

CONSOLIDATED FINANCIAL STATEMENTS  
AND SUPPLEMENTARY INFORMATION

Southwest Community Health System and Subsidiaries  
Years Ended December 31, 2018 and 2017  
With Report of Independent Auditors

Ernst & Young LLP



Southwest Community Health System and Subsidiaries

Consolidated Financial Statements  
and Supplementary Information

Years Ended December 31, 2018 and 2017

**Contents**

Report of Independent Auditors.....1

Consolidated Financial Statements

Consolidated Balance Sheets .....3

Consolidated Statements of Operations and Changes in Net Assets .....5

Consolidated Statements of Cash Flows.....7

Notes to Consolidated Financial Statements.....8

Supplementary Information

Report of Independent Auditors on Supplementary Information .....39

Consolidating Balance Sheet – December 31, 2018.....40

Consolidating Statement of Operations and Changes in Net Assets Without Donor  
Restrictions – Year Ended December 31, 2018 .....42

Consolidating Balance Sheet – December 31, 2017 .....43

Consolidating Statement of Operations and Changes in Net Assets Without Donor  
Restrictions – Year Ended December 31, 2017 .....45



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

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

## Report of Independent Auditors

The Board of Trustees  
Southwest Community Health System

We have audited the accompanying consolidated financial statements of Southwest Community Health System and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### **Management’s Responsibility for the 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 Southwest Community Health System and Subsidiaries at December 31, 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.

### **Adoption of ASU No. 2014-09, *Revenue from Contracts with Customers***

As discussed in Note 1 to the consolidated financial statements, Southwest Community Health System and Subsidiaries changed its method for recognizing revenue as a result of the adoption of the amendments to the Financial Accounting Standards Board Accounting Standards Codification resulting from Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers*, effective January 1, 2018. Our opinion is not modified with respect to this matter.

*Ernst & Young LLP*

April 19, 2019

# Southwest Community Health System and Subsidiaries

## Consolidated Balance Sheets

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
	<i>(In Thousands)</i>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 29,898	\$ 22,739
Patient accounts receivable, net of allowance for bad debts of \$35,692 in 2017	34,793	33,791
Other receivables, net	4,435	2,131
Inventories	9,401	8,646
Prepaid expenses	9,007	10,325
Investments for current use	5,731	6,310
<b>Total current assets</b>	<b>93,265</b>	<b>83,942</b>
Investments:		
Board-designated and other	219,034	226,031
Self-insurance reserve funds	9,852	9,936
	<b>228,886</b>	<b>235,967</b>
Property, plant, and equipment, net	182,207	186,404
Other assets	6,284	6,637
<b>Total assets</b>	<b>\$ 510,642</b>	<b>\$ 512,950</b>

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
	<i>(In Thousands)</i>	
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 23,081	\$ 13,492
Accrued compensation and related liabilities	27,846	26,092
Other accrued liabilities	10,451	9,874
Drawable credited earnings due to UHHS	9,169	5,127
Estimated amounts payable to third-party payors	3,144	2,696
Current portion of long-term liabilities	2,948	2,860
Total current liabilities	<u>76,639</u>	<u>60,141</u>
Long-term liabilities:		
Revenue bonds	149,748	152,420
Notes payable and capital leases	1,594	1,841
Accrued retirement benefits	34,737	41,560
Other liabilities	15,844	19,747
Total long-term liabilities	<u>201,923</u>	<u>215,568</u>
Total liabilities	<u>278,562</u>	<u>275,709</u>
Net assets:		
Without donor restrictions	227,779	233,128
With donor restrictions	4,301	4,113
Total net assets	<u>232,080</u>	<u>237,241</u>
Total liabilities and net assets	<u>\$ 510,642</u>	<u>\$ 512,950</u>

*See accompanying notes.*

Southwest Community Health System and Subsidiaries

Consolidated Statements of Operations  
and Changes in Net Assets

	<b>Year Ended December 31</b>	
	<b>2018</b>	<b>2017</b>
	<i>(In Thousands)</i>	
<b>Unrestricted revenue</b>		
Net patient service revenue	\$ 370,887	\$ 376,582
Provision for bad debts	—	(20,828)
	<u>370,887</u>	<u>355,754</u>
Other revenue	12,861	11,789
Total unrestricted revenue	<u>383,748</u>	<u>367,543</u>
<b>Expenses</b>		
Salaries, wages, and benefits	174,303	163,957
Supplies, insurance, and other	169,470	158,316
Depreciation and amortization	22,635	24,816
Interest	6,265	6,153
Total expenses	<u>372,673</u>	<u>353,242</u>
Income from operations	11,075	14,301
Nonoperating gains (losses):		
Tax levy receipts	786	847
Investment income	9,640	8,913
Other – net	(2,398)	(4,106)
Total nonoperating gains, net	<u>8,028</u>	<u>5,654</u>
Excess of revenue over expenses before drawable credited earnings due to UHHS	19,103	19,955
Drawable credited earnings due to UHHS	(9,169)	(5,127)
Excess of revenue over expenses	<u>9,934</u>	<u>14,828</u>

Southwest Community Health System and Subsidiaries

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

	<b>Year Ended December 31</b>	
	<b>2018</b>	<b>2017</b>
	<i>(In Thousands)</i>	
<b>Changes in net assets without donor restrictions</b>		
Excess of revenue over expenses	\$ 9,934	\$ 14,828
Net change in unrealized (losses) gains on other-than-trading investments	(17,528)	16,978
Net assets released from restrictions for capital	399	772
Pension adjustment	1,846	1,895
(Decrease) increase in net assets without donor restrictions	<u>(5,349)</u>	<u>34,473</u>
<b>Changes in net assets with donor restrictions</b>		
Contributions	808	351
Net investment (loss) income	(195)	273
Net assets released from restrictions	(425)	(789)
Increase (decrease) in net assets with donor restrictions	<u>188</u>	<u>(165)</u>
(Decrease) increase in net assets	(5,161)	34,308
Net assets at beginning of year	237,241	202,933
Net assets at end of year	<u>\$ 232,080</u>	<u>\$ 237,241</u>

*See accompanying notes.*

# Southwest Community Health System and Subsidiaries

## Consolidated Statements of Cash Flows

	<b>Year Ended December 31</b>	
	<b>2018</b>	<b>2017</b>
	<i>(In Thousands)</i>	
<b>Operating activities</b>		
(Decrease) increase in net assets	\$ (5,161)	\$ 34,308
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities:		
Net realized and unrealized losses (gains) on investments	19,890	(19,809)
Depreciation and amortization	23,301	25,539
Pension adjustment	(1,846)	(1,895)
Restricted contributions	(808)	(351)
Changes in operating assets and liabilities:		
Patient accounts receivable	(1,002)	(686)
Other current assets	(1,741)	829
Other noncurrent assets	353	(938)
Accrued retirement benefits	(4,977)	(9,965)
Accounts payable	5,297	(3,226)
Other current liabilities	2,867	1,871
Other long-term liabilities	(3,903)	1,201
Net cash provided by operating activities	<u>32,270</u>	<u>26,878</u>
<b>Investing activities</b>		
Purchases of property, plant, and equipment	(14,812)	(11,751)
Purchases of investments	(187,140)	(99,784)
Sales of investments	174,910	78,366
Net cash used in investing activities	<u>(27,042)</u>	<u>(33,169)</u>
<b>Financing activities</b>		
Principal payments on long-term debt	(2,919)	(2,832)
Restricted contributions	808	351
Drawable credited earnings due to/from UHHS	4,042	2,101
Net cash provided by (used in) financing activities	<u>1,931</u>	<u>(380)</u>
Net increase (decrease) in cash and cash equivalents	7,159	(6,671)
Cash and cash equivalents at beginning of year	22,739	29,410
Cash and cash equivalents at end of year	<u>\$ 29,898</u>	<u>\$ 22,739</u>

*See accompanying notes.*

# Southwest Community Health System and Subsidiaries

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

December 31, 2018

### 1. Summary of Organization and Accounting Policies

Southwest Community Health System's (the System) purpose is to participate in and promote activities related to the delivery of health care services and other services which are related to or supportive of these activities. The System is a not-for-profit corporation under federal income tax laws. A brief summary of each of the organizations for which the System is the sole member and parent organization follows:

*Southwest General Health Center* – Southwest General Health Center (the Health Center) is a not-for-profit corporation that was organized to establish, operate, and maintain a hospital and other health care facilities. The Health Center offers a full range of services at its main campus located in Middleburg Heights, Ohio and a wide variety of outpatient services at its nearby medical centers in Brunswick and Strongsville. The Health Center is the sole shareholder of Southwest General Medical Group, a physician corporation. A wholly owned subsidiary of the Health Center, Southwest Holdings, Inc. (Holdings), was incorporated to engage in for-profit activities. Holdings' main activities are the operation of a retail pharmacy on the hospital campus and the provision of wellness services.

*Southwest Community Health Foundation* – Southwest Community Health Foundation (the Foundation) is a not-for-profit corporation that was organized to develop and operate fund-raising activities, capital-giving programs, deferred-giving programs, and to support community health care projects.

The consolidated financial statements include the accounts of the Health Center (the Obligated Group) and the Foundation (the Non-Obligated Group), which has no liability under the Master Trust Indenture amended and restated as of December 1, 2012, between the Health Center and the Huntington National Bank, as Trustee. All significant intercompany accounts and transactions are eliminated upon consolidation.

A summary of significant accounting policies of the System follows:

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

## Southwest Community Health System and Subsidiaries

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

#### 1. Summary of Organization and Accounting Policies (continued)

*Concentration of Credit Risk* – The Health Center provides patient care services primarily to residents of Cuyahoga and Medina counties, Ohio. Concentration of credit risk relating to patient accounts receivable is limited to some extent by the diversity and number of patients and payors. Patient accounts receivable consist of amounts due from government programs, commercial insurance companies, private pay patients, and other insurance programs. Medicare and Medicaid represented approximately 30% and 3%, respectively, at December 31, 2018, and 30% and 5%, respectively, at December 31, 2017, of patient accounts receivable. One commercial payor represented approximately 15% of patient accounts receivable at both December 31, 2018 and 2017. Excluding these payors, no one payor source represents more than 10% of patient accounts receivable at December 31, 2018 and 2017.

*Net Patient Service Revenue* – Net patient service revenue is reported at the amount that reflects the consideration to which the Health Center expects to be entitled in exchange for providing care. These amounts are due from patients, third-party payors and others, including retroactive adjustments under reimbursement agreements with third-party payors. Generally, the Health Center 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.

The Health Center provides health care services in health care facilities, which include inpatient, outpatient and ambulatory care facilities, physician practices and other sites. The Health Center recognizes patient service revenue at the amount that reflects the consideration to which the Health Center expects to be paid for providing patient care. Patient service revenue is recognized as performance obligations based on the nature of the services provided by the Health Center are satisfied. Performance obligations satisfied over time relate to patients in the Health Center receiving inpatient acute care services from admission to the point when services are no longer required, which is generally at the time of discharge. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected or actual charges. Outpatient services are performance obligations satisfied at a point in time and revenue is recognized when goods or services are provided and the Health Center does not believe it is required to provide additional goods or services. Management believes this method provides a fair depiction of the transfer of services over the term of performance obligations based on the inputs needed to satisfy the obligations.

# Southwest Community Health System and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

### **1. Summary of Organization and Accounting Policies (continued)**

As a result of all its performance obligations relating to patient contracts being less than a year in duration, the Health Center has elected to apply the optional exemption provided in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 606-10-50-14(a). This exemption does not require the Health Center to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially satisfied 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 Health Center 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 outpatient revenue. Based on the historical collection trends and other analysis, the Health Center 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 Health Center determines the transaction price based on standard charges for goods and services provided, reduced by explicit price concessions provided to third-party payors, discounts provided to uninsured and underinsured patients in accordance with policy and/or implicit price concessions based on the historical collection experience of patient accounts. The Health Center 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 of the arrangements are subject to retroactive audit and adjustment.

The Health Center is paid a prospectively determined rate for the majority of inpatient acute care, transitional care, and certain outpatient services provided. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Provision for estimated retroactive adjustments, if any, resulting from changes in diagnostic related group (DRG) assignment, regulatory matters, or other retroactive adjustments under reimbursement agreements are accrued on an estimated basis in the period the related services are provided. Any changes in these estimated amounts are recorded in operations as final settlements are determined.

## Southwest Community Health System and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### **1. Summary of Organization and Accounting Policies (continued)**

Certain other Medicare and Medicaid outpatient services are reimbursed at established fee schedules. The Health Center is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Health Center and audits thereof by the Medicare and Medicaid Administrative Contractors.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Health Center believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

The Health Center also enters into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payments to the Health Center under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates. Provision for estimated retroactive adjustments, if any, resulting from regulatory matters or other adjustments under payment agreements are estimated in the period the related services are provided.

For uninsured patients who do not qualify for charity care, the Health Center recognizes revenue based on established rates, subject to certain discounts and implicit price concessions as determined by the Health Center. Implicit price concessions are based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in health care coverages, and other collection indicators.

## Southwest Community Health System and Subsidiaries

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

#### **1. Summary of Organization and Accounting Policies (continued)**

*Charity Care and Community Benefit* – The Health Center treats all patients requiring hospital care regardless of their ability to pay. The Health Center provides care to patients who meet certain criteria under its charity care assistance policy without charge or at amounts less than its established rates. Because the Health Center does not pursue collection of amounts determined to qualify for charity care, they are not reported as revenue. The cost of charity care provided in 2018 and 2017 approximated \$1,743 and \$1,148, respectively. To offset the cost of charity care, the System received reimbursement through the State of Ohio’s Hospital Care Assurance Program of \$532 and \$907 in 2018 and 2017, respectively. The Health Center estimated these costs by calculating a ratio of cost to gross charges and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients. In addition to providing direct charity care to patients in furtherance of its exempt purpose to benefit the community, the Health Center operates an Emergency Trauma Center 24 hours a day; provides various community screenings for detection of disease and to promote health and wellness; and operates a community outreach program to bring health care services and support to homes. In addition, the Health Center has a second emergency department in Brunswick, Ohio that is open 24 hours a day.

*Cash and Cash Equivalents* – The System considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents, excluding investments held by Board designation or other arrangements.

*Inventories* – Inventories (primarily supplies and pharmaceuticals) are stated at the lower of cost, determined on the first-in, first-out method, or net realizable value.

*Investments and Investment Income* – Investments in equity securities and mutual funds and all investments in debt securities are measured at fair value in the consolidated balance sheets. Investment income or loss (including realized gains and losses on investments determined by the average cost method, other-than-temporary losses on other-than-trading investments due to declines in investment market values, interest, and dividends) is included in the excess of revenue over expenses unless the income or loss is restricted by donor or law. Changes in the unrealized gains and losses on investments which are classified as other-than-trading are excluded from the excess of revenue over expenses.

## Southwest Community Health System and Subsidiaries

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

#### 1. Summary of Organization and Accounting Policies (continued)

The System reviews other-than-trading investments for impairment conditions that indicate that an other-than-temporary decline in market value has occurred and an unrealized investment loss should be recognized. In conducting this review, various factors are considered, which individually or in combination, indicate that a decline is other-than-temporary. These factors include specific information pertaining to an individual company or a particular industry, general market conditions that reflect prospects for the economy as a whole, the recommendations of advisors, the length of time and extent to which the market value has been less than cost and the intent and ability of management to hold such investments until value has returned. Losses recorded for other-than-temporary decline in the value of investments were \$8,392 and \$0 in 2018 and 2017, respectively.

As part of its investment portfolio, the System had an approximate 3.47% ownership interest at December 31, 2017 in a limited partnership (LP) that invests in publicly traded equities with readily determinable values. The System's investment in the LP was \$7,929 at December 31, 2017, and was included in board-designated investments in the consolidated balance sheet. The System divested of the investment in 2018. The System accounted for its investment in the LP using the equity method of accounting based on net asset value information provided by the partnership and recorded its share of the LP's net (loss) gain of \$(214) and \$1,260 in 2018 and 2017, respectively, in investment income.

*Fair Value Measurement* – Fair value measurements are defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

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

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

## Southwest Community Health System and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### **1. Summary of Organization and Accounting Policies (continued)**

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

*Property, Plant, and Equipment* – Property, plant, and equipment are recorded at cost. Depreciation is computed using the straight-line method based on the estimated useful lives of the assets which range from 3 to 40 years. Depreciation on the Health Center's medical office buildings of \$808 in 2018 and \$723 in 2017, is classified as a component of nonoperating gains (losses) in the consolidated statements of operations and changes in net assets. Expenditures which substantially increase the useful lives of existing assets are capitalized. Routine maintenance and repairs are expensed as incurred. Leased equipment is amortized using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment.

*Excess of Revenue Over Expenses* – The consolidated statements of operations and changes in net assets include excess of revenue over expenses, which is the System's performance indicator. Changes in net assets without donor restrictions which are excluded from the excess of revenue over expenses, consistent with industry practice, include change in unrealized gains and losses on other-than-trading investments, certain pension adjustments, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purpose of acquiring such assets).

*Derivative Instruments* – The System recognizes all derivative instruments in the financial statements at fair value. The System participates in interest rate swap contracts that are considered derivative financial instruments. The interest rate swap contracts are not designated as hedges. Changes in fair value of the derivative financial instruments are recognized in the consolidated statements of operations and changes in net assets as a component of investment income.

## Southwest Community Health System and Subsidiaries

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

#### 1. Summary of Organization and Accounting Policies (continued)

*Nonoperating Losses, Net* – Gains and losses not directly related to the ongoing operations of the System are reported as nonoperating. Other net nonoperating losses are summarized as follows:

	<b>Year Ended December 31</b>	
	<b>2018</b>	<b>2017</b>
Medical office buildings, net of rental revenue of \$1,569 in 2018 and \$1,526 in 2017	<b>\$ (1,693)</b>	\$ (1,995)
Pension expense	(20)	(1,335)
Payments to counterparty on swap agreements	(160)	(286)
Community outreach services	(525)	(490)
	<b>\$ (2,398)</b>	\$ (4,106)

*Recent Accounting Pronouncements* – In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance, and requires significantly expanded disclosures about revenue recognition. The core principle of the revenue model is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The System adopted ASU 2014-09 on January 1, 2018 using the modified retrospective method of transition. The System performed an analysis of revenue streams and transactions under ASU 2014-09. In particular, for net patient service revenue, the System performed an analysis into the application of the portfolio approach as a practical expedient to group patient contracts with similar characteristics, such that revenue for a given portfolio would not be materially different than if it were evaluated on a contract-by-contract basis. Upon adoption, the majority of what was previously classified as provision for bad debts and presented as a reduction to net patient service revenue on the consolidated statements of operations and changes in net assets is treated as a price concession that reduces the transaction price, which is reported as net patient service revenue. The new standard also requires enhanced disclosures related to the disaggregation of revenue and significant judgments made in measurement and recognition. The impact of adopting ASU 2014-09 was not material to total unrestricted revenue, excess of revenue over expenses or total net assets.

## Southwest Community Health System and Subsidiaries

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

#### 1. Summary of Organization and Accounting Policies (continued)

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements for Not-for-Profit Entities*. This standard intends to make certain improvements to the current reporting requirements for not-for-profit entities. This standard sets forth changes to net asset classification requirements and the information presented about a not-for-profit entity's liquidity, financial performance and cash flows. The System adopted ASU 2016-14 in its consolidated financial statements effective December 31, 2018, applying retrospectively to all periods presented. The impact of adoption changes the classification of net assets from three classes of net assets to two classes of net assets. The System also added disclosure for the liquidity and availability of financial assets at the balance sheet date to meet cash needs for general expenditures within one year and disaggregated functional expense classifications by their natural expense classification. The impact of adopting ASU 2016-14 had no impact to total unrestricted revenue, excess of revenue over expenses or total net assets.

In February 2016, the FASB issued ASU 2016-02, *Leases*. This ASU requires lessees to recognize assets and liabilities on the balance sheet for leases with lease terms greater than 12 months. The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. This amends current guidance that requires only capital leases to be recognized on the lessee balance sheet. ASU 2016-02 will also require additional disclosures on the amount, timing and uncertainty of cash flows arising from leases. The System adopted ASU 2016-02 on January 1, 2019 using a modified retrospective approach. The impact of adoption on the consolidated financial statements will be an increase in other current and noncurrent assets to record right-of-use assets and an increase in other current and noncurrent liabilities to record lease obligations for current operating leases of approximately \$12 million to \$14 million representing the present value of remaining lease payments for operating leases.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments*, that will require entities to measure equity investments that do not result in consolidation and are not accounted for under the equity method at fair value and recognize any changes in fair value in excess of revenue over expenses. The guidance is effective for the System for reporting periods beginning after December 15, 2018.

## Southwest Community Health System and Subsidiaries

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

#### **1. Summary of Organization and Accounting Policies (continued)**

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. This ASU intends to clarify and improve current accounting guidance to determine when a transaction should be accounted for as a contribution or as an exchange transaction and provides additional guidance about how to determine whether a contribution is conditional. The ASU is effective for the System for annual reporting periods beginning after June 15, 2018 for contributions received and after December 15, 2018 for contributions made, and interim periods beginning after December 31, 2019 with early adoption permitted. The System is currently assessing the impact that ASU 2018-08 will have on its consolidated financial statements and will adopt the provisions upon the effective date.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820)*. This ASU improves the effectiveness of the notes to financial statements through changes in the disclosure requirements for fair value measurement. The ASU is effective January 1, 2020 and will be applied using a retrospective approach. The System is currently assessing the impact of this ASU on its consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-14, *Compensation Retirement Benefits Defined Benefit Plans General, Disclosure Framework Changes to the Disclosure Requirements for Defined Benefit Plans*. This ASU intends to improve the effectiveness of disclosures in the notes to financial statements by modifying disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. The ASU is effective for the System for annual reporting periods ending after December 15, 2021 with early adoption permitted. The System is currently assessing the impact that ASU 2018-14 will have on its consolidated financial statements and will adopt the provisions upon the effective date.

Southwest Community Health System and Subsidiaries

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

**2. Net Patient Service Revenue and Patient Accounts Receivable**

Net patient service revenue by major payor source, net of price concessions, for the year ended December 31, 2018 is as follows:

	<u>2018</u>	
Medicare	\$ 149,842	40%
Medicaid	20,090	6
Managed care and commercial	199,988	54
Self-pay	967	-
	<u>\$ 370,887</u>	<u>100%</u>

Net patient service revenue by major payor source before the provision for bad debts for the year ended December 31, 2017 is as follows:

	<u>2017</u>	
Medicare	\$ 135,276	36%
Medicaid	24,383	6
Managed care and commercial	199,913	53
Self-pay	17,010	5
	<u>\$ 376,582</u>	<u>100%</u>

The composition of net patient service revenue based on area of operations is as follows:

	<u>2018</u>	
Hospital inpatient services	\$ 138,362	37%
Hospital outpatient services	208,730	56
Southwest General Medical Group	23,795	7
	<u>\$ 370,887</u>	<u>100%</u>

## Southwest Community Health System and Subsidiaries

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

#### 2. Net Patient Service Revenue and Patient Accounts Receivable (continued)

As a result of certain changes required by ASU 2014-09, the System's provisions for bad debts is recorded as a direct reduction to net patient service revenue instead of being presented as a separate line item on the consolidated statements of operations and changes in net assets. The adoption of ASU 2014-09 has no impact on the System's patient accounts receivable as it was historically recorded net of allowance for bad debts and contractual adjustments on the consolidated balance sheets.

#### 3. Investments

The composition of investments at December 31 was as follows:

	2018	2017
Investments:		
Cash	\$ 451	\$ 1,212
Money market funds	8,436	9,305
Fixed income securities:		
U.S. government agencies	40,752	33,187
U.S. corporate	37,193	27,938
Common stocks:		
U.S.	4,077	9,320
Mutual funds:		
Fixed income	30,630	40,306
Equity	101,452	102,066
Commingled funds	11,626	11,014
Limited partnership	-	7,929
Total investments	\$ 234,617	\$ 242,277

Southwest Community Health System and Subsidiaries

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

**3. Investments (continued)**

Total investment return is comprised of the following for the years ended December 31:

	<u>2018</u>	<u>2017</u>
Nonoperating gains (losses):		
Interest income and dividends	\$ 10,718	\$ 5,146
Net realized gains on sales of investments	8,097	990
Equity method investment income	346	1,767
Change in unrealized (losses) gains on trading investments	(1,636)	201
Other-than-temporary impairment on other-than-trading investments	(8,392)	–
Derivative gain	507	809
Total investment income	<u>9,640</u>	<u>8,913</u>
Other changes in net assets:		
Net change in unrealized gains (losses) on other-than-trading investments and restricted investment income	(17,723)	17,251
Total investment return	<u>\$ (8,083)</u>	<u>\$ 26,164</u>

With the exception of certain board-designated mutual funds, all investments are managed by professional asset managers. Because the asset managers have discretion to buy and sell individual securities, these investments are accounted for as trading securities. Investments not managed by professional asset managers are controlled by the System and are accounted for as other-than-trading.

## Southwest Community Health System and Subsidiaries

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

#### 4. Fair Value

The carrying values of cash and cash equivalents, accounts receivable, and accounts payable are reasonable estimates of fair value due to the short-term nature of these financial instruments. Investments, other than the limited partnership investment, are recorded at their fair value. At December 31, 2018 and 2017, the fair value of the System's long-term debt as estimated by discounted cash flow analyses using current borrowing rates for similar types of borrowing arrangements and adjusted for credit was \$161,332 and \$167,295, respectively (see Note 8). Long-term debt would be classified as Level 2 in the fair value hierarchy. Other noncurrent assets and liabilities have carrying values that approximate fair value.

The following tables present the financial instruments carried at fair value on a recurring basis at December 31 by valuation hierarchy:

	2018		
	Level 1	Level 2	Total
<b>Assets</b>			
Investments:			
Cash	\$ 451	\$ –	\$ 451
Money market funds	–	8,436	8,436
Fixed income securities:			
U.S. government agencies	–	40,752	40,752
U.S. corporate	–	37,193	37,193
Common stocks:			
U.S.	4,077	–	4,077
Mutual funds:			
Fixed income	30,630	–	30,630
Equity	101,452	–	101,452
Total assets at fair value	\$ 136,610	\$ 86,381	\$ 222,991
<b>Liabilities</b>			
Interest rate swap	\$ –	\$ 1,793	\$ 1,793
Total liabilities at fair value	\$ –	\$ 1,793	\$ 1,793

Southwest Community Health System and Subsidiaries

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

**4. Fair Value (continued)**

	<b>2017</b>		
	<b>Level 1</b>	<b>Level 2</b>	<b>Total</b>
<b>Assets</b>			
Investments:			
Cash	\$ 1,212	\$ —	\$ 1,212
Money market funds	—	9,305	9,305
Fixed income securities:			
U.S. government agencies	—	33,187	33,187
U.S. corporate	—	27,938	27,938
Common stocks:			
U.S.	9,320	—	9,320
Mutual funds:			
Fixed income	40,306	—	40,306
Equity	102,066	—	102,066
Total assets at fair value	<u>\$ 152,904</u>	<u>\$ 70,430</u>	<u>\$ 223,334</u>
<b>Liabilities</b>			
Interest rate swap	\$ —	\$ 2,300	\$ 2,300
Total liabilities at fair value	<u>\$ —</u>	<u>\$ 2,300</u>	<u>\$ 2,300</u>

Financial instruments at December 31 are reflected in the consolidated balance sheets as follows:

	<b>2018</b>	<b>2017</b>
Investments measured at fair value	<b>\$ 222,991</b>	\$ 223,334
Commingled funds measured at net asset value	<b>11,626</b>	11,014
Limited partnership investment accounted for under the equity method	—	7,929
Total investments	<u><b>\$ 234,617</b></u>	<u>\$ 242,277</u>

## Southwest Community Health System and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### **4. Fair Value (continued)**

The following is a description of the System's valuation methodologies for assets and liabilities measured at fair value:

Fair value for Level 1 is based upon quoted market prices.

Fair value for Level 2 U.S. government agencies and U.S. corporate securities are valued on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources including market participants, dealers, and brokers. Fair value for Level 2 money market funds are valued using broker quotes that utilize observable market inputs.

The fair values of interest rate swaps were determined based on the present value of future cash flows using discount rates appropriate with the risks involved and adjusted for credit. The valuations include a credit spread adjustment to market interest rate curves to appropriately reflect nonperformance risk. The credit spread adjustment is derived from other comparably rated entities' bonds recently priced in the market.

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

The System held no assets or liabilities at fair value which would be subject to Level 3 measurements as of December 31, 2018 or 2017.

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

Southwest Community Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

**5. Property, Plant, and Equipment**

Property, plant, and equipment at December 31 consist of the following:

	<u>2018</u>	<u>2017</u>
Land and land improvements	\$ 15,381	\$ 15,379
Buildings and fixed equipment	317,362	313,206
Movable equipment	147,160	144,056
Construction in progress	12,092	6,933
	<u>491,995</u>	<u>479,574</u>
Accumulated depreciation	309,788	293,170
	<u>\$ 182,207</u>	<u>\$ 186,404</u>

**6. Liquidity and Availability**

As part of its liquidity management, the System structures its financial assets to be available to satisfy general operating expenses, current liabilities, and other obligations as they come due. The system has a line of credit, as discussed in Note 8, to help manage unanticipated liquidity needs. Investments include board-designated funds which may be utilized if necessary.

Financial assets available for general expenditure within one year of December 31, 2018 include the following:

	<u>2018</u>
Cash and cash equivalents	\$ 29,808
Patient accounts receivable	34,793
Investments	215,191
	<u>\$ 279,792</u>

## Southwest Community Health System and Subsidiaries

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

#### **7. Partnering Agreement With University Hospitals Health System, Inc.**

Effective July 1, 1997, the System (excluding the Foundation) entered into a Partnering Agreement (the Partnering Agreement) with University Hospitals Health System, Inc. (UHHS). UHHS owns and operates a large integrated delivery system. Under a five-year Partnering Agreement, UHHS brought the Rainbow Babies and Children, MacDonald Women's and Seidman Cancer programs (UHHS Programs) to the Health Center's facilities. Upon the closing of the Partnering Agreement in 1997, UHHS transferred \$20 million of unrestricted funds to the Health Center. At the end of the initial five-year term, the Partnering Agreement was automatically extended for an additional ten-year term. Under the Partnering Agreement, UHHS obtained 50% representation on the Health Center's Board of Directors, and the System obtained two seats on UHHS's Board of Directors. If at such time the System (excluding the Foundation) votes to merge with UHHS, an additional \$20 million, as adjusted (Additional Commitment Amount), shall be transferred to the System even if the community delegates reject the merger recommendation. Effective January 1, 2011, the System's Partnering Agreement with UHHS was renewed for an additional ten years. At the end of the ten-year renewal term, 2020, UHHS or the System may terminate the Partnering Agreement. Upon termination of the Partnering Agreement, the System is required to return all funds transferred by UHHS or provide certain assets of equal value, pay any outstanding drawable credited earnings, and cease using the names associated with the UHHS Programs.

On an annual basis, UHHS shares 50% of the annual net income or loss of the Health Center (exclusive of tax levy receipts), one-half of which is immediately due and payable. The remaining one-half of earnings is credited against (losses added to) the Additional Commitment Amount. The Additional Commitment Amount bears interest at a rate of 6% per annum, compounded annually. In 2017, the Additional Commitment Amount was fully funded and, as a result, the full 50% is immediately due and payable to UHHS starting in 2018. UHHS no longer has any additional commitment owed under the Partnering Agreement.

Drawable credited earnings due to UHHS were \$9,169 and \$5,127 at December 31, 2018 and 2017, respectively.

Southwest Community Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

**8. Debt**

A summary of long-term debt at December 31, is as follows:

	Type	2018	2017
Series 2012A revenue bonds	Fixed	\$ 50,140	\$ 50,985
Series 2012B revenue bonds	Variable	10,535	11,493
Series 2012C revenue bonds	Variable	15,110	15,568
Series 2012D revenue bonds	Variable	7,605	7,605
Series 2012E revenue bonds	Variable	7,240	7,240
Series 2011 revenue bonds	Fixed	61,975	62,335
Notes payable and capital leases		1,841	2,081
		<u>154,446</u>	<u>157,307</u>
Less:			
Unamortized premium		(1,076)	(1,122)
Unamortized debt issuance costs		1,232	1,308
Current portion		2,948	2,860
		<u>\$ 151,342</u>	<u>\$ 154,261</u>

In November 2012, the Health Center through the City of Middleburg Heights, Ohio, issued \$54,355 of Hospital Facilities Revenue and Refunding Bonds, Series 2012A (Series 2012A Bonds). The Series 2012A Bonds are payable from the general revenue of the Health Center. A portion of the proceeds from the issuance of the Series 2012A Bonds was used to reimburse the Health Center for prior capital expenditures. The remaining portion of the proceeds from the sale of the Series 2012A Bonds was used to partially fund the second phase of the master facility project to build a private-room patient bed tower. The Series 2012A Bonds bear fixed interest rates which will average 4.47% and have a final maturity of 2047.

In November 2012, the Health Center through the City of Middleburg Heights, Ohio, issued \$16,282 of Series 2012B Bonds. The Series 2012B Bonds are payable from the general revenue of the Health Center. The private placement bonds were purchased by a bank. The proceeds from the issuance of the Series 2012B Bonds were used to extinguish the outstanding variable rate Series 2009 Bonds. The Series 2012B Bonds bear variable interest rates based upon LIBOR and have interest payments due semiannually and principal payments due annually. At December 31, 2018, the interest rate was 1.93%. The Series 2012B Bonds have a final maturity of 2028.

## Southwest Community Health System and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### **8. Debt (continued)**

In November 2012, the Health Center through the City of Middleburg Heights, Ohio, issued \$16,878 of Series 2012C Bonds. The Series 2012C Bonds are payable from the general revenue of the Health Center. The private placement bonds were purchased by a bank. The proceeds from the issuance of the Series 2012C Bonds were used to partially fund the second phase of the master facility project to build a private-room patient bed tower. The Series 2012C Bonds bear variable interest rates based upon LIBOR. At December 31, 2018, the interest rate was 2.26%.

In November 2012, the Health Center through the County of Medina, Ohio, executed \$7,605 of Series 2012D Bonds and \$7,240 of Series 2012E Bonds to refinance the Variable Rate Demand Revenue Bonds, Series 2007A (Series 2007A Bonds) and of Variable Rate Demand Taxable Revenue Bonds, Series 2007B (Series 2007B Bonds), which were used to finance construction of the Brunswick Medical Center. The Series 2012D Bonds and the Series 2012E Bonds are payable from the general revenue of the Health Center as were the Series 2007A Bonds and the Series 2007B Bonds. The private placement bonds were purchased by a bank. The Series 2012D Bonds and Series 2012E Bonds bear variable interest rates that are based on LIBOR. The Series 2012D and Series 2012E Bonds have a semiannual interest payment schedule and an annual principal payment schedule. The 15 annual principal payments commence August 1, 2023. At December 31, 2018, the interest rates for the Series 2012D and Series 2012E Bonds were 1.98% and 2.68%, respectively.

In December 2011, the Health Center through the City of Middleburg Heights, Ohio, issued \$63,045 of Hospital Facilities Revenue and Refunding Bonds, Series 2011 (Series 2011 Bonds). The Series 2011 Bonds are payable from the general revenue of the Health Center. A portion of the proceeds from the sale of the Series 2011 Bonds were used to refund the outstanding fixed-rate Series 1995 Bonds. The remaining portion of the proceeds from the sale of the Series 2011 Bonds were used to fund the facility project to expand the emergency department and critical care unit. The Series 2011 Bonds bear fixed interest rates which will average 5.19% and have a final maturity of 2041.

The System is subject to certain restrictive covenants, including provisions relating to maintaining certain debt ratios and other matters. The System is in compliance with debt covenants at December 31, 2018.

## Southwest Community Health System and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### **8. Debt (continued)**

Combined current aggregate maturities of bonds payable and capital leases, the Series 2012A, 2012B, 2012C, 2012D, 2012E, and the Series 2011 Bonds for five years subsequent to December 31, 2018, are as follows: 2019 – \$2,948; 2020 – \$3,031; 2021 – \$3,227; 2022 – \$3,342; 2023 – \$3,478.

The System paid interest of \$6,182 in 2018 and \$6,128 in 2017.

In December 2017, the System executed a bank agreement for a \$10,000 line of credit, which will expire on December 31, 2022. There have not been any draws on the line of credit and the amount due under the line of credit is \$0 at December 31, 2018 and 2017.

#### **9. Interest Rate Swap**

The System utilizes interest rate swaps to manage the overall cost of debt and risk profile related to its long-term debt. The swaps utilized include (i) fixed payor swaps, whereby the System receives a floating rate and pays a fixed rate to either hedge against rising interest rates or achieve a lower overall cost of debt relative to traditional fixed-rate structures and (ii) basis swaps whereby the System receives a floating rate based on a taxable index (LIBOR) and pays a floating rate based on a tax-exempt index (SIFMA) designed to reduce interest costs associated with its traditional fixed rate debt. The fair value of all interest rate swap agreements is determined by relevant factors such as dealer price quotations and valuation pricing models. The swap agreements are not designated as hedging instruments.

Southwest Community Health System and Subsidiaries

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

**9. Interest Rate Swap (continued)**

The following table summarizes the System's interest rate swap agreements:

Swap Type	Expiration Date	System Pays	System Receives	Notional Amount at December 31, 2018	Notional Amount at December 31, 2017
Fixed-payor	2037	3.49%	70% of LIBOR	\$ 7,605	\$ 7,605
Fixed-payor	2037	4.925%	100% of LIBOR	7,240	7,240
Fixed spread basis	2041	SIFMA index	67% of LIBOR +.72596%	30,988	31,168
				<u>\$ 45,833</u>	<u>\$ 46,013</u>

The following table summarizes the location and fair value for the System's interest rate swap agreements:

	Derivatives Liability			
	December 31, 2018		December 31, 2017	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
<b>Derivatives not designated as hedging instruments</b>				
Interest rate swap agreements	Other long-term liabilities	\$ (3,107)	Other long-term liabilities	\$ (3,804)
	Other assets	1,314	Other assets	1,504

The following table summarizes the location and amounts of cash settlements and changes in fair value on the System's interest rate swap agreements:

	Location of Gain (Loss) Recognized	Year Ended December 31	
		2018	2017
<b>Derivatives not designated as hedging instruments</b>			
Payments to counterparty	Other net nonoperating gains (losses)	\$ (160)	\$ (286)
Changes in fair value	Investment income (loss)	507	809

## Southwest Community Health System and Subsidiaries

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

#### **10. Retirement Plan**

The System has a noncontributory defined benefit retirement plan covering substantially all System employees. Benefits for employees are based on a percentage of annual compensation and years of service. The System's funding policy is to contribute amounts sufficient to provide for future benefits and to meet minimum Employee Retirement Income Security Act of 1974 (ERISA) funding requirements.

Effective January 1, 2015, the plan benefit formula changed from a final average compensation formula to a cash balance for participants whose age plus years of service are 75 or more as of January 1, 2009 (grandfathered group). The grandfathered group employees' final averages compensation benefit was frozen at December 31, 2014, with the cash balance formula starting January 1, 2015. As of December 31, 2015, the plan was completely frozen (i.e., no future cash balance compensation credits will be provided to participants).

The System applies a spot rate approach by applying the specific spot rates along the yield curve to the relevant projected cash flows in the estimation of the interest components of benefit cost. The spot rates used to determine interest costs range from 1.27% to 4.44% for the plan.

Included in unrestricted net assets are unrecognized actuarial losses that have not yet been recognized in net periodic benefit cost of \$71,910 and \$73,756 at December 31, 2018 and 2017, respectively. The actuarial loss expected to be recognized during the year ending December 31, 2019 is \$2,349.

Southwest Community Health System and Subsidiaries

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

**10. Retirement Plan (continued)**

Changes in plan assets and benefit obligations recognized in net assets without donor restrictions during December 31 included:

	<b>2018</b>	<b>2017</b>
Changes recognized in net assets without donor restrictions:		
Current year actuarial gain	\$ 536	\$ 514
Amortization of actuarial loss	(2,382)	(2,409)
Total	<u>\$ (1,846)</u>	<u>\$ (1,895)</u>

A summary of the changes in the benefit obligation and plan assets and the resulting funded status of the pension plan are as follows:

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 168,179	\$ 160,042
Interest cost	5,573	5,741
Actuarial (gains) losses	(14,153)	8,472
Benefits paid	(6,240)	(6,076)
Benefit obligation at end of year	<u>153,359</u>	168,179
Change in plan assets:		
Fair value of plan assets at beginning of year	126,619	106,622
Actual return on plan assets	(6,757)	14,773
Employer contributions	5,000	11,300
Benefits paid	(6,240)	(6,076)
Fair value of plan assets at end of year	<u>118,622</u>	126,619
Underfunded status of the plan	<u>(34,737)</u>	(41,560)
Accrued retirement benefits	<u>\$ (34,737)</u>	<u>\$ (41,560)</u>
Accumulated benefit obligation	<u>\$ 153,359</u>	<u>\$ 168,179</u>

Southwest Community Health System and Subsidiaries

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

**10. Retirement Plan (continued)**

	<b>Year Ended December 31</b>	
	<b>2018</b>	<b>2017</b>
Components of net periodic benefit cost:		
Interest cost	\$ 5,573	\$ 5,741
Expected return on assets	(7,935)	(6,815)
Amortization of net actuarial loss	2,382	2,409
	<u>\$ 20</u>	<u>\$ 1,335</u>

The components of net periodic benefit cost are included in other nonoperating gains and losses in the consolidated statements of operations and changes in net assets.

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
Weighted-average assumptions used to determine the benefit obligation at year-end:		
Discount rate	4.39%	3.68%
Expected return on plan assets	6.25	6.25

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
Weighted-average assumptions used to determine net periodic benefit cost for the year ended:		
Discount rate	3.68%	4.16%
Expected return on plan assets	6.25	6.25

## Southwest Community Health System and Subsidiaries

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

#### 10. Retirement Plan (continued)

Plan assets by investment category are as follows:

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
Equity investments	<b>51%</b>	55%
Fixed income investments	<b>38</b>	34
Alternative investments	<b>11</b>	11
	<b>100%</b>	100%

The plan's investment strategy is long-term oriented, which the plan manages through a target investment allocation. Plan assets are selected by various professional asset managers following System investment guidelines. The plan's investment guidelines target allocation ranges of the investment pool to various asset classes including equity investments (40% to 70% target), fixed income investments (20% to 40% target), alternative investments (5% to 25% target) and cash and cash equivalents (0% target) and are designed to diversify the portfolio in a way that achieves an efficient trade-off between long-term return and risk while providing adequate liquidity to meet near-term expenses and obligations. The plan's expected long-term rate of return is determined based upon its historical returns as well as expected future returns based upon targeted long-term returns of 9% to 11% for equity securities and 3% to 5% for debt securities. The System expects to contribute approximately \$5,000 to the plan in 2019.

Future expected benefits payments during the years ending December 31 are as follows: 2019 – \$6,518; 2020 – \$6,985; 2021 – \$7,602; 2022 – \$8,079; 2023 – \$8,498; and 2024 through 2028 – \$47,758.

Southwest Community Health System and Subsidiaries

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

**10. Retirement Plan (continued)**

The following tables present the investments in the defined benefit pension as of December 31, measured at fair value on a recurring basis based on the fair value hierarchy:

	<b>December 31, 2018</b>		
	<b>Level 1</b>	<b>Level 2</b>	<b>Total</b>
<b>Assets</b>			
Cash and investments:			
Money market funds	\$ —	\$ 827	\$ 827
Fixed income securities:			
U.S. treasuries	484	—	484
U.S. government agencies	—	25,482	25,482
U.S. corporate	—	19,530	19,530
Common stocks:			
U.S.	—	—	—
Mutual funds:			
Equity	52,513	—	52,513
Total assets at fair value	<u>\$ 52,997</u>	<u>\$ 45,839</u>	<u>\$ 98,836</u>

	<b>December 31, 2017</b>		
	<b>Level 1</b>	<b>Level 2</b>	<b>Total</b>
<b>Assets</b>			
Cash and investments:			
Money market funds	\$ —	\$ 1,291	\$ 1,291
Fixed income securities:			
U.S. treasuries	487	—	487
U.S. government agencies	—	23,706	23,706
U.S. corporate	—	18,003	18,003
Common stocks:			
U.S.	5,947	—	5,947
Mutual funds:			
Equity	57,313	—	57,313
Total assets at fair value	<u>\$ 63,747</u>	<u>\$ 43,000</u>	<u>\$ 106,747</u>

## Southwest Community Health System and Subsidiaries

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

#### 10. Retirement Plan (continued)

Total plan assets in the defined benefit pension as of December 31, 2018 and 2017 are comprised of the following:

	<u>2018</u>	<u>2017</u>
Investments measured at fair value	\$ 98,836	\$ 106,747
Commingled funds measured at net asset value	6,733	6,337
Alternative investments measured at net asset value	13,053	13,535
Total investments	<u>\$ 118,622</u>	<u>\$ 126,619</u>

Fair value methodologies for Level 1 and Level 2 are consistent with the inputs described in Note 4.

Fixed income securities include debt obligations of the U.S. government and various agencies, and U.S. corporations. The composition of these securities represents an expected return and risk profile that is commensurate with broadly defined fixed income indexes such as the Barclays Capital U.S. Aggregate Index.

Equity securities include investments of publicly traded common stocks of U.S. corporations, the majority of which represent actively traded and liquid securities that are traded on many of the world's major exchanges and include large-, mid-, and small-capitalization securities. The composition of these securities represent an expected return and risk profile that is commensurate with broadly defined equity indexes such as the Russell 1000 Index, the Russell 2500 Index and the Morgan Stanley Capital International (MSCI) EAFE (Europe, Australasia, Far East) Index. Commingled investment funds are valued using, as a practical expedient, the net asset value as provided by the respective investment companies and partnerships. There are no significant redemption restrictions on the commingled investment funds.

Alternative investments include hedge funds that are meant to provide equity-like returns with fixed-income-like levels of risk. Included in this category are investments that are diversified across various strategies and may consist of long/short equity funds and other opportunistic funds. The underlying investments in such funds may include publicly traded and privately held equity and debt instruments issued by U.S. and international corporations as well as various derivatives based on these securities. No significant redemption restrictions or remaining investment commitments apply to the System's investments in these funds; however, the Fund Manager would evaluate such features or restrictions, as applicable, to estimate fair value.

## Southwest Community Health System and Subsidiaries

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

#### **10. Retirement Plan (continued)**

The System offers a defined contribution plan. Under the plan, employees voluntarily contribute a percentage of their annual salary. In 2018 and 2017, the System matched 50% of the employee's contributions up to an additional 6% of the employee's annual salary. Benefit expense in connection with the defined contribution plan was \$2,582 in 2018 and \$2,382 in 2017.

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

Prior to August 1, 2011, the System provided coverage for professional liability, general liability and workers' compensation through a combination of self-insured retentions and commercial insurance policies. Effective August 1, 2011, the System entered into a participation agreement with Western Reserve Assurance Co., Ltd., an offshore captive insurance company (Western Reserve) which is a wholly owned subsidiary of UHHS. The System consolidates the assets and liabilities held in its segregated portfolio operated by Western Reserve on the System's behalf. Segregated portfolios, by law, do not have access or rights to the assets of any other segregated portfolio operated by Western Reserve. The participation agreement with Western Reserve provides for primary professional liability and primary general liability insurance coverage on a claims-made basis for substantially all of the System. The System purchases commercial insurance policies for automobile liability; heliport operations liability; commercial property liability; and excess workers' compensation. Western Reserve provides excess liability for the above risks through reinsurance agreements in place with unrelated commercial insurance companies. The System has stop-loss insurance for workers' compensation and employee health care claims.

Through Western Reserve, the System has set aside investments for the payment of the Health Center's professional liability claims, expenses, and settlements based on actuarial funding recommendations. The investments are \$13,883 (\$4,031 included in investments for current use) and \$14,572 (\$4,636 included in investments for current use) at December 31, 2018 and 2017, respectively. The provision for estimated self-insured professional liability claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. Liability claims have been asserted that are in various stages of processing or are in litigation and are discounted at a rate of 2.5% for 2018 and 0% for 2017. There may also be incurred but unreported incidents, which may result in the assertion of additional claims. The System's recorded reserve for professional liability, including both the Health Center and Southwest General Medical Group, was \$13,336 and \$17,081 at December 31, 2018 and 2017, respectively, and is included in other accrued liabilities and other liabilities on the consolidated balance sheets. The System's

## Southwest Community Health System and Subsidiaries

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

#### **11. Professional and General Liability Insurance (continued)**

recorded reserve for workers' compensation claims was \$635 and \$841 at December 31, 2018 and 2017, respectively, and is included in other accrued liabilities and other liabilities on the consolidated balance sheets. The System's recorded reserve for employee health care was \$1,700 and \$1,550 at December 31, 2018 and 2017, respectively, and is included in other accrued liabilities on the consolidated balance sheets.

#### **12. Commitments**

The System leases certain office space and equipment, which are accounted for as operating leases.

Rental expense, including items rented on a month-to-month basis, under operating leases was \$5,242 in 2018 and \$4,284 in 2017. Future minimum rental payments under noncancelable operating leases are as follows: 2019 – \$5,747; 2020 – \$4,209; 2021 – \$2,489; 2022 – \$460; and 2023 – \$248.

Total minimum lease rentals, exclusive of System occupied space in System-owned medical office buildings, to be received under current noncancelable leases as of December 31, 2018, are \$576 in 2019, \$302 in 2020, \$60 in 2021 and insignificant thereafter. Rental revenue of \$1,569 in 2018 and \$1,526 in 2017 is included in other net nonoperating gains (losses).

#### **13. Income Taxes**

The System has been granted tax-exempt status under Section 501(c)(3) of the Internal Revenue Code and therefore is not subject to federal income taxes on related income. Management is not aware of any situation that would have an adverse impact on the System's tax-exempt status.

## Southwest Community Health System and Subsidiaries

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

#### 14. Functional Expenses

The System provides health care services to patients within its geographic location. Functional expenses related to providing these services are as follows:

##### Year Ended December 31, 2018

	Health care services	General and administrative	Total
Salaries, wages, and benefits	\$ 157,425	\$ 16,878	\$ 174,303
Supplies, insurance, and other	135,445	34,025	169,470
Depreciation and amortization	12,107	10,528	22,635
Interest	–	6,265	6,265
	<u>\$ 304,977</u>	<u>\$ 67,696</u>	<u>\$ 372,673</u>

##### Year Ended December 31, 2017

	Health care services	General and administrative	Total
Salaries, wages, and benefits	\$ 146,824	\$ 17,133	\$ 163,957
Supplies, insurance, and other	126,007	32,309	158,316
Depreciation and amortization	13,425	11,391	24,816
Interest	–	6,153	6,153
	<u>\$ 286,256</u>	<u>\$ 66,986</u>	<u>\$ 353,242</u>

The consolidated financial statements report certain categories of expenses that are attributable to either health care services or general and administrative functions. Some categories of natural class expenses are attributable to both. Therefore, the expenses require allocation on a reasonable basis that is consistently applied. General and administrative functions consist of corporate functions such as legal, accounting and information systems. The expenses that are allocated include salaries, wages and benefits, which include allocations on the basis of estimates of time and effort.

#### 15. Subsequent Events

The System evaluated events and transactions occurring subsequent to December 31, 2018 through April 19, 2019, the date of issuance of the consolidated financial statements. During this period, there were no subsequent events requiring recognition or disclosure in the consolidated financial statements.

# Supplementary Information



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

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

## Report of Independent Auditors on Supplementary Information

The Board of Trustees  
Southwest Community Health System

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating balance sheets and consolidating statements of operations and changes in net assets without donor restrictions are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

*Ernst & Young LLP*

April 19, 2019

# Southwest Community Health System and Subsidiaries

## Consolidating Balance Sheet

December 31, 2018

	<b>Obligated Group</b>	<b>Non-Obligated Group</b>	<b>Consolidating Eliminations</b>	<b>Consolidated Total</b>
	<i>(In Thousands)</i>			
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$ 29,123	\$ 775	\$ –	\$ 29,898
Patient accounts receivable, net	34,793	–	–	34,793
Other receivables, net	4,189	246	–	4,435
Due from affiliated organizations	5	128	(133)	–
Inventories	9,346	55	–	9,401
Prepaid expenses	9,006	1	–	9,007
Investments for current use	5,731	–	–	5,731
<b>Total current assets</b>	<b>92,193</b>	<b>1,205</b>	<b>(133)</b>	<b>93,265</b>
Investments:				
Board-designated and other	215,191	3,843	–	219,034
Self-insurance reserve funds	9,852	–	–	9,852
	<b>225,043</b>	<b>3,843</b>	<b>–</b>	<b>228,886</b>
Property, plant, and equipment, net	182,200	7	–	182,207
Other assets	5,369	915	–	6,284
<b>Total assets</b>	<b>\$ 504,805</b>	<b>\$ 5,970</b>	<b>\$ (133)</b>	<b>\$ 510,642</b>

	<b>Obligated Group</b>	<b>Non-Obligated Group</b>	<b>Consolidating Eliminations</b>	<b>Consolidated Total</b>
	<i>(In Thousands)</i>			
<b>Liabilities and net assets</b>				
Current liabilities:				
Accounts payable	\$ 23,069	\$ 12	\$ –	\$ 23,081
Due to affiliated organizations	128	5	(133)	–
Accrued compensation and related liabilities	27,657	189	–	27,846
Other accrued liabilities	10,432	19	–	10,451
Drawable credited earnings due to UHHS	9,169	–	–	9,169
Estimated amounts payable to third-party payors	3,144	–	–	3,144
Current portion of long-term liabilities	2,948	–	–	2,948
Total current liabilities	<u>76,547</u>	<u>225</u>	<u>(133)</u>	<u>76,639</u>
Long-term liabilities:				
Revenue bonds	149,748	–	–	149,748
Notes payable and capital leases	1,594	–	–	1,594
Accrued retirement benefits	34,737	–	–	34,737
Other liabilities	15,844	–	–	15,844
Total long-term liabilities	<u>201,923</u>	<u>–</u>	<u>–</u>	<u>201,923</u>
Total liabilities	<u>278,470</u>	<u>225</u>	<u>(133)</u>	<u>278,562</u>
Net assets:				
Without donor restrictions	226,252	1,527	–	227,779
With donor restrictions	83	4,218	–	4,301
Total net assets	<u>226,335</u>	<u>5,745</u>	<u>–</u>	<u>232,080</u>
Total liabilities and net assets	<u>\$ 504,805</u>	<u>\$ 5,970</u>	<u>\$ (133)</u>	<u>\$ 510,642</u>

# Southwest Community Health System and Subsidiaries

## Consolidating Statement of Operations and Changes in Net Assets Without Donor Restrictions

Year Ended December 31, 2018

	Obligated Group	Non-Obligated Group	Consolidating Eliminations	Consolidated Total
	<i>(In Thousands)</i>			
<b>Unrestricted revenue</b>				
Net patient service revenue	\$ 370,887	\$ –	\$ –	\$ 370,887
Other revenue	12,168	693	–	12,861
Total unrestricted revenue	383,055	693	–	383,748
<b>Expenses</b>				
Salaries, wages, and benefits	173,881	422	–	174,303
Supplies, insurance, and other	169,186	284	–	169,470
Depreciation and amortization	22,627	8	–	22,635
Interest	6,265	–	–	6,265
Total expenses	371,959	714	–	372,673
Income from operations	11,096	(21)	–	11,075
Nonoperating gains (losses):				
Tax levy receipts	786	–	–	786
Investment income	9,640	–	–	9,640
Other – net	(2,398)	–	–	(2,398)
Total nonoperating gains (losses), net	8,028	–	–	8,028
Excess of revenue over expenses before				
drawable credited earnings due to UHHS	19,124	(21)	–	19,103
Drawable credited earnings due to UHHS	(9,169)	–	–	(9,169)
Excess of revenue over expenses	9,955	(21)	–	9,934
<b>Changes in net assets without donor restrictions</b>				
Excess of revenue over expenses	9,955	(21)	–	9,934
Net change in unrealized gains (losses) on other-than-trading investments	(17,442)	(86)	–	(17,528)
Net assets released from restrictions for capital	399	–	–	399
Pension adjustment	1,846	–	–	1,846
Contributions to Foundation from Southwest General Health Center	(234)	234	–	–
Increase (decrease) in net assets without donor restrictions	(5,476)	127	–	(5,349)
Net assets without donor restrictions at beginning of year	231,728	1,400	–	233,128
Net assets without donor restrictions at end of year	\$ 226,252	\$ 1,527	\$ –	\$ 227,779

# Southwest Community Health System and Subsidiaries

## Consolidating Balance Sheet

December 31, 2017

	<b>Obligated Group</b>	<b>Non-Obligated Group</b>	<b>Consolidating Eliminations</b>	<b>Consolidated Total</b>
	<i>(In Thousands)</i>			
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$ 22,399	\$ 340	\$ —	\$ 22,739
Patient accounts receivable, net	33,791	—	—	33,791
Other receivables, net	1,841	290	—	2,131
Due from affiliated organizations	16	—	(16)	—
Inventories	8,598	48	—	8,646
Prepaid expenses	10,310	15	—	10,325
Investments for current use	6,310	—	—	6,310
<b>Total current assets</b>	<b>83,265</b>	<b>693</b>	<b>(16)</b>	<b>83,942</b>
Investments:				
Board-designated and other	222,209	3,822	—	226,031
Self-insurance reserve funds	9,936	—	—	9,936
	<b>232,145</b>	<b>3,822</b>	<b>—</b>	<b>235,967</b>
Property, plant, and equipment, net	186,389	15	—	186,404
Other assets	5,559	1,078	—	6,637
<b>Total assets</b>	<b>\$ 507,358</b>	<b>\$ 5,608</b>	<b>\$ (16)</b>	<b>\$ 512,950</b>

	<b>Obligated Group</b>	<b>Non-Obligated Group</b>	<b>Consolidating Eliminations</b>	<b>Consolidated Total</b>
	<i>(In Thousands)</i>			
<b>Liabilities and net assets</b>				
Current liabilities:				
Accounts payable	\$ 13,474	\$ 18	\$ –	\$ 13,492
Due to affiliated organizations	–	16	(16)	–
Accrued compensation and related liabilities	25,975	117	–	26,092
Other accrued liabilities	9,848	26	–	9,874
Drawable credited earnings due to UHHS	5,127	–	–	5,127
Estimated amounts payable to third-party payors	2,696	–	–	2,696
Current portion of long-term liabilities	2,860	–	–	2,860
<b>Total current liabilities</b>	<b>59,980</b>	<b>177</b>	<b>(16)</b>	<b>60,141</b>
Long-term liabilities:				
Revenue bonds	152,420	–	–	152,420
Notes payable and capital leases	1,841	–	–	1,841
Accrued retirement benefits	41,560	–	–	41,560
Other liabilities	19,747	–	–	19,747
<b>Total long-term liabilities</b>	<b>215,568</b>	<b>–</b>	<b>–</b>	<b>215,568</b>
<b>Total liabilities</b>	<b>275,548</b>	<b>177</b>	<b>(16)</b>	<b>275,709</b>
Net assets:				
Without donor restrictions	231,728	1,400	–	233,128
With donor restrictions	82	4,031	–	4,113
<b>Total net assets</b>	<b>231,810</b>	<b>5,431</b>	<b>–</b>	<b>237,241</b>
<b>Total liabilities and net assets</b>	<b>\$ 507,358</b>	<b>\$ 5,608</b>	<b>\$ (16)</b>	<b>\$ 512,950</b>

## Southwest Community Health System and Subsidiaries

### Consolidating Statement of Operations and Changes in Net Assets Without Donor Restrictions

Year Ended December 31, 2017

	<b>Obligated Group</b>	<b>Non-Obligated Group</b>	<b>Consolidating Eliminations</b>	<b>Consolidated Total</b>
	<i>(In Thousands)</i>			
<b>Unrestricted revenue</b>				
Net patient service revenue	\$ 376,582	\$ –	\$ –	\$ 376,582
Provision for bad debts	(20,828)	–	–	(20,828)
Net patient service revenue	355,754	–	–	355,754
Other revenue	11,186	603	–	11,789
Total unrestricted revenue	366,940	603	–	367,543
<b>Expenses</b>				
Salaries, wages, and benefits	163,616	341	–	163,957
Supplies, insurance, and other	158,136	180	–	158,316
Depreciation and amortization	24,808	8	–	24,816
Interest	6,153	–	–	6,153
Total expenses	352,713	529	–	353,242
Income from operations	14,227	74	–	14,301
Nonoperating gains (losses):				
Tax levy receipts	847	–	–	847
Investment income	8,913	–	–	8,913
Other – net	(4,106)	–	–	(4,106)
Total nonoperating gains, net	5,654	–	–	5,654
Excess of revenue over expenses before				
drawable credited earnings due to UHHS	19,881	74	–	19,955
Drawable credited earnings due to UHHS	(5,127)	–	–	(5,127)
Excess of revenue over expenses	14,754	74	–	14,828
<b>Changes in net assets without donor restrictions</b>				
Excess of revenue over expenses	14,754	74	–	14,828
Net change in unrealized gains on other-than-trading investments	16,881	97	–	16,978
Net assets released from restrictions for capital	772	–	–	772
Pension adjustment	1,895	–	–	1,895
Increase in net assets without donor restrictions	34,302	171	–	34,473
Net assets without donor restrictions at beginning of year	197,426	1,229	–	198,655
Net assets without donor restrictions at end of year	<u>\$ 231,728</u>	<u>\$ 1,400</u>	<u>\$ –</u>	<u>\$ 233,128</u>

**About EY**

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit [ey.com](http://ey.com).

© 2019 Ernst & Young LLP.  
All Rights Reserved.

**[ey.com](http://ey.com)**