(10,705)	(10,295)
Net cash used in financing activities	<u>(1,931)</u>	<u>(2,024)</u>
(Decrease) increase in cash and cash equivalents	(6,761)	1,961
Cash and cash equivalents at beginning of year	59,460	57,499
Cash and cash equivalents at end of year	<u>\$ 52,699</u>	<u>\$ 59,460</u>

See accompanying notes.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements *(Dollars in Thousands)*

September 30, 2018

1. Organization and Basis of Presentation

NorthShore University HealthSystem (NorthShore) is an integrated health care system dedicated to providing health care services, including inpatient acute and non-acute care, primary and specialty physician services, and various outpatient services. NorthShore operates four acute care facilities, including Evanston Hospital, Highland Park Hospital, Glenbrook Hospital, and Skokie Hospital, that serve the greater Chicago “North Shore” and northern Illinois communities. NorthShore also includes research activities, home health and hospice care, and foundation operations.

NorthShore is the sole corporate member of NorthShore University HealthSystem Faculty Practice Associates (FPA), Radiation Medicine Institute (RMI), and NorthShore University HealthSystem Insurance International (Insurance International). FPA is the sole shareholder of NorthShore Physician Associates (NPA). NPA is the sole shareholder of Community Care Partners (CCP) and NorthShore Physician Associates Value Based Care (VBC). All significant intercompany accounts and transactions have been eliminated in consolidation. The accompanying consolidated financial statements include the accounts and transactions of NorthShore and its affiliates (collectively, the Corporation).

NorthShore, FPA, and RMI are tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code (IRC). NPA, CCP, and VBC are for-profit corporations. Insurance International is a foreign corporation organized in the Cayman Islands, which does not tax the activities of this organization.

The Corporation is the primary teaching affiliate of the University of Chicago Pritzker School of Medicine, under which the Corporation sponsors graduate medical education programs for physicians and other health-care-related personnel.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the amounts disclosed in the notes to the consolidated financial statements at the date of the consolidated financial statements.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Estimates affect the reported amounts of revenues and expenses during the reporting period. Although estimates are considered to be fairly stated at the time the estimates are made, actual results could differ.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments, which are not limited as to use, with a remaining maturity of three months or less from the date of purchase.

Patient Accounts Receivable

The Corporation evaluates the collectability of its accounts receivable based on the length of time the receivable is outstanding, the payor class, and the anticipated future uncollectible amounts based on historical experience. Accounts receivable are charged to the allowance for uncollectible accounts when they are deemed uncollectible.

Inventories

Inventories are stated at the lower of cost or market, based on the first-in, first-out (FIFO) method.

Investments

Investments in equity securities and mutual funds are carried at fair value based on quoted market prices. Commingled funds are carried at fair value based on other observable inputs. Debt securities are valued using institutional bids or pricing services. Alternative investments, primarily limited partnerships and hedge funds, are accounted for using the cost or equity method, depending on the extent of the Corporation's ownership within the fund, which is evaluated quarterly.

The Corporation classifies substantially all of its investments as trading. Under a trading classification, all unrestricted realized and unrealized gains and losses are included in revenues, gains, and other support in excess of expenses, unless the income or loss is restricted by donor. Realized and unrealized gains and losses on donor restricted investments are reported as a change in temporarily restricted net assets.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Pursuant to Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurement*, the Corporation has no nonfinancial assets or liabilities that are required to be measured at fair value on a recurring basis as of September 30, 2018 or 2017.

Investments Limited as to Use

Investments limited as to use include investments internally designated by the Board of Directors (the Board) for property and equipment replacement and expansion that the Board, at its discretion, may subsequently use for other purposes and investments externally designated under indenture or donor restriction.

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. Typical useful lives are 5 to 40 years for buildings and improvements and 3 to 20 years for equipment and furniture. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Total depreciation was \$67,025 and \$109,489 for the years ended September 30, 2018 and 2017, respectively.

The Corporation performed an analysis of the remaining useful lives of certain fixed assets and as a result, the estimated useful lives of some assets have been modified. This resulted in a reduction of depreciation expense of approximately \$40,750 for the year ended September 30, 2018.

Goodwill and Other Intangible Assets

Goodwill has been recorded at the excess of the purchase price over the fair value of the assets purchased in acquisitions. For 2018 and 2017, the Corporation performed a quantitative assessment which determined that the Corporation's fair value exceeds its carrying value, and no goodwill was impaired. The assessment included a review of several variables, including macroeconomic conditions, industry/market considerations, cost factors, and overall financial performance. The Corporation has goodwill of \$116,388 included in other noncurrent assets as of September 30, 2018 and 2017.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Other intangible assets with definite lives, such as noncompete clauses or trade names, are amortized over the estimated useful life of the asset. The Corporation has \$219 and \$268 included in other noncurrent assets at September 30, 2018 and 2017, respectively. Amortization expense related to these other intangible assets for the years ended September 30, 2018 and 2017, was \$50 and \$184, respectively.

Impairments

The Corporation considers whether indicators of impairment are present and performs the necessary tests to determine whether the carrying value of an asset is appropriate. Asset impairments are recognized in operating expenses at the time the impairment is identified. There was no impairment of long-lived assets in fiscal years 2018 or 2017. Impairments of alternative investments are recognized in nonoperating income or changes in temporarily restricted net assets at the time the impairment is identified. Alternative investment impairments for fiscal years 2018 and 2017 are described in Note 4.

Asset Retirement Obligations

The Corporation accounts for the fair value of legal obligations associated with long-lived asset retirements in accordance with ASC 410-20, *Asset Retirement and Environmental Obligations – Asset Retirement Obligations*. The asset retirement obligation, which primarily relates to future asbestos remediation, is recorded in accrued self-insurance and other liabilities and was accreted to its present fair value at September 30, 2018 and 2017, of \$5,959 and \$6,443, respectively.

General and Professional Liability

The provision for self-insured general and professional liability claims, per actuarial calculations, includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. The estimated receivable from the excess insurance carrier is reported in other noncurrent assets.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are assets whose use has been limited by donors or grantors to a specific period of time or a specific purpose. Temporarily restricted gifts, grants, and bequests are reported as an increase in temporarily restricted net assets in the period received. When specific purposes are satisfied, net assets used for capital purposes are reported in the consolidated statements of operations and changes in net assets as additions to unrestricted net assets; net assets used for operating purposes are reported in the consolidated statements of operations and changes in net assets as unrestricted revenues and other support. Contributions received with donor-imposed restrictions are reported as unrestricted if the restrictions are met in the same reporting period.

Permanently restricted net assets have been restricted by donors to be invested by the Corporation in perpetuity. Certain income from such investments may be temporarily restricted as to use. Associated income that is without donor restrictions is recorded in nonoperating income.

Contributions

Unconditional pledges of others to give cash and other assets to the Corporation are reported at fair value at the date the pledge is received, to the extent estimated to be collectible. Pledges received with donor restrictions that limit the use of the donated assets are reported as increases in temporarily restricted net assets. When donor restrictions are satisfied or met as a result of meeting the specified requirement or the time frame indicated, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions used for operations. Contributions of long-lived fixed assets are recorded at fair value as an increase to property and equipment and an increase to unrestricted net assets.

Net Patient Service Revenue

Net patient service revenue is revenue generated from services provided by the Corporation to patients. The Corporation receives payments for these services either directly from patients or on behalf of patients from third-party payors. Net patient service revenue is reported at the estimated net realizable amounts in the period the related services are provided and is adjusted in future periods as final settlements and payments are made.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) *(Dollars in Thousands)*

2. Summary of Significant Accounting Policies (continued)

Community Service and Care to the Indigent

The Corporation provides care to patients who meet certain criteria established under its charity care policy without charge or at amounts less than the Corporation's established rates. Community service and care to the indigent provided by the Corporation are deducted to arrive at net patient service revenue. The estimated costs incurred by the Corporation to provide these services were \$20,505 and \$18,794 for the years ended September 30, 2018 and 2017, respectively. These estimates were determined using a ratio of cost-to-gross charges calculated from the Corporation's most recently filed Medicare cost reports and applying that ratio to the gross charges of charity care provided in the period.

Premium Revenue

The Corporation has agreements with health maintenance organizations to provide medical services to subscribing participants. Under these agreements, the Corporation receives monthly payments based on the number of participants, regardless of actual medical services provided to participants. For the years ended September 30, 2018 and 2017, \$74,811 and \$69,300, respectively, of premium revenue was recorded.

Revenues, Gains, and Other Support in Excess of Expenses

The consolidated statements of operations and changes in net assets include revenues, gains, and other support in excess of expenses. The Board has approved a policy to include certain investment earnings in support of academic initiatives, as well as to provide funding for other activities, such as research. Changes in unrestricted net assets that are excluded from revenues, gains, and other support in excess of expenses include contributions of long-lived assets (including assets acquired using contributions that by donor restriction were used for the purposes of acquiring such assets) and pension-related changes other than net periodic costs.

Other Revenue and Other Nonoperating Income

Other revenue includes all other miscellaneous activities, such as rental income, cafeteria sales, unrestricted donations, and other miscellaneous revenue. Other, net, within nonoperating income, consists primarily of the expenses of the Foundation, investment management expenses, pension settlement charges, and transfer of professional liability asset earnings to operating income.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements

Adopted

In March 2016, the FASB issued ASU 2016-07, *Investments – Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting*. The amendments in this update eliminate the requirement to retroactively adjust an investment when it becomes qualified for use under the equity method as a result of an increase in the level of ownership interest or degree of influence. The amendments in this update are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The Corporation adopted the new guidance in the fiscal year 2018, and there was no significant impact on its consolidated financial statements.

Prospective

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The amendments in this update require not-for-profit entities that are conduit bond obligors to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In March 2016, the FASB issued ASU 2016-08, clarifying the implementation guidance on principal vs. agent considerations. During the third quarter of 2016, the FASB issued ASU 2016-10 and 2016-12. The amendments in these updates further clarify key guidance related to revenue recognition. The Corporation is required to adopt the new guidance in conjunction with ASU 2014-09. This new guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2017, with early adoption not permitted. The requirements of the guidance will result in changes to the presentation and disclosure of revenue from services to patients. Currently, a significant portion of the Corporation's provision for uncollectible accounts relates to uninsured patients as well as deductibles and co-pays due from patients with insurance. Under the new guidance, the uncollectible amounts due from patients will generally be reported as a direct reduction to net patient service revenue and will eliminate, or significantly reduce, the amounts presented separately as provision for uncollectible accounts. Although the adoption of the new guidance will have a significant impact on the amounts presented in certain categories of the Corporation's consolidated statements of operations and changes in net assets, it is not expected to materially impact the Corporation's overall consolidated financial position, results of operations, or cash flows. The Corporation will adopt the guidance using the full retrospective method as of October 1, 2018, and there will be no material cumulative adjustment recorded.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. Investments, except for those accounted for under the equity method of accounting, or those that result in consolidating the investment, will be measured at fair value with changes in fair value recognized in nonoperating income. This new guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Corporation is required to adopt the new guidance for the fiscal year beginning on October 1, 2019, and is currently evaluating the impact this guidance will have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. Under the new guidance, lessees are required to capitalize leases with greater than 12-month terms on the balance sheet. Leases will be classified as operating or financing. Both types of leases will be recorded on the balance sheet. Operating leases will reflect lease expense on a straight-line basis whereas financing leases will accelerate lease expense in the early period of the lease term and decline with passage of time similar to current accounting for capital leases. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Corporation is required to adopt the new guidance for the fiscal year beginning on October 1, 2019, and is currently evaluating the impact this guidance will have on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The FASB proposed a single, principles-based model for all entities to account for credit losses on loans, debt securities, trade, lease, and other receivables. The allowance for expected credit losses at each reporting date would represent the current estimate of contractual cash flows not expected to be collected. ASU 2016-13 applies to financial assets subjected to credit losses that are not already classified as fair value through net income. The Corporation is required to adopt the new guidance for the fiscal year beginning on October 1, 2021, and is currently evaluating the impact this guidance will have on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The amendments in this update replace the three classes of net assets (unrestricted, temporary, and permanent) with two classes (with and without donor restrictions). ASU 2016-14 also requires additional disclosures relating to net assets and

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

expenses. The Corporation is required to adopt the new guidance for annual reporting periods beginning on October 1, 2018, and subsequent interim periods. The Corporation is currently evaluating the impact this guidance will have on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. The amendments in this update clarify the classification of eight types of transactions in the statement of cash flows to reduce diversity in practices. The Corporation is required to adopt the new guidance for the fiscal year beginning on October 1, 2018; however, the Corporation is not expecting this guidance to have a material impact on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. The guidance requires entities to show the changes in the total cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. As a result, entities will no longer be required to present transfers between these categories. The Corporation is required to adopt the new guidance for the fiscal year beginning on October 1, 2018; however, the Corporation is not expecting this guidance to have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. The amendments in this update are intended to simplify the accounting for goodwill impairments. Goodwill impairment will be determined by using the difference in fair value and carrying value rather than the original two-step approach. Early adoption is permitted. The Corporation is required to adopt the new guidance for the fiscal year beginning on October 1, 2022; however, the Corporation is not expecting this guidance to have a material impact on its consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The amendments in this update require an employer to separate the service cost component from the other components of net benefit cost. The service cost component will be reported as part of compensation while the remaining components will be reflected in nonoperating income. The amendments in this update should be applied retrospectively for the presentation of the service cost component and other components of net period pension costs and net periodic postretirement benefit costs in the income statement. Since the Corporation's pension plan is currently frozen, it

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

does not have service costs. All other components will be presented as a part of nonoperating income. The Corporation is required to adopt the new guidance for the fiscal year beginning on October 1, 2019; however, the Corporation is not expecting this guidance to have a material impact on its consolidated financial statements.

In June of 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*. The amendment in this update improves consistency in how entities determine whether a transfer of assets is an exchange transaction or a contribution and whether a contribution is conditional. The Corporation is required to adopt the new guidance for the fiscal year beginning on October 1, 2018, however, the Corporation is not expecting this guidance to have a material impact on its consolidated financial statements.

3. Contractual Arrangements With Third-Party Payors

The Corporation has entered into contractual arrangements with various managed care organizations, including Blue Cross Blue Shield (BCBS), the terms of which call for the Corporation to be paid for covered services at predetermined rates. Certain services provided to BCBS program inpatients are paid at interim rates with annual settlements based on allowable reimbursable costs. Outpatient services for this BCBS population are covered by an indemnity fee-for-service policy and, therefore, are not covered under the cost settlement program. The Corporation also provides care to certain patients with government insurance programs, such as Medicare and Medicaid, at predetermined rates. Reported costs and/or services provided, under certain of the arrangements, are subject to audit by the administering agencies. Changes in the various programs, including Medicare and Medicaid, could have an adverse effect on the Corporation.

A provision has been made in the consolidated financial statements for contractual adjustments, representing the difference between the charges for services provided and estimated reimbursement from the various third-party payors. Net patient service revenue increased by \$846 and \$78 for the years ended September 30, 2018 and 2017, respectively, to reflect changes in the estimated Medicare and Medicaid settlements for prior years.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

3. Contractual Arrangements With Third-Party Payors (continued)

The percentages of total gross patient service revenue applicable to specific payors' contractual arrangements for the years ended September 30 are as follows:

	2018	2017
Medicare	44%	44%
BCBS	21	22
Managed care	19	19
Medicaid	8	9
Other	8	6
Total	100%	100%

The percentages of gross patient accounts receivable applicable to specific payors' contractual arrangements as of September 30 are as follows:

	2018	2017
Medicare	37%	31%
Managed care	20	20
Medicaid	20	27
BCBS	14	13
Other	9	9
Total	100%	100%

The Corporation's estimation of the allowance for doubtful accounts is based primarily upon the type and age of patient accounts receivable and the effectiveness of the Corporation's collection efforts.

The Corporation's policy is to establish reserves for a portion of all self-pay receivables, including amounts due from the uninsured and amounts related to co-payments and deductibles, as these charges are recorded. The allowance for uncollectible accounts as a percentage of all accounts receivable was 29% and 26% as of September 30, 2018 and 2017, respectively.

The Corporation's methodology for both years ended September 30, 2018 and 2017, was to reserve for all commercial claims over 360 days.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

3. Contractual Arrangements With Third-Party Payors (continued)

The Corporation's total reserve for self-pay accounts receivable, including the allowance for uncollectible accounts and charity care, was 85% and 86% of self-pay accounts receivable at September 30, 2018 and 2017, respectively.

On a monthly basis, the Corporation reviews its patient accounts receivable balances and employs various analytics to support the determination of its estimates. These efforts primarily consist of reviewing the following: historical write-off and collection experience, revenue and volume trends by payor (particularly self-pay components), changes in the aging and payor mix of patient accounts receivable (including accounts due from the uninsured and accounts that represent co-payments and deductibles due from patients), trending of days revenue in accounts receivable, and various allowance coverage statistics.

Total net patient service revenue was \$1,989,091 and \$1,953,327 for the years ended September 30, 2018 and 2017, respectively. Included in this amount is third-party payor revenue of \$1,896,845 and \$1,865,072 and self-pay revenue of \$92,245 and \$88,255 for the years ended September 30, 2018 and 2017, respectively.

The Corporation is subject to routine audits and reviews by various governmental and commercial agencies related to payments received for services provided. In fiscal year 2016, the Office of the Inspector General completed a compliance review for Medicare services provided in 2013 and 2014. As a result of this review, the Corporation refunded \$3,900 to the Centers for Medicare & Medicaid Services in March 2017. The Corporation has appealed the results of this review.

The Corporation believes that it is in compliance with all applicable Medicare and Medicaid laws and regulations and is not aware of any pending or threatened investigations or allegations of potential wrongdoing.

Current liabilities include \$119,829 and \$106,992 for September 30, 2018 and 2017, respectively, related to various estimated settlements due to third-party payors, including Medicare, Medicaid, and BCBS. Laws and regulations governing Medicare and Medicaid change frequently, are complex, and are subject to interpretation. Administrative procedures for both Medicare and Medicaid preclude the final settlement until the related cost reports have been audited by the sponsoring agency and settled. As a result, there is a reasonable possibility that these recorded estimates will change as new information becomes available, and the amount of the change may be material.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

3. Contractual Arrangements With Third-Party Payors (continued)

Under the state of Illinois' Hospital Assessment program, the Corporation recognized \$57,095 and \$56,699 of net patient revenue for the years ended September 30, 2018 and 2017, respectively. Additionally, \$45,362 and \$43,636 of program assessment expense was recognized for the years ended September 30, 2018 and 2017, respectively.

4. Financial Instruments

The presentation of investments at September 30 is as follows:

	2018	2017
Other short-term investments	\$ 1,240	\$ 1,150
Investments available for general use	1,875,690	1,695,893
Investments limited as to use:		
Current portion	52,605	50,705
All other (noncurrent)	222,758	206,691
Other noncurrent assets	99,671	84,458
Total investments	\$ 2,251,964	\$ 2,038,897

Total investment return for the years ended September 30 is summarized as follows:

	2018	2017
Nonoperating:		
Dividend and interest income	\$ 36,556	\$ 32,350
Net realized gains on investments	116,861	54,463
Net unrealized gains on investments	11,418	126,512
Total nonoperating investment return	164,835	213,325
Temporarily restricted:		
Net realized gains	6,918	2,059
Net unrealized gains	14,407	15,572
Total temporarily restricted investment return	21,325	17,631
Total investment return	\$ 186,160	\$ 230,956

Investment fees for the years ended September 30, 2018 and 2017, were \$28,768 and \$28,549, respectively, and are included in other, net, within nonoperating income.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

4. Financial Instruments (continued)

The Corporation continually reviews its alternative investment portfolio recorded at cost and evaluates whether declines in the fair value of such securities should be considered other than temporary. Factored into this evaluation are general market conditions, the issuer's financial condition and near-term prospects, conditions in the issuer's industry, and the length of time and extent to which the fair value has been less than cost. For the year ended September 30, 2018 one investment held at cost was determined to be impaired, resulting in the corporation recording a loss of \$3,323. No related investments were impaired for the year ended September 30, 2017.

5. Fair Value Measurements

The Corporation holds certain debt securities, equity securities, and investments in funds that are measured using a prescribed fair value hierarchy and related valuation methodologies. The concept of the highest and best use of an asset is used for valuation. Highest and best use is determined by the use of the asset by market participants, even if the intended use of the asset by the reporting entity is different.

ASC 820 specifies a hierarchy of valuation techniques based on whether the inputs to each measurement are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Corporation's assumptions about current market conditions.

The prescribed fair value hierarchy and related valuation methodologies are as follows:

Level 1 – Quoted market prices for identical instruments in active markets. Active markets are defined by daily trading and investor ability to exit holdings at the daily pricing. Redemption frequency is daily.

Level 2 – Quoted market prices for similar or identical instruments and model-derived valuations in which all significant inputs are observable in the market. The separately managed accounts are based on institutional bid evaluations. Institutional bid evaluations are estimated prices computed by pricing vendors. These prices are determined using observable inputs for similar securities as of the measurement date. Redemption frequency is daily or monthly.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

5. Fair Value Measurements (continued)

Level 3 – Valuations derived from valuation techniques in which one or more significant inputs are unobservable. These prices are based on the net asset value reported from the investee and reviewed by an independent third party as its best estimate of fair market value on the reporting date for its investments in limited partnerships and hedge funds. Because there are no observable market transactions for interests in investments in limited partnerships and hedge funds, any investments of this nature would be classified in Level 3 of the fair value hierarchy. Redemption frequency varies from monthly to longer than one year for hedge funds. Limited partnerships are expected to be held for the life of the fund.

The Corporation's financial assets that are carried at fair value at September 30, 2018, were as follows:

Nature of Investment	Level 1	Level 2	Level 3	Total
Common stock	\$ 192,335	\$ –	\$ –	\$ 192,335
Mutual funds	308,266	–	–	308,266
Bond funds	105,666	–	–	105,666
Fixed income accounts	–	215,669	–	215,669
Total assets at fair value	<u>\$ 606,267</u>	<u>\$ 215,669</u>	<u>\$ –</u>	<u>\$ 821,936</u>

Total investments at September 30, 2018, are \$2,251,964. This amount includes \$821,936 in investments recorded at fair value and \$878,750 in investments measured at net asset value. In addition, this amount includes \$465,835 in limited partnerships and hedge funds recorded at cost, \$13,882 in limited partnerships recorded using the equity method, cash in transit of \$40,467 and other assets of \$31,094 recorded at cost.

The Corporation's financial assets that are carried at fair value at September 30, 2017, were as follows:

Nature of Investment	Level 1	Level 2	Level 3	Total
Common stock	\$ 188,870	\$ –	\$ –	\$ 188,870
Mutual funds	223,850	–	–	223,850
Bond funds	183,010	–	–	183,010
Real asset funds	15,610	–	–	15,610
Fixed-income accounts	–	124,508	–	124,508
Total assets at fair value	<u>\$ 611,340</u>	<u>\$ 124,508</u>	<u>\$ –</u>	<u>\$ 735,848</u>

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

5. Fair Value Measurements (continued)

Total investments at September 30, 2017, are \$2,038,897. This amount includes \$735,848 in investments recorded at fair value and \$804,226 in investments measured at net asset value. In addition, this amount includes \$480,066 in limited partnerships and hedge funds recorded at cost, \$10,278 in limited partnerships recorded using the equity method, and other assets of \$8,479 recorded at cost.

ASC 825, *Financial Instruments*, permits entities to elect to measure many financial instruments and certain other items at fair value. The fair value option may be applied instrument by instrument and is irrevocable. The Corporation has made no such elections to date.

There were no transfers between Level 1, Level 2, or Level 3 assets during the years ended September 30, 2018 or 2017.

The carrying values of patient accounts receivable, accounts payable, and accrued expenses are reasonable estimates of their fair values due to the short-term nature of these financial instruments.

The estimated fair value of total debt was \$329,160 and \$344,257 at September 30, 2018 and 2017, respectively. Under the guidance set forth in ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, the Corporation's debt is classified as a Level 2 liability. The estimated fair value of the fixed rate debt is determined by recalculating the dollar prices of each of the Corporation's outstanding fixed rate bonds using current market yields. The variable rate debt is remarketed daily or weekly, and par value is considered to be fair value. The fair value included a consideration of third-party credit enhancements, which had no impact on the estimated fair value of the debt.

6. Long-Term Debt and Debt With Self-Liquidity

All bonds issued by the Corporation were used to pay or reimburse the Corporation for certain capital projects, to provide for a portion of the interest on the bonds, and to pay certain expenses incurred in connection with the issuance of the bonds. The variable rate bonds are subject to periodic remarketing and can be converted to a fixed rate subject to certain terms of the loan agreements.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) *(Dollars in Thousands)*

6. Long-Term Debt and Debt With Self-Liquidity (continued)

The Series 2001B, 2001C, 1995, and 1996 bonds have standby bond purchase agreements issued by a financial institution that expire on October 15, 2020. In the event these bonds cannot be remarketed, the bond trustee will call the bonds and the bonds will become bank bonds held by the liquidity facility provider. The liquidity facility provider will hold the bonds for 367 days or until a replacement liquidity facility is secured. After the 367-day period, the bonds will begin to amortize over a three-year period. In the event an SBPA cannot be renewed or replaced, the liquidity facility provider will make a loan in the amount necessary to complete the mandatory tender of the bonds. The principal and interest on the loan will be amortized over three years.

The Corporation has an LOC backup facility with a financial institution in conjunction with the 2008 Pooled Program that expires on November 30, 2019. The LOC may be drawn upon by the trustee to make payments of principal and interest on maturing commercial paper in the event that an issuance of commercial paper does not roll over. Repayments on any liquidity advance received prior to the LOC expiration date will be made in equal quarterly installments beginning on the first subsequent quarter-end date.

Under the terms of the long-term debt arrangements, various amounts are on deposit with trustees, and certain specified payments are required for bond redemption, interest payments, and asset replacement. The terms of certain long-term debt agreements require, among other things, the maintenance of various financial ratios and place limitations on additional indebtedness and pledging of assets. The Corporation remained in compliance with these agreements during the reporting periods.

The Corporation has various outstanding LOCs in connection with construction projects and property lease obligations, which amount to \$500 at September 30, 2018 and 2017. No amounts have been drawn against these LOCs.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

6. Long-Term Debt and Debt With Self-Liquidity (continued)

For the years ending September 30, maturities of long-term debt, including an \$88 bond premium, are as follows:

<u>Fiscal Year</u>	<u>Maturities of Long-Term Debt</u>
2019	\$ 11,193
2020	\$ 11,638
2021	\$ 12,133
2022	\$ 12,623
2023	\$ 13,158

Interest paid for the years ended September 30, 2018 and 2017, was \$8,322 and \$7,705, respectively. Interest of \$1,208 and \$1,300 was capitalized for the same periods, respectively. In addition, bond premium amortization was \$88 for the years ended September 30, 2018 and 2017.

Total long-term debt at September 30 is summarized as follows:

<u>Type/Issuer</u>	<u>Series</u>	<u>Amortization</u>		<u>Outstanding Principal</u>		<u>Interest Rate</u>	
		<u>Amount Range</u>	<u>Years From-To</u>	<u>September 30</u>		<u>September 30</u>	
				<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Illinois Development Finance Authority Variable Rate Demand Revenue Bonds							
	2001B	\$1,800-\$5,000	2019-2031	\$ 32,500	\$ 34,300	1.18%	0.68%
	2001C	1,800- 5,000	2019-2031	32,500	34,300	1.18%	0.68%
Illinois Health Facilities Authority Variable Rate Adjustable Demand Revenue Bonds							
	1995	\$1,490-\$8,605	2019-2035	\$ 38,575	\$ 40,020	1.29%	0.78%
	1996	1,475- 8,560	2019-2035	38,635	40,070	1.30%	0.77%
Illinois Educational Facilities Authority Commercial Paper Revenue Note							
	2008	\$995-\$13,305	2032-2038	\$ 75,000	\$ 75,000	1.38%	0.79%
Illinois Finance Authority Revenue Refunding Bonds							
	2010	\$825-\$9,685	2019-2037	\$ 107,540	\$ 111,765	4.6%-5.25%	4.00%-5.25%
Total long-term debt				\$ 324,750	\$ 335,455		
Less: current maturities of debt				11,193	10,793		
Less: debt issuance costs				2,278	2,409		
Plus: 2010 bond premium (current and long-term)				1,638	1,726		
Total long-term debt, less current maturities				\$ 312,917	\$ 323,979		

For all variable rate securities, the interest rate is a weighted average.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

7. Employee Benefit Programs

The Corporation sponsors a funded, noncontributory, defined benefit pension plan (the NorthShore Plan), which was frozen to all participants on December 31, 2013. Assets held by the NorthShore Plan consist primarily of fixed-income securities, domestic/international stocks, limited partnership interests, and hedge funds. A plan measurement date of September 30 is used for the NorthShore Plan.

For the year ended September 30, 2018, the Corporation did not make contributions to the plan. The Corporation recognized \$9,838 in settlement charges, in nonoperating income, for the year ended September 30, 2018.

The summary of the changes in the projected benefit obligation and plan assets for the years ended September 30 is as follows:

	2018	2017
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 259,313	\$ 269,633
Interest cost	10,307	10,372
Actuarial losses	(9,521)	(5,648)
Benefits paid	(8,006)	(15,044)
Settlements	(28,470)	—
Projected benefit obligation at end of year	\$ 223,623	\$ 259,313

The accumulated benefit obligation is equal to the projected benefit obligation for the years ended September 30 as the Plan was frozen of December 31, 2013.

	2018	2017
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 230,187	\$ 197,479
Actual return on plan assets	10,970	17,752
Employer contributions	—	30,000
Benefits paid	(8,006)	(15,044)
Settlements	(28,470)	—
Fair value of plan assets at end of year	\$ 204,681	\$ 230,187

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

7. Employee Benefit Programs (continued)

A summary of changes in the funded status and net periodic pension cost as of and for the years ended September 30 is as follows:

	2018	2017
Funded status of the plan	\$ (18,942)	\$ (29,126)
Unrecognized net actuarial loss	77,080	94,024
Prepaid pension cost	58,138	64,898
Accumulated adjustments to unrestricted net assets	(77,080)	(94,024)
Amounts recognized in consolidated balance sheets	\$ (18,942)	\$ (29,126)

Changes in the plan's assets and benefit obligation recognized in unrestricted net assets for the years ended September 30 include the following:

	2018	2017
Current year actuarial loss	\$ (5,132)	\$ (9,186)
Recognized loss	(11,812)	(2,074)
	\$ (16,944)	\$ (11,260)

The Corporation's target and actual pension asset allocations are as follows:

Asset Category	Strategic Target	2018	2017
Equity securities	37%	40%	39%
Debt securities	33	25	34
Other	30	35	27
Total	100%	100%	100%

The Corporation holds certain debt securities, equity securities, and investments in funds that must be measured using a prescribed fair value hierarchy and related valuation methodologies. The concept of the "highest and best use" of an asset is used for valuation. Highest and best use is determined by the "use of the asset by market participants, even if the intended use of the asset by the reporting entity is different."

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

7. Employee Benefit Programs (continued)

ASC 820 specifies a hierarchy of valuation techniques based on whether the inputs to each measurement are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Corporation's assumptions about current market conditions.

The following table presents total financial instruments for the NorthShore Plan as of September 30, 2018, measured at fair value on a recurring basis by the ASC 820 valuation hierarchy defined in Note 5:

Nature of Investment	Level 1	Level 2	Level 3	Total
Money market funds	\$ 5,711	\$ –	\$ –	\$ 5,711
Mutual funds	17,173	–	–	17,173
Fixed-income accounts	–	40,638	–	40,638
Total assets at fair value	<u>\$ 22,884</u>	<u>\$ 40,638</u>	<u>\$ –</u>	<u>63,522</u>
Investments measured at net asset value				<u>141,159</u>
Total pension plan assets				<u>\$ 204,681</u>

The following table presents total financial instruments for the NorthShore Plan as of September 30, 2017, measured at fair value on a recurring basis by the ASC 820 valuation hierarchy defined in Note 5:

Nature of Investment	Level 1	Level 2	Level 3	Total
Money market funds	\$ 3,295	\$ –	\$ –	\$ 3,295
Mutual funds	41,583	–	–	41,583
Fixed-income accounts	–	48,476	–	48,476
Total assets at fair value	<u>\$ 44,878</u>	<u>\$ 48,476</u>	<u>\$ –</u>	<u>93,354</u>
Investments measured at net asset value				<u>136,833</u>
Total pension plan assets				<u>\$ 230,187</u>

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

7. Employee Benefit Programs (continued)

The components of net periodic benefit cost included in the consolidated statements of operations and changes in net assets for the years ended September 30 are as follows:

	2018	2017
Interest cost	\$ 10,308	\$ 10,372
Expected return on plan assets	(15,359)	(14,215)
Actuarial loss	2,010	2,074
Net periodic benefit cost	\$ (3,041)	\$ (1,769)

Expected employee benefit payments for the NorthShore Plan are \$14,906 in 2019, \$14,508 in 2020, \$14,955 in 2021, \$15,315 in 2022, \$16,057 in 2023, and \$77,904 during the period from 2024 through 2028.

Assumptions used to determine benefit obligations at the measurement date of September 30 are in the table below. To develop the expected long-term rate of return on assets assumption, the Corporation considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio.

	2018	2017
Discount rate	4.48%	4.09%
Expected return on plan assets	6.75	6.75

Assumptions used to determine net pension expense for the years ended September 30 are as follows:

	2018	2017
Discount rate	4.09%	3.95%
Expected return on plan assets	6.75	7.00

During fiscal year 2017, the Corporation switched from the Adjusted RP-2014 Mortality Table with generational mortality improvement using Scale MP-2016 to using Scale MP-2017, which increased the projected benefit obligation by \$(7,915).

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

7. Employee Benefit Programs (continued)

The Corporation also sponsors a 403(b) plan that matches employee contributions at an annual discretionary percentage. Matching cash contributions to the defined contribution plan totaled \$20,164 and \$23,758 in 2018 and 2017, respectively. The related liability at September 30, 2018 and 2017, is \$21,800 and \$16,310, respectively, which was included in accrued expenses.

In addition, the Corporation sponsors a defined contribution retirement plan (the RCP Plan), in which it enrolled new employees hired after January 1, 2013, and all employees as of January 1, 2014. Cash contributions to the RCP Plan totaled \$25,831 and \$24,663 in 2018 and 2017, respectively. The Corporation recorded a liability of \$20,325 and \$18,825 related to the RCP Plan as of September 30, 2018 and 2017, respectively, which was included in accrued expenses.

The Corporation also sponsors various supplemental executive retirement plans. The total liability for these plans is \$16,908 and \$16,585 for the years ended September 30, 2018 and 2017, respectively, and is included in accrued expenses and employee retirement plans based on the expected payout dates. The Corporation funded \$3,458 and \$2,540 of the liabilities for these plans as of September 30, 2018 and 2017, respectively, and recorded these amounts in other noncurrent assets.

The Corporation also offers an Executive and Physician Income Deferral Plan (457B), which is 100% employee-funded. The plan assets and liabilities for September 30, 2018 and 2017, are \$96,326 and \$82,021, respectively. These amounts are included in other noncurrent assets and employee retirement and deferred compensation plans for the years ended September 30, 2018 and 2017.

8. Professional Liability Insurance

The Corporation has claims-made basis policies in excess of the amounts retained by the Corporation for professional and general liability claims. As of September 30, 2015 (beginning with policy year March 26, 2009), claims are subject to deductibles of \$10,000 with a \$15,000/\$15,000 buffer layer. The estimated professional liability losses are calculated with the assistance of consulting actuaries, and an accrual has been made for potential claims to be paid. The discounted reserve balance was \$215,301 and \$251,645 as of September 30, 2018 and 2017, respectively, using a 3.0% and 2.5% discount rate, respectively. Included in these amounts is a receivable for anticipated insurance recoveries of \$14,201 and \$13,115 as of September 30, 2018 and 2017, respectively. The undiscounted reserve balance would have been higher by

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

8. Professional Liability Insurance (continued)

approximately \$21,704 and \$24,183 as of September 30, 2018 and 2017, respectively. The Corporation is not aware of any factors that would cause insurance expense to vary materially from the amounts provided. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term but reported subsequently may not be insured.

9. Litigation and Contingencies

In February 2004, the Federal Trade Commission (FTC) issued a complaint against the Corporation challenging its January 2000 merger with Highland Park Hospital (HPH). On April 28, 2008, the FTC issued a Final Order that requires the Corporation to conduct separate negotiations with private third-party payors for health care services of HPH unless a payor specifically elects to opt out and negotiate jointly for all of the Corporation's hospitals. The Final Order also requires the Corporation to give prior notification to the FTC for any future acquisitions of hospitals within the Chicago Metropolitan Statistical Area through April 2018. The Final Order terminates in April 2028.

In August 2007, three individual private plaintiffs filed a purported antitrust class action lawsuit against the Corporation in Federal District Court in Chicago, Illinois, alleging anticompetitive price increases as a result of the Corporation's January 2000 merger with HPH. In May 2008, an entity titled the Painters District Council No. 30 Health and Welfare Fund filed a nearly identical antitrust class action against the Corporation. All four of the separate suits have been consolidated into one action. On March 30, 2010, the District Court denied the plaintiffs' motion for class certification. The plaintiffs appealed the District Court's denial of class certification to the Seventh Circuit Court of Appeals, and on January 13, 2012, the Seventh Circuit issued an opinion that vacated the District Court's decision and remanded the case back to the District Court for further proceedings. On April 4, 2012, the plaintiffs filed a renewed motion for class certification that the Corporation opposed on July 12, 2012. On December 10, 2013, the District Court granted plaintiffs' renewed motion for class certification. On September 4, 2015, the District Court granted in part the Corporation's motions to compel arbitration against the largest managed care organizations that are alleged to be part of the class. In particular, the District Court found that Aetna, Blue Cross (PPO product), Cigna, United, and Unicare must resolve their dispute with the Corporation (if any) through arbitration, and cannot participate in the class.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

9. Litigation and Contingencies (continued)

Several other managed care organizations, including Blue Cross (HMO product) and Humana, remain within the class. Fact discovery closed in November 2015. The parties completed expert discovery in April 2017. The parties filed competing motions for summary judgment, motions to decertify the class, and motions to exclude experts during the spring and summer of 2017. On March 31, 2018, the District Court issued a partial ruling on the various pending motions. The court granted the Corporation's motion to decertify the class finding that named the plaintiffs were "inadequate" to represent the proposed class. The Court further limited the class to "direct" purchasers of only "inpatient" services, and found the current Plaintiffs were "indirect" purchasers of only "outpatient" services. On July 2, 2018, the District Court granted plaintiffs' counsel's request to substitute two new patients who claim to meet the amended class definition. During discovery into the two new patients' claims, Plaintiffs' counsel elected to voluntarily dismiss one patient, leaving only one individual patient as the sole proposed class representative. On October 3, 2018, the Corporation filed a renewed and supplemental Motion for Summary Judgment and Motion for Decertification seeking to disqualify the lone remaining Plaintiff as an inadequate class member, as well as obtain judgment against the one remaining patient for failure to establish any injury or harm. A decision on the pending motions is expected in early 2019. The Corporation has denied all allegations within the plaintiffs' complaints and intends to pursue its rights in defense of the claims. The Corporation is unable to predict the ultimate outcomes, including liability, if any, in this litigation; however, such liabilities could be material.

The Corporation is a defendant in various lawsuits arising in the ordinary course of business. Although the outcome of these lawsuits cannot be predicted with certainty, management believes the ultimate disposition of such matters will not have a material effect on the Corporation's consolidated financial condition or operations.

10. Commitments

Future minimum lease payments for property and equipment for all noncancelable operating leases for the next five years are as follows:

2019	\$	24,217
2020	\$	22,869
2021	\$	22,437
2022	\$	21,730
2023	\$	20,498

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

10. Commitments (continued)

Lease expense for the years ended September 30, 2018 and 2017, was \$25,841 and \$25,249, respectively, and is recorded within supplies, services, and other.

At September 30, 2018, the Corporation is committed to \$98,971 in construction-related contracts.

At September 30, 2018, the Corporation is committed to fund \$128,261 to limited partnerships, which is expected to occur over the next decade. At September 30, 2018, the pension plan is committed to fund \$5,390 to limited partnerships, which is expected to occur over the next decade.

Future minimum intangible asset amortization for the next five years is as follows:

2019	\$	35
2020	\$	35
2021	\$	35
2022	\$	35
2023	\$	35

11. General, Administrative, and Fund-Raising Expenses

General and administrative expenses incurred in connection with providing inpatient, outpatient, professional, and emergency care services amounted to \$319,276 and \$317,839 in 2018 and 2017, respectively. Fund-raising expenses for the years ended September 30, 2018 and 2017, were \$3,555 and \$3,040, respectively.

12. Temporarily and Permanently Restricted Net Assets

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

	<u>2018</u>	<u>2017</u>
Restricted for:		
Research	\$ 21,154	\$ 20,270
Special purpose	118,407	104,603
Total temporarily restricted net assets	<u>\$ 139,561</u>	<u>\$ 124,873</u>

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

12. Temporarily and Permanently Restricted Net Assets (continued)

Permanently restricted net assets totaled \$77,394 and \$77,093 for the years ended September 30, 2018 and 2017, respectively. Earnings from permanently restricted net assets are used toward research, special purpose, and general operations and to fund department chairs, as well as uncompensated care offered to patients who meet certain criteria established under the Corporation's charity care policy.

Activity in the endowment funds was as follows:

	Temporarily Permanently			Total
	Unrestricted	Restricted	Restricted	
Endowment net assets at September 30, 2016	\$ 7,916	\$ 55,089	\$ 76,857	\$ 139,862
Contributions	-	-	236	236
Investment return	565	3,681	-	4,246
Change of value in trust	2,383	15,573	-	17,956
Distributions	(565)	(6,454)	-	(7,019)
Endowment net assets at September 30, 2017	10,299	67,889	77,093	155,281
Contributions	-	-	301	301
Investment return	1,318	8,501	-	9,819
Change of value in trust	2,209	14,407	-	16,616
Distributions	(1,318)	(6,823)	-	(8,141)
Endowment net assets at September 30, 2018	<u>\$ 12,508</u>	<u>\$ 83,974</u>	<u>\$ 77,394</u>	<u>\$ 173,876</u>

The state of Illinois passed the Uniform Prudent Management of Institutional Funds Act (UPMIFA) effective June 30, 2009. The Corporation has interpreted UPMIFA as sustaining the preservation of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulation to the contrary. In compliance with this interpretation of UPMIFA, the Corporation classifies permanently restricted net assets as (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated in a manner considered with the standard of prudence prescribed by UPMIFA.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

12. Temporarily and Permanently Restricted Net Assets (continued)

The Corporation has adopted a policy of requiring a minimum donation of \$1,500 to establish an endowed chair and \$1,000 to establish an endowed research project or endowed clinical program.

The Corporation has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowment, while seeking to maintain the purchasing power of endowment assets. Currently, the Corporation expects its endowment funds over time to provide an average rate of return of approximately 5% annually. To achieve this long-term rate of return objective, the Corporation relies on a total return strategy in which investment returns are achieved through capital appreciation (realized and unrealized) and current yield (interest and dividends). Actual returns in any given year may vary from this amount.

An endowment fund is considered to be underwater when the market value of the endowment is less than the original (and any subsequent) donations received by the Corporation. The Corporation has adopted a policy that such shortfall amounts will be funded by the Corporation from its unrestricted investment funds. There were no underwater endowments as of September 30, 2018 or 2017.

13. Income Taxes

The Corporation and its related affiliates, except for NPA and CCP, known as NorthShore Exempt Group, have been determined to qualify as a tax-exempt organization under Section 501(c)(3) of the IRC. Most of the income received by NorthShore Exempt Group is exempt from taxation under Section 501(a) of the IRC as income related to the mission of the organization. Accordingly, there is no material provision for income tax for these entities. Some of the income received by exempt entities is subject to taxation as unrelated business income. NorthShore and its subsidiaries file federal income tax returns and returns for various states in the U.S.

ASC 740, *Income Taxes*, requires that realization of an uncertain income tax position is more likely than not (i.e., greater than 50% likelihood of receiving a benefit) before it is recognized in the financial statements as the amount most likely to be realized assuming a review by tax authorities having all relevant information and applying current conventions. This interpretation also clarifies the financial statement classification of tax-related penalties and interest and sets forth new disclosures regarding unrecognized tax benefits. No amount was recorded for the years ended September 30, 2018 or 2017.

NorthShore University HealthSystem

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

13. Income Taxes (continued)

For the year ended September 30, 2018, the Corporation has a net operating loss carryforward of \$8,643, which generated assets of \$2,464. These assets are offset by a valuation allowance of \$1,020.

For the year ended September 30, 2017, the Corporation has a net operating loss carryforward of \$9,494, which generated assets of \$3,823. These assets are offset by a valuation allowance of \$2,380.

14. Subsequent Events

The Corporation evaluated events and transactions occurring subsequent to September 30, 2018 through February 4, 2019, the date of issuance of the accompanying consolidated financial statements.

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