



## **Texas Health Resources**

Consolidated Financial Statements

December 31, 2018 and 2017

(With Independent Auditors' Report Thereon)



KPMG LLP  
Suite 1400  
2323 Ross Avenue  
Dallas, TX 75201-2721

## Independent Auditors' Report

The Board of Trustees,  
Texas Health Resources:

We have audited the accompanying consolidated financial statements of Texas Health Resources and its 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 consolidated financial statements in accordance 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 consolidated financial statements.

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

### Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Texas Health Resources and its subsidiaries as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

**KPMG LLP**

Dallas, Texas  
April 25, 2019

**TEXAS HEALTH RESOURCES  
CONSOLIDATED BALANCE SHEETS**

December 31, 2018 and 2017

(Dollars in Thousands)

	<b>2018</b>	<b>2017</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 442,765	\$ 435,168
Short-term investments	7,275	8,275
Patient accounts receivable, less allowance for doubtful accounts of \$150,476 in 2017	559,813	532,595
Other receivables, net	123,616	110,818
Assets limited as to use	471,438	504,341
Other current assets	143,597	144,267
Total current assets	1,748,504	1,735,464
Assets limited as to use	4,377,750	4,564,995
Property and equipment, net	2,108,400	1,989,474
Investments in unconsolidated affiliates	425,271	369,917
Goodwill and intangible assets, net	142,836	148,412
Other assets, net	96,733	86,966
Total assets	\$ 8,899,494	\$ 8,895,228
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Current portion of long-term debt	\$ 350,104	\$ 351,226
Accounts payable	233,169	238,004
Estimated third-party payor settlements	24,381	33,275
Accrued salaries, wages, and employee benefits	219,557	239,389
Other accrued liabilities	302,694	240,308
Total current liabilities	1,129,905	1,102,202
Long-term debt, net of current portion	1,585,890	1,600,980
Other noncurrent liabilities	48,341	47,255
Total liabilities	2,764,136	2,750,437
Net assets:		
Net assets of Texas Health Resources		
Without donor restrictions	5,848,915	5,853,468
With donor restrictions	166,509	171,196
Total net assets of Texas Health Resources	6,015,424	6,024,664
Non-controlling ownership interest in equity of consolidated affiliates	119,934	120,127
Total net assets	6,135,358	6,144,791
Total liabilities and net assets	\$ 8,899,494	\$ 8,895,228

See accompanying notes to the consolidated financial statements.

**TEXAS HEALTH RESOURCES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS**  
For the Years Ended December 31, 2018 and 2017  
(Dollars in Thousands)

	<u>2018</u>	<u>2017</u>
Operating revenue:		
Net patient service revenue before provision for bad debts		\$ 4,794,014
Less: Provision for bad debts		<u>362,776</u>
Net patient service revenue	\$ 4,551,739	4,431,238
Equity in earnings of unconsolidated affiliates	68,771	77,436
Other operating revenue	<u>180,367</u>	<u>179,882</u>
Total operating revenue	<u>4,800,877</u>	<u>4,688,556</u>
Operating expenses:		
Salaries, wages, and employee benefits	2,455,341	2,378,759
Supplies	783,813	777,809
Depreciation and amortization	238,575	232,797
Interest expense	92,116	90,779
Other operating expenses	<u>919,092</u>	<u>888,937</u>
Total operating expenses	<u>4,488,937</u>	<u>4,369,081</u>
Operating income	<u>311,940</u>	<u>319,475</u>
Nonoperating (losses) gains, net:		
Net realized investment income and gains	299,731	278,882
Net unrealized (losses) gains on investments	(514,264)	358,357
Equity in (losses) earnings of unconsolidated affiliates, nonoperating	(2,413)	1,450
Gain on extinguishment of long-term debt	—	2,098
Other, net	<u>(8,063)</u>	<u>(10,953)</u>
Total nonoperating (losses) gains, net	<u>(225,009)</u>	<u>629,834</u>
Revenue and gains in excess of expenses and losses before income taxes	86,931	949,309
Less: Income tax expense	<u>5,123</u>	<u>4,880</u>
Revenue and gains in excess of expenses and losses	81,808	944,429
Less: Revenue and gains in excess of expenses and losses attributable to non-controlling interest	<u>86,033</u>	<u>83,643</u>
Revenue and gains (less than) in excess of expenses and losses from continuing operations attributable to Texas Health Resources	(4,225)	860,786

(Continued)

See accompanying notes to the consolidated financial statements.

**TEXAS HEALTH RESOURCES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS**  
For the Years Ended December 31, 2018 and 2017  
(Dollars in Thousands)

	<u>2018</u>	<u>2017</u>
Other changes in net assets without donor restrictions:		
Net unrealized losses on investments, other than trading securities	\$ (5,909)	\$ (4,164)
Net assets released from restrictions used for purchase of property and equipment	6,658	5,310
Change in fair value of interest rate swap agreements	48	117
Other changes, net	<u>(1,125)</u>	<u>(1,994)</u>
(Decrease) increase in net assets without donor restrictions	<u>(4,553)</u>	<u>860,055</u>
Changes in net assets with donor restrictions:		
Contributions received for purchase of property and equipment	12,465	906
Contributions received for operations	8,461	9,116
Net realized investment income and gains	5,530	5,534
Net unrealized (losses) gains on investments	(12,040)	10,534
Change in value of split-interest agreements	(584)	352
Net assets released from restrictions	<u>(18,519)</u>	<u>(16,651)</u>
(Decrease) increase in net assets with donor restrictions	<u>(4,687)</u>	<u>9,791</u>
(Decrease) increase in net assets of Texas Health Resources	(9,240)	869,846
Net assets of Texas Health Resources, beginning of year	<u>6,024,664</u>	<u>5,154,818</u>
Net assets of Texas Health Resources, end of year	<u><u>\$ 6,015,424</u></u>	<u><u>\$ 6,024,664</u></u>

See accompanying notes to the consolidated financial statements.

**TEXAS HEALTH RESOURCES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
For the Years Ended December 31, 2018 and 2017  
(Dollars in Thousands)

	<b>2018</b>	<b>2017</b>
Cash flows from operating activities:		
(Decrease) increase in net assets of Texas Health Resources	\$ (9,240)	\$ 869,846
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities, excluding the net effects of acquisitions:		
Gain on extinguishment of long-term debt	—	(2,098)
Net unrealized losses (gains) on investments	532,213	(364,727)
Net realized gains on investments	(214,622)	(208,761)
Change in value of split-interest agreement	584	(352)
Provision for bad debts	2,612	367,406
Restricted contributions received for purchase of property and equipment	(12,465)	(906)
Depreciation and amortization	238,575	232,797
Amortization of bond premiums/discounts and debt issuance costs	(2,603)	(2,547)
Net losses on impairment and disposal of property and equipment	1,810	11,986
Equity in earnings of unconsolidated affiliates	(68,771)	(77,436)
Distributions from unconsolidated affiliates	74,210	65,301
Equity in losses (earnings) of unconsolidated affiliates, nonoperating	2,413	(1,450)
Change in fair value of interest rate swap agreements	(48)	(117)
Revenue and gains in excess of expenses and losses attributable to non-controlling interest	86,033	83,643
Change in operating assets and liabilities:		
Patient accounts receivable	(27,218)	(399,704)
Other receivables, net	(15,410)	(52,523)
Other assets, net	(6,848)	1,910
Accounts payable	(4,835)	(24,881)
Estimated third-party payor settlements	(8,894)	3,304
Accrued salaries, wages, and employee benefits	(19,832)	8,002
Other accrued liabilities	62,386	80,209
Other noncurrent liabilities	1,086	1,327
Net cash provided by operating activities	611,136	590,229

(Continued)

See accompanying notes to the consolidated financial statements.

**TEXAS HEALTH RESOURCES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
For the Years Ended December 31, 2018 and 2017  
(Dollars in Thousands)

	<u>2018</u>	<u>2017</u>
Cash flows from investing activities:		
Purchases of property and equipment, net	\$ (351,289)	\$ (264,689)
Proceeds from disposal of property and equipment	1,946	44,759
Cash used to acquire physician practices and other consolidated affiliates	(3,084)	(1,308)
Investment in unconsolidated affiliates, net	(63,206)	(131,832)
Purchases of short-term investments and assets limited as to use, net	<u>(97,027)</u>	<u>(198,462)</u>
Net cash used in investing activities	<u>(512,660)</u>	<u>(551,532)</u>
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	2,916	137,633
Principal payments on capital lease obligations	(650)	(152)
Principal payments on long-term debt	(19,340)	(42,554)
Redemption of long-term debt	—	(126,875)
Contributions from non-controlling interest holders	3,215	5,508
Distributions to non-controlling interest holders	(89,485)	(79,821)
Proceeds from restricted contributions received for purchase of property and equipment	<u>12,465</u>	<u>906</u>
Net cash used in financing activities	<u>(90,879)</u>	<u>(105,355)</u>
Net increase (decrease) in cash and cash equivalents	7,597	(66,658)
Cash and cash equivalents, beginning of year	<u>435,168</u>	<u>501,826</u>
Cash and cash equivalents, end of year	<u>\$ 442,765</u>	<u>\$ 435,168</u>
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	\$ 95,136	\$ 87,280
Cash paid for income taxes	\$ 4,600	\$ 4,940
Property and equipment acquired through capital lease obligations	\$ 3,466	\$ 44

See accompanying notes to the consolidated financial statements.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2018 and 2017

**1. Organization**

Texas Health Resources (THR), a Texas non-profit corporation, operates through its controlled affiliates a health care system with services and facilities throughout north central Texas. THR is organized and operated for the benefit of its tax-exempt controlled affiliates and has been recognized by the Internal Revenue Service (IRS) as exempt from federal income taxes under Section 501(a) of the Internal Revenue Code of 1986, as amended (the Code), as an organization described in Section 501(c)(3). THR's wholly-controlled facilities include 14 acute care hospital locations, a 10-bed long-term care hospital, and a rehabilitation center. The following table provides the locations of THR's tax-exempt member hospitals (the Tax-Exempt Hospitals) as of December 31, 2018. The Tax-Exempt Hospitals have been recognized as exempt from federal income taxes under the Code as organizations described in Section 501(c)(3).

<b>Tax-Exempt Hospital</b>	<b>Location (Texas)</b>
Texas Health Arlington Memorial Hospital	Arlington
Texas Health Harris Methodist Hospital Alliance	Fort Worth
Texas Health Harris Methodist Hospital Azle	Azle
Texas Health Harris Methodist Hospital Cleburne	Cleburne
Texas Health Harris Methodist Hospital Fort Worth	Fort Worth
Texas Health Harris Methodist Hospital Hurst-Euless-Bedford	Bedford
Texas Health Harris Methodist Hospital Southwest Fort Worth	Fort Worth
Texas Health Harris Methodist Hospital Stephenville	Stephenville
Texas Health Hospital Clearfork <sup>1</sup>	Fort Worth
Texas Health Presbyterian Hospital Allen	Allen
Texas Health Presbyterian Hospital Dallas	Dallas
Texas Health Presbyterian Hospital Denton	Denton
Texas Health Presbyterian Hospital Kaufman	Kaufman
Texas Health Presbyterian Hospital Plano	Plano
Texas Health Specialty Hospital Fort Worth (10-bed long-term care hospital)	Fort Worth

<sup>1</sup> *Texas Health Hospital Clearfork is a separate hospital location serving as a licensed department of Texas Health Harris Methodist Hospital Southwest Fort Worth.*

THR is the sole member or sole shareholder of certain other wholly-controlled affiliates engaged in health care related activities in support of its mission, including Texas Health Physicians Group (THPG), a Texas non-profit organization certified by the Texas Medical Board pursuant to Section 162.001(b) of the Texas Occupations Code that consists of approximately 940 employed physicians and advanced practice providers in more than 210 locations throughout north central Texas, and Texas Health Recovery and Wellness Center (THRW), a rehabilitation center located in Mansfield, Texas. THPG and THRW have been recognized as exempt from federal income taxes under the Code as organizations described in Section 501(c)(3).

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**1. Organization**, continued

THR and some of its controlled affiliates participate in joint ventures with physicians and non-physicians to operate hospitals and other health related ventures. The following table provides the location of the joint venture hospitals along with THR's ownership interest in those hospitals as of December 31, 2018 and 2017:

Hospital	Location (Texas)	2018 Ownership Interest	2017 Ownership Interest
<b>Consolidated:</b>			
AMH Cath Labs, L.L.C. (d/b/a Texas Health Heart & Vascular Hospital Arlington)	Arlington	54.0%	54.0%
Flower Mound Hospital Partners, L.L.C. (d/b/a Texas Health Presbyterian Hospital Flower Mound)	Flower Mound	53.5%	53.5%
Physicians Medical Center, L.L.C. (d/b/a Texas Health Center for Diagnostics & Surgery Plano)	Plano	53.6%	53.5%
Rockwall Regional Hospital, L.L.C. (d/b/a Texas Health Presbyterian Hospital Rockwall)	Rockwall	62.0%	61.8%
Southlake Specialty Hospital, L.L.C. (d/b/a Texas Health Harris Methodist Hospital Southlake)	Southlake	54.2%	54.1%
Texas Health Hospital Frisco <sup>1</sup>	Frisco	51.0%	—
Texas Institute for Surgery, L.L.P. (d/b/a Texas Institute for Surgery at Texas Health Presbyterian Hospital Dallas)	Dallas	50.0%	50.0%
<b>Unconsolidated:</b>			
Texas Health Hospital	Carrollton	51.0%	51.0%
Texas Health Huguley, Inc. (d/b/a Texas Health Huguley Hospital Fort Worth South)	Fort Worth	51.0%	51.0%
Texas Rehabilitation Hospital of Arlington, L.L.C.	Arlington	30.0%	30.0%
Texas Rehabilitation Hospital of Fort Worth, L.L.C.	Fort Worth	30.0%	30.0%
USMD Hospital of Arlington, L.P.	Arlington	51.0%	51.0%
USMD Hospital of Fort Worth, L.P.	Fort Worth	51.0%	51.0%

<sup>1</sup>Estimated to open in 2019

In addition to the hospitals listed above, there are numerous other non-hospital health related joint ventures included in THR's accompanying consolidated financial statements, including outpatient imaging and surgery centers and free-standing emergency rooms. THR does not control the governing bodies of the unconsolidated affiliates.

THR and its tax-exempt controlled affiliates receive support from the Texas Health Resources Foundation (Foundation). The Foundation operates as a non-private foundation exempt from federal income taxes under Section 501(a) of the Code as an organization described in Section 501(c)(3), and THR is the sole corporate member.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**2. Summary of Significant Accounting Policies**

***Basis of Presentation***

The accompanying consolidated financial statements include the accounts of THR, the Foundation, and THR's wholly-controlled affiliates and consolidated joint ventures (collectively, the System). All significant intercompany accounts and transactions have been eliminated in the accompanying consolidated financial statements.

***Use of Estimates***

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

***Cash and Cash Equivalents***

Cash and cash equivalents include cash, money market funds, and governmental or other securities with original maturities of three months or less at the time of purchase, excluding amounts limited as to use by board designation or other arrangements. THR's cash management system provides for daily investment of available balances and the funding of outstanding checks when presented for payment. Outstanding but unrepresented checks totaling \$23,021,000 and \$36,036,000 at December 31, 2018 and 2017, respectively, have been included in accounts payable on the accompanying consolidated balance sheets. Upon presentation for payment, these checks are funded through available cash or cash equivalent balances. The change in outstanding but unrepresented checks is included in cash used in operating activities on the accompanying consolidated statements of cash flows.

***Investments and Investment Income***

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value on the consolidated balance sheets. Realized investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in revenue and gains (less than) in excess of expenses and losses unless the income or loss is restricted by donor or law. Investments in mineral interests, which have limited marketability, are stated at fair value, as estimated based on a multiple of annual revenues. Investments in real estate are stated at fair value, as estimated by private valuations. Investments in private equity and hedge funds are stated at fair value, if readily determinable, or at net asset value as a practical expedient to fair value if the fair value is not readily determinable, as estimated by the general partner of the hedge fund and reviewed by management. Unrealized gains and losses on investments are excluded from revenue and gains (less than) in excess of expenses and losses unless the investments are trading securities. Management reviews individual securities to determine whether a decline in fair value below the amortized cost basis is other than temporary. If the decline in fair value is judged to be other than temporary, the cost basis of the individual security is written down to fair value as a new cost basis and the amount of the write-down is included in realized investment gains or losses in the consolidated statements of operations and changes in net assets. To determine whether a decline is other than temporary, management considers whether it has the ability and intent to hold the investment until a market price recovery, which may be maturity, and whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary.

The System invests in various securities. Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility risks. Due to the level of risk associated with certain investment securities, it is reasonable to assume that changes in the values of investment securities will occur in the near term and that such changes could be material to the accompanying consolidated financial statements.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**2. Summary of Significant Accounting Policies**, continued

***Split-Interest Agreements***

The System has received as contributions various types of split-interest agreements, including charitable gift annuities, charitable remainder unitrusts and perpetual trusts held by a third party. Under charitable gift annuity arrangements for which the System is the trustee of the assets, the System records the assets at fair value and the liabilities to the beneficiaries at the present value of the estimated future payments to be distributed by the System to such beneficiaries. The amount of the contribution is the difference between the asset and the liability and is recorded as unrestricted revenue, unless otherwise restricted by the donor. Subsequent changes to the annuity liability are recorded as changes in value of split-interest agreements in the appropriate net asset class.

Under charitable remainder unitrust arrangements for which the System is the trustee of the assets, the System records the present value of the residual interest in the trust as donor-restricted contributions in the period in which the trust is established. The assets held in trust are recorded at fair value when received, and the liabilities to the beneficiaries are recorded at the present value of the estimated future payments to be distributed by the System to such beneficiaries. The amount of the contribution is the difference between the asset and the liability and is recorded as support with donor restrictions. Subsequent changes in fair value for charitable remainder unitrusts are recorded as changes in value of split-interest agreements in the appropriate net asset class.

Under perpetual trusts held by a third-party arrangement, the System records contribution revenue and an asset when it is notified of the trust's existence. The fair value of the contribution is measured at the present value of the estimated future cash receipts from the trust's assets, and that value may generally be measured by the fair value of the assets contributed to the trust, unless facts and circumstances indicate that the fair value of the assets contributed to the trust differs from the present value of the expected future cash flows. Distributions from the trust are reported as investment income in the appropriate net asset class. Adjustments to the amount reported as an asset, based on periodic review, are recognized as net unrealized gains or losses on investments in the net assets with donor restrictions class.

Under the charitable gift annuity arrangements and charitable remainder unitrust arrangements for which the System is not the trustee of the assets, the System records a receivable and contribution revenue at the present value of the estimated future distributions expected to be received by the System over the expected term of the agreement. However, if an unrelated third-party has variance power to redirect the benefits to another organization or if the System's rights to the benefits are conditional, the System does not recognize its potential for future distributions from the asset held by the trustee.

The discount rates and actuarial assumptions used in calculating present values have been based on IRS guidelines and actuarial tables. For agreements in which the System is the trustee, the discount rates used are commensurate with the risks involved at the time the contributions are initially recognized and are not subsequently revised. For agreements in which the System is not the trustee, under Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958-30, *Not-for-Profit Entities Split-Interest Agreements*, and the guidance as provided in the *AICPA Audit and Accounting Guide, Not-for-Profit Organizations*, net expected cash flows are revalued to fair value at each year-end using a current risk-free rate of return, which ranged from 2.51% to 3.02% and 2.20% to 2.74% for the years ended December 31, 2018 and 2017, respectively.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
December 31, 2018 and 2017

**2. Summary of Significant Accounting Policies, continued**

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

Effective January 1, 2018, THR adopted the new revenue recognition standard, Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, issued by the FASB in 2014, using the modified retrospective method. With the adoption of the new revenue recognition standard, net patient service revenue is reported at the amount that reflects the consideration to which THR expects to be entitled in exchange for providing patient care. Healthcare services promised in the contract with a patient represent a bundle of goods and (or) services that is distinct and accounted for as a single performance obligation. The transaction price for the bundled goods and (or) services provided is estimated by reducing the total standard charges by variable price concessions, including contractual adjustments based on the terms provided by (in the case of Medicare and Medicaid) or negotiated with (in the case of managed care and commercial insurance companies) third-party payors, THR discount policies, and other implicit price concessions based on historical collections experience for uninsured and under-insured patients who do not qualify for financial assistance. A portfolio approach by major payor categories and types of service was used to estimate the historical collections experience. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to net patient service revenue in the period of the change. Portfolio collection estimates are updated at least quarterly based on actual collections experience. THR believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach was used. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

Under THR's financial assistance policy, the Tax-Exempt Hospitals, THRW, and THPG provide care to patients without charge or at amounts less than their established rates if the patient meets certain established criteria. The consolidated joint venture hospitals and healthcare entities have similar financial assistance policies, or have adopted the THR financial assistance policy. As the System does not pursue collection of amounts determined to qualify as financial assistance, those amounts are not reported as net patient service revenue or patient accounts receivable.

Revenue related to providing care to patients is recognized as the performance obligation is satisfied over the period of time the patient is receiving treatment, as the patient is simultaneously receiving and consuming the benefits provided by THR. The performance obligation is generally satisfied over an average period of less than five days for inpatient services and one day for outpatient services. Generally, patients and third-party payors are billed within days after the services are performed and (or) the patient is discharged. The transaction price related to unsatisfied or partially unsatisfied performance obligations at the end of the reporting period primarily relate to inpatient acute care services for patients who remain admitted at that time (in-house patients). These contract assets were \$37,668,000 on January 1, 2018 at the adoption of the new revenue recognition standard. As of December 31, 2018, contract assets of \$38,520,000 were recorded in patient accounts receivable on the consolidated balance sheet.

Patient accounts receivable is reported at the amount that reflects the consideration to which THR expects to be entitled in exchange for providing patient care. The primary collection risks relate to uninsured patient accounts, including patient accounts for which the primary insurance company has paid the amounts covered by the applicable agreement, but patient responsibility amounts remain outstanding. Implicit price concessions relate primarily to amounts due directly from patients based upon management's assessment of historical write-offs and expected net collections considering business and economic conditions, trends in health care coverage, and other collection indicators. Patient accounts are monitored and, if necessary, past due accounts are placed with collection agencies in accordance with guidelines established by management. Accounts are written off when all reasonable internal and external collection efforts have been performed. Estimated implicit price concessions of \$379,437,000 were recorded as reductions to patient accounts receivable at December 31, 2018 on the consolidated balance sheets.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
December 31, 2018 and 2017

**2. Summary of Significant Accounting Policies, continued**

***Accounts Receivable and Net Patient Service Revenue, continued***

Prior to January 1, 2018 and the adoption of the new revenue recognition standard, net patient service revenue was recognized as services were provided and reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments were accrued on an estimated basis in the period the related services were rendered and adjusted in future periods as final settlements were determined.

Patient accounts receivable was reported net of estimated allowances for doubtful accounts and contractual adjustments on the consolidated balance sheets. The allowance and resulting provision for bad debts were based upon a combination of the aging of receivables and management's assessment of historical and expected net collections considering business and economic conditions, trends in health care coverage, and other collection indicators for each of its major payor sources of revenue. Management assessed the adequacy of the allowance for doubtful accounts based upon historical write-off experience and payment trends by payor category. For receivables associated with services provided to patients who had third-party coverage, the System analyzed contractually due amounts and provided an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments, or for payors who were known to be having financial difficulties that made the realization of amounts due unlikely). For receivables associated with self-pay patients (which included both patients without insurance and patients with deductible and copayment balances due for which third-party coverage existed for part of the bill), the System recorded a significant provision for bad debts in the period of service on the basis of its past experience, which indicated that many patients were unable or unwilling to pay the portion of their bill for which they were financially responsible. The difference between the billed rates and the amounts actually collected after all reasonable collection efforts were exhausted was charged off against the allowance for doubtful accounts.

The System's allowance for doubtful accounts for self-pay patients (including allowances for financial assistance) was 97.5% of self-pay accounts receivable at December 31, 2017. In addition, the System's self-pay write-offs for bad debts were approximately \$368,000,000 for the year ended December 31, 2017. The System did not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors.

***Assets Limited as to Use***

The System maintains certain assets that are limited as to use under board designation, indenture agreements, donor restriction, and other provisions. Amounts required to fund current liabilities of the System have been classified as current assets on the consolidated balance sheets.

***Property and Equipment***

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated statements of operations and changes in net assets. 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.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
December 31, 2018 and 2017

**2. Summary of Significant Accounting Policies, continued**

***Property and Equipment, continued***

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support and are excluded from revenue and gains (less than) in excess of expenses and losses unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

***Goodwill and Intangible Assets***

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized. The System reviews goodwill annually, or more frequently if circumstances warrant a more timely review, to determine if there has been an impairment. FASB ASC Topic 350, *Intangibles—Goodwill and Other (ASC 350)*, provides an entity the option to first assess qualitative factors to determine whether the existence of events or circumstances indicates that it is more likely than not that the fair value of a reporting unit is less than its carrying amount or that indefinite-lived assets are impaired. If, after assessing the totality of events and circumstances, an entity determines it is more likely than not that the fair value of the reporting unit is less than its carrying amount or that the indefinite-lived intangible asset is impaired, then the entity is required to perform the two-step goodwill impairment test described in ASC 350 or determine the fair value of the indefinite-lived intangible asset and perform a quantitative impairment test by comparing the fair value with the carrying amount. However, if an entity concludes otherwise, no further action is required. For the years ended December 31, 2018 and 2017, the System prepared a qualitative assessment of goodwill and indefinite-lived intangible assets impairment for all reporting units that have assigned goodwill and indefinite-lived intangible assets. No impairment was identified for the year ended December 31, 2018, and an impairment of \$56,000 related to the closure of specific physician practices was identified for the year ended December 31, 2017.

A summary of goodwill activity for the years ended December 31, 2018 and 2017 is presented below (dollars in thousands):

	<u>2018</u>	<u>2017</u>
Balance at beginning of year	\$ 141,571	\$ 145,629
Impairment of goodwill	—	(56)
Amortization of goodwill - consolidated joint venture	<u>(4,002)</u>	<u>(4,002)</u>
Balance at end of year	<u>\$ 137,569</u>	<u>\$ 141,571</u>

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**2. Summary of Significant Accounting Policies**, continued

***Asset Retirement Obligations***

The System recognizes a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. This applies to legal obligations to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The fair value of a liability for a legal obligation associated with the retirement of long-lived assets is recognized in the period in which it is incurred. The fair value, which approximates the cost a third party would incur in performing the tasks necessary to retire such assets, is recognized at the present value of expected future cash flows and is added to the carrying value of the associated asset and depreciated over the asset's useful life. The liability is accreted over time and is reduced upon settlement of the obligation.

***Impairment or Disposal of Long-Lived Assets***

When events or changes in circumstances indicate that the carrying amount of long-lived assets, including property and equipment, or other long-lived assets, may not be recoverable, an evaluation of the recoverability of currently recorded costs is performed. When an evaluation is performed, the estimated value of undiscounted future net cash flows associated with the assets is compared to the assets' carrying value to determine if a write-down to fair value is required.

If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. Long-lived assets to be disposed of are reflected at the lower of either their carrying amounts or their fair value less costs to sell or close. In such circumstances, estimates of fair value are based on independent appraisals, established market prices for comparable assets, or internal calculations of estimated discounted future cash flows.

***Physician Income Guarantees***

Consistent with its policy on physician relocation and recruitment, THR hospitals provide income guarantee agreements to certain non-employed physicians who agree to relocate to its communities to fill a need in the hospital's service area and commit to remain in practice there. Under such agreements, THR hospitals are required to make payments to the physicians in excess of the amounts they earn in their practice up to the amount of the income guarantee. The income guarantee periods are typically 12 months, but are occasionally negotiated for longer periods of time if obstacles to the physician's startup are anticipated. Such payments plus interest are recoverable from the physicians if they do not fulfill their obligation to practice full-time in the community and maintain active privileges at the recruiting hospital for typically three years subsequent to the guarantee period. At December 31, 2018, the maximum potential amount of future payments under these guarantees was \$7,801,000.

At December 31, 2018 and 2017, THR had a liability of \$2,575,000 and \$2,110,000, respectively, for the fair value of guarantees entered into, with a corresponding asset recorded in other current assets on the consolidated balance sheets, which will be amortized over the commitment period.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**2. Summary of Significant Accounting Policies**, continued

***Donor-Restricted Gifts***

Unconditional promises to give cash and other assets to THR and its tax-exempt controlled affiliates are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as net assets with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, donor-restricted net assets are reclassified as net assets without donor restrictions and reported in the accompanying consolidated statements of operations and changes in net assets as net assets released from restrictions and other operating revenue.

***Net Assets with Donor Restrictions***

Net assets with donor restrictions are those whose use by THR and its tax-exempt controlled affiliates have been limited by donors to a specific time period or purpose. Net assets with donor restrictions that are perpetual in nature have been restricted by donors to be maintained by THR and its tax-exempt controlled affiliates in perpetuity.

***Revenue and Gains (Less Than) in Excess of Expenses and Losses***

The consolidated statements of operations and changes in net assets include revenue and gains (less than) in excess of expenses and losses. Changes in net assets without donor restrictions excluded from revenue and gains (less than) in excess of expenses and losses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), and other items required by GAAP to be reported separately.

***Self-Insurance***

Under THR's self-insurance programs, claims are reflected as liabilities based upon actuarial estimation, including both reported and incurred but not reported claims, taking into consideration the severity of the incidents and the expected timing of claim payments.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
December 31, 2018 and 2017

**2. Summary of Significant Accounting Policies, continued**

***Recent Accounting Pronouncements – Adopted***

Effective January 1, 2018, THR adopted, FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, using the modified retrospective method. The core principle of the guidance in this ASU is that an entity should 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. Adoption of ASU 2014-09 resulted in changes to the presentation and disclosure of revenue related to uninsured or underinsured patients. Prior to the adoption of ASU 2014-09, a significant portion of the provision for bad debts related to self-pay patients, as well as co-pays and deductibles owed by patients with insurance. Under ASU 2014-09, the estimated uncollectible amounts due from these patients are generally considered implicit price concessions that are a direct reduction to net patient service revenues and, correspondingly, result in a material reduction in the amounts presented separately as provision for bad debts. Management used a portfolio approach to apply the new model to classes of payors with similar characteristics and analyzed cash collection trends over an appropriate collection look-back period depending on the payor. Management also assessed the impact of the new standard on various reimbursement programs that represent variable consideration and concluded that accounting for these programs under the new standard is substantially consistent with THR's historical accounting practices. While the adoption of ASU 2014-09 had a material impact on the presentation of net patient service revenue in the consolidated statements of operations and changes in net assets and impacted certain disclosures, it did not materially impact THR's financial position, results of operations, or cash flows.

Effective January 1, 2018, THR also adopted FASB issued ASU 2018-15, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract*, which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software and hosting arrangements that include an internal use software license. The amendments in the ASU require an entity in a hosting arrangement that is a service contract to capitalize certain implementation costs as an asset in the same line item that a prepayment for the fees of the associated hosting arrangement would be presented on the consolidated balance sheets, and expense those costs over the term of the hosting arrangement in the same line item as the fees associated with the hosting element (service) of the arrangement in the consolidated statements of operations and changes in net assets. The adoption of the ASU on a prospective basis beginning January 1, 2018 did not have a material impact on the consolidated financial statements.

For the annual period ending December 31, 2018, THR adopted ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, which requires not-for-profit entities to report two classes of net assets, as well as enhanced disclosures about board designated funds, liquidity, and functional expenses. In connection with the adoption, the opening net assets previously reported for fiscal year 2017 have been reclassified. "Unrestricted" net assets of \$5,853,468,000, "Temporarily restricted" net assets of \$98,676,000, and "Permanently restricted" net assets of \$72,520,000 have been reclassified to net assets "Without donor restrictions" of \$5,853,468,000 and "With donor restrictions" of \$171,196,000.

For the annual period ending December 31, 2018, THR early adopted ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*, which eliminated and (or) modified certain disclosures about recurring and nonrecurring fair value measurements for nonpublic entities.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
December 31, 2018 and 2017

**2. Summary of Significant Accounting Policies, continued**

***Recent Accounting Pronouncements – To Be Adopted***

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which significantly modifies the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under current GAAP. While the new standard retains most of the principles of the existing lessor model, it aligns many of those principles with the FASB's new revenue guidance (ASU 2014-09). Under ASU 2016-02, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach, which includes a number of optional practical expedients. In July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842): Targeted Improvements*, which allows lessees and lessors to recognize and measure leases at the beginning of the period of adoption without modifying the comparative period financial statements. Management has evaluated the impact of the provisions of ASU 2016-02, as amended by ASU 2018-01, ASU 2018-11, and ASU 2018-20, which are effective for THR beginning January 1, 2019, and intends to use the retrospective method as of the period of adoption and elect a number of the optional practical expedients. Upon adoption, THR expects to record a material amount of right-of-use assets, representing the present value of future lease payments under leases with terms greater than twelve months. THR also expects to record corresponding liabilities for the same amount. THR does not expect to make any material cumulative adjustments to the opening balance of net assets. Management continues to gather lease contracts and abstract key financial data to calculate and record the right-of-use assets and obligations.

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*, which clarifies and improves current guidance about whether a transfer of assets is a contribution or an exchange transaction and requires entities to determine whether a contribution is conditional based on clarified indicators. The amendments in ASU 2018-08 should be applied using a modified prospective approach. Management has evaluated the impact of this guidance, which is effective for THR beginning January 1, 2019, and concluded the adoption will not impact the consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which makes targeted improvements to the measurement and disclosure of financial assets and financial liabilities, especially equity investments and other financial instruments, liabilities resulting from instrument-specific credit risk, and valuation allowances for deferred tax assets. Management is evaluating all of the provisions of this ASU, as amended by ASU 2018-03, *Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which is effective for THR for the annual period ending December 31, 2019, and does not expect the adoption of this guidance to have a material impact on 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*, which applies to all entities that are required to present a statement of cash flows under Topic 230. ASU 2016-15 addresses the presentation and classification of cash flows related to (i) debt prepayment or debt extinguishment costs, (ii) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, (iii) contingent consideration payments made after a business combination, (iv) proceeds from the settlement of insurance claims, (v) proceeds from the settlement of corporate-owned life insurance policies (including bank-owned life insurance policies), (vi) distributions received from equity method investees, (vii) beneficial interests in securitization transactions, and (viii) separately identifiable cash flows and application of the predominance principle. The amendments in ASU 2016-05 should be applied using a retrospective transition method to each period presented, unless it is impracticable. Management is currently evaluating the potential impact of this guidance, which is effective for THR for the annual period ending December 31, 2019, and does not expect the adoption of this guidance to have a material impact on the statement of cash flows.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
December 31, 2018 and 2017

**2. Summary of Significant Accounting Policies, continued**

***Recent Accounting Pronouncements – To Be Adopted, continued***

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which requires that a statement of cash flows explain the change during the period in the total of cash and cash equivalents, which will now include restricted cash and restricted cash equivalents in the beginning and ending balances on the statement of cash flows. The ASU is effective for THR for the annual period ending December 31, 2019, and the adoption will result in a change to the beginning and ending balances of cash and cash equivalents reported on the statement of cash flows. Under the new guidance, these balances will include cash and cash equivalents included in assets limited as to use which are currently excluded.

***Reclassifications***

Certain reclassifications have been made to the December 31, 2017 financial statements to conform to the December 31, 2018 presentation. The reclassifications had no effect on revenue and gains (less than) in excess of expenses and losses or net assets as previously reported. Previously, commercial payors were presented separately in certain disclosures related to net patient service revenue (footnote 3) and concentrations of credit risk (footnote 15), but now are presented combined with managed care and other.

**3. Net Patient Service Revenue**

The System has agreements with third-party payors that provide for payments at amounts different from established rates. A summary of the payment arrangements with major payors follows:

***Medicare.*** Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient non-acute services, outpatient services, and certain capital and medical education costs related to Medicare beneficiaries are paid based on a combination of prospective and cost reimbursement methodologies or fee schedule. The hospitals are reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the hospitals and audits thereof by the Medicare fiscal intermediary.

***Medicaid.*** Inpatient services rendered to Medicaid program beneficiaries are reimbursed under a prospectively determined system similar to Medicare. Most outpatient services are reimbursed by the Medicaid program under a cost reimbursement methodology or fee schedule. The hospitals are reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the hospitals and audits thereof by the Medicaid fiscal intermediary.

***Managed Care and Other Commercial.*** The System has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the System under these arrangements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates. Items such as high cost drugs and implants are sometimes paid as an add-on to prospectively determined rates. All of these payment methods can occur independently or in combination for different commercial agreements.

***Private Pay.*** The Tax-Exempt Hospitals and THRW provide self-pay price concessions to uninsured patients. The pricing is calculated by applying a discount to charges for services received. The price concession was 45% in 2018 and 2017. The consolidated and unconsolidated joint venture hospitals and THPG also provide similar discounted pricing to uninsured patients.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**3. Net Patient Service Revenue**, continued

Medicare and Medicaid cost report settlements are estimated in the period services are provided to the program beneficiaries. These estimates are revised as needed until final settlement of the cost report. Laws and regulations governing the Medicare and Medicaid programs are extremely 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. Net patient service revenue increased approximately \$12,643,000 and \$9,048,000 in 2018 and 2017, respectively, due to reassessment of settlement issues and other changes in estimates related to final settlements.

The System recognizes patient service revenue associated with a bundle of goods and (or) services provided to patients over the period of time the patient is receiving treatment or as the performance obligation is satisfied. Based on historical experience, a significant portion of the System's uninsured patients will be unable or unwilling to pay for the services provided; thus, the System records a significant uninsured price concession and (or) financial assistance related to uninsured patients in the period the services are provided. For uninsured patients that do not qualify for financial assistance, the System recognizes revenue using the "expected value" method for the bundle of goods and (or) services provided.

Patient service revenue, net of all price concessions for the year ended December 31, 2018, and net of contractual discounts (but before the provision for bad debts) for the year ended December 31, 2017, disaggregated by major payor sources, is as follows (dollars in thousands):

	<u>2018</u>	<u>2017</u>
Medicare	\$ 802,081	\$ 800,992
Medicare managed care	590,186	543,048
Medicaid	140,532	104,050
Medicaid managed care	180,338	132,770
Managed care and other commercial	2,811,863	3,101,556
Private pay	26,739	111,598
	<u>\$ 4,551,739</u>	<u>\$ 4,794,014</u>

The estimated percentage of patient service revenue, net of all price concessions for the year ended December 31, 2018, disaggregated by major service line, is as follows (dollars in thousands):

	<u>2018</u>
Inpatient	48%
Outpatient	39
Physician	10
Other	3
	<u>100%</u>

**4. Section 1115 Waiver**

In late 2011, the Texas Health and Human Services Commission (HHSC) implemented a five-year demonstration program, the Texas Healthcare Transformation and Quality Improvement Program: Section 1115 Waiver Program (Waiver Program), which was approved by the Centers for Medicare & Medicaid Services (CMS). The Waiver Program provides for two pools of supplemental Medicaid funding: an uncompensated care (UC) pool and a delivery system reform incentive payment (DSRIP) pool. Both the UC and DSRIP programs have been extended through September 30, 2022 and September 30, 2021, respectively. THR (through certain wholly controlled tax-exempt and joint venture hospitals) participates in both the UC pool and DSRIP pool in Tarrant, Dallas, Collin, and Johnson counties.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
December 31, 2018 and 2017

**4. Section 1115 Waiver, continued**

The UC pool of the Waiver Program helps eligible hospitals and certain other providers offset a portion of their unreimbursed costs for services already provided to Medicaid patients and uninsured persons. During 2018 and 2017, THR, on behalf of its participating hospitals, recorded UC pool supplemental Medicaid revenue of \$113,077,000 and \$83,827,000, respectively, included in net patient service revenue in the accompanying consolidated statements of operations and changes in net assets. At December 31, 2018 and 2017, THR had a receivable of \$23,353,000 and \$17,280,000, respectively, related to the UC pool recorded in other receivables, net on the consolidated balance sheets.

The DSRIP pool of the Waiver Program provides funding distributed as incentive payments to be earned by facilities for initiating and performing projects that benefit the community and help redesign the overall healthcare delivery system to improve access, quality, and efficiency. Hospitals receive funding for reaching predetermined, CMS-approved metrics for each project. In year one of the program, facilities that chose to participate received incentive payments for submitting acceptable project plans that would span the five years of the initially-approved Waiver Program. For years two through six of the program, providers continued to receive DSRIP pool funding by meeting the project metrics and reporting achievement to HHSC. Beginning in year seven of the program, providers earned payments by meeting entity level metrics chosen from a menu of standardized metrics. THR recorded DSRIP revenue of \$35,523,000 and \$37,251,000 for the years ended December 31, 2018 and 2017, respectively, included in other operating revenue in the accompanying consolidated statements of operations and changes in net assets. At December 31, 2018 and 2017, THR had a receivable of \$22,718,000 and \$22,229,000, respectively, related to the DSRIP pool recorded in other receivables, net on the accompanying consolidated balance sheets. CMS and HHSC have purview over project achievement and initiate regular audits to ensure DSRIP project metrics are met in accordance with the requirements set forth by the agencies. At December 31, 2018 and 2017, \$1,386,000 and \$4,430,000, respectively, was recorded in other accrued liabilities on the accompanying consolidated balance sheets as a reserve for possible adjustments resulting from such compliance audits.

During the course of the Waiver Program, CMS has reviewed funding arrangements in certain geographic areas of the State of Texas to ensure the Waiver Program is in compliance with the provider-related donation prohibitions in federal law. On June 9, 2015, CMS acknowledged in writing in response to an HHSC inquiry that the longstanding public-private collaborative funding model arrangements in Texas could continue without risk of disallowance of federal financial participation matching funds, provided that HHSC worked with CMS to redesign certain components of Waiver Program financing prior to September 2017. However, in September 2016, CMS subsequently disallowed federal financing participation matching funds for the fourth quarter of 2015 in the Dallas and Tarrant markets, as noted below.

Funding for THR related to the participation of certain wholly controlled tax-exempt and joint venture hospitals in the Waiver Program results from the Tarrant County Hospital District (TCHD) d/b/a JPS Health Network (JPS) and Dallas County Hospital District (DCHD) d/b/a Parkland Health & Hospital System (Parkland) providing intergovernmental transfers to HHSC as the state share, which is then matched by federal funds. It is within the sole discretion of JPS and Parkland to make, or not make, intergovernmental transfers to HHSC as the state share. In a letter to HHSC dated September 1, 2016, CMS disallowed federal matching funds totaling \$26,845,000 for the quarter ended December 31, 2015, of which \$7,306,000 is THR's disallowed federal match portion. CMS alleged that the private hospitals participating in these affiliations failed to comply with the federal provider-related donation requirements. HHSC sought reconsideration of CMS' disallowance and subsequently appealed to the Department of Health and Human Services' Departmental Appeals Board (DAB). On August 7, 2018, the DAB ruled in favor of CMS. As a result of the DAB's unfavorable decision, all UC pool Waiver Program payments made to THR using this funding mechanism could be at risk. HHSC is expected to appeal the unfavorable ruling to federal district court, if necessary. It is too early to predict the ultimate outcome of the litigation or its possible financial impact; however, management believes THR is adequately reserved and does not anticipate a material financial impact. Total payments received by THR using this funding mechanism from inception of the program through December 31, 2018 were \$554,552,000.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
December 31, 2018 and 2017

**4. Section 1115 Waiver, continued**

On March 1, 2018, THR began participation in the Uniform Hospital Rate Increase Program (UHRIP). UHRIP is designed to offset a portion of unreimbursed Medicaid costs through managed care payments made to providers to enhance care coordination and access to care for Medicaid managed care patients. Intergovernmental transfers from non-state governmental entities are used to support capitation payment increases for the Dallas and Tarrant service delivery areas (SDA) and other SDAs in the state that choose to participate in the program. Each managed care organization (MCO) within the SDAs is contractually required by the State to increase hospital payment rates by a specified percentage for all of its public and private contracted hospitals. The increased payments from MCOs to hospitals for inpatient and outpatient services are based on the utilization and delivery of those services by the hospitals to the Medicaid managed care members enrolled with that MCO. Payments are made according to a letter of agreement between the hospitals and the MCOs, which contains payment terms that are substantially similar to the regular MCO claims payment processes and deadlines. In addition, the UHRIP program has a Quality Incentive Fund component to incentivize providers to improve the quality of patient care and contain costs. THR recorded UHRIP revenue of \$42,262,000 for the year ended December 31, 2018, included in net patient service revenue in the accompanying consolidated statements of operations and changes in net assets. At December 31, 2018, \$7,120,000 was recorded in other accrued liabilities on the accompanying consolidated balance sheets as a reserve for possible settlements or potential adjustments related to this program.

In June 2017, the 85th Texas Legislature enacted legislation to authorize TCHD and DCHD to establish and administer a local health care provider participation program (LPPF). The purpose of this program is to generate local revenue from a mandatory payment fee on nonpublic entities that can be used to fund certain intergovernmental transfers for securing reimbursement in Medicaid supplemental payment programs for fiscal year 2018, including UC and UHRIP. By the terms of the respective LPPF enabling statutes, the fee on nonpublic entities cannot exceed 6% of net patient revenue. The mandatory payment fee must be consistent with CMS rules regarding provider taxes, which stipulates the fee must be broad-based and uniform, and there is no hold harmless guarantee from the sponsoring governmental entity. Upon payment of the mandatory fee, funds are considered restricted and included as assets whose use is limited until funds are used for their intended purpose, Medicaid supplemental payments to eligible hospitals. In a letter to HHSC dated December 20, 2018, CMS opined the mandatory payment fee met the broad-based and uniformity requirements and did not constitute a hold harmless arrangement.

In October 2017, THR, Baylor Scott and White, Healthcare Corporation of America, Methodist Health System, Children's Health System, and Cook Children's Medical Center formed the Dallas Safety Net Service Corporation (DSNSC) and (or) the Tarrant Safety Net Service Corporation (TSNSC). The DSNSC and TSNSC are organized to operate as charitable organizations exclusively for charitable purposes within the meaning of Section 501(c)(3) of the Code. The purpose of DSNSC and TSNSC is to operate exclusively for the benefit of, to perform the function of, or to carry out the exempt purposes of hospitals that are located within Dallas and Tarrant counties, respectively, by promoting high-quality and cost-effective healthcare services to low-income individuals and encouraging community benefit program participation of hospitals. This includes the provision of grants from time to time to Dallas and Tarrant hospitals supporting the provision of cost effective healthcare services to low-income individuals.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**4. Section 1115 Waiver, continued**

As of December 31, 2018 and 2017, \$104,903,000 and \$64,468,000, respectively, was recorded in assets whose use is limited on the accompanying consolidated balance sheets related to payments of the LPPF mandatory assessment, and \$84,792,000 and \$49,920,000, respectively, was recorded in other accrued liabilities on the accompanying consolidated balance sheets related to accrued LPPF mandatory assessment and intergovernmental transfer payments. Additionally, THR recorded LPPF and other program expenses, related to both the UC and UHRIP programs of \$83,804,000 and \$21,099,000 for the years ended December 31, 2018 and 2017, respectively, included in other operating expenses in the consolidated statements of operations and changes in net assets.

**5. Financial Assistance and Community Benefit**

In accordance with its mission, the System commits substantial resources to sponsor a broad range of services for the indigent as well as the broader community. Community benefit provided to the indigent includes the cost of providing services to persons who cannot afford health care due to inadequate resources and (or) to persons who are underinsured. This category of community benefit, in accordance with Texas law, includes the unreimbursed costs of traditional financial assistance as well as the estimated unreimbursed costs of care provided to beneficiaries of Medicaid and other indigent public programs. The System also benefits the communities it serves by providing facilities for the education and training of health care professionals and by participating in research activities that offer the potential of improving health care.

The System promotes access to health care services by providing support for indigent care clinics, promoting community health education and wellness programs, supporting other local community based non-profit organizations through charitable donations, and sponsoring a variety of health-related support groups and programs. These activities are classified as community benefit under Texas law.

The System provides care to patients who meet criteria established under its financial assistance policy without charge or at amounts less than their established rates. As the System does not pursue collection of amounts determined to qualify as financial assistance, they are not reported as net patient service revenue. When the System does not have the information required to properly determine financial status, the amounts owed by these individuals are classified as a price concession in 2018 or bad debt expense in 2017. The System estimates costs associated with financial assistance was \$324,013,000 and \$300,670,000 for the years ended December 31, 2018 and 2017, respectively, applying the ratio of cost to gross charges. The System receives certain funds to offset or subsidize financial assistance provided from gifts or grants restricted for financial or indigent care. The amount of such funds recognized in unrestricted operations from such sources totaled \$502,000 and \$354,000 for the years ended December 31, 2018 and 2017, respectively.

THR (through certain wholly controlled tax-exempt and joint venture hospitals), Baylor Health Care System, HCA North Texas Division, and Methodist Hospitals of Dallas created Dallas County Indigent Care Corporation (DCICC), and Tarrant County Indigent Care Corporation (TCICC), both Texas non-profit corporations, to provide joint community benefit programs and services. DCICC entered into agreements with The University of Texas Southwestern Medical Center (UTSW) to provide services to patients in Dallas County. The term of the agreement with UTSW ended September 30, 2017 and DCICC decided not to renew. TCICC entered into agreements with various provider groups to provide professional healthcare services to indigent persons in Tarrant County. TCICC assigned all of the contracts to TCHD effective September 30, 2017.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**5. Financial Assistance and Community Benefit**, continued

In 2013, THR (through certain wholly controlled tax-exempt hospitals) began participating in similar community benefit programs in other counties. These include: Johnson County, through the Johnson County Community Care Corporation (JCCCC), which has entered into contracts with healthcare providers to pay for the care of indigent county residents; Collin County, where THR has entered into a contract with Primamed Physicians Association to pay for the care of indigent county residents; and Denton County to provide hospital care for indigent county residents. The contracts with JCCCC and Collin County were discontinued effective September 30, 2018, and the contract with Denton County was discontinued effective December 31, 2018.

During 2018 and 2017, THR, on behalf of its participating hospitals, recorded expense of \$677,000 and \$42,070,000, respectively, representing disbursements made for services listed above through DCICC, TCICC, JCCCC, and Collin and Denton Counties for providing services to indigent patients.

**6. Investments**

***Short-Term Investments***

The composition of short-term investments at December 31, 2018 and 2017 is set forth in the following table (dollars in thousands):

	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 299	\$ 674
U.S. government securities	1,191	—
Fixed income securities	5,703	7,514
Equity securities	82	87
	<u>\$ 7,275</u>	<u>\$ 8,275</u>

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**6. Investments**, continued

***Assets Limited as to Use***

Assets limited as to use that are required for obligations classified as current liabilities are included in current assets in the consolidated balance sheet. The composition of assets limited as to use at December 31, 2018 and 2017 is set forth in the following table (dollars in thousands):

	<b>2018</b>	<b>2017</b>
Internally designated:		
Cash and cash equivalents	\$ 112,779	\$ 137,006
Fixed income securities	1,722,051	1,527,676
Equity securities	2,646,245	3,000,133
Mutual funds	5,494	631
Other alternative investments	21,600	14,979
Donor-restricted special purpose and endowment funds:		
Cash and cash equivalents	1,608	1,236
Fixed income securities	45,764	46,710
Equity securities	85,696	95,683
Mineral interests	2,357	2,890
Real estate	18	18
Other alternative investments	—	71
Beneficial interest in perpetual trust, held in charitable remainder unitrusts, and held in charitable gift annuities:		
Cash and cash equivalents	498	392
Fixed income securities	1,055	1,677
Equity securities	12,125	7,873
Mutual funds	—	5,422
Hedge funds	—	152
Mineral interests	615	655
Real estate	876	876
Other provisions:		
Cash and cash equivalents	28,199	101,664
Fixed income securities	30,434	39,598
Equity securities	9,734	9,644
	4,727,148	4,994,986
Less: Assets limited as to use required for current liabilities	(471,438)	(504,341)
	\$ 4,255,710	\$ 4,490,645

Excluded from the above table are internally designated restricted cash held for use related to LPPF mandatory payments (see footnote 4) of \$104,903,000 and \$64,468,000 at December 31, 2018 and 2017, respectively, and promises to give of \$17,137,000 and \$9,882,000 at December 31, 2018 and 2017, respectively. Both the internally designated restricted cash and the promises to give are included in assets limited as to use on the accompanying consolidated balance sheets.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**6. Investments**, continued

***Assets Limited as to Use***, continued

These promises to give are comprised of the following at December 31, 2018 and 2017 (dollars in thousands):

	<u>2018</u>	<u>2017</u>
Unconditional promises to give before unamortized discount and allowance for uncollectibles	\$ 18,626	\$ 10,088
Less: Unamortized discount	<u>(1,162)</u>	<u>(83)</u>
	17,464	10,005
Less: Allowance for uncollectibles	<u>(327)</u>	<u>(123)</u>
Net unconditional promises to give	<u>\$ 17,137</u>	<u>\$ 9,882</u>
Schedule of future amounts due:		
Less than one year	\$ 6,356	\$ 4,979
One to five years	8,116	3,428
Over five years	<u>4,154</u>	<u>1,681</u>
Total	<u>\$ 18,626</u>	<u>\$ 10,088</u>

Discount rates for these promises to give ranged from 1.01% to 2.98% and from 1.19% to 1.80% for the years ended December 31, 2018 and 2017, respectively.

THR and its wholly-controlled affiliates participate in a pooled, long-term investment fund administered by THR. Amounts internally designated represent THR and its wholly-controlled affiliates' pro rata share of the fund. These funds exist to provide liquidity for the System, to support its capital program, and to backstop short-term reserves as a buffer against interruption of business operations due to catastrophic events. The fund's asset allocation is a reflection of the System's investment objectives as stated in its investment policy statement. Prior to July 16, 2012, the fixed income securities in the pool, which are primarily U.S. government obligations, were designated as other-than-trading securities while the equity securities were designated as trading. As a result of modifications to THR's investment policy statement effective July 16, 2012, all purchases of fixed income securities in the pool after this date are designated as trading securities.

Management evaluates THR and its wholly-controlled affiliates' fixed income securities purchased prior to July 16, 2012 to determine whether any are deemed to be other-than-temporarily impaired due to credit worthiness of the bond issuers. There were no securities deemed to be other-than-temporarily impaired at December 31, 2018 or 2017.

At December 31, 2018, the fair value and gross unrealized losses on THR and its wholly-controlled affiliates' fixed income securities that were purchased prior to July 16, 2012 and have been in a continuous unrealized loss position for twelve months or greater were \$34,523,000 and \$436,000, respectively. Because THR has the ability and intent to hold these investments until a market price recovery, which may be maturity, these investments are not considered other-than-temporarily impaired.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**6. Investments**, continued

***Investment Income***

Net realized investment income and gains in the consolidated statements of operations and changes in net assets, is comprised of the following for the years ended December 31, 2018 and 2017 (dollars in thousands):

	<u>2018</u>	<u>2017</u>
Interest and dividends	\$ 90,639	\$ 75,655
Realized gains, net	<u>214,622</u>	<u>208,761</u>
Total net realized investment income	305,261	284,416
Less: Net realized investment income and gains related to restricted funds	<u>(5,530)</u>	<u>(5,534)</u>
Net realized investment income, other than amount related to restricted funds	<u>\$ 299,731</u>	<u>\$ 278,882</u>

**7. Liquidity and Availability**

The System's financial assets available for general expenditures within one year of December 31, 2018 and 2017 are as follows (dollars in thousands):

	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 442,765	\$ 435,168
Short-term investments	7,275	8,275
Patient accounts receivable	559,813	532,595
Other receivables, net	123,616	110,818
Assets limited as to use - board-designated	4,486,569	4,665,446
Other current assets	<u>143,597</u>	<u>144,267</u>
	<u>\$ 5,763,635</u>	<u>\$ 5,896,569</u>

The System board-designated assets limited as to use are designated for future capital expenditures and operating reserves, but could be made available, if necessary, for general expenditures within the next year. Accordingly, these assets have been included in the above table. The System has other assets limited as to use for donor-restricted purposes, debt service, professional and general liability captive insurance program, and other restricted purposes of \$341,019,000 and \$388,911,000 at December 31, 2018 and 2017, respectively, that are not available for general expenditures within the next year and are not reflected in the amounts above. Additionally, the System has certain board-designated assets limited as to use with time horizons greater than one year of \$21,600,000 and \$14,979,000 at December 31, 2018 and 2017, respectively, that are not reflected in the amounts above. See footnote 6 for the composition of assets limited as to use.

As part of the System's liquidity management plan, cash balances in excess of daily requirements are invested in short-term investments. Additionally, the System maintains \$150 million in lines of credit, as discussed in more detail in footnote 9. At December 31, 2018 and 2017, \$150 million remained available on the System's lines of credit; however, the available lines of credit are not reflected in the amounts above.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**8. Property and Equipment**

A summary of property and equipment at December 31, 2018 and 2017 is as follows (dollars in thousands):

	<u>2018</u>	<u>2017</u>
Land	\$ 171,806	\$ 170,234
Buildings and improvements	2,383,382	2,314,068
Fixed equipment	579,000	553,522
Major movable equipment	1,174,519	1,159,541
Building and equipment under capital lease obligations	<u>3,538</u>	<u>576</u>
	4,312,245	4,197,941
Less: Accumulated depreciation and amortization	<u>(2,467,884)</u>	<u>(2,318,000)</u>
	1,844,361	1,879,941
Construction and renovation in progress	<u>264,039</u>	<u>109,533</u>
Property and equipment, net	<u>\$ 2,108,400</u>	<u>\$ 1,989,474</u>

Depreciation and amortization expense related to property and equipment for the years ended December 31, 2018 and 2017 was \$232,333,000 and \$226,274,000, respectively. Included in the above table is the cost, \$423,579,000 and \$403,348,000, and accumulated depreciation, \$228,560,000 and \$205,702,000, of property and equipment held out for lease at December 31, 2018 and 2017, respectively.

The System has several construction projects in progress, which include renovation and modernization of existing facilities and construction of new facilities. Total remaining estimated costs of these projects is \$614,488,000, of which the System has outstanding commitments of \$249,467,000 at December 31, 2018. Total interest capitalized during the years ended December 31, 2018 and 2017 was \$2,868,000 and \$1,419,000, respectively.

Asset retirement obligations related to asbestos removal are recorded as other noncurrent liabilities on the accompanying consolidated balance sheets and totaled \$7,047,000 and \$7,341,000 at December 31, 2018 and 2017, respectively. As a result of changes in estimated costs to abate certain types of asbestos, the System recorded decreases to the liability and an increase in asbestos abatement expenses of \$313,000 and \$148,000 during the years ended December 31, 2018 and 2017, respectively. Depreciation expense related to the associated assets was \$30,000 in 2018 and 2017. Additional accretion costs were \$326,000 and \$318,000 for the years ended December 31, 2018 and 2017, respectively.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**9. Long-Term Debt**

A summary of long-term debt at December 31, 2018 and 2017 is as follows (dollars in thousands):

	<u>2018</u>	<u>2017</u>
System Revenue Bonds (Texas Health Resources), Series 2017A and 2017B, variable interest rates, due through 2051, (interest rates ranged from 1.67% to 1.73% and 1.25% to 1.27% at December 31, 2018 and 2017, respectively)	\$ 133,470	\$ 133,470
System Revenue Bonds (Texas Health Resources), Series 2016A fixed interest rates of 2.25% to 5.00%, due through 2047	631,105	631,105
System Revenue Bonds (Texas Health Resources), Series 2015 (Taxable), fixed interest rate of 4.33%, due through 2055	300,000	300,000
System Revenue Bonds (Texas Health Resources), Series 2015A fixed interest rates of 4.25% and 5.00%, due through 2052	60,000	60,000
System Tax-Exempt Loan (Texas Health Resources), The Northern Trust Company Private Loan, variable interest rates, due through 2033, (interest rate was 2.07% and 1.41% at December 31, 2018 and 2017, respectively)	67,500	67,500
System Tax-Exempt Loan (Texas Health Resources), UMB Bank, N.A. Private Loan, variable interest rates, due through 2035, (interest rate was 2.21% and 1.58% at December 31, 2018 and 2017, respectively)	66,475	66,780
System Revenue Bonds (Texas Health Resources), Series 2012A (Taxable), fixed interest rate of 4.366%, due through 2047	100,000	100,000
System Revenue Bonds (Texas Health Resources), Series 2012B, variable interest rates, due through 2047 (interest rates were 1.66% and 1.20% at December 31, 2018 and 2017, respectively)	50,000	50,000
System Revenue Bonds (Texas Health Resources), Series 2010, fixed interest rate of 5.00%, due through 2040	157,550	157,550
System Revenue Bonds (Texas Health Resources), Series 2008A, 2008B, and 2008C, variable interest rates, due through 2033, (interest rates ranged from 1.66% to 1.79% at December 31, 2018, and 1.20% to 1.22% at December 31, 2017)	149,180	149,180
Term and Revolving Loans (Rockwall Regional Hospital, L.L.C.), fixed and variable interest rates, due through 2023, (interest rates ranging from 2.63% to 4.13% and 2.56% to 3.52% at December 31, 2018 and 2017, respectively)	29,646	32,066
Term and Revolving Loans (Flower Mound Hospital Partners, L.L.C.), fixed and variable interest rates, due through 2022, (interest rates ranging from 3.06% to 3.81% and 2.24% to 3.46% at December 31, 2018 and 2017, respectively)	71,672	77,836
Term and Revolving Loans (AMH Cath Labs, L.L.C.), variable interest rates, due through 2021, (interest rates ranging from 3.15% to 3.55% and 2.16% to 2.56% at December 31, 2018 and 2017, respectively)	16,492	17,360
Term Loan (Health Imaging Partners, LLC), fixed interest rate of 3.87%, due through 2020	3,689	7,860
Notes Payable (Health Imaging Partners, LLC), varying rates of interest, due through 2024, (interest rates ranging from 3.60% to 5.71% and 3.60% to 5.24% at December 31, 2018 and 2017, respectively)	5,224	6,200

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
December 31, 2018 and 2017

**9. Long-Term Debt, continued**

	<b>2018</b>	<b>2017</b>
Capital Lease Obligations, collateralized by leased equipment, at an imputed interest range rate of 0.00% to 5.00% at December 31, 2018 and 2017	2,960	145
Other loans and notes payable, fixed and variable interest rates, due through 2032 (interest rates ranging from 2.01% to 5.00% and 2.01% to 4.00% at December 31, 2018 and 2017, respectively)	35,669	37,189
	1,880,632	1,894,241
Add:		
Unamortized original issue premium/discount, net	66,689	69,630
Less:		
Costs of issuance	(11,327)	(11,665)
Current portion of long-term debt	(350,104)	(351,226)
Long-term debt, net of current portion	\$ 1,585,890	\$ 1,600,980

THR issued variable rate demand bonds, Series 2017A (Series 2017A Bonds) and 2017B (Series 2017B Bonds) bonds (collectively, the Series 2017 Bonds) through the Tarrant County Cultural Education Facilities Finance Corporation (official statement dated October 11, 2017) in the amount of \$133,470,000. The proceeds of the Series 2017 Bonds were used to (a) refund the Tarrant County Cultural Education Facilities Finance Corporation Texas Health Resources System Refunding Revenue Bonds, Series 2007B, (b) finance and (or) refinance the costs of acquisition, construction, renovation, remodeling and (or) equipping of capital improvements, and (c) pay certain expenses incurred in connection with the issuance of the Series 2017 Bonds. The Series 2017 Bonds are tax-exempt variable rate demand bonds, and are as such subject to periodic tender and remarketing provisions. The interest rates at which the bonds are remarketed are determined in accordance with the remarketing agreement applicable to the Series 2017 Bonds. Liquidity for payment of the Series 2017 Bonds tendered for purchase and not remarketed is provided by THR under a self-liquidity program. As a result, THR has classified the Series 2017 Bonds as a current liability in the current portion of long-term debt. Actual scheduled principal repayment dates range from 2048 – 2051.

THR issued Series 2016A bonds (Series 2016A Bonds) through Tarrant County Cultural Education Facilities Finance Corporation (official statement dated October 5, 2016) in the amount of \$631,105,000. The proceeds of the Series 2016A Bonds were used to (a) refund a portion of the Tarrant County Cultural Education Facilities Finance Corporation Texas Health Resources System Refunding Revenue Bonds, Series 2007A, (b) finance and (or) reimburse certain capital projects of THR, and (c) pay costs of issuance of the Series 2016A Bonds.

THR issued Series 2015 Taxable (Series 2015 Taxable Bonds) and 2015A (Series 2015A Bonds) bonds (collectively, the Series 2015 Bonds) through Tarrant County Cultural Education Facilities Finance Corporation (official statements dated April 28 and May 6, 2015) in the amounts of \$300,000,000 and \$60,000,000, respectively. The proceeds of the Series 2015 Bonds were used (a) to finance and (or) reimburse certain capital projects of THR, (b) to pay costs of issuance of the Series 2015 Bonds, and (c) for other eligible corporate purposes.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**9. Long-Term Debt**, continued

Effective July 31, 2015, THR refinanced tax-exempt advancing term loan agreements (Bank Loans) with Kansas City Financial Corporation, an affiliate of UMB Bank, N.A. (UMB) and The Northern Trust Company (Northern). The UMB bank loan was issued for \$67,375,000 with a final maturity date of September 1, 2035, and an optional tender date of July 31, 2030. The Northern bank loan was issued for \$67,500,000 with a final maturity date of December 1, 2033, and a mandatory tender date of July 31, 2025. The Bank Loans bear interest at variable rates calculated as a percentage of LIBOR plus a spread. The refinanced notes were effective November 2010 with Bank of America, N.A. and Compass Mortgage Corporation in the aggregate principal amount of \$135,000,000. The proceeds of these Bank Loans were used to (a) pay costs of acquiring, constructing, renovating, remodeling and (or) equipping capital improvements for certain THR tax-exempt health facilities and (b) pay certain costs incurred in connection with the issuance of the Bank Loans.

THR issued variable rate demand bonds, Series 2012A (Series 2012A Bonds) and 2012B (Series 2012B Bonds) bonds (collectively, the Series 2012 Bonds) through the Tarrant County Cultural Education Facilities Finance Corporation (official statements dated September 27, 2012) in the amounts of \$100,000,000 and \$50,000,000, respectively. The proceeds of the Series 2012 Bonds were used to (a) finance and reimburse THR for the costs of the acquisition, construction, renovation, remodeling and (or) equipping of capital improvements and (b) pay certain costs incurred in connection with the issuance of the Series 2012 Bonds. The Series 2012B Bonds are tax-exempt variable rate demand bonds, and are as such subject to periodic tender and remarketing provisions. The interest rates at which the bonds are remarketed are determined in accordance with the remarketing agreement applicable to the Series 2012B Bonds. Liquidity for payment of the Series 2012B Bonds tendered for purchase and not remarketed is provided by THR under a self-liquidity program. As a result, THR has classified the Series 2012B Bonds as a current liability in the current portion of long-term debt. Actual scheduled principal repayment dates range from 2041 – 2047.

In December 2012, THR entered into credit agreements with Wells Fargo Bank, N.A. and U.S. Bank N.A. for lines of credit of \$75,000,000 each bearing interest at a variable rate calculated as a percentage of LIBOR plus a spread. In December 2017, the U.S. Bank agreement was amended to extend the term date to December 31, 2020. At December 31, 2018 and 2017, there were no outstanding balances.

THR issued Series 2010 bonds (the Series 2010 Bonds) through the Tarrant County Cultural Education Facilities Finance Corporation (official statement dated November 11, 2010) in the amount of \$157,550,000. The proceeds of the Series 2010 Bonds were used to (a) refund the Tarrant County Cultural Education Facilities Finance Corporation Texas Health Resources System Revenue Bonds, Series 2008D, 2008F, and 2008G; and (b) pay certain costs incurred in connection with the issuance of the Series 2010 Bonds and the provisions for payment of the refunded Series 2008D, 2008F, and 2008G Bonds.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
December 31, 2018 and 2017

**9. Long-Term Debt, continued**

THR issued variable rate demand bonds, Series 2008A-G bonds (the Series 2008 Bonds) through the Tarrant County Cultural Education Facilities Finance Corporation (official statement dated October 27, 2008) in the amount of \$366,120,000. The proceeds of the Series 2008 Bonds were used to (a) refund the Tarrant County Health Facilities Development Corporation Texas Health Resources System Revenue Bonds, Series 2003 (the Series 2003 Bonds) and the Plano Health Facilities Development Corporation Unit Priced Demand Adjustable Revenue Bonds (Children's and Presbyterian Healthcare Center of North Texas Project) Series 1989 (the Series 1989 Bonds), (b) finance or refinance the purchase, development, construction, reconstruction, renovation, rehabilitation, and (or) equipping of certain THR tax-exempt health facilities, and (c) pay certain costs incurred in connection with the issuance of the Series 2008 Bonds and the provisions for payment of the refunded Series 2003 and Series 1989 Bonds. As previously discussed, THR defeased all of the outstanding Series 2008D, 2008F, and 2008G Bonds in the aggregate principal amount of \$153,925,000 in November 2010, with proceeds from the issuance of the Series 2010 Bonds. In addition, THR redeemed all of the outstanding Series 2008E Bonds on November 22, 2010 at a purchase price equal to the principal amount of \$36,140,000 thereof plus interest accrued thereon to the redemption date. THR used available cash to redeem the Series 2008E Bonds. In May 2015, THR remarketed the Series 2008C Bonds, converting them from a daily to a weekly rate and converting the liquidity provision from a Standby Bond Purchase Agreement (SBPA) to self-liquidity. On October 17, 2017, THR used available cash to redeem a portion of the outstanding Series 2008A, 2008B, and 2008C Bonds in the aggregate principal amount of \$26,875,000 plus interest accrued through the redemption date.

The Series 2008 Bonds are subject to periodic tender and remarketing provisions. The interest rates at which the bonds are remarketed are determined in accordance with the remarketing agreement applicable to each series of the Series 2008 Bonds. Liquidity for payment of the outstanding Series 2008 Bonds tendered for purchase and not remarketed is provided by THR under a self-liquidity program. As a result, THR has classified these series as current liabilities in the current portion of long-term debt. Actual scheduled principal repayment dates range from 2027 – 2033.

Concurrent with the issuance of the Series 1997 Bonds and amended in connection with the issuance of the Series 2008, Series 2012, Series 2015 Bonds, Series 2016A Bonds, and Series 2017 Bonds, THR entered into the Second Amended and Restated Master Trust Indenture (the Master Indenture). Among other requirements, THR granted a security interest in (a) certain of its revenue (as defined in the Master Indenture) and accounts receivable of the grantor, (b) all money and investments held or required to be held for the credit of the funds and accounts established by or under the Master Indenture, and (c) any and all property that may, from time to time, be subjected to the lien and security interest of the Master Indenture.

In April and May 2007, at THR's request, Tarrant County Cultural Education Facilities Finance Corporation issued \$597,840,000 of Refunding Revenue Bonds and \$100,000,000 of Revenue Bonds, Series 2007A and 2007B, respectively. The proceeds of the Series 2007A Bonds were used to (a) provide payment of principal, redemption premium, and interest to redemption or maturity on \$366,985,000 outstanding Series 1997A Bonds, \$157,090,000 outstanding Series 1997B Bonds, and \$68,745,000 outstanding Series 1997C Bonds, and (b) pay certain costs incurred in connection with the issuance of the Series 2007A Bonds and the provisions for the refunded bonds. In November 2016, THR refunded a portion of the outstanding Series 2007A Bonds from the issuance of the Series 2016A Bonds with the remaining refund in February 2017 at principal of \$22,235,000 plus premium and accrued interest. The proceeds of the sale of the Series 2007B Bonds were used to (a) pay or reimburse THR for the costs of acquiring, constructing, renovating, remodeling, and (or) equipping capital improvements for THR and its tax-exempt controlled affiliates, and (b) pay certain costs incurred in connection with the issuance of the Series 2007B Bonds. As previously discussed, in October 2017, THR refunded the Series 2007B Bonds outstanding principal balance of \$100,000,000 from the issuance of the Series 2017 Bonds, plus premium and accrued interest, resulting in a gain on extinguishment of long-term debt of \$2,098,000 for the year ended December 31, 2017.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**9. Long-Term Debt**, continued

On December 21, 2010, Rockwall Regional Hospital, L.L.C. (Rockwall) entered into a credit agreement (the Rockwall Agreement) with JPMorgan Chase Bank N.A. (Chase). The Rockwall Agreement provided Rockwall with a Real Estate Term Loan of \$42,000,000 and an Equipment Term Loan of \$13,000,000 bearing interest at one-, two-, or three-month LIBOR plus 1.95%, and also provided a Revolving Loan Commitment of \$5,000,000 to be used as working capital. On April 26, 2013, the Rockwall Agreement was amended to add an Improvement Loan of \$5,150,000. On March 31, 2016, Rockwall refinanced its Real Estate Term Loan and Equipment Term Loan, as well as amended and restated the Revolving Loan Commitment, all included in the Rockwall Agreement, by entering into a new credit agreement with Chase (the 2016 Rockwall Agreement). The 2016 Rockwall Agreement provides Rockwall with a term loan of \$36,302,000 (previously the Real Estate Term Loan and Equipment Term Loan), comprised of a fixed rate term loan of \$25,550,000 bearing interest at 3.52% and a variable rate term loan of \$10,752,000 bearing interest at one-, two-, three-, or six-month LIBOR plus 1.75%. The amount outstanding on the term loan at December 31, 2018 and 2017 was \$29,646,000 and \$32,066,000, respectively. The 2016 Rockwall Agreement amended and restated the \$5,000,000 Revolving Loan Commitment with a commitment fee of 0.20% bearing interest at a variable rate of LIBOR plus 1.75%. The original maturity date of September 30, 2016 was later extended to September 30, 2020 per the Third Amendment to the 2016 Rockwall Agreement. There was no outstanding balance on the Revolving Loan Commitment at December 31, 2018 and 2017.

On February 28, 2008, Flower Mound Hospital Partners, L.L.C. entered into a Credit Agreement (the Flower Mound Agreement) with various lending institutions with JP Morgan Chase Bank, N.A. acting as agent for the lenders for an Advancing Term Loan Commitment of \$105,000,000 and a Revolving Loan Commitment of \$20,000,000, later reduced to \$1,000,000. On July 18, 2014, the Flower Mound Agreement was amended to provide additional term loans of \$11,280,000, comprised of a \$7,896,000 fixed rate term loan bearing interest at 3.46% and a \$3,384,000 variable term loan bearing interest at LIBOR plus 1.43%. Amounts outstanding on the additional term loans as of December 31, 2018 and 2017 were \$8,084,000 and \$8,836,000, respectively. On December 22, 2015, the Flower Mound Agreement was amended and restated to provide a term loan of \$81,176,000, comprised of a \$57,400,000 fixed rate term loan bearing interest at 3.32% and a \$23,776,000 variable rate term loan bearing interest at one-, two-, three-, or six-month LIBOR plus 1.43%. The amount outstanding on the term loan at December 31, 2018 and 2017 was \$63,588,000 and \$69,000,000, respectively. Additionally, there were no amounts outstanding related to the Revolving Loan commitment as of December 31, 2018 and 2017.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
December 31, 2018 and 2017

**9. Long-Term Debt, continued**

On December 28, 2011, AMH Cath Labs, L.L.C. (ACL) entered into three loan agreements with Bank of America, N.A., (collectively, the ACL Agreements). The ACL Agreements are secured by the THR guaranty (discussed below) as well as the revenues and substantially all the assets of ACL. The first agreement provides ACL with a ten-year floating rate Service Line Term Loan of \$15,300,000 bearing interest at LIBOR plus a credit spread. The credit spread at inception of the loan was at the maximum rate of 1.30%; however, the spread can be reduced to 1.15% if ACL's Funded Debt to EBITDA ratio declines to specific agreed upon levels. The interest rate at December 31, 2018 was 3.55%, with balances outstanding of \$11,628,000 and \$12,240,000 as of December 31, 2018 and 2017, respectively. The second agreement provides ACL with a seven-year floating rate Equipment Term Loan of \$6,400,000 bearing interest at LIBOR plus a credit spread. The credit spread at inception of the loan was at the maximum rate of 0.90%; however, the spread can be reduced to 0.75% if ACL's Funded Debt to EBITDA ratio declines to specific agreed upon levels. The original maturity date of January 1, 2019 was later extended to January 1, 2022 per the Second Amendment to the Equipment Term Loan agreement dated January 2, 2019. The interest rate at December 31, 2018 was 3.15%, with balances outstanding of \$4,864,000 and \$5,120,000 as of December 31, 2018 and 2017, respectively. The third agreement provides ACL with a five-year floating rate Revolving Line of Credit of \$10,000,000, which was amended to reduce the amount of available funding to \$2,000,000 and extend the maturity date to January 1, 2022. The Revolving Line of Credit bears interest at LIBOR plus a credit spread. The credit spread at inception of the loan was at the maximum rate of 0.90%; however, the spread can be reduced to 0.80% if ACL's Funded Debt to EBITDA ratio declines to specific agreed upon levels. The Revolving Line of Credit can be priced at daily LIBOR, one-, three-, six-, nine- or twelve-month LIBOR plus the applicable credit spread. There were no balances outstanding on the Revolving Line of Credit as of December 31, 2018 and 2017.

On December 22, 2011, ACL entered into Interest Rate Swap Agreements (collectively, the ACL Swap Agreements) with Bank of America, N.A., with respect to the Service Line Term Loan and Equipment Term Loan. These swaps are intended to reduce the financial risk related to rising LIBOR interest rates by executing a cash flow hedge that will convert the floating rate exposure to a synthetic fixed rate. ACL accounts for these interest rate swap agreements as cash flow hedges in accordance with FASB ASC Topic 815, *Derivatives and Hedging*, which requires entities to recognize all derivative instruments as either assets or liabilities on the consolidated balance sheets at their respective fair values and the effective portion of the gain or loss on the derivative as changes in fair value of interest rate swap agreements in net assets without donor restrictions and reclassified into earnings in the same period or periods during which earnings are affected by the variability in cash flows of the designated hedged item. Gains or losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in revenues and gains in excess of expenses and losses.

ACL will discontinue hedge accounting prospectively when it is determined that the derivative is no longer effective in offsetting cash flows or the hedged item, the derivative expires or is sold, terminated, or exercised, or the derivative designation is removed, and subsequent changes in its fair value are recorded in revenues and gains in excess of expenses and losses. When it is probable that a forecasted transaction will not occur, ACL discontinues hedge accounting and recognizes immediately any gains and losses that were accumulated in other changes in net assets without donor restrictions.

While the associated swaps are outstanding, the Service Line Term Loan and the Equipment Term Loan will be priced at one-month LIBOR plus the applicable credit spread mentioned in the paragraphs above. The fixed rate on the Service Line Term Loan hedge is 2.0025%, with a start date of December 28, 2011 and ending date of January 1, 2022. The fixed rate on the Equipment Term Loan hedge is 1.6470%, with a start date of December 28, 2011 and ending date of January 1, 2019. The swap maturity was not extended in conjunction with the refinancing of the Equipment Term loan discussed above. The fair value of the interest rate swap agreements at December 31, 2018 and 2017 was \$144,000 and \$53,000, respectively, and included in other assets, net on the accompanying consolidated balance sheets.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**9. Long-Term Debt**, continued

In December 2013, Health Imaging Partners, LLC (HIP) entered into a Senior Secured Credit Facility with KeyBank National Association (the Credit Facility). The Credit Facility provides HIP with a seven-year fixed rate Term Loan of \$28,500,000 bearing interest at 3.87%. The amount outstanding on the Term Loan at December 31, 2018 and 2017 was \$3,689,000 and \$7,860,000, respectively.

Scheduled principal repayments on long-term debt are as follows (dollars in thousands):

<u>Year Ending December 31,</u>	<u>Scheduled Principal Payments</u>	<u>Principal Based on Liquidity Provisions</u>
2019	\$ 17,454	\$ 350,104
2020	11,949	11,949
2021	17,302	17,302
2022	65,332	65,332
2023	21,638	21,638
Thereafter	<u>1,746,957</u>	<u>1,414,307</u>
Total	<u>\$ 1,880,632</u>	<u>\$ 1,880,632</u>

Unamortized bond and debt issuance costs at December 31, 2018 and 2017 were \$11,327,000 and \$11,665,000, respectively, and are included as a component of long-term debt on the accompanying consolidated balance sheets.

The Master Indenture, Bank Loans and Credit Agreements contain various covenants which require, among other things, the maintenance of certain financial ratios and certain other restrictions. Management believes THR is in compliance with its covenants as of December 31, 2018.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**10. Net Assets**

Net assets with donor restrictions at December 31, 2018 and 2017 were held for the following purposes (dollars in thousands):

	<u>2018</u>	<u>2017</u>
Subject to expenditure for specific purpose:		
Patient care	\$ 17,589	\$ 19,506
Research and education	13,961	13,588
Capital improvements	26,270	16,394
Community outreach	5,181	6,331
Other restricted purposes	<u>3,761</u>	<u>5,711</u>
	<u>66,762</u>	<u>61,530</u>
Subject to the System spending policy and appropriation:		
Endowments, including corpus restricted in perpetuity of \$60,859 and \$59,091 at December 31, 2018 and 2017, respectively, which, once appropriated, is expendable to support:		
Patient care	16,287	17,911
Research and education	56,290	61,330
Capital improvements	5,213	6,070
Community outreach	4,257	4,523
Other restricted purposes	<u>2,497</u>	<u>2,735</u>
	<u>84,544</u>	<u>92,569</u>
Subject to appropriation and expenditure when a specified event occurs:		
Beneficial interest in perpetual trusts to provide proceeds when distributed by the trustee	12,208	13,429
Split-interest agreements that will provide proceeds at termination	2,578	3,231
Paid-up life insurance policy that will provide proceeds upon death of insured for capital improvements	<u>417</u>	<u>437</u>
	<u>15,203</u>	<u>17,097</u>
Total net assets with donor restrictions	<u>\$ 166,509</u>	<u>\$ 171,196</u>

Net assets were released from donor restrictions by incurring the following expenses for the years ended December 31, 2018 and 2017, respectively, satisfying the restricted purposes specified by donors (dollars in thousands):

	<u>2018</u>	<u>2017</u>
Patient care	\$ 1,738	\$ 1,717
Research and education	4,963	6,101
Capital improvements	6,658	5,310
Community outreach	4,226	2,691
Other restricted purposes	<u>934</u>	<u>832</u>
	<u>\$ 18,519</u>	<u>\$ 16,651</u>

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
December 31, 2018 and 2017

**10. Net Assets, continued**

Net assets without donor restrictions at December 31, 2018 and 2017 are as follows (dollars in thousands):

	<b>2018</b>	<b>2017</b>
Undesignated	\$ 5,737,702	\$ 5,738,466
Quasi-endowment	62,004	65,694
Board-designated for research and education	49,209	49,308
	\$ 5,848,915	\$ 5,853,468

**11. Endowment**

The System's endowments consist of donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. Net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Based on the interpretation of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) by the Board of Trustees, the guidance in FASB ASC 958-205, *Not-for-Profit Entities Presentation of Financial Statements*, and absent explicit donor stipulations to the contrary, the System classifies the original value of gifts donated to the permanent endowment, as well as accumulations to the permanent endowment made at the direction of the donor or by policy, as net assets with donor restrictions until appropriated for expenditure by the System in a manner consistent with the standard of prudence prescribed in UPMIFA.

In accordance with UPMIFA, the System considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the Foundation and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the Foundation
- (7) The investment policies of the Foundation

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**11. Endowment**, continued

Changes in the System's invested endowment assets for the years ended December 31, 2018 and 2017 are as follows (dollars in thousands):

	<b>Without Donor Restrictions</b>	<b>With Donor Restrictions</b>	<b>Total Endowment Funds</b>
Balance at December 31, 2016	\$ 58,075	\$ 93,165	\$ 151,240
Contributions collected	—	153	153
Interest and dividends	724	1,455	2,179
Realized and unrealized gains, net	7,099	12,321	19,420
Amounts appropriated for expenditure	(204)	(2,768)	(2,972)
Balance at December 31, 2017	65,694	104,326	170,020
Contributions collected	—	229	229
Interest and dividends	867	1,527	2,394
Realized and unrealized losses, net	(4,042)	(6,604)	(10,646)
Amounts appropriated for expenditure	(515)	(2,825)	(3,340)
Balance at December 31, 2018	<u>\$ 62,004</u>	<u>\$ 96,653</u>	<u>\$ 158,657</u>

From time to time, the fair value of assets associated with an individual donor-restricted endowment fund may fall below the original value of the fund. In accordance with GAAP, deficiencies of this nature are reported in unrestricted net assets and were insignificant as of December 31, 2018. There were no deficiencies of this nature as of December 31, 2017.

The System has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Under this policy, the endowment assets are invested in securities and other instruments which complement or balance one another, thereby reducing risk without significantly reducing average returns.

To satisfy its long-term rate-of-return objectives, the System relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The System targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

The System has spending policies that allow up to 4% of the endowment to be appropriated for expenditure unless otherwise stipulated in the donor agreement, calculated after the endowment principal has been increased by the annual Consumer Price Index. This is consistent with the System's objectives to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term, as well as to provide additional real growth.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**12. Non-Controlling Interests**

The System controls and therefore consolidates certain investments in its joint ventures with physicians and non-physicians to operate hospitals and other health related ventures. The activity for non-controlling interests for the years ended December 31, 2018 and 2017 is summarized below (dollars in thousands):

	<u>2018</u>	<u>2017</u>
Non-controlling ownership interest in equity of consolidated affiliates, beginning of year	\$ 120,127	\$ 110,697
Revenue and gains in excess of expenses and losses attributable to non-controlling interest	86,033	83,643
Non-controlling interest in change in fair value of interest rate swap agreements	44	100
Contributions from non-controlling interest holders	3,215	5,508
Distributions to non-controlling interest holders	<u>(89,485)</u>	<u>(79,821)</u>
Non-controlling ownership interest in equity of consolidated affiliates, end of year	<u>\$ 119,934</u>	<u>\$ 120,127</u>

**13. Retirement Plans**

The System has various plans, primarily defined contribution plans, which cover eligible full-time and part-time employees of the System. Plan contributions, included in salaries, wages, and employee benefits in the consolidated statement of operations and changes in net assets, were \$75,312,000 and \$68,142,000 for the years ended December 31, 2018 and 2017, respectively.

**14. Federal and State Income Taxes**

The System has certain subsidiaries and operations such as joint venture interests, retail pharmacies and outside laboratory services that are taxable for federal income tax purposes. On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was signed into law. The Tax Act amends the Code to reduce tax rates and modify policies, credits, and deductions for individuals and businesses. For businesses, the Tax Act makes broad and complex changes to the Code impacting THR, including, but not limited to, (1) reducing the corporate federal tax rate from a maximum of 35% to a flat 21% rate, effective January 1, 2018, (2) implementing a separate calculation for unrelated business taxable income for each trade or business, (3) eliminating tax exemption for interest related to the advance refunding of private activity bonds issued after 2017, and (4) implementing an excise tax on a portion of certain key employee compensation. All of these changes had a minimal impact to THR.

As a result of the reduction in the corporate income tax rate for THR from 34% to 21% under the Tax Act, THR revalued the net deferred tax assets at December 31, 2017, resulting in a reduction in the value of the deferred tax asset of approximately \$261,000 (prior to the valuation allowance). THR accrued \$500,000 related to the excise tax on employee compensation for the year ended December 31, 2018, included in income tax expense in the accompanying consolidated statements of operations and changes in net assets and accounts payable on the accompanying consolidated balance sheets. Other changes resulting from the Tax Act were insignificant. The taxable activities of all includible entities have approximately \$458,000 and \$422,000 in net deferred tax assets, against which a 100% valuation allowance has been recorded, for the years ended December 31, 2018 and 2017, respectively. The change in the deferred tax assets as well as the change in the valuation allowance was recorded in income tax expense in the accompanying consolidated statements of operations and changes in net assets. While the System expects to generate taxable income from certain activities in the future, the valuation allowance has been recorded because the System does not believe taxable income will be incurred by the entities that generated the net deferred tax assets.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**14. Federal and State Income Taxes**, continued

The Texas franchise tax applies to certain of the System's consolidated for-profit and joint venture interests. Under this law, tax is calculated on a margin base and is therefore reflected in the System's statements of operations and changes in net assets as income tax expense.

Federal and state income tax expense of \$5,123,000 and \$4,880,000 is included in the accompanying consolidated statements of operations and changes in net assets for the years ended December 31, 2018 and 2017, respectively.

**15. Concentrations of Credit Risk**

Financial instruments that potentially subject the System to concentrations of credit risk consist of deposits in banks and investments in excess of the Federal Deposit Insurance Corporation, Securities Investor Protection Corporation and other privately insured limits. The System maintains cash and cash equivalents in excess of the federally insured limits at financial institutions with strong credit ratings and has not experienced any credit losses on these financial instruments.

The hospitals and physician practices grant credit without collateral to their patients, most of whom are local residents and are insured under third-party payor agreements. The concentrations of net patient receivables on a percentage basis at December 31, 2018 and 2017 are as follows:

	<u>2018</u>	<u>2017</u>
Medicare	11%	13%
Medicare managed care	13	12
Medicaid	1	1
Medicaid managed care	5	3
Managed care and other commercial	68	69
Private pay	2	2
	<u>100%</u>	<u>100%</u>

**16. Commitments and Contingencies**

Management evaluates contingencies based upon available evidence. In addition, allowances for losses are provided each year for disputed items which have continuing significance. Management believes that allowances for losses have been provided to the extent necessary, and that its assessment of contingencies is reasonable. Due to the inherent uncertainties and subjectivity involved in accounting for contingencies, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. To the extent that the resolution of contingencies results in amounts which vary from management's estimates, future operating results will be charged or credited. The principal commitments and contingencies are described below.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
December 31, 2018 and 2017

**16. Commitments and Contingencies, continued**

***Professional and General Liability Insurance***

The System has known professional and general liability claims and incidents that may result in the assertion of claims, as well as exposure from unknown incidents that may be asserted. In connection with these risks, THR maintains a self-insurance program for the professional and general liabilities of THR and its wholly-controlled affiliates, whereby undiscounted reserves are recorded based on actuarial estimates from an independent third-party actuary. In December 2014, THR formed Grace Indemnity Company, Ltd., a wholly-owned captive insurance company, for the purpose of paying professional and general liability claims. Prior to January 1, 2015, THR maintained trust funds, which held assets for the purpose of paying potential professional and general liability claims, and the System purchased claims-made professional liability coverage from commercial carriers for providers employed by THPG. The System also purchases insurance for professional and general liability claims in excess of THR's self-insurance retention level. The System's consolidated joint ventures each maintain separate professional and general liability insurance programs covering their risks individually. The System's established liability for professional and general liability claims was \$43,267,000 and \$35,019,000 at December 31, 2018 and 2017, respectively, and is recorded in other accrued liabilities and other noncurrent liabilities on the accompanying consolidated balance sheets.

***Workers' Compensation Insurance***

The System purchases workers' compensation insurance from commercial carriers with per claim deductibles and aggregate limits. Accrued claims include estimates for known claims and incidents incurred but not reported at December 31, 2018 and 2017, respectively. The System's established liability for workers' compensation claims was \$3,630,000 and \$4,326,000 at December 31, 2018 and 2017, respectively, and is recorded in other accrued liabilities on the accompanying consolidated balance sheets.

***Employee Health Insurance***

THR maintains a self-insurance medical plan for the employees of THR and its wholly-controlled affiliates. Accrued claims include estimates for known claims and services incurred but not reported at December 31, 2018 and 2017, respectively. The System's consolidated joint ventures each maintain separate employee health insurance programs. The System's established liability for employee health claims was \$23,028,000 and \$20,713,000 at December 31, 2018 and 2017, respectively, and is recorded in accrued salaries, wages, and employee benefits on the accompanying consolidated balance sheets.

***Guarantees of Indebtedness***

The Tax-Exempt Hospitals and ACL guaranteed \$20,337,000 and \$20,710,000 of patient notes purchased by banks at December 31, 2018 and 2017, respectively. The System recorded a contingent liability of \$5,610,000 and \$5,556,000 at December 31, 2018 and 2017, respectively, for these guarantees based on historical default rates.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**16. Commitments and Contingencies**, continued

***Guarantees of Indebtedness***, continued

In February 2013, THR entered into a limited guaranty agreement with JPMorgan Chase Bank, N.A. (JPM) for 51% of any indebtedness outstanding between JPM and USMD Arlington. In September 2015, the limited guaranty agreement for USMD Arlington was amended in conjunction with a debt refinancing to add a maximum guaranty amount of \$24,000,000. In May 2013, THR entered into a limited guaranty agreement with Southwest Bank for 51% of any indebtedness outstanding between Southwest Bank and USMD Fort Worth up to a maximum guaranty amount of \$6,150,000. At December 31, 2018 and 2017, THR's share of principal on USMD Arlington's and USMD Fort Worth's outstanding indebtedness was \$12,274,000 and \$3,041,000, and \$13,276,000 and \$3,343,000, respectively. Payments are due from THR if USMD Arlington or USMD Fort Worth is unable to fulfill its obligations at the scheduled payment dates. As of December 31, 2018, it is not probable that THR will be required to make significant payments under the limited guaranty agreements. No amounts have been recorded in the accompanying consolidated financial statements for these guarantees.

***Litigation***

The System is a party to several legal actions arising in the ordinary course of its business. In management's opinion, the System has adequate legal defenses, insurance coverage, and (or) self-insured retention for each of these actions, and management estimates that these matters will be resolved without material adverse effect on the System's future financial position, results of operations, or cash flows.

***Regulatory Compliance***

The health care industry is subject to numerous laws and regulations of federal, state, and local governments, and compliance can be subject to future review and interpretation as well as the possible emergence of regulatory actions unknown or unasserted at this time. Management believes that the System is in substantial compliance with applicable government laws and regulations. Regulatory inquiries and voluntary reports may be made from time to time. It is management's policy to cooperate fully in resolving any such reports or inquiries.

In May 2013, THR learned sheets of microfiche containing records for patients treated at Texas Health Harris Methodist Hospital Fort Worth from 1980-1990 were not securely handled by the outside vendor with which THR contracted for all of its document destruction. THR has made all legally required notifications of the incident, including letters to the patients involved, a notice posted on THR's public website, and a press release. The Office of Civil Rights has closed this matter; however, to date, the State of Texas has not responded. THR does not anticipate a material financial impact due to this incident.

In March 2015, the System made a disclosure to the Office of Inspector General (OIG) regarding THPG billing of certain PET scan tests and nuclear stress tests that did not meet Medicare medical necessity requirements. Management believes it is too early to predict with certainty the outcome of this matter; however, management does not anticipate a material financial impact.

On January 17, 2018, law enforcement notified THR that information appearing to be from THR email accounts was potentially compromised in October 2017. THR has made all legally required notifications of the incident, including letters to the patients involved, a notice published on the public website of THPG, a wholly-controlled affiliate of THR, and a press release. On October 22, 2018, THR received a closure notification letter from the Office for Civil Rights (OCR). The OCR reviewed documentation submitted by THR and determined no further action was required. All matters were resolved through the voluntary compliance actions of THR and no fines have been levied.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**16. Commitments and Contingencies**, continued

***Regulatory Compliance***, continued

On July 13, 2018, the OIG notified THR and initiated a Hospital Medicare Compliance Review at Texas Health Presbyterian Hospital Dallas to determine whether the hospital complied with Medicare requirements for billing certain inpatient and outpatient services on selected claims from January 1, 2016 through December 31, 2017. Management believes it is too early to predict the outcome of this matter; however, management does not anticipate a material financial impact.

THR's Corporate Compliance Department investigates all compliance matters reported through its compliance program. As of the date of these financial statements, there was no additional pending or, to the knowledge of System management, threatened litigation, including professional liability claims, or reported compliance issues which in the opinion of System management involves any substantial risk of material liability for the System, and where applicable, in excess of available reserves and insurance coverage. In management's opinion, the System does not expect the resolution of any known regulatory compliance matters to have a material adverse effect on the System's future financial position, results of operations, or cash flows.

***Operating Leases***

The System leases various equipment and facilities under operating leases expiring at various dates through 2030. Total rental expense, included in other operating expenses in the consolidated statements of operations and changes in net assets, was \$76,510,000 and \$71,567,000 for the years ended December 31, 2018 and 2017, respectively.

The following is a five-year schedule, by year, of future minimum lease payments under non-cancelable operating leases that have initial terms in excess of one year as of December 31, 2018 (dollars in thousands):

<b>Year Ending December 31,</b>		
2019	\$	47,074
2020		39,613
2021		34,350
2022		30,740
2023		25,124
Thereafter		58,861
	<b>\$</b>	<b>235,762</b>

The System leases office space and land at fair market value to non-THPG physicians, health care related businesses, and others under operating leases expiring at various dates through 2072. Total rental income, included in other operating revenue and other nonoperating gains in the consolidated statements of operations and changes in net assets, was a \$34,839,000 and \$34,709,000 for the years ended December 31, 2018 and 2017, respectively.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

16. **Commitments and Contingencies**, continued

*Operating Leases, continued*

The following is a five-year schedule, by year, of future minimum rental income payments under non-cancelable leases that have initial terms in excess of one year as of December 31, 2018 (dollars in thousands):

<b>Year Ending December 31,</b>	
2019	\$ 26,491
2020	21,984
2021	17,614
2022	13,964
2023	10,191
Thereafter	<u>191,804</u>
	<u><u>\$ 282,048</u></u>

17. **Functional Operating Expenses**

The System provides general and comprehensive health care services to residents within its geographic locations. The table below presents expenses by both nature and function for the years ended December 31, 2018 and 2017 (dollars in thousands):

	<b>2018</b>				
	<b>Patient Care Services</b>	<b>General and Administrative</b>	<b>Research and Education</b>	<b>Fundraising</b>	<b>Total</b>
Salaries, wages, and employee benefits	\$ 2,063,283	\$ 379,712	\$ 7,889	\$ 4,457	\$ 2,455,341
Supplies	780,648	2,830	300	35	783,813
Depreciation and amortization	194,030	44,338	155	52	238,575
Interest expense	53,293	38,823	-	-	92,116
Other operating expenses	615,608	273,123	28,552	1,809	919,092
	<u>\$ 3,706,862</u>	<u>\$ 738,826</u>	<u>\$ 36,896</u>	<u>\$ 6,353</u>	<u>\$ 4,488,937</u>
	<b>2017</b>				
	<b>Patient Care Services</b>	<b>General and Administrative</b>	<b>Research and Education</b>	<b>Fundraising</b>	<b>Total</b>
Salaries, wages, and employee benefits	\$ 2,003,946	\$ 360,699	\$ 9,782	\$ 4,332	\$ 2,378,759
Supplies	774,508	2,612	651	38	777,809
Depreciation and amortization	191,529	40,811	401	56	232,797
Interest expense	52,163	38,616	-	-	90,779
Other operating expenses	590,259	269,904	27,014	1,760	888,937
	<u>\$ 3,612,405</u>	<u>\$ 712,642</u>	<u>\$ 37,848</u>	<u>\$ 6,186</u>	<u>\$ 4,369,081</u>

The financial statements report certain expense categories that are attributable to more than one healthcare service or support function. Therefore, these expenses require an allocation on a reasonable basis that is consistently applied. Costs not directly attributable to a function, including interest and insurance (included in other operating expenses) are allocated to a function based on percentage of property and equipment basis or an appropriate exposure metric, such as percentage of payroll, percentage of insured value, percentage of revenue, and (or) loss history, depending on the type of insurance.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
December 31, 2018 and 2017

**18. Fair Value Measurements**

The System follows the provisions of FASB ASC 820, *Fair Value Measurement*, for its financial assets and liabilities that are measured and reported at fair value each reporting period. The financial assets recorded at fair value on a recurring basis primarily relate to investments, assets limited as to use, interest rate swap agreements, and contributions receivable from split-interest agreements. FASB ASC 820 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

In general, fair values determined by Level 1 inputs utilize unadjusted quoted prices in active markets for identical assets or liabilities. Fair values determined by Level 2 inputs utilize data points that are observable, such as quoted prices, interest rates, and yield curves. Fair values determined by Level 3 inputs utilize unobservable data points for the asset or liability and include situations where there is little, if any, market activity for the asset or liability. The System's assets limited as to use that are categorized as Level 3, or valued using significant unobservable inputs, primarily represent contributions receivable from split-interest agreements and funds primarily holding real estate and mineral interests. The following tables present information about the System's assets and liabilities that are measured at fair value as of December 31, 2018 and 2017, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value (dollars in thousands):

	<u>2018</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<b>Financial Assets:</b>				
Domestic equity securities	\$ 2,023,815	\$ 2,023,815	\$ -	\$ -
International equity securities	270,082	270,082	-	-
Fixed income securities:				
U.S. Government, including agency				
mortgage-backed securities	1,438,052	-	1,438,052	-
Corporate bonds and other	364,699	-	364,699	-
Mutual funds (blended securities)	5,494	639	4,855	-
Texas Methodist Foundation	1,216	-	1,216	-
Real estate	894	-	-	894
Mineral interests	2,972	-	-	2,972
Contributions receivable from				
split-interest agreements	1,403	-	-	1,403
Total investments	\$ 4,108,627	\$ 2,294,536	\$ 1,808,822	\$ 5,269
Held for sale real estate	\$ 19,133	\$ -	\$ 19,133	\$ -
Interest rate swap agreements	\$ 144	\$ -	\$ 144	\$ -

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**18. Fair Value Measurements**, continued

	<u>2017</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<b>Financial Assets:</b>				
Domestic equity securities	\$ 2,246,324	\$ 2,246,324	\$ -	\$ -
International equity securities	293,172	293,172	-	-
Fixed income securities:				
U.S. Government, including agency mortgage-backed securities	1,272,798	-	1,272,798	-
Corporate bonds and other	344,686	-	344,686	-
Mutual funds (blended securities)	6,053	631	5,422	-
Hedge fund	152	-	152	-
Texas Methodist Foundation	1,200	-	-	1,200
Real estate	894	-	876	18
Mineral interests	3,545	-	-	3,545
Contributions receivable from split-interest agreements	1,656	-	-	1,656
Other alternative investments	71	-	71	-
Total investments	\$ 4,170,551	\$ 2,540,127	\$ 1,624,005	\$ 6,419
Held for sale real estate	\$ 8,000	\$ -	\$ 8,000	\$ -
Interest rate swap agreements	\$ 53	\$ -	\$ 53	\$ -

Included in short-term investments and assets limited as to use on the accompanying consolidated balance sheets, but excluded from total investments in the above fair value tables, are \$15,734,000 and \$8,226,000 of pledges receivable, \$2,230,000 and \$4,500,000 of short-term investments not subject to fair value measurement, \$481,586,000 and \$588,894,000 of international equity common collective trust investments and other alternative investments that determined the fair market value of the investments using net asset value as a practical expedient, and \$143,383,000 and \$240,972,000 of cash and cash equivalents recorded at cost or cost plus accrued interest at December 31, 2018 and 2017, respectively. Of the total cash and cash equivalents excluded from the above table, \$51,045,000 and \$87,581,000 relates to residual cash in the allocated fixed income portfolio, and \$60,740,000 and \$49,199,000 relates to residual cash in the allocated equity securities portfolio at December 31, 2018 and 2017, respectively.

Transfers into Level 3 of \$876,000 and out of Level 3 of \$1,200,000 occurred during the year ended December 31, 2018 due to evaluation of information obtained related to the observability of market inputs and valuation methodologies used for these certain investments. There were no transfers into or out of Level 3 during the year ended December 31, 2017.

The following methods and assumptions were used by the System in estimating the fair value of its financial instruments on a recurring and non-recurring basis, as well as financial assets and liabilities stated at a measure other than fair value.

**Equity Securities**

Equity securities held by THR or held in trust controlled by THR are measured using quoted market prices. Equity securities held in trust not controlled by THR are measured using the net asset value of the trust based on the fair value of underlying securities, which are measured using quoted market prices.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**18. Fair Value Measurements**, continued

***Common Collective Trusts***

Investments in common collective trusts may be accessed at any time at the net asset value as reported by the manager on a daily basis. THR's interest in these trusts contains no other rights or obligations. As such, net asset value represents fair value for these investments. Each common collective trust invests in either equity or fixed income securities. The domestic equity common collective trust is an exchange traded collective trust, thus the net asset value of the trust is based on the fair value of the underlying securities, which are measured using quoted market prices.

***Fixed Income Securities***

Fixed income securities are measured using quoted market prices, if available, or estimated using quoted market prices for similar assets.

***Mutual Funds***

Values of investments in mutual funds are based on quoted market prices for publicly traded funds and net asset values for funds that are not publicly traded. THR's interest in these funds contains no other rights or obligations. As such, net asset value represents fair value for these investments. Each fund invests in either equity or fixed income securities.

***Hedge Funds***

Investments in hedge funds are transacted through publicly traded mutual funds. See mutual fund valuation above.

***Texas Methodist Foundation***

The value of the investment in the Texas Methodist Foundation is based on the original investment plus accrued interest as set by the manager of the foundation.

***Real Estate***

Investments in real estate, including real estate held for sale, are measured by private valuations.

***Mineral Interests***

Investments in mineral interests are estimated based on a multiple of annual revenues.

***Contributions Receivable from Split-Interest Agreements***

The fair value of the contribution is measured at the present value of the estimated future cash receipts from the trust's assets.

***Other Alternative Investments***

Where available, fair value is based on observable market prices or parameters, or derived from such prices or parameters. Where observable prices or inputs are not available, valuation models are applied. These valuation models involve some level of management estimation and judgement, the degree of which is dependent on the price transparency for the assets or liabilities or market, and the assets' or liabilities' complexity. The following factors may where relevant be taken into consideration in determining the fair value of such investments: the enterprise value of a portfolio company, the nature and realizable value of any collateral, the portfolio company's ability to make payments and its earnings and discounted cash flows, the markets in which the portfolio company does business, comparisons to publicly traded securities, and changes in the interest rate environment and the credit markets generally that may affect the price at which similar investments may be made and other relevant factors.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
December 31, 2018 and 2017

**18. Fair Value Measurements, continued**

***Interest Rate Swap Agreements***

Current market pricing models are used to estimate fair values of interest rate swap agreements.

**19. Investments in Unconsolidated Affiliates**

THR and its controlled affiliates participate with other organizations, physicians, and non-physicians to provide health care related services. At December 31, 2018, THR and its controlled affiliates own interests in Community Hospice of Texas (Hospice), a provider of hospice services;; Imaging Center Partnership, L.L.P. (d/b/a Southwest Diagnostic Imaging Center) (SDIC), a provider of outpatient diagnostic imaging services; North Central Texas Services (d/b/a CareFlite) (CareFlite), a provider of helicopter, fixed wing and ground ambulance services; North Texas Health Care Laundry Cooperative Association (NTHC Laundry), a provider of laundry services; Southwestern Health Resources Network (SWHR Network), multiple legal entities consisting of a clinically integrated network of physicians, a joint operating company that clinically and financially aligns the operations of the participating hospitals, and a payor relations and quality oversight entity; Texas Health Aetna, a health plan company; Texas Health Huguley, Inc. (d/b/a Texas Health Huguley Hospital Fort Worth South) (Huguley), an acute care hospital; USMD Arlington and USMD Fort Worth, short-stay hospitals; 21 ambulatory surgery centers; one endoscopy center; and other joint ventures.

The ownership interests, carrying values, and equity in earnings of investments in unconsolidated affiliates at December 31, 2018 and 2017 were as follows (dollars in thousands):

	Ownership Interest		Carrying Value		Equity in Earnings	
	2018	2017	2018	2017	2018	2017
Texas Health Aetna	50.0%	50.0%	\$ 114,248	\$ 120,521	\$ (1,274)	\$ 8,221
Surgery centers	51.0% – 77.6%	51.0% – 75.5%	83,649	80,078	55,189	47,410
Huguley	51.0%	51.0%	79,296	68,898	10,398	10,250
USMD Arlington	51.0%	51.0%	35,166	34,501	6,505	10,831
SW HR Network	49.0% – 51.0%	49.0% – 51.0%	33,857	(13,752)	(18,899)	(16,624)
Endoscopy center	51.0%	51.0%	23,911	24,310	9,512	9,476
Hospice	50.0%	50.0%	21,759	23,359	(1,599)	1,802
USMD Fort Worth	51.0%	51.0%	16,418	15,775	1,045	2,097
NTHC Laundry	43.9%	45.6%	6,239	5,878	484	569
CareFlite	50.0%	50.0%	5,971	6,786	(814)	(352)
SDIC	50.0%	50.0%	1,713	1,850	2,394	2,643
Others	1.2% – 51.0%	1.2% – 51.0%	3,044	1,713	3,417	2,563
			<u>\$ 425,271</u>	<u>\$ 369,917</u>	<u>\$ 66,358</u>	<u>\$ 78,886</u>

The equity in earnings of unconsolidated affiliates providing services that the System does not provide as part of its routine services are included in nonoperating (losses) gains, net in the accompanying consolidated statements of operations and changes in net assets. All others are included in operating revenue.

**TEXAS HEALTH RESOURCES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**, Continued  
December 31, 2018 and 2017

**20. Related-Party Transactions**

THR incurred expenses for purchased services from NTHC Laundry of \$9,505,000 and \$9,781,000 for the years ended December 31, 2018 and 2017, respectively, which is recorded in other operating expenses in the accompanying consolidated statements of operations and changes in net assets. Amounts due to NTHC Laundry, which total \$1,056,000 and \$810,000 at December 31, 2018 and 2017, respectively, are reflected in current liabilities on the accompanying consolidated balance sheets. THR recorded management services and purchased workforce revenue from SWHR Network totaling \$16,837,000 and \$15,867,000 for the years ended December 31, 2018 and 2017, respectively, which is recorded in other operating revenue in the accompanying consolidated statements of operations and changes in net assets. THPG recorded shared savings revenue from SWHR Network totaling \$11,739,000 for the year ended December 31, 2018, which is recorded in net patient service revenue in the accompanying consolidated statements of operations and changes in net assets. In addition, THR recorded payor relations management services expense from SWHR Network totaling \$3,170,000 and \$2,662,000 for the years ended December 31, 2018 and 2017, respectively, which is recorded in other operating expenses in the accompanying consolidated statements of operations and changes in net assets. Net amounts due from SWHR Network, which total \$30,139,000 and \$18,150,000 at December 31, 2018 and 2017, respectively, are reflected in other receivables, net and accounts payable on the accompanying consolidated balance sheets. Additionally, THR had various other immaterial transactions with certain of its unconsolidated affiliates throughout the year.

**21. Subsequent Events**

The System evaluated events subsequent to December 31, 2018 and through April 25, 2019, the date on which the financial statements were issued.