

CONSOLIDATED FINANCIAL STATEMENTS

NorthShore University HealthSystem  
Years Ended September 30, 2019 and 2018  
With Report of Independent Auditors

Ernst & Young LLP



NorthShore University HealthSystem

Consolidated Financial Statements

Years Ended September 30, 2019 and 2018

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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, which comprise the consolidated balance sheets as of September 30, 2019 and 2018, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

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

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

### **Auditor’s Responsibility**

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

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

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



## Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of NorthShore University HealthSystem and its affiliates at September 30, 2019 and 2018, 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*

December 17, 2019

# NorthShore University HealthSystem

## Consolidated Balance Sheets (Dollars in Thousands)

	<b>September 30</b>	
	<b>2019</b>	<b>2018</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 74,229	\$ 52,699
Other short-term investments	1,736	1,240
Investments limited as to use, current portion	64,150	52,605
Patient accounts receivable	280,053	261,570
Inventories, prepaid expenses, and other	80,590	87,942
Total current assets	500,758	456,056
Investments available for general use	1,898,353	1,875,690
Investments limited as to use	222,225	222,758
Property and equipment:		
Land and improvements	107,656	107,331
Buildings	1,641,834	1,600,879
Equipment and furniture	458,082	426,920
Construction-in-progress	150,676	68,280
Accumulated depreciation	(1,138,685)	(1,075,189)
Total property and equipment, net	1,219,563	1,128,221
Other noncurrent assets	141,150	254,587
Total assets	\$ 3,982,049	\$ 3,937,312

NorthShore University HealthSystem

Consolidated Balance Sheets (continued)

(Dollars in Thousands)

	September 30	
	2019	2018
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 115,474	\$ 88,651
Accrued expenses	203,427	201,006
Current portion of self-insurance	52,600	41,500
Due to third-party payors	103,082	119,829
Current maturities of long-term debt	11,638	11,193
Total current liabilities	<u>486,221</u>	462,179
Noncurrent liabilities:		
Long-term debt, less current maturities	299,074	312,917
Employee retirement and deferred compensation plans	164,031	124,034
Accrued self-insurance and other	207,685	195,647
Total noncurrent liabilities	<u>670,790</u>	632,598
Net assets:		
Without donor restrictions	2,605,432	2,625,580
With donor restrictions	219,606	216,955
Total net assets	<u>2,825,038</u>	2,842,535
Total liabilities and net assets	<u><u>\$ 3,982,049</u></u>	<u><u>\$ 3,937,312</u></u>

See accompanying notes.

NorthShore University HealthSystem

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

	<b>Year Ended September 30</b>	
	<b>2019</b>	<b>2018</b>
<b>Unrestricted revenues and other support</b>		
Patient service revenue	\$ 2,089,601	\$ 1,937,449
Premium revenue	72,546	74,811
Net assets released from restrictions used for operations	17,348	14,836
Other revenue	54,647	48,616
Total unrestricted revenues and other support	<u>2,234,142</u>	<u>2,075,712</u>
<b>Expenses</b>		
Salaries and benefits	1,199,151	1,156,576
Supplies, services, and other	761,492	723,675
Depreciation and amortization	71,858	67,075
Insurance	57,899	21,850
Medicaid assessment	49,602	45,362
Interest	9,550	8,722
Total expenses	<u>2,149,552</u>	<u>2,023,260</u>
Income from operations before nonrecurring items	<u>84,590</u>	<u>52,452</u>
Goodwill impairment	<u>(116,388)</u>	—
(Loss) income from operations	<u>(31,798)</u>	<u>52,452</u>
<b>Nonoperating income</b>		
Dividend and interest income	44,186	36,556
Net realized gains on investments	75,190	116,861
Net unrealized (losses) gains on investments	(31,239)	11,418
Other, net	(41,655)	(52,370)
Total nonoperating income	<u>46,482</u>	<u>112,465</u>
Revenues in excess of expenses	<u>14,684</u>	<u>164,917</u>

Continued on next page.

NorthShore University HealthSystem

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

	<b>Year Ended September 30</b>	
	<b>2019</b>	<b>2018</b>
<b>Net assets without donor restrictions</b>		
Revenues in excess of expenses	\$ 14,684	\$ 164,917
Pension-related changes other than net periodic costs	(34,777)	17,832
Net assets released from restrictions used for capital	-	274
Other transfers, net	(55)	(254)
(Decrease) increase in net assets without donor restrictions	(20,148)	182,769
<b>Net assets with donor restrictions</b>		
Contributions and other	16,159	8,774
Net realized gains on investments	13,392	6,918
Net unrealized (losses) gains on investments	(9,552)	14,407
Net assets released from restrictions	(17,348)	(15,110)
Increase in net assets with donor restrictions	2,651	14,989
(Decrease) increase in net assets	(17,497)	197,758
Net assets at beginning of period	2,842,535	2,644,777
Net assets at end of period	\$ 2,825,038	\$ 2,842,535

*See accompanying notes.*

NorthShore University HealthSystem

Consolidated Statements of Cash Flows

(Dollars in Thousands)

	<b>Year Ended September 30</b>	
	<b>2019</b>	<b>2018</b>
<b>Operating activities</b>		
(Decrease) increase in net assets	\$ (17,497)	\$ 197,758
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities:		
Change in net unrealized losses (gains) on investments	40,791	(25,825)
Change in trading portfolio investments, net	(62,921)	(170,039)
Contributions with donor restrictions	(16,159)	(8,774)
Depreciation and amortization	71,858	67,075
Bond premium amortization	(88)	(88)
Pension-related changes other than net periodic cost	34,777	(17,832)
Goodwill impairment	116,388	-
Changes in operating assets and liabilities:		
Patient accounts receivable	(18,483)	69,268
Other current assets	(4,689)	(14,657)
Noncurrent assets and liabilities	14,413	(37,872)
Accounts payable and accrued expenses	40,344	26,997
Due to third-party payors	(16,747)	12,837
Net cash provided by operating activities	<u>181,987</u>	<u>98,848</u>
<b>Investing activities</b>		
Investments in property and equipment, net	(163,175)	(103,678)
Net cash used in investing activities	<u>(163,175)</u>	<u>(103,678)</u>
<b>Financing activities</b>		
Contributions with donor restrictions	16,159	8,774
Payments of long-term debt	(13,441)	(10,705)
Net cash provided by (used in) financing activities	<u>2,718</u>	<u>(1,931)</u>
Increase (decrease) in cash and cash equivalents	21,530	(6,761)
Cash and cash equivalents at beginning of period	52,699	59,460
Cash and cash equivalents at end of period	<u>\$ 74,229</u>	<u>\$ 52,699</u>

See accompanying notes.

# NorthShore University HealthSystem

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

September 30, 2019

### **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 member 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 is a for-profit corporation. CCP and VBC are limited liability companies. 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.

Certain reclassifications were made to the fiscal year 2018 consolidated financial statements to conform with the classifications made in fiscal year 2019. The reclassifications had no effect on the changes in net assets or net assets previously reported.

#### **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**

Patient service revenue and patient accounts receivable are reported at the amount that reflects the consideration to which the Corporation expects to be entitled in exchange for providing care.

#### **Inventories**

Inventories are stated at the lower of cost or market, based on the first-in, first-out 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 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 net assets with donor restrictions.

# NorthShore University HealthSystem

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

### **2. Summary of Significant Accounting Policies (continued)**

Pursuant to Accounting Standards Codification Topic (ASC) 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, 2019 or 2018.

#### **Investments Limited as to Use**

Investments limited as to use include investments internally designated for current portions of malpractice reserve and long-term debt, along with externally designated investments for research, education, and other donor-specified purposes.

#### **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 \$71,823 and \$67,025 for the years ended September 30, 2019 and 2018, respectively.

#### **Other Intangible Assets**

Other intangible assets with definite lives are amortized over the estimated useful life of the asset. The Corporation has \$184 and \$219 included in other noncurrent assets at September 30, 2019 and 2018, respectively. Amortization expense related to these other intangible assets for the years ended September 30, 2019 and 2018, was \$35 and \$50, 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 2019 or 2018. Impairments of alternative investments are recognized in nonoperating income or changes in net assets with donor restrictions at the time the impairment is identified. Alternative investment impairments for fiscal years 2019 and 2018 are described in Note 4.

# NorthShore University HealthSystem

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

### **2. Summary of Significant Accounting Policies (continued)**

The Corporation performs an annual quantitative assessment of goodwill to determine whether the Corporation's fair value exceeds its carrying value. The assessment includes a review of several variables, including macroeconomic conditions, industry/market considerations, cost factors, and overall financial performance. The assessment utilizes a market and discounted cash flow approach to determine fair value. As of the annual impairment test date, the carrying value of the Corporation exceeded the fair value and therefore an impairment charge of \$116,388 was recorded in the year ended September 30, 2019. This charge eliminated all goodwill from noncurrent assets. There was no goodwill impairment recorded in the year ended September 30, 2018.

#### **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, 2019 and 2018, of \$5,946 and \$5,959, 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.

#### **Net Assets With Donor Restrictions**

Net assets with donor restrictions are those assets whose use by the Corporation has been limited by donors to a specific time period or purpose, or consist of gifts with corpus values that have been restricted by donors to be maintained in perpetuity. Net assets with donor restrictions are used in accordance with the donor's wishes and are primarily for research, education, and other donor-specified purposes.

# NorthShore University HealthSystem

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

### **2. Summary of Significant Accounting Policies (continued)**

Assets released from restrictions to fund purchases of property and equipment are reported on the consolidated statements of operations and changes in net assets as increases to net assets without donor restrictions. Those assets released from restriction for operating purposes are reported on the consolidated statements of operations and changes in net assets as other revenue. When restricted, earnings are recorded as net assets with donor restrictions until amounts are expended in accordance with the donor's specifications.

#### **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 net assets with donor restrictions. When donor restrictions are satisfied or met as a result of meeting the specified requirement or the time frame indicated, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported on 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 net assets without donor restrictions. Contributions received with donor restrictions are reported as without donor restrictions if the restrictions are met in the same reporting period.

#### **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 not reported as patient service revenue. The estimated costs incurred by the Corporation to provide these services were \$21,925 and \$20,505 for the years ended September 30, 2019 and 2018, respectively. These estimates were determined using a ratio of cost-to-charges calculated from the Corporation's most recently filed Medicare cost report.

# NorthShore University HealthSystem

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

### **2. Summary of Significant Accounting Policies (continued)**

#### **Revenues in Excess of Expenses**

The consolidated statements of operations and changes in net assets include revenues in excess of expenses. Changes in net assets without donor restrictions that are excluded from revenues 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 grant revenue, cafeteria sales, rent revenue, 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.

#### **New Accounting Pronouncements**

##### *Adopted*

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The amendments in this update require companies 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 versus 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. The Corporation adopted the new guidance for fiscal year 2019 using the full retrospective method.

# NorthShore University HealthSystem

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

### **2. Summary of Significant Accounting Policies (continued)**

As a result of ASU 2014-09, the amounts which were previously reported as provision for uncollectible accounts on the consolidated statements of operations and changes in net assets are now reflected as implicit price concessions and are therefore included as a reduction to patient service revenue. With the adoption of this guidance, changes in credit assessments not recognized at the date of service are recorded as other expenses on the consolidated statements of operations and changes in net assets. Additionally, with the adoption of this standard, the allowance for doubtful accounts is presented as a component of patient accounts receivable. The adoption of this guidance did not have a material impact on the consolidated results of operations for the year ended September 30, 2019, other than these changes in presentation on the consolidated statements of operations and changes in net assets and consolidated balance sheets.

Because the Corporation's performance obligations relate to contracts with durations of less than one year, the Corporation has elected to apply the optional exemption provided in the guidance 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. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

As provided for under the guidance, the Corporation has elected the practical expedient allowed and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to the Corporation's expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less. However, the Corporation does, in certain instances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract.

The Corporation does not incur significant incremental costs in obtaining contracts with patients. As permitted in the guidance, any costs which are incurred are expensed in the period of occurrence, as the amortization period of any asset that the Corporation would have recognized is one year or less in duration.

# NorthShore University HealthSystem

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

### 2. Summary of Significant Accounting Policies (continued)

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). The ASU also requires additional disclosures relating to net assets and expenses. The Corporation adopted the new guidance in fiscal year 2019. The new standard changes NorthShore's net asset categories on the financial statements as described above and requires additional disclosures related to underwater endowments, operating expenses, and liquidity. The adoption of this ASU only resulted in presentational changes within the 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 on the statement of cash flows to reduce diversity in practices. The Corporation adopted the new guidance for fiscal year 2019 and there was no significant impact on the 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 on the statement of cash flows. As a result, entities will no longer be required to present transfers between these categories. The Corporation adopted the new guidance for fiscal year 2019, and there was no significant impact on the consolidated financial statements.

In June 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 adopted the new guidance for fiscal year 2019, and there was no significant impact on the 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 early adopted the new guidance effective October 1, 2018.

# NorthShore University HealthSystem

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

### 2. Summary of Significant Accounting Policies (continued)

#### *Prospective*

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. The Corporation adopted the new guidance on October 1, 2019, resulting in an increase in investments available for general use and total net assets of approximately \$160,000.

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 consolidated 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 ASU will require disclosures to help financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Corporation adopted the new guidance on October 1, 2019, and recorded a right-of-use asset and right-of-use liability of approximately \$154,000 under the modified retrospective approach. This guidance did not have a material impact on the Corporation's consolidated statements of operations and changes in net assets.

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 periodic pension costs and net periodic postretirement benefit costs. Since the Corporation's pension plan is currently frozen, it 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 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.

# NorthShore University HealthSystem

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

### 2. Summary of Significant Accounting Policies (continued)

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Statements*. 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. The ASU applies to financial assets subjected to credit losses that are not already classified at fair value through net income. The Corporation is required to adopt the new guidance for the fiscal year beginning on October 1, 2023, and is currently evaluating the impact this guidance will have on its consolidated financial statements.

### 3. Revenue and Receivables

#### *Patient Service Revenue*

Patient service revenue is reported at the amount that reflects the consideration to which the Corporation expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, the Corporation bills the patients and third-party payors several days after the services are performed and/or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services that the Corporation provides. Revenue for performance obligations is recognized over time based on actual charges incurred in relation to total expected (or actual) charges. Performance obligations satisfied over time relate to patients receiving inpatient acute care services. The Corporation measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. The Corporation does not measure the individual services provided, but rather on an episode of care where all goods and services are combined into a single performance obligation.

## NorthShore University HealthSystem

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

#### **3. Revenue and Receivables (continued)**

Revenue for performance obligation satisfied at a point in time, generally outpatient services, is recognized when goods or services are provided and the Corporation believes it has completely satisfied its obligation to the patient. Although a patient's treatment may include more than one outpatient service, the patient can benefit from an outpatient service on its own. The Corporation's promise to transfer goods or services to the patient is also separately identifiable for each outpatient service.

The Corporation believes that this method provides a reasonable depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation.

The Corporation uses a portfolio approach to account for categories of patient contracts as a collective group rather than recognizing revenue on an individual contract basis. The portfolios consist of major payor classes for inpatient revenue and major payor classes and types of services provided for outpatient revenue. Based on historical collection trends and other analyses, the Corporation believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach were used.

The Corporation determines the transaction price, which involves significant estimates and judgment, based on standard charges for goods and services provided, reduced by explicit and implicit price concessions, including adjustments to contractual arrangements with third-party payors, discounts provided to uninsured and underinsured patients in accordance with the Corporation's charity care policy, and/or implicit price concessions based on this historical collection experience of patients. The Corporation determines the transaction price associated with services provided to patients who have third-party payor coverage with Medicare, Medicaid, managed care programs, and other third-party payors based on reimbursement terms per contractual agreements, discount policies, and historical experience. Payment arrangements with those payors include prospectively determined rates per admission or visit, reimbursed costs, discounted charges, per diem rates, and value-based payments. Reported costs and/or services provided under certain arrangements are subject to retroactive audit and adjustment. For uninsured and underinsured patients who do not qualify for charity care, the Corporation determines the transaction price associated with services on the basis of charges reduced by implicit price concessions. Implicit price concessions included in the estimate of the transaction price are based on the Corporation's historical collection experience for applicable patient portfolios. Patients who meet the Corporation's criteria for free care are provided care without charge and such amounts are not reported as revenue.

## NorthShore University HealthSystem

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

#### 3. Revenue and Receivables (continued)

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. The Corporation believes it is in compliance with such laws and regulations but there can be no assurance the regulatory authorities will not challenge the Corporation's compliance with these laws and regulations. Additionally, the Corporation's contracts with commercial payors provide for retroactive audit and review of claims. Estimated settlements are adjusted in future periods as new information becomes available or as years are settled.

For the year ended September 30, 2019, changes in the Corporation's estimates of implicit price concessions, discounts, and contractual adjustments or other reductions to expected payments for performance obligations in prior years were not significant.

Currently, Illinois utilizes supplemental reimbursement programs for providers to offset a portion of the cost of providing care to Medicaid and indigent patients. These programs are designed with input from the Centers for Medicare and Medicaid Services and are funded with a combination of state and federal resources, including assessments levied on the providers. Under these supplemental programs, the Corporation recognizes revenue and related expenses in the period in which amounts are estimable and collection is reasonably assured. Reimbursement under these programs is reflected in patient service revenue and the assessment is reflected as an expense on the consolidated statements of operations and changes in net assets. The Corporation recognized \$59,890 and \$57,095 of patient service revenue for the years ended September 30, 2019 and 2018, respectively. Additionally, \$49,602 and \$45,362 of program assessment expense was recognized for the years ended September 30, 2019 and 2018, respectively.

The composition of patient service revenue by payor is as follows:

	2019		2018	
Managed care	\$ 1,183,008	56%	\$ 1,116,160	57%
Medicare	730,291	35	657,243	34
Medicaid	128,116	6	115,981	6
Other	33,950	2	33,186	2
Self-pay	14,236	1	14,879	1
Total	\$ 2,089,601	100%	\$ 1,937,449	100%

## NorthShore University HealthSystem

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

#### 3. Revenue and Receivables (continued)

In accordance with the Corporation's practice, deductibles, copayments, and coinsurance under third-party payment programs which are the patient's responsibility are included within the primary payor category in the table above.

The composition of patient service revenue based on the Corporation's main business lines are as follows:

	<b>2019</b>		<b>2018</b>	
Facility Services	<b>\$ 1,587,687</b>	<b>76%</b>	\$ 1,457,846	75%
Physician Services	<b>478,689</b>	<b>23</b>	456,901	24
Home Health and Hospice Services	<b>23,225</b>	<b>1</b>	22,702	1
<b>Total</b>	<b>\$ 2,089,601</b>	<b>100%</b>	<b>\$ 1,937,449</b>	<b>100%</b>

#### *Premium Revenue*

The Corporation has an agreement with a health maintenance organization to provide medical services to subscribing participants in exchange for monthly payments regardless of actual medical services provided to participants.

Premium revenue is recognized each month as a result of agreeing to provide or arrange for their medical care. Patient service revenue does not include revenue for services provided to patient's covered under capitated arrangements. Premium revenue for the year ended September 30, 2019 and 2018, was \$72,546 and \$74,811, respectively.

#### *Other Revenue*

Other revenue is recognized at an amount that reflects the consideration to which the Corporation expects to be entitled in exchange for providing goods and services. The amounts recognized reflect consideration due from customers, third-party payors, and others. Primary categories of other revenue include grant revenue, cafeteria sales, rent revenue, unrestricted donations, and other miscellaneous revenue.

# NorthShore University HealthSystem

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

### 3. Revenue and Receivables (continued)

#### *Patient Accounts Receivable*

The Corporation's patient accounts receivable are reported at the amount that reflects the consideration to which the Corporation expects to be entitled in exchange for providing patient care.

In certain instances, the Corporation does receive payment in advance of the services provided and would consider these amounts to represent contract liabilities. These liabilities were not significant at September 30, 2019 or 2018.

The revenue related to patient accounts receivable is reported at net realizable value based on certain assumptions. For third-party payors, including Medicare, Medicaid, Blue Cross, and Managed Care, the net realizable value is based on the estimated contractual reimbursement percentage, which is based on current contract prices or historical paid claims data by payor. For self-pay, which includes patients who are uninsured and the patient responsibility portion for patients with insurance, and other accounts receivable, the net realizable value is determined using estimates of historical collection experience, including an analysis by aging category. These estimates are adjusted for expected recoveries and any anticipated changes in trends, including significant changes in payor mix, shared revenue cycle operations, and economic conditions or trends in federal and state governmental health care coverage.

### 4. Financial Instruments

The presentation of investments at September 30 is as follows:

	<b>2019</b>	<b>2018</b>
Other short-term investments	\$ 1,736	\$ 1,240
Investments available for general use	1,898,353	1,875,690
Investments limited as to use:		
Current portion	64,150	52,605
All other (noncurrent)	222,225	222,758
Other noncurrent assets	107,138	99,671
Total investments	<u>\$ 2,293,602</u>	<u>\$ 2,251,964</u>

## NorthShore University HealthSystem

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

#### 4. Financial Instruments (continued)

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

	<b>2019</b>	<b>2018</b>
Nonoperating:		
Dividend and interest income	\$ 44,186	\$ 36,556
Net realized gains on investments	75,190	116,861
Net unrealized (losses) gains on investments	(31,239)	11,418
Total nonoperating investment return	88,137	164,835
Net assets with donor restrictions:		
Net realized gains	13,392	6,918
Net unrealized (losses) gains	(9,552)	14,407
Total net assets with donor restrictions investment return	3,840	21,325
Total investment return	\$ 91,977	\$ 186,160

Investment fees for the years ended September 30, 2019 and 2018, were \$25,321 and \$28,768, respectively, and are included in other, net, within nonoperating income.

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, 2019, eight investments held at cost were determined to be impaired, resulting in the Corporation recording a loss of \$8,511. 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.

#### 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.

## NorthShore University HealthSystem

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

#### **5. Fair Value Measurements (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 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.

*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.

## NorthShore University HealthSystem

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

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

The Corporation's financial assets that are carried at fair value at September 30, 2019, were as follows:

Nature of Investment	Level 1	Level 2	Level 3	Total
Common stock	\$ 169,300	\$ –	\$ –	\$ 169,300
Mutual funds	505,119	–	–	505,119
Bond funds	–	–	–	–
Fixed income accounts	–	298,663	–	298,663
Total assets at fair value	<u>\$ 674,419</u>	<u>\$ 298,663</u>	<u>\$ –</u>	<u>\$ 973,082</u>

Total investments at September 30, 2019, are \$2,293,602. This amount includes \$973,082 in investments recorded at fair value and \$821,590 in investments measured at net asset value. In addition, this amount includes \$468,926 in limited partnerships and hedge funds recorded at cost, \$17,241 in limited partnerships recorded using the equity method, and other assets of \$12,763 recorded at cost.

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.

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.

# NorthShore University HealthSystem

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

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

There were no transfers between Level 1, Level 2, or Level 3 assets during the years ended September 30, 2019 or 2018.

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 \$313,412 and \$329,160 at September 30, 2019 and 2018, 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**

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.

The Series 2001B, 2001C, 1995, and 1996 bonds have standby bond purchase agreements (SBPAs) 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 a 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.

# NorthShore University HealthSystem

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

### 6. Long-Term Debt (continued)

The Corporation has a letter of credit backup facility with a financial institution in conjunction with the 2008 Pooled Program that expires on May 31, 2022. The letter of credit 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 letter of credit 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 letters of credit in connection with construction projects and property lease obligations, which amount to \$695 as of September 30, 2019, and \$500 as of September 30, 2018. No amounts have been drawn against these letters of credit.

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

<b>Fiscal Year</b>	<b>Maturities of Long-Term Debt</b>	
2020	\$	11,638
2021	\$	12,133
2022	\$	12,623
2023	\$	13,158
2024	\$	13,703

Interest paid for the years ended September 30, 2019 and 2018, was \$8,883 and \$8,322, respectively. Interest of \$648 and \$1,208 was capitalized for the same periods, respectively. In addition, bond premium amortization was \$88 for each of the years ended September 30, 2019 and 2018.

# NorthShore University HealthSystem

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

### 6. Long-Term Debt (continued)

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

Type/Issuer	Series	Amortization		Outstanding Principal		Interest Rate	
		Amount Range	Years From-To	September 30		September 30	
				2019	2018	2019	2018
<b>Illinois Development Finance Authority Variable Rate Demand Revenue Bonds</b>							
	2001B	\$1,800-\$5,000	2019-2031	\$ 30,700	\$ 32,500	1.52%	1.18%
	2001C	\$1,800-\$5,000	2019-2031	30,700	32,500	1.51	1.18
<b>Illinois Health Facilities Authority Variable Rate Adjustable Demand Revenue Bonds</b>							
	1995	\$1,490-\$8,605	2019-2035	\$ 37,030	\$ 38,575	1.61%	1.29%
	1996	\$1,475-\$8,560	2019-2035	37,100	38,635	1.61	1.30
<b>Illinois Educational Facilities Authority Commercial Paper Revenue Note</b>							
	2008	\$995-\$13,305	2032-2038	\$ 75,000	\$ 75,000	1.90%	1.38%
<b>Illinois Finance Authority Revenue Refunding Bonds</b>							
	2010	\$825-\$9,685	2019-2037	\$ 100,780	\$ 107,540	5.00%-5.25%	4.6%-5.25%
Total long-term debt				\$ 311,310	\$ 324,750		
Less: current maturities of debt				(11,638)	(11,193)		
Less: debt issuance costs				(2,147)	(2,278)		
Plus: 2010 bond premium (current and long term)				1,549	1,638		
Total long-term debt, less current maturities				<u>\$ 299,074</u>	<u>\$ 312,917</u>		

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

### 7. Employee Benefit Programs

The Corporation sponsors a funded, noncontributory, defined benefit pension plan (the NorthShore Plan), which was frozen to all participants as of 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.

NorthShore University HealthSystem

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

**7. Employee Benefit Programs (continued)**

A summary of the changes in projected benefit obligation, changes in plan assets, and the resulting funded status of the plan for the years ended September 30 is as follows:

	<u>2019</u>	<u>2018</u>
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	\$ 223,623	\$ 259,313
Interest cost	9,685	10,307
Actuarial loss (gain)	28,837	(9,521)
Benefits paid	(12,560)	(8,006)
Settlements	–	(28,470)
Projected benefit obligation at end of year	<u>\$ 249,585</u>	<u>\$ 223,623</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 204,681	\$ 230,187
Actual return on plan assets	5,138	10,970
Employer contributions	–	–
Benefits paid	(12,560)	(8,006)
Settlements	–	(28,470)
Fair value of plan assets at end of year	<u>\$ 197,259</u>	<u>\$ 204,681</u>
Plan assets less than projected benefit obligation	<u>\$ (52,326)</u>	<u>\$ (18,942)</u>
Accumulated benefit obligation at end of year	<u>\$ 249,585</u>	<u>\$ 223,623</u>

Included in net assets without donor restrictions for the years ended September 30 is the following item not yet recognized as a component of net periodic pension cost:

	<u>2019</u>	<u>2018</u>
Unrecognized net actuarial loss	<u>\$ 112,881</u>	<u>\$ 77,080</u>

## NorthShore University HealthSystem

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

#### 7. Employee Benefit Programs (continued)

Changes in the plan's assets and benefit obligation recognized in net assets without donor restrictions for the years ended September 30 include the following:

	<b>2019</b>	<b>2018</b>
Current year actuarial loss (gain)	\$ <b>37,404</b>	\$ (5,132)
Amortization of actuarial loss	<b>(1,603)</b>	(11,812)
	<b>\$ 35,801</b>	\$ (16,944)

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

	<b>2019</b>	<b>2018</b>
Interest cost	\$ <b>9,685</b>	\$ 10,308
Expected return on plan assets	<b>(13,705)</b>	(15,359)
Amortization of actuarial loss	<b>1,603</b>	2,010
Net periodic credit cost	<b>\$ (2,417)</b>	\$ (3,041)

The Corporation recognized \$9,838 in settlement charges, in nonoperating income, for the year ended September 30, 2018. No settlement charges were recognized for the year ended September 30, 2019.

Expected employee benefit payments for the NorthShore Plan are \$14,927 in 2020, \$14,166 in 2021, \$14,289 in 2022, \$14,996 in 2023, \$14,930 in 2024, and \$71,449 during the period from 2025 through 2029.

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.

	<b>2019</b>	<b>2018</b>
Discount rate	<b>3.32%</b>	4.48%
Expected return on plan assets	<b>5.50</b>	6.75

## NorthShore University HealthSystem

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

#### 7. Employee Benefit Programs (continued)

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

	<b>2019</b>	<b>2018</b>
Discount rate	<b>4.48%</b>	4.09%
Expected return on plan assets	<b>6.75</b>	6.75

During fiscal year 2019, the Corporation switched from the Adjusted RP-2014 Mortality Table with generational mortality improvement using Scale MP-2018 to the Pri-2012 Mortality Table with generational mortality improvement using Scale MP-2019, which decreased the projected benefit obligation by \$2,929.

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

<b>Asset Category</b>	<b>Strategic Target</b>	<b>2019</b>	<b>2018</b>
Equity securities	40%	<b>42%</b>	40%
Debt securities	25	<b>27</b>	25
Other	35	<b>31</b>	35
Total	100%	<b>100%</b>	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.

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.

## NorthShore University HealthSystem

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

#### 7. Employee Benefit Programs (continued)

The following table presents total financial instruments for the NorthShore Plan as of September 30, 2019, 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	\$ 5,484	\$ –	\$ –	\$ 5,484
Mutual funds	36,087	–	–	36,087
Fixed-income accounts	–	37,398	–	37,398
Total assets at fair value	<u>\$ 41,571</u>	<u>\$ 37,398</u>	<u>\$ –</u>	<u>78,969</u>
Investments measured at net asset value				<u>118,290</u>
Total pension plan assets				<u>\$ 197,259</u>

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 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 \$26,786 and \$20,164 in 2019 and 2018, respectively. The related liability at September 30, 2019 and 2018, is \$22,615 and \$21,800, respectively, which was included in accrued expenses.

## NorthShore University HealthSystem

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

#### **7. Employee Benefit Programs (continued)**

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 \$27,187 and \$25,831 in 2019 and 2018, respectively. The Corporation recorded a liability of \$21,450 and \$20,325 related to the RCP Plan as of September 30, 2019 and 2018, respectively, which was included in accrued expenses.

The Corporation also sponsors various supplemental executive retirement plans. The total liability for these plans is \$9,524 and \$16,908 for the years ended September 30, 2019 and 2018, respectively, and is included in accrued expenses and employee retirement plans based on the expected payout dates. The Corporation funded \$4,584 and \$3,458 of the liabilities for these plans as of September 30, 2019 and 2018, 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, 2019 and 2018, are \$102,672 and \$96,326, respectively. These amounts are included in other noncurrent assets and employee retirement and deferred compensation plans for the years ended September 30, 2019 and 2018.

#### **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, 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 \$236,429 and \$215,301 as of September 30, 2019 and 2018, respectively, using a 3.0% discount rate. The Corporation also has a receivable for anticipated insurance recoveries of \$8,694 and \$14,201 as of September 30, 2019 and 2018, respectively. The undiscounted reserve balance would have been higher by approximately \$22,772 and \$21,704 as of September 30, 2019 and 2018, 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.

## NorthShore University HealthSystem

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

#### **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.

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 the named 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

# NorthShore University HealthSystem

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

### 9. Litigation and Contingencies (continued)

of only “outpatient” services. On July 2, 2018, the District Court granted plaintiffs’ counsels’ request to substitute two new patients who claim to meet the amended class definition. During discovery into the two new patients’ claims, plaintiffs’ counsels 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. On March 29, 2019, the District Court denied the Corporation’s motion for Decertification and Summary Judgment against the lone remaining class representative, and stated that the remaining motions for summary judgment and decertification remain under advisement. A decision on the pending motions is expected by the end of 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 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:

2020	\$	27,638
2021		27,005
2022		26,267
2023		25,054
2024		22,424

Lease expense for the years ended September 30, 2019 and 2018, was \$25,930 and \$25,841, respectively, and is recorded within supplies, services, and other.

## NorthShore University HealthSystem

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

#### 10. Commitments (continued)

At September 30, 2019, the Corporation is committed to \$91,384 in construction-related contracts.

At September 30, 2019, the Corporation is committed to fund \$274,211 to limited partnerships, which is expected to occur over the next decade. At September 30, 2019, the pension plan is committed to fund \$4,801 to limited partnerships, which is expected to occur over the next decade.

#### 11. Functional Operating Expenses

The tables below present expenses by both their nature and function for the years ended September 30.

	<b>Health Services</b>	<b>General and Administrative</b>	<b>Total</b>
<b>Year ended September 30, 2019</b>			
Salaries and benefits	\$ 1,037,504	\$ 161,647	\$ 1,199,151
Supplies, services, and other	750,257	11,235	761,492
Depreciation and amortization	50,499	21,359	71,858
Insurance	55,589	2,310	57,899
Medicaid assessment	49,602	–	49,602
Interest	9,550	–	9,550
Total expenses	<u>\$ 1,953,001</u>	<u>\$ 196,551</u>	<u>\$ 2,149,552</u>
<b>Year ended September 30, 2018</b>			
Salaries and benefits	\$ 1,002,887	\$ 153,689	\$ 1,156,576
Supplies, services, and other	713,914	9,761	723,675
Depreciation and amortization	47,746	19,329	67,075
Insurance	19,540	2,310	21,850
Medicaid assessment	45,362	–	45,362
Interest	8,722	–	8,722
Total expenses	<u>\$ 1,838,171</u>	<u>\$ 185,089</u>	<u>\$ 2,023,260</u>

# NorthShore University HealthSystem

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

### 11. Functional Operating Expenses (continued)

The accompanying consolidated financial statements report certain categories of expenses that are attributable to one or more programs or supporting activities of the Corporation. Therefore, expenses require allocation on a reasonable basis that is consistently applied. Those expenses include fringe benefits, malpractice insurance, and building expenses. Fringe benefits are allocated based on a percentage of salaries, malpractice insurance is allocated using risk levels and market insurance rates, and building expenses are allocated on a square footage basis.

The expenses of the Corporation for the years ended September 30, 2019 and 2018, were \$3,845 and \$3,555, respectively, and are included in other, net, within nonoperating income.

### 12. Liquidity

The table below represents financial assets and liquidity resources available for general expenditures within one year as of September 30, 2019 and 2018. The Corporation defines general expenditures as the normal expenditures related to the operations, excluding capital expenditures.

	<b>2019</b>	<b>2018</b>
Financial assets:		
Cash and cash equivalents	\$ 74,229	\$ 52,699
Other short-term investments	1,736	1,240
Investments limited as to use, current portion	64,150	52,605
Patient accounts receivable	280,053	261,570
Investments available for general use	1,898,353	1,875,690
Investments limited as to use	222,225	222,758
Other	183,715	190,419
Total financial assets	<b>2,724,461</b>	2,656,981
Less amounts not available within one year or not designated for general expenditures:		
Alternative investments	349,448	308,488
Endowment funds	171,561	173,876
Other	164,411	153,836
Total financial assets not available for use within one year	<b>685,420</b>	636,200
Financial assets and liquidity resources available for general expenditures within one year	<b>\$ 2,039,041</b>	\$ 2,020,781

# NorthShore University HealthSystem

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

### 12. Liquidity (continued)

The Corporation holds certain investments in low-risk cash and fixed-income accounts with an objective of setting funds aside to be drawn upon in the event of financial distress or an immediate liquidity need resulting from events outside the typical life cycle of converting financial assets to cash or settling financial liabilities. In addition to working capital, the Corporation's policy is to have one year of cash needs invested in liquid, fixed-income securities. Cash needs are based on the historical amounts of investment support transferred to operations. These investments are included in the cash and cash equivalents and investments available for general use lines on the balance sheet and totaled \$372,892 and \$373,971 as of September 30, 2019 and 2018, respectively.

Alternative investments not available within one year consist of private equity funds, as well as a portion of the hedge funds based on contractual restrictions which prevent redemption of all or portions of such funds within a year. Endowment funds are restricted for research, education, department chairs, and general operations. Other financial assets not available within one year include internally designated investments for professional liability insurance and long-term debt, assets with donor restrictions, and other restricted cash.

### 13. Net Assets With Donor Restrictions

Net assets with donor restrictions are available for the following purposes at September 30:

	<u>2019</u>	<u>2018</u>
Restricted for:		
Endowments	\$ 160,747	\$ 161,368
Research	22,185	21,154
Other	36,674	34,433
Total net assets with donor restrictions	<u>\$ 219,606</u>	<u>\$ 216,955</u>

Net assets with donor restrictions are used toward research, education, and to fund department chairs, as well as general operations and uncompensated care offered to patients who meet certain criteria established under the Corporation's charity care policy.

NorthShore University HealthSystem

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

**13. Net Assets With Donor Restrictions (continued)**

Activity in the endowment funds was as follows:

	<b>Net Assets Without Donor Restrictions</b>	<b>Net Assets With Donor Restrictions</b>	<b>Total</b>
Endowment net assets at September 30, 2017	\$ 10,299	\$ 144,982	\$ 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	12,508	161,368	173,876
Contributions	–	<b>51</b>	<b>51</b>
Investment return	<b>2,389</b>	<b>15,854</b>	<b>18,243</b>
Change of value in trust	<b>(1,694)</b>	<b>(9,553)</b>	<b>(11,247)</b>
Distributions	<b>(2,389)</b>	<b>(6,973)</b>	<b>(9,362)</b>
Endowment net assets at September 30, 2019	<b>\$ 10,814</b>	<b>\$ 160,747</b>	<b>\$ 171,561</b>

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 net assets with donor restrictions 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 is also considered part of net assets with donor restrictions until those amounts are appropriated in a manner considered with the standard of prudence prescribed by UPMIFA.

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.

## NorthShore University HealthSystem

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

#### **13. Net Assets With Donor Restrictions (continued)**

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, 2019 or 2018.

#### **14. Income Taxes**

The Corporation and its related affiliates, except for Insurance International, NPA, CCP, and VBC 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 740-10, *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 can be recognized in the financial statements. Furthermore, this interpretation prescribes the benefit to be recorded 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, 2019 or 2018.

## NorthShore University HealthSystem

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### **14. Income Taxes (continued)**

For the year ended September 30, 2019, the Corporation has a net operating loss carryforward of \$8,154, which generated assets of \$2,324. These assets are offset by a valuation allowance of \$916.

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.

#### **15. Other Events**

On June 27, 2019, the Corporation entered into a Membership Substitution Agreement with Swedish Covenant Health and its sole member, Covenant Ministries of Benevolence. The Corporation has received state and regulatory approval and expects the transaction to close around January 1, 2020.

#### **16. Subsequent Events**

The Corporation evaluated events and transactions occurring subsequent to September 30, 2019, through December 17, 2019, the date of issuance of the accompanying consolidated financial statements. During the period, there were no subsequent events requiring recognition or disclosure in the consolidated financial statements.

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