



**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Consolidated Financial Statements  
and Supplementary Information

December 31, 2017 and 2016

(With Independent Auditors' Reports Thereon)

## UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

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## Independent Auditors' Report

The Board of Directors  
University Hospitals Health System, Inc.:

We have audited the accompanying consolidated financial statements of University Hospitals Health System, Inc. and its subsidiaries (the System), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, 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 University Hospitals Health System, Inc. and its subsidiaries as of December 31, 2017 and 2016, 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**

Cleveland, Ohio  
March 21, 2018

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Consolidated Balance Sheets

December 31, 2017 and 2016

(In thousands of dollars)

<b>Assets</b>	<b>2017</b>	<b>2016</b>
Current assets:		
Cash and cash equivalents	\$ 201,782	264,527
Patient accounts receivable, less allowance for doubtful accounts of \$69,920 in 2017 and \$61,653 in 2016	564,874	550,057
Other receivables	49,921	71,872
Other current assets	163,365	149,155
<b>Total current assets</b>	<b>979,942</b>	<b>1,035,611</b>
Investments	1,747,491	1,528,680
Property and equipment, net	1,663,717	1,618,013
Other assets:		
Investments in affiliates	96,306	91,163
Beneficial interest in Foundations	175,013	157,985
Perpetual trusts	210,846	191,015
Other	144,739	147,549
<b>Total other assets</b>	<b>626,904</b>	<b>587,712</b>
<b>Total assets</b>	<b>\$ 5,018,054</b>	<b>4,770,016</b>

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Consolidated Balance Sheets

December 31, 2017 and 2016

(In thousands of dollars)

<b>Liabilities and Net Assets</b>	<b>2017</b>	<b>2016</b>
Current liabilities:		
Current installments of long-term debt	\$ 23,736	23,190
Accounts payable and accrued expenses	414,530	421,235
Other current liabilities	80,465	73,601
Estimated amounts due to third-party payors	23,167	24,725
Total current liabilities	541,898	542,751
Long-term debt, less current installments	1,252,444	1,272,085
Revolving credit commitment	40,000	40,000
Other liabilities	676,146	700,234
Total liabilities	2,510,488	2,555,070
Net assets:		
Unrestricted	1,738,444	1,508,451
Temporarily restricted	365,611	339,121
Permanently restricted	403,511	367,374
Total net assets	2,507,566	2,214,946
Total liabilities and net assets	\$ 5,018,054	4,770,016

See accompanying notes to consolidated financial statements.

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2017 and 2016

(In thousands of dollars)

	<u>2017</u>	<u>2016</u>
Unrestricted revenues:		
Net patient service revenue	\$ 3,787,793	3,659,165
Provision for bad debts	<u>(112,520)</u>	<u>(89,142)</u>
Net patient service revenue less provision for bad debts	3,675,273	3,570,023
Other revenue	<u>221,398</u>	<u>219,549</u>
Total unrestricted revenues	<u>3,896,671</u>	<u>3,789,572</u>
Expenses:		
Salaries, wages, and employee benefits	2,221,151	2,154,230
Purchased services	267,517	278,476
Patient care supplies	654,964	609,902
Other supplies	45,595	52,507
Insurance	37,925	42,273
Other	327,999	335,560
Depreciation and amortization	151,722	140,616
Interest	45,560	47,408
Special charges	<u>470</u>	<u>3,764</u>
Net operating income	<u>3,752,903</u>	<u>3,664,736</u>
Net operating income	143,768	124,836
Nonoperating revenues (expenses):		
Investment income	128,072	25,233
Other-than-temporary decline in investments	(2,022)	(5,368)
Change in fair value of derivative instruments	4,463	10,456
Loss on extinguishment of debt	—	(8,156)
Gain on disposition of business unit	2,612	4,039
Other nonservice periodic pension costs	<u>(23,521)</u>	<u>(20,514)</u>
Excess of revenues over expenses	<u>\$ 253,372</u>	<u>130,526</u>

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2017 and 2016

(In thousands of dollars)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Net assets at December 31, 2015	\$ 1,372,564	334,026	359,968	2,066,558
Excess of revenues over expenses	130,526	—	—	130,526
Investment income	—	8,173	—	8,173
Other support and revenue	—	29,489	4,524	34,013
Change in beneficial interest in Foundations and perpetual trusts	—	4,011	2,882	6,893
Net assets released from restrictions used for operations	—	(32,646)	—	(32,646)
Change in net unrealized gains				
on other-than-trading securities	31,929	214	—	32,143
Pension liability adjustment	(30,993)	—	—	(30,993)
Net assets released from restrictions for acquisition of property and equipment	4,146	(4,146)	—	—
Contributed capital	<u>279</u>	<u>—</u>	<u>—</u>	<u>279</u>
Increase in net assets	<u>135,887</u>	<u>5,095</u>	<u>7,406</u>	<u>148,388</u>
Net assets at December 31, 2016	<u>1,508,451</u>	<u>339,121</u>	<u>367,374</u>	<u>2,214,946</u>
Excess of revenues over expenses	253,372	—	—	253,372
Investment income	—	9,284	—	9,284
Other support and revenue	—	39,041	10,405	49,446
Change in beneficial interest in Foundations and perpetual trusts	—	11,127	25,732	36,859
Net assets released from restrictions used for operations	—	(28,232)	—	(28,232)
Change in net unrealized gains				
on other-than-trading securities	3,535	249	—	3,784
Change in joint venture unrestricted net assets	(325)	—	—	(325)
Pension liability adjustment	(32,631)	—	—	(32,631)
Net assets released from restrictions for acquisition of property and equipment	4,979	(4,979)	—	—
Contributed capital	<u>1,063</u>	<u>—</u>	<u>—</u>	<u>1,063</u>
Increase in net assets	<u>229,993</u>	<u>26,490</u>	<u>36,137</u>	<u>292,620</u>
Net assets at December 31, 2017	\$ <u>1,738,444</u>	<u>365,611</u>	<u>403,511</u>	<u>2,507,566</u>

See accompanying notes to consolidated financial statements.

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Consolidated Statements of Cash Flows

Years ended December 31, 2017 and 2016

(In thousands of dollars)

	<u>2017</u>	<u>2016</u>
Operating activities:		
Increase in net assets	\$ 292,620	148,388
Adjustments to reconcile increase in net assets to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	151,722	140,616
Amortization of bond premium, discount, and financing costs	(233)	(1,513)
Provision for bad debts	112,520	89,142
Loss on extinguishment of debt	—	8,156
Other than temporary decline in investments	2,022	5,368
Change in beneficial interest in foundations and perpetual trusts	(36,859)	(6,893)
Change in net unrealized investment gains and losses	(3,784)	(32,143)
Net realized gains and losses on sale of investments	(98,473)	(2,838)
Pension liability adjustment	32,631	30,993
Net change attributable to investments in joint ventures	(5,143)	(5,938)
Restricted revenue and investment income	(21,529)	(21,203)
Gain on termination of interest rate swap	—	(980)
Gain on disposal of business unit	(2,612)	(4,039)
Net change in operating assets and liabilities:		
Patient accounts receivable	(127,338)	(181,701)
Other current assets	9,631	16,577
Accounts payable, accrued expenses, and other current liabilities	846	(14,591)
Other assets and liabilities	<u>(57,315)</u>	<u>34,272</u>
Net cash provided by operating activities	<u>248,706</u>	<u>201,673</u>
Investing activities:		
Acquisition of property and equipment	(198,685)	(179,154)
Proceeds from sales of investments	1,329,836	2,814,030
Purchases of investments	(1,448,414)	(2,827,271)
Net proceeds from disposal of business unit	<u>3,000</u>	<u>4,042</u>
Net cash used in investing activities	<u>(314,263)</u>	<u>(188,353)</u>
Financing activities:		
Proceeds from restricted revenue and investment income	21,529	21,203
Repayment of long-term debt	(75,976)	(310,431)
Proceeds from issuance of long-term debt	57,114	300,074
Bond issuance costs	—	(1,948)
Proceeds from revolving credit borrowing	—	40,000
Proceeds from termination of interest rate swap	—	980
Increase (decrease) in treasury service agreement	<u>145</u>	<u>(128)</u>
Net cash provided by financing activities	<u>2,812</u>	<u>49,750</u>
(Decrease) increase in cash and cash equivalents	(62,745)	63,070
Cash and cash equivalents at beginning of year	<u>264,527</u>	<u>201,457</u>
Cash and cash equivalents at end of period	<u>\$ 201,782</u>	<u>264,527</u>
Supplemental cash flow information:		
Change in accounts payable related to property and equipment	\$ (1,259)	(123)

See accompanying notes to consolidated financial statements.

## UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

### **(1) Organization and Principles of Consolidation**

University Hospitals Health System, Inc. (the System) is the parent of various corporations involved in the delivery of healthcare services, including a network of physicians, outpatient centers, hospitals, wellness, occupational health, skilled nursing, elder health, rehabilitation, and home care services that operate in the Northeast Ohio region. University Hospitals Cleveland Medical Center (UHCMC) is the System's major subsidiary. The System provides certain management and planning services to its subsidiaries. The System also has joint venture investments in other healthcare systems (note 13), which are accounted for under the equity method.

The consolidated financial statements include the accounts of the System and its subsidiaries. All significant intercompany transactions have been eliminated in the consolidated financial statements.

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

#### **(a) Cash and Cash Equivalents**

The System considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents, excluding investments. The carrying amount of cash and cash equivalents approximates fair value.

#### **(b) Concentrations of Credit Risk**

Financial instruments that potentially subject the System to concentrations of credit risk consist principally of cash, cash equivalents, and patient accounts receivable. The System invests its cash equivalents in highly rated financial instruments including time deposits, U.S. Treasury bonds and notes, government-backed mortgage securities, and corporate notes with original maturities of three months or less.

The System's concentration of credit risk relating to patient accounts receivable is limited by the diversity and number of the System's patients and payors. Patient accounts receivable consist of amounts due from governmental programs, commercial insurance companies, other group insurance companies, and private pay patients. Combined revenues from the Medicare and Medicaid programs accounted for approximately 44% and 45% of the System's net patient service revenue for the years ended December 31, 2017 and 2016, respectively. Excluding governmental programs, no one payor source represents more than 15% of the System's patient accounts receivable. The System maintains an allowance for doubtful accounts based on the expected collectability of patient accounts receivable considering historical collection experience and other economic factors.

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

**(c) 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 and are classified as other-than-trading securities. Investment income, including realized gains and losses, is reported as investment income in nonoperating revenue on the consolidated statements of operations and changes in net assets. Unrealized gains and losses on investments recorded at fair value are reported within net assets. Interest and dividend income on temporarily and permanently restricted investments is recorded according to the donor's intentions and as temporarily restricted investment income within the consolidated statements of operations and changes in net assets.

The System's alternative investments, which include private equity, real estate, hedge funds, and distressed debt investments, are reported at fair value as estimated and reported by general partners, based upon the underlying net asset value (NAV) of the fund or partnership as a practical expedient. Adjustment to NAV is required when the System expects to sell the investment at a value other than NAV. Interest and dividends, unrealized and realized gains and losses from these investments are recorded within nonoperating revenues on the consolidated statements of operations and changes in net assets as investment income.

Investments, in general, are exposed to various risks such as interest rate, credit and overall market volatility. As such, it is reasonably possible that changes in the values of investments will occur in the near term, and that such changes could materially affect the amounts reported in the consolidated financial statements.

Other-than-temporary declines result from decreases in the fair market values of debt, equity, and alternative investments below the cost basis in these securities. Other-than-temporary declines for unrestricted investments are recorded in the consolidated statements of operations and changes in net assets. Other-than-temporary losses for temporarily and permanently restricted net assets are recorded within temporarily restricted investment income in the consolidated statements of operations and changes in net assets. Other-than-temporary declines also result in a new cost basis for the investment.

**(d) Costs of Borrowing**

Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Capitalized interest totaled \$2,210 and \$986 for the years ended December 31, 2017 and 2016, respectively. Deferred financing costs are capitalized when incurred, and then amortized on a straight-line basis during the period in which the debt is outstanding. Deferred financing costs totaled \$9,852 and \$11,115 for the years ended December 31, 2017 and 2016 and are reported as a component of long-term debt on the consolidated balance sheets.

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

**(e) Property and Equipment and Other Long-Lived Assets**

Additions and improvements to property and equipment are capitalized at cost. Costs for maintenance and repairs are charged to expense as incurred. Depreciation on plant and equipment is computed on the straight-line basis over the estimated useful lives of the respective assets. Buildings and improvements are depreciated over estimated useful lives ranging generally from 5 to 50 years. Leasehold improvements are depreciated over the lesser of the life of the asset or the term of the lease. Estimated useful lives of equipment vary generally from 3 to 20 years.

Long-lived assets, such as property and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted cash flows expected to be generated by the asset. An impairment loss is recognized when the carrying value of the asset exceeds its fair value. There were no impaired assets identified in the years ended December 31, 2017 or 2016.

**(f) Gifts, Private Grants, Bequests, and Pledges**

Unconditional donor promises to give cash, marketable securities, and other assets to the System are reported at fair value, net of fund-raising costs, and discounted to present value at the date the promise is received to the extent estimated to be collectible. Conditional donor promises to give and indications of intentions to give are not recognized until the condition is satisfied. The System has conditional donor promises to give of \$201,310 and \$204,768 at December 31, 2017 and 2016, respectively, which have not been recognized as assets or revenues in these accompanying consolidated financial statements. Unrestricted contributions are included in the consolidated statements of operations and changes in net assets as unrestricted other revenue. Contributions that are received with donor restrictions that limit the use of the donated asset are reported as either temporarily or permanently restricted in the consolidated statements of operations and changes in net assets as other support and revenue. When the donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is met, temporarily restricted nets assets are transferred to unrestricted net assets.

Gifts, private grants, and bequests that have been received from various corporations, foundations, and individuals for the years ended December 31, 2017 and 2016 are reported as follows:

	<u>2017</u>	<u>2016</u>
Unrestricted	\$ 3,842	2,088
Temporarily restricted	39,041	29,489
Permanently restricted	<u>10,405</u>	<u>4,524</u>
	<u>\$ 53,288</u>	<u>36,101</u>

Unconditional pledges (pledges) are recorded as other receivables on the consolidated balance sheets in the year made and reported as either temporarily or permanently restricted in the consolidated statements of operations and changes in net assets as other support and revenue.

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

Outstanding pledges receivable from various corporations, foundations, and individuals are recorded at their net present value. The balances at December 31, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Pledges due:		
In less than one year	\$ 42,677	43,128
In one year to five years	49,336	53,108
In more than five years	<u>38,609</u>	<u>37,899</u>
	130,622	134,135
Discount	(11,420)	(11,197)
Allowance for doubtful pledges	<u>(2,849)</u>	<u>(2,952)</u>
	<u>\$ 116,353</u>	<u>119,986</u>

**(g) Government Grants**

Amounts received from government agencies are reported in the consolidated statements of operations and changes in net assets as unrestricted other revenue. Grants revenue totaled \$7,803 and \$9,531 for the years ended December 31, 2017 and 2016, respectively.

**(h) Charity Care and Provision for Bad Debts**

Throughout the admission, billing, and collection processes, certain patients are identified by the System as qualifying for charity care. The System provides care to these patients without charge or at amounts less than its established rates. Charity care includes those patients required to be identified in connection with the System's participation in the State of Ohio's Care Assurance Program. Under this Program, patients who are Ohio residents without any or adequate health insurance coverage and income at or below 100% of the federally defined poverty level are eligible to receive Medicaid covered services free of charge. The charges forgone for charity care provided by the System are not reported as net patient service revenue or as patient accounts receivable. The System accepts all patients covered by Medicare and Medicaid and treats patients requiring emergency care regardless of their ability to pay.

The uncompensated cost of charity care is estimated by applying an overall cost to charge ratio to the charges associated with patients who qualify for charity care. The estimated uncompensated costs of charity care are \$42,562 and \$44,600 for the years ended December 31, 2017 and 2016, respectively.

In addition, the System provides services to other medically indigent patients under various state Medicaid programs. Such programs pay providers amounts that are less than the established charges for the services provided to the recipients. The uncompensated costs associated with these state programs is estimated as the total direct and indirect costs in excess of the payments received for the services provided. Services provided to Medicaid recipients (including Medicaid recipients who are

## UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

participants in a Medicaid managed care plan) represented approximately 22% and 21% of the System's gross patient revenue for 2017 and 2016, respectively.

The System also provides other uncompensated care and community benefits. In furtherance of its exempt purpose to benefit the community, the System operates an inner city medical clinic to serve the healthcare needs of the community; operates emergency rooms open to the public 24 hours per day, 7 days per week; maintains research facilities for the study of disease and injuries; provides facilities for teaching and training various medical personnel; facilitates the advancement of medical and surgical education; provides community screenings for the detection of various diseases such as breast and colorectal cancer; sponsors cancer support groups; provides various community health education classes, speeches, television appearances, and articles published in newspapers and magazines; and undertakes other types of community benefit activities.

In addition to charity care and insufficient funding from the Medicaid program, there are significant losses related to self-pay patients who fail to make payment for services rendered or insured patients who fail to remit co-payments and deductibles as required under applicable health insurance arrangements.

### **(i) Excess of Revenues over Expenses**

The consolidated statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets, which, consistent with industry practice, are excluded from excess of revenues over expenses, include unrealized gains and losses on other-than-trading securities (except declines in fair value that management has determined to be other than temporary, which are reported as nonoperating losses), certain changes in joint venture net assets, assets acquired using funds restricted by the donor for the purpose of acquiring such assets, contributed capital, and adjustments for pension accounting (note 12).

### **(j) Derivative Financial Instruments**

Derivative financial instruments are utilized by the System to manage: (i) interest rate risk; (ii) the fixed and floating interest rate mix of the System's total debt portfolio; and (iii) related overall cost of borrowing. The interest rate swap agreements involve the periodic exchange of payments without the exchange of the notional amount upon which the payments are based. The System does not use derivative financial instruments for trading purposes. The related liability to counterparties under interest rate swap agreements is included in noncurrent other liabilities and the related asset from counterparties under swap agreements is included in noncurrent other assets on the consolidated balance sheets (note 9).

Derivative financial instruments are recorded on the consolidated balance sheets at their respective fair value. The interest rate swap agreements are not designated as hedging instruments. Gains and losses on derivative financial instruments are recorded in the change in fair value of derivative instruments within the consolidated statements of operations and changes in net assets. The net amount paid or received under the swap agreements is recorded as a component of interest expense in the consolidated statements of operations and changes in net assets.

## UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

The System minimizes credit risk related to derivative financial instruments by requiring high credit standards for its counterparties and periodic settlements. The counterparties to these contractual arrangements are financial institutions that carry investment-grade credit ratings with which the System also has other financial relationships. The System is exposed to credit loss in the event of nonperformance by these counterparties. To mitigate credit exposure, the swap agreements contain certain collateral provisions applicable to both the System and the counterparties.

### **(k) Income Taxes**

The System and most of its subsidiaries, including UHCMC, are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code (Code) and are exempt from federal income taxes pursuant to Section 501(a) of the Code. The System also has certain subsidiaries that are taxable for federal income tax purposes (note 18).

The System must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the consolidated financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. As of December 31, 2017 and 2016, the System does not have any uncertain tax positions.

### **(l) Loss Contingencies**

Liabilities for asserted or unasserted claims and assessments are recorded when an unfavorable outcome of a matter is deemed to be both probable and the loss contingency is reasonably estimable.

### **(m) Use of Estimates**

The preparation of consolidated financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### **(n) Treasury Service Agreement**

The System included amounts due to a third party financing company for the use under a Supplemental Treasury Services Agreement (Agreement), entered into during 2013, within accounts payable in the accompanying consolidated balance sheets. Cash flows related to the Agreement are classified as financing activities in the consolidated statements of cash flows. The Agreement is a \$70,000 unsecured trade payables and corporate card float program that is noninterest bearing and is not collateralized. The Agreement includes customary covenants as well as customary events of defaults. The amounts outstanding on the Agreement fluctuate on a daily basis, but as of December 31, 2017 and 2016, the amount outstanding included within accounts payable was \$62,547 and \$62,402, respectively. The System incurred no interest under this Agreement for the years ended December 31, 2017 and 2016.

## UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

### **(o) Adopted Accounting Standard**

Effective January 1, 2017, the System early adopted Financial Accounting Standards Board Accounting Standards Update, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost* (ASU 2017-07). As a result of adopting the standard, the System reclassified the component of net benefit cost, excluding the service cost component, totaling \$20,514 from salaries, wages, and employees benefits to other nonservice periodic pension costs in the consolidated statement of operations and changes in net assets for the year ended December 31, 2016. ASU 2017-07 allows a practical expedient approach, which the System applied, that permits the use of amounts disclosed in footnote 12 (Retirement Plans) for the prior comparative period as the estimation basis for applying the retrospective presentation requirements for the year ended December 31, 2016.

### **(p) Reclassifications**

Certain amounts included in the 2016 consolidated financial statements have been reclassified to conform to the 2017 presentation.

### **(3) Net Patient Service Revenue**

The System and certain of its subsidiary corporations have agreements with third party payors (e.g., Medicare, Medicaid, and commercial insurance carriers) that provide for payments and reimbursement at amounts different from the System's established billing rates. Net patient service revenue is 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. Adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as settlements are determined. Adjustments to amounts recorded in previous periods for the Medicare, Medicaid, and Champus/Tricare program resulted in net patient service revenue increasing by \$8,553 and \$6,698 for the years ended December 31, 2017 and 2016, respectively.

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. The System believes that it is in compliance, in all material respects, with all applicable laws and regulations.

Patients' accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of patients' accounts receivable, the System analyzes its past history and identifies trends to estimate the appropriate allowance for doubtful accounts. Management regularly reviews data about the System's major payer sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For accounts receivable associated with services provided to patients who have third-party coverage, the System analyzes contractually due amounts and provides an allowance for doubtful accounts, if necessary (e.g., for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For accounts receivable associated with self-pay patients, those with no third-party coverage, the System records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard

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rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is written off against the allowance for doubtful accounts.

The System's allowance for uncollectible accounts was 87% and 88% of self-pay and known guarantor balance patient accounts receivable at December 31, 2017 and 2016, respectively. The System did not change its charity care or uninsured discount policies during fiscal year 2017 or 2016. The System does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors.

The System recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the System recognizes revenue on the basis of its standard rates for services provided. On the basis of 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 provision for bad debts related to uninsured patients in the period the services are provided. The percentage of patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), derived from these major payor sources as of December 31, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Third party	96 %	96 %
Uninsured	4	4
	<u>100 %</u>	<u>100 %</u>

**(4) Net Assets**

Temporarily restricted net assets are available for the following purposes and the amount of beneficial interest in Foundations at December 31, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Capital expenditures	\$ 47,735	46,168
Education	9,193	7,431
Research	100,038	91,870
Patient care	65,338	61,308
Beneficial interest in Foundations	143,307	132,344
	<u>\$ 365,611</u>	<u>339,121</u>

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Permanently restricted net assets consist of amounts held in perpetuity as designated by donors, including the System's portion of beneficial interests in several perpetual trusts. Investment income on temporarily and permanently restricted investments, including realized gains and losses, is recorded according to the donor intentions. Changes in unrealized gains and losses on investments are recognized directly in net assets.

During the years ended December 31, 2017 and 2016, net assets released from restrictions used for operations totaled \$28,232 and \$32,646, respectively. Net assets released from restrictions are recorded in other revenue in the consolidated statements of operations and changes in net assets. In addition, \$4,979 and \$4,146 in net assets were released from restriction for the acquisition of property and equipment in the years ended December 31, 2017 and 2016, respectively.

The System's endowment consists of 438 individual funds established for a variety of purposes. Endowments include both donor-restricted funds and funds designated by the Board of Directors (the Board) to function as endowments. Net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions. The System's permanently restricted endowment funds are donor restricted, which totaled \$144,372 and \$135,849 at December 31, 2017 and 2016, respectively. Board designated funds are unrestricted and totaled \$32,727 and \$30,005 at December 31, 2017 and 2016, and are included within unrestricted investments.

The System's investment policy establishes a limited number of investment pools with a specific purpose of aggregating various System funds' investments according to their risk tolerance. Asset allocation is reviewed quarterly with respect to: i) System tolerance for risk based on its financial condition and need for cash from investments to support operations; ii) expected asset class return, risk, and correlation characteristics; iii) changes in accounting guidance or tax law; and iv) changes in bond covenants or other restrictions. Management of the System is responsible to ensure the proper allocation of funds according to the specific needs, timing of cash flows, and risk tolerance of each fund.

The System's spending practices are intended to comply with the donor's wishes and meet all applicable laws and regulations including the Uniform Prudent Management of Institutional Funds Act. Spending must be for a purpose that is consistent with the documented intent of the donor. The System generally appropriates an amount not to exceed 5% of the endowment fund's fair value for annual spending subject to spending guidelines and restrictions per the System's policy. The fair value of the endowment fund is determined quarterly and averaged over a period of a rolling thirty-six months.

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	<b>Unrestricted (board designated)</b>	<b>Temporarily restricted</b>	<b>Permanently restricted</b>	<b>Total</b>
Endowment net assets, at December 31, 2015	\$ 29,435	25,334	129,036	183,805
Endowment return:				
Investment income	1,081	9,158	—	10,239
Contributions	323	—	6,813	7,136
Appropriation of endowment assets for expenditure	<u>(834)</u>	<u>(6,778)</u>	<u>—</u>	<u>(7,612)</u>
Endowment net assets, at December 31, 2016	\$ 30,005	27,714	135,849	193,568
Endowment return:				
Investment income	\$ 3,357	29,995	—	33,352
Contributions	—	—	8,523	8,523
Appropriation of endowment assets for expenditure	<u>(635)</u>	<u>(7,321)</u>	<u>—</u>	<u>(7,956)</u>
Endowment net assets, at December 31, 2017	\$ <u>32,727</u>	<u>50,388</u>	<u>144,372</u>	<u>227,487</u>

**(5) Fair Value Measurements**

Assets and liabilities carried at fair value are disclosed on a hierarchy for ranking the quality and reliability of the information used to determine fair values according to the following three levels:

**Level 1** – Unadjusted quoted prices for identical assets or liabilities in active markets. Level 1 yields the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

**Level 2** – Observable inputs other than quoted prices in Level 1. Inputs such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar liabilities that are not active, or other inputs that are observable or can be corroborated by observable market data.

**Level 3** – Unobservable inputs that are significant to the valuation of assets or liabilities and are supported by little or no market data. This includes discounted cash flow methodologies, pricing models, and similar techniques that use significant unobservable inputs.

The inputs used to fair value Level 1 instruments are unadjusted quoted prices derived from stock exchanges, and the Chicago Board of Trade. Level 1 instruments primarily consist of equities, exchange traded funds, and certain government securities.

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Investments in Level 2 are primarily comprised of corporate bonds, bonds, asset-backed securities, fixed income mutual funds, and derivative financial instruments. Level 2 inputs primarily consist of quotes from independent pricing vendors based on recent trading activity, and other relevant information including matrix pricing, market corroborated pricing, yield curves, and other indices that are used when Level 1 inputs are not available.

Items classified as Level 3 in the fair value hierarchy include beneficial interest in Foundations, perpetual trusts, and exclude pledges of \$119,202 and \$122,938 at December 31, 2017 and 2016, respectively.

Investments that are measured at NAV per share are not categorized in the following fair value hierarchy tables.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
December 31, 2017:				
Assets:				
Cash and cash equivalents	\$ 201,782	—	—	201,782
Cash and cash equivalents – pooled with investments:				
Cash equivalents	44,093	—	—	44,093
Fixed income securities:				
Corporate bonds	—	193,258	—	193,258
Fixed income mutual funds	638,588	—	—	638,588
Government securities	76,331	63,499	—	139,830
Total fixed income securities	<u>714,919</u>	<u>256,757</u>	<u>—</u>	<u>971,676</u>
Equities, mutual and exchange traded funds:				
Domestic mutual funds	204,666	—	—	204,666
International mutual funds	59,766	—	—	59,766
Total equities, mutual and exchange traded funds	<u>264,432</u>	<u>—</u>	<u>—</u>	<u>264,432</u>
Deferred compensation assets – mutual funds	21,421	—	—	21,421
Beneficial interest in Foundations	—	—	175,013	175,013
Perpetual trusts	—	—	210,846	210,846
Interest rate swaps	—	6,476	—	6,476
Total assets	<u>\$ 1,246,647</u>	<u>263,233</u>	<u>385,859</u>	<u>1,895,739</u>
December 31, 2017:				
Liabilities:				
Deferred compensation liabilities	\$ 21,421	—	—	21,421
Interest rate swaps	—	56,724	—	56,724
Total Liabilities	<u>\$ 21,421</u>	<u>56,724</u>	<u>—</u>	<u>78,145</u>

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	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
December 31, 2016:				
Assets:				
Cash and cash equivalents	\$ 264,527	—	—	264,527
Cash and cash equivalents – pooled with investments:				
Cash equivalents	49,991	—	—	49,991
Fixed income securities:				
Corporate bonds	—	192,894	—	192,894
Fixed income mutual funds	472,117	—	—	472,117
Government securities	103,515	57,552	—	161,067
Total fixed income securities	<u>575,632</u>	<u>250,446</u>	<u>—</u>	<u>826,078</u>
Equities, mutual and exchange traded funds:				
Domestic mutual funds	159,001	—	—	159,001
International mutual funds	48,699	—	—	48,699
Total equities, mutual and exchange traded funds	207,700	—	—	207,700
Deferred compensation assets – mutual funds				
Beneficial interest in Foundations	20,193	—	—	20,193
Perpetual trusts	—	—	157,985	157,985
Interest rate swaps	—	5,031	191,015	191,015
Total assets	<u>\$ 1,118,043</u>	<u>255,477</u>	<u>349,000</u>	<u>1,722,520</u>
December 31, 2016:				
Liabilities:				
Deferred compensation liabilities	\$ 20,193	—	—	20,193
Interest rate swaps	—	61,198	—	61,198
Total Liabilities	<u>\$ 20,193</u>	<u>61,198</u>	<u>—</u>	<u>81,391</u>

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The following table summarizes the System's investments at December 31, 2017 and 2016, for which NAV was used as a practical expedient to estimate fair value:

	<u>2017</u>	<u>2016</u>
Commingled funds:		
Domestic commingled funds	\$ 12,191	41,299
International commingled funds	<u>131,741</u>	<u>99,647</u>
Total commingled funds	<u>143,932</u>	<u>140,946</u>
Alternative investments:		
Hedge funds	218,057	204,649
Real estate	32,901	25,522
Distressed debt	23,568	20,101
Private equity	<u>28,029</u>	<u>37,472</u>
Total alternative investments	<u>302,555</u>	<u>287,744</u>
Total	<u>\$ 446,487</u>	<u>428,690</u>

The System evaluated transfers between levels based upon the nature of the financial instrument and size of the transfer relative to the total. For the years ended December 31, 2017 and 2016, there were no transfers into or out of Level 1, 2, or 3.

The System has various interest rate swaps as of December 31, 2017 and 2016, consisting of fixed-payor and fixed spread basis swaps. Fair values for the System's interest rate swaps are provided on a monthly basis by the System's independent financial advisor and counterparties. Monthly valuations are derived by pricing models, which use market inputs such as LIBOR, Securities Industry and Financial Markets Association (SIFMA) Swap Index, and bond coupon rates provided by various inter-broker sources. The resulting combination of market data feeds, specific structuring characteristics such as the amortization of notional amounts, effective dates, payment frequencies, day counts, credit risk, and indices, are factored into the pricing model to determine the fair market value of the System's interest rate swaps.

Foundations operate for the exclusive benefit of the System, and variance power was not explicitly given to the Foundations by the donors. Therefore, the System is required to record its beneficial interest in the net assets of the Foundations. The investment in the Foundations is categorized as a Level 3 item. The primary input utilized in calculating the Foundations' fair value is its net assets, which represents fair market valuation of certain equity, debt, and other instruments held by the Foundations. The System records 100% of the Foundations' net assets at approximate fair market value.

Permanently restricted net assets consist of amounts held in perpetuity as designated by donors, including the System's portion of beneficial interests in several perpetual trusts held and administered by others in which the System is an income beneficiary. Perpetual trusts are measured at fair value by the external

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trustee, which approximates the present value of expected future cash flows. Perpetual trusts utilize significant unobservable inputs determined by the external trustees in estimating fair value.

	<b>Fair value measurements using significant unobservable inputs (Level 3)</b>		
	<b>Beneficial interest in Foundations</b>	<b>Perpetual trusts</b>	<b>Total</b>
Balance at December 31, 2015	\$ 153,285	188,822	342,107
Total change included in:			
Temporarily restricted net assets	4,011	—	4,011
Permanently restricted net assets	689	2,193	2,882
Balance at December 31, 2016	157,985	191,015	349,000
Total change included in:			
Temporarily restricted net assets	11,127	—	11,127
Permanently restricted net assets	5,901	19,831	25,732
Balance at December 31, 2017	\$ 175,013	210,846	385,859

**(6) Investments**

The composition of investments at December 31, 2017 and 2016 are as follows:

	<b>2017</b>	<b>2016</b>
Cash and cash equivalents – pooled with investments	\$ 44,093	49,991
Fixed income securities	971,676	826,078
Equities, mutual and exchange traded funds	408,364	348,646
Alternative investments	302,555	287,744
Other	20,803	16,221
Total investments	\$ 1,747,491	1,528,680

The System holds certain investments in fixed income securities including domestic and international corporate bonds, U.S. Treasuries, government, and agency bonds; non-U.S. sovereign debt; and emerging market debt. The System holds common and preferred stock including investments in small cap, mid cap, and large cap companies as well as in non-U.S. equities in developed and emerging markets.

Alternative investments include private equity, real estate, hedge funds, and distressed debt. These investments are made either directly or through various Fund-of-Funds, both of which are typically Limited

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Partnership structures. For the Fund-of-Funds investments, the System is invested in a Limited Partnership, which in turn utilizes its expertise to invest in underlying Limited Partnership Funds and make certain other investments.

The General Partner of each direct Limited Partnership determines the fair market valuation of its underlying holdings based on i) the nature and terms of each underlying investment, ii) market inputs, and iii) certain other relevant information. The General Partner of each Fund-of-Funds Limited Partnership determines the fair market valuation of its underlying Limited Partnership investments. These valuations are based primarily on the quarterly internal and annual audited consolidated financial statements of the underlying Limited Partnership Funds, which report net asset value based on i) the nature and terms of each underlying investment, ii) market inputs, and iii) certain other relevant information. The System undertakes various measures to validate that the reported net asset value approximates the fair market value. The determination of fair market values for the alternative investments requires the General Partners and System management to make estimates and assumptions about certain inputs and other factors that are inherently uncertain. These estimates are subjective and require judgment regarding significant matters such as the amount and timing of future cash flows and the selection of discount rates that appropriately reflect market and credit risks.

Assets categorized as alternative investments may be subject to liquidity restrictions such as gates. These gates prevent short-term liquidation of assets. Hedge funds may be redeemed at quarter-end requiring advanced notice ranging from 45 to 65 days, prior written notice subject to certain limitations that may be imposed by the General Partner of the fund without notice. Private equity and private real estate funds generally have contractual terms of 10 years or greater from the time the commitment to the fund is made. While distributions of capital during this term typically occur, many of these funds have provisions that allow the General Partner to extend the final term and suspend distributions. Distressed debt funds are typically 1-year to 5-year or 6-year to 10-year term structures, and although some of the funds offer liquidity, the fund documents allow the General Partner to suspend redemptions if they deem necessary. As a result of these contractual limitations on liquidity, these alternative assets are generally considered illiquid. Contractual liquidity terms of alternative investments at December 31, 2017 are as follows:

	<u>Carrying value</u>	<u>Unfunded commitments</u>
Less than 1 year, no contractual restrictions have been imposed	\$ 211,439	2,570
Subject to existing gates or restrictions	10,754	2,143
Limited Partnership Fund expiring in 1 – 5 years	34,050	10,022
Limited Partnership Fund expiring in 6 – 10 years	37,337	29,035
Limited Partnership Fund expiring in 11 – 12 years	<u>8,975</u>	<u>42,554</u>
Total alternative investments	\$ <u>302,555</u>	<u>86,324</u>

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The components and related restrictions of investments shown above are as follows:

	<u>2017</u>	<u>2016</u>
Unrestricted and board designated	\$ 1,475,566	1,290,176
Swap collateral	4,850	5,875
Temporarily restricted	121,952	96,780
Permanently restricted	<u>145,123</u>	<u>135,849</u>
Total investments	\$ <u><u>1,747,491</u></u>	<u><u>1,528,680</u></u>

Investment income is comprised of the following for the years ended December 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Interest and dividend income:		
Unrestricted	\$ 29,599	22,395
Temporarily restricted	<u>4,452</u>	<u>2,973</u>
	<u>34,051</u>	<u>25,368</u>
Net realized gain (loss) on sales of securities:		
Unrestricted	78,814	(2,854)
Temporarily restricted	<u>4,832</u>	<u>5,200</u>
	83,646	2,346
Unrestricted – Gains from alternative investments	<u>19,659</u>	<u>5,692</u>
	\$ <u><u>137,356</u></u>	<u><u>33,406</u></u>

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**(7) Property and Equipment**

Property and equipment, at December 31, 2017 and 2016, are summarized below:

	<u>2017</u>	<u>2016</u>
Land and land improvements	\$ 165,226	165,143
Buildings and fixed equipment	1,902,560	1,852,750
Movable equipment and furnishings	1,381,582	1,271,540
Construction in progress	91,196	57,481
	<u>3,540,564</u>	<u>3,346,914</u>
Less accumulated depreciation	<u>1,876,847</u>	<u>1,728,901</u>
Net property and equipment	<u>\$ 1,663,717</u>	<u>1,618,013</u>

As of December 31, 2017, the System has made commitments on construction contracts, including information technology projects, of \$79,822.

**(8) Short-Term Borrowings and Long-Term Debt**

The System's \$180,000 revolving credit commitment (the Credit Commitment), is a syndicated commitment with a maturity date of January 21, 2021. The Credit Commitment bears interest at various rates for short-term periods. For the years ended December 31, 2017 and 2016, the average interest rate for borrowings under this credit line was 2.04% and 1.07%, respectively. As of December 31, 2017 and 2016, there were \$40,000 in borrowings outstanding under the Credit Commitment reported within noncurrent liabilities in the consolidated balance sheet. The remaining available Credit Commitment is \$140,000 at December 31, 2017 and 2016.

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A summary of long-term debt at December 31, 2017 and 2016 is as follows:

Series	Type	Weighted average interest rate% for the year ended December 31, 2017	Final maturity	Amount outstanding December 31	
				2017	2016
2017A Revenue Notes	Variable	1.82	2035	\$ 41,000	—
2017B Revenue Bonds	Variable	1.48	2035	9,000	—
2016A Revenue Bonds	Fixed	3.59	2046	229,725	229,725
2015A Revenue Bonds	Variable	1.00	2045	30,000	30,000
2015B Revenue Bonds	Variable	1.08	2045	30,000	30,000
2015C Revenue Bonds	Variable	0.96	2045	40,000	40,000
2015D Revenue Bonds	Variable	1.42	2046	77,560	78,550
2015E Revenue Bonds	Variable	1.42	2046	12,285	12,450
2014A Revenue Bonds	Fixed	3.69	2044	56,145	56,145
2014B Revenue Bonds	Variable	1.00	2045	30,000	30,000
2014C Revenue Bonds	Variable	1.42	2039	35,000	35,000
2013A Revenue Bonds	Fixed	4.65	2029	85,560	88,175
2013B Revenue Bonds	Variable	1.07	2033	30,000	30,000
2013C Revenue Bonds	Variable	1.05	2050	75,000	75,000
2012A Revenue Bonds	Fixed	4.73	2041	172,090	173,630
2012B Revenue Bonds	Variable	1.51	2019	9,290	14,190
2012C Revenue Bonds	Fixed	3.71	2042	55,825	55,825
2012D Revenue Bonds	Variable	1.48	2021	18,645	22,695
2010A Revenue Bonds	Fixed	4.82	2027	51,410	56,040
2010B Revenue Bonds	Variable	1.20	2035	50,000	50,000
2007A Revenue Bonds	Fixed	4.85	2041	52,445	52,445
2001 Revenue Bonds	Variable	1.55	2033	10,000	10,000
Term loan	Variable	2.03	2029	49,600	50,700
Note payable	Fixed	1.50	2036	5,000	60,000
Other long-term debt				7,580	1,452
				<u>1,263,160</u>	<u>1,282,022</u>
Unamortized premium				24,697	26,309
Less:					
Unamortized discount				1,825	1,941
Deferred financing costs				9,852	11,115
Current installments				23,736	23,190
				<u>23,736</u>	<u>23,190</u>
Long-term debt, less current installments				<u>\$ 1,252,444</u>	<u>1,272,085</u>

The System is party to a Master Trust Indenture, amended and restated as of June 15, 1989 (the Indenture). The Revenue Bonds listed in the table above are secured by the Indenture and are general obligations of the Obligated Group. The Obligated Group consists of the System, UHCMC, University Hospitals Geauga Medical Center, University Hospitals Ahuja Medical Center, University Hospitals Parma Medical Center, University Hospitals Elyria Medical Center, and University Hospitals St. John Medical Center.

In March 2017, the System issued tax-exempt bonds totaling \$50,000. The debt is comprised of the 2017A and B bonds in respective amounts of \$41,000 and \$9,000. The Bonds have a variable rate based on a set spread over a percent of LIBOR. The System used proceeds to finance new capital projects.

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During 2017, the System entered into a New Market Tax Credit (NMTC) financing transaction with a lender to finance the construction and development of the Rainbow Center for Women and Children. As of December 31, 2017, the System has recorded \$7,114 in other long-term debt in connection with the NMTC transaction. The NMTC provides the lender a specified amount of tax credits as the System satisfies of certain government compliance requirements over a seven-year period. The System anticipates that the liability of \$7,114 will ultimately be forgiven by the lender.

In March 2016, the System issued tax-exempt bonds totaling \$229,725 with a premium of \$19,649. The Series 2016A Bonds carry an average yield to maturity of 3.96%. The proceeds from these bonds were used to refund \$229,725 of the 2007A fixed-rate tax-exempt bonds.

In December 2016, the System entered into a term loan totaling \$50,700. The term loan has a variable rate based on a set spread over a percent of LIBOR. Proceeds from the term loan were used to refund the Series 2013D and 2013E bonds and the remainder paid for cost of issuance.

The System's debt structure consists of 56% fixed rate debt and 44% floating rate debt, \$708,200 and \$547,380 respectively. The floating rate debt structure includes \$10,000 in daily reset self-liquidity bonds that could come due at any time, \$160,000 in variable rate remarketed obligations pricing daily and weekly, \$27,935 of bank direct purchase bonds fully amortizing through 2021, \$274,445 in bank direct purchase bonds which renew at various points beginning in 2019 through 2024, and \$75,000 of weekly remarketed bonds backed with a bank letter of credit expiring in 2021.

A total of \$23,638 of bonds could become due in 2018. This amount represents i) variable rate bonds totaling \$13,638 backed by a bank letter of credit that could become due in 2018 based on the repayment schedule of the bank letter of credit upon the failure to remarket these bonds and ii) \$10,000 of variable rate bonds for which the System provides self-liquidity and are not backed by a letter of credit. The total that could become due in 2018 can be offset by the remaining available borrowing capacity of \$140,000 on the Credit Commitment, which is not due until January 21, 2021.

In connection with the issuance of the Series 2017A and B, 2016A, 2015A, B, C, D, and E, 2014A, B, and C, 2013A and B, 2012A, B, C, and D, 2010A and B, and 2007A tax-exempt bonds by the Ohio Higher Educational Facility Commission (the Commission) for the benefit of the System, the System has leased to the Commission, and the Commission has subleased to the System the certain bond-financed assets. The System does not receive rental payments under its lease to the Commission and is required only to make rental payments to the Commission at the times and in the amounts sufficient to pay principal and interest on the outstanding tax-exempt bonds under its lease from the Commission. The lease agreements expire upon repayment of all indebtedness secured by the leases.

In connection with the issuance of the Series 2001 tax-exempt bonds by Cuyahoga County (the County) for the benefit of the System, the System has leased to the County, and the County has subleased to the System, certain healthcare facilities of the System. The System does not receive rental payments under its lease to the County and is required only to make rental payments to the County at the times and in the amounts sufficient to pay principal and interest on the outstanding tax-exempt bonds under its lease from the County. The lease agreements expire upon repayment of all indebtedness secured by the leases.

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

During the term of the various agreements and leases, the System is required to make specified deposits with trustees to fund principal and interest payments due. The System is subject to certain restrictive covenants, including provisions relating to certain debt ratios, days cash on hand, and other matters. The System was in compliance with these debt covenants at December 31, 2017 and 2016.

Combined current aggregate scheduled maturities of long-term debt for the five years subsequent to December 31, 2017 are as follows: 2018 – \$23,736; 2019 – \$24,015; 2020 – \$24,835; 2021 – \$25,815; 2022 – \$26,845; and 2023 and thereafter – \$1,137,914.

The average interest rate provided in the table above includes the weighted average interest cost for each individual variable rate type series and is for the year ended December 31, 2017.

Cash paid for operating interest totaled \$46,149 and \$45,118 in 2017 and 2016, respectively.

**(9) Interest Rate Swap Agreements**

The System utilizes interest rate swaps to manage the overall cost of debt and risk profile related to its long-term debt. The swaps utilized include i) fixed-payer swaps, whereby the System receives a floating rate and pays a fixed rate designed to either hedge against rising interest rates or achieve a lower overall cost of debt relative to traditional fixed-rate structures and ii) basis swaps whereby the System receives a floating rate based on a taxable index (LIBOR) and pays a floating rate based on a tax-exempt index (SIFMA) designed to reduce interest costs associated with its traditional fixed rate debt. A summary of the System's interest rate swap agreements is as follows:

Swap type	Maturity date	Year ended December 31, 2017		Notional value at December 31	
		System pays	System receives	2017	2016
Fixed-payer	2034	3.361%	67% of 1-month LIBOR	\$ 37,500	37,500
Fixed-payer	2034	3.416%	67% of 1-month LIBOR	37,500	37,500
Basis	2028	SIFMA Index	67% of 1-month LIBOR + 0.47%	25,000	25,000
Basis	2028	SIFMA Index	67% of 1-month LIBOR + 0.53%	25,000	25,000
Fixed-payer	2034	3.493%	67% of 1-month LIBOR	37,500	37,500
Fixed-payer	2034	3.465%	67% of 1-month LIBOR	37,500	37,500
Basis	2027	SIFMA Index	86.2% of 1-month LIBOR	50,000	50,000
Fixed-payer	2044	2.295%	65% of 1-month LIBOR + 0.12%	50,000	50,000
Fixed-payer	2044	3.497%	65% of 1-month LIBOR + 0.12%	50,000	50,000
Fixed-payer	2042	3.640%	70% of 1-month LIBOR	26,590	26,590
Basis	2032	SIFMA Index	85.3% of 3-month LIBOR	50,000	50,000
Fixed-payer	2029	3.606%	64.11% of 5-year LIBOR	24,395	25,915
Fixed-payer	2030	5.091%	91.03% of 5-year LIBOR	8,380	9,140
Fixed-payer	2030	3.623%	64.09% of 5-year LIBOR	8,165	8,625
Fixed-payer	2026	3.780%	70% of 1-month LIBOR	7,455	8,185
Fixed-payer	2022	3.680%	70% of 1-month LIBOR	2,995	3,520
Fixed-payer	2021	3.308%	70% of 1-month LIBOR	8,995	11,045
Fixed-payer	2047	1.434%	70% of 1-month LIBOR	25,000	25,000
Fixed-payer	2047	1.232%	70% of 1-month LIBOR	25,000	25,000
Total Return Swap	2022	SIFMA Index + 0.625%	4.850%	52,445	—
				<u>\$ 589,420</u>	<u>543,020</u>

## UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

### Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

In 2017, the System entered into a Municipal Financing Agreement or Total Return Swap for a notional amount of \$52,445 and a termination date of 2022.

SIFMA is an index of high-grade, tax-exempt variable rate demand obligations. SIFMA ranged from 0.62% to 1.71% (average rate of 0.85%) for the year ended December 31, 2017 and 0.01% to 0.87% (average rate of 0.42%) for the year ended December 31, 2016.

The net fair value of interest rate swap agreements was a liability of \$51,703 as of December 31, 2017. The net fair value for swap agreements at December 31, 2017 consisted of \$6,476 recorded in other assets and \$58,179 recorded in other liabilities within the December 31, 2017 consolidated balance sheet. The net fair value of interest rate swap agreements was a liability of \$56,167 as of December 31, 2016. The net fair value for swap agreements at December 31, 2016 consisted of \$5,031 recorded in other assets and \$61,198 recorded in other liabilities within the December 31, 2016 consolidated balance sheet.

Change in fair value of derivative instruments in the consolidated statements of operations and changes in net assets totaled \$4,463 and \$10,456 for the years ended December 31, 2017 and 2016, respectively. Cash paid to counterparties totaled \$9,350 and \$10,701 for the years ended December 31, 2017 and 2016, respectively. Cash received from counterparties totaled \$1,737 and \$2,592 for the years ended December 31, 2017 and 2016, respectively.

The System posted collateral of \$4,947 and \$5,875 due to the decrease in swap valuations as of December 31, 2017 and 2016, respectively. The collateral is comprised of U.S. Treasury and government securities, is limited as to use, and is recorded as an investment within the consolidated balance sheets.

#### (10) Operating Leases

The System leases various facilities and equipment under operating lease agreements, which extend to 2069. Lease expense in the years ended December 31, 2017 and 2016 totaled \$35,843 and \$40,952, respectively. Future minimum noncancelable operating lease payments with terms in excess of one year are as follows:

2018	\$	28,324
2019		22,833
2020		16,535
2021		10,669
2022		8,677
2023 and thereafter		<u>27,738</u>
	\$	<u><u>114,776</u></u>

#### (11) Insurance

Western Reserve Assurance Company, Ltd. (Western Reserve), a wholly owned subsidiary of the System, provides professional and general liability insurance coverage on a claims-made basis for substantially all of the System. Effective July 1, 2004, Western Reserve was restructured from a single parent company to a segregated portfolio company (SPC), Western Reserve Assurance Company, Ltd., SPC (Western

## UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

### Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

Reserve SPC). SPC is an insurance company that operates as a single legal entity, which allows for assets and liabilities to be segregated between different protected portfolios of the company. The individual segregated portfolios do not, by law, have access or rights to the assets of any of the other segregated portfolios within SPC. At December 31, 2017, the Western Reserve SPC consists of several individual segregated portfolios. Each segregated portfolio provides coverage for its respective entity's insurance programs and is consolidated into each respective entity's consolidated financial statements. Western Reserve SPC has reinsurance agreements with unrelated commercial carriers in place relative to a portion of the risks.

Various claimants have asserted professional and general liability and workers' compensation claims against the System. These claims are in various stages of processing or are in litigation. In addition, there are known incidents, and there also may be unknown incidents, which may result in the assertion of additional claims. The System has accrued an estimate of both asserted and unasserted losses primarily based on actuarially determined amounts. The System's reserves for professional, general, and workers' compensation liabilities (including incurred but not reported claims) total \$160,796 and \$168,063 at December 31, 2017 and 2016, respectively. The current portion of the reserves, amounts to \$10,000 in both years, is recorded in other current liabilities and the remaining portion is recorded in other long-term liabilities. The retention limits per occurrence for the various policies written by Western Reserve SPC are up to \$15,000.

#### (12) Retirement Plans

The System maintains a noncontributory defined benefit pension plan (the plan) for the benefit of eligible employees. The benefits are based upon years of service and the employees' compensation, as defined by the plan. It is the System's policy to contribute annually to the defined benefit plan amounts that are actuarially determined to provide the plan with sufficient assets to meet future benefit payment requirements. In April 2015, the System froze its final average pay formula benefit, replacing it with a cash balance formula.

The System recognizes the funded status (difference between the fair value of plan assets and the projected benefit obligation) of the defined benefit pension plan on its consolidated balance sheets. Gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit costs are recognized as a component of unrestricted net assets. The System uses December 31 as the measurement date for plan assets and benefit obligations.

The amounts recognized in changes in unrestricted net assets at December 31, 2017 and 2016 consisted of the following:

	<u>2017</u>	<u>2016</u>
Amount recognized in unrestricted net assets at end of year:		
Unrecognized actuarial loss	\$ 526,693	496,460
Unrecognized prior service costs	<u>(13,288)</u>	<u>(15,686)</u>
Net amount recognized	<u>\$ 513,405</u>	<u>480,774</u>

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

The accumulated benefit obligation for the plan was \$1,238,505 and \$1,088,339 as of December 31, 2017 and 2016, respectively. The following represents selected information about the plan as of December 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Change in benefit obligation:		
Projected benefit obligation (PBO) at beginning of year	\$ 1,110,764	1,051,227
Service cost	46,178	41,292
Interest cost	38,385	38,090
Actuarial loss	135,301	51,982
Benefits paid	<u>(58,511)</u>	<u>(71,827)</u>
Projected benefit obligation at end of year	<u>1,272,117</u>	<u>1,110,764</u>
Change in plan assets:		
Fair value of assets at beginning of year	711,108	722,570
Actual return on assets	117,535	38,565
Employer contribution	115,600	21,800
Benefits paid	<u>(58,511)</u>	<u>(71,827)</u>
Fair value of assets at end of year	<u>885,732</u>	<u>711,108</u>
Funded status (PBO in excess of plan assets)	\$ <u><u>(386,385)</u></u>	<u><u>(399,656)</u></u>
	<u>2017</u>	<u>2016</u>
The components of net periodic pension costs included the following:		
Service cost	\$ 46,178	41,292
Interest cost	38,385	38,090
Expected return on plan assets	(52,122)	(51,256)
Amortization of prior service costs	(2,398)	(2,393)
Recognized net actuarial loss	<u>39,656</u>	<u>36,073</u>
Net periodic pension cost	\$ <u><u>69,699</u></u>	<u><u>61,806</u></u>

In connection with the System's adoption of ASU 2017-07, the service cost component of the net periodic pension cost are included in salaries, wages, and employees benefits and the remaining components are reported as other nonservice periodic pension costs in the accompanying consolidated statement of operations and changes in net assets for the years ended December 31, 2017 and 2016.

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

The amounts in unrestricted net assets expected to be recognized as components of net periodic pension costs in the year ended December 31, 2018 are as follows:

Amortization of prior service costs	\$	(2,399)
Recognized actuarial losses		<u>44,688</u>
Total	\$	<u><u>42,289</u></u>

The weighted average assumptions used to determine benefit obligations and net benefit cost for the years ended December 31, 2017 and 2016 were as follows:

	<u>2017</u>	<u>2016</u>
Weighted average assumptions:		
Discount rate	3.72 %	4.29 %
Expected return on plan assets	6.75	6.75
Rate of compensation increase	3.75	3.75

Pension assets are invested in various asset classes as follows:

	<u>2017</u>	<u>2016</u>
Asset class:		
Equities, mutual and exchange traded funds	42 %	44 %
Fixed income	26	22
Alternative investments	30	32
Cash and cash equivalents	2	2

The Investment Committee of the Board of Directors has responsibility for establishing and monitoring compliance with the investment policy governing the investment of pension assets. The investment policy is utilized as the basis for determining the long-term return assumption for the assets. Historical data, combined with future expected returns of each asset class, are the primary components utilized in developing this assumption. Additional information, such as specific manager performance and risk characteristics, is also included in the assessment of the long-term rate of return assumption.

The System expects to contribute \$136,200 to the plan in the year ended December 31, 2018. The estimated benefit payments, which reflect expected future service, as appropriate, are expected to be paid by the System as follows: 2018 – \$73,411; 2019 – \$78,483; 2020 – \$82,038; 2021 – \$86,514; 2022 – \$91,597; and 2023 to 2027 – \$486,633.

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

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(In thousands of dollars)

The following tables present the System's fair value leveling hierarchy for those plan assets measured at fair value as of December 31, 2017 and 2016. Refer to note 5 for level definitions.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
December 31, 2017:				
Cash and cash equivalents	\$ 15,453	—	—	15,453
Fixed income securities:				
Corporate bonds	124,935	—	—	124,935
Government securities	<u>39,403</u>	<u>—</u>	<u>—</u>	<u>39,403</u>
Total fixed securities	<u>164,338</u>	<u>—</u>	<u>—</u>	<u>164,338</u>
Equities, mutual and exchange traded funds:				
Domestic mutual funds	102,967	—	—	102,967
International mutual funds	<u>122,872</u>	<u>—</u>	<u>—</u>	<u>122,872</u>
Total equities, mutual and exchange traded funds	<u>225,839</u>	<u>—</u>	<u>—</u>	<u>225,839</u>
Total	\$ <u><u>405,630</u></u>	<u><u>—</u></u>	<u><u>—</u></u>	<u><u>405,630</u></u>

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
December 31, 2016:				
Cash and cash equivalents	\$ 14,104	—	—	14,104
Fixed income securities:				
Corporate bonds	84,049	—	—	84,049
Government securities	<u>24,762</u>	<u>—</u>	<u>—</u>	<u>24,762</u>
Total fixed securities	<u>108,811</u>	<u>—</u>	<u>—</u>	<u>108,811</u>
Equities, mutual and exchange traded funds:				
Domestic mutual funds	81,915	—	—	81,915
International mutual funds	<u>110,369</u>	<u>—</u>	<u>—</u>	<u>110,369</u>
Total equities, mutual and exchange traded funds	<u>192,284</u>	<u>—</u>	<u>—</u>	<u>192,284</u>
Total	\$ <u><u>315,199</u></u>	<u><u>—</u></u>	<u><u>—</u></u>	<u><u>315,199</u></u>

The plan held certain investments in cash and cash equivalents consisting of short-term money market instruments including commercial paper, asset backed securities, treasury bonds and bills, and short-term corporate bonds. The plan also holds certain alternative investments including hedge funds, real estate, and distressed debt.

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

The following table summarizes the System's investments at December 31, 2017 and 2016, for which NAV was used as a practical expedient to estimate fair value:

	<u>2017</u>	<u>2016</u>
Fixed income securities:		
Corporate bonds	\$ 65,051	46,021
Commingled funds:		
Domestic commingled funds	10,537	16,514
International commingled funds	<u>134,141</u>	<u>104,977</u>
Total equities, mutual and exchange traded funds	<u>144,678</u>	<u>121,491</u>
Alternative investments:		
Hedge funds	132,798	104,315
Real estate	79,585	67,667
Distressed debt	34,887	31,468
Private equity	<u>23,103</u>	<u>24,947</u>
Total alternative investments	<u>270,373</u>	<u>228,397</u>
Total	<u>\$ 480,102</u>	<u>395,909</u>

The table below classifies the net asset value at December 31, 2017 for the alternative investment portion of the plan assets into categories based on the stated contractual liquidity terms of the underlying investments:

	<u>Net asset value</u>	<u>Unfunded commitments</u>
Less than 1 year, no contractual restrictions have been imposed	\$ 133,583	1,232
Subject to existing gates or restrictions	21,839	6,429
Limited partnership fund expiring in 1–5 years	22,356	7,588
Limited partnership fund expiring in 6–10 years	82,001	46,730
Limited partnership fund expiring in 11–15 years	<u>10,594</u>	<u>59,854</u>
Total alternative investments	<u>\$ 270,373</u>	<u>121,833</u>

The System sponsors various defined contribution employee benefit plans. The System contributed \$28,274 and \$28,961 to the defined contribution employee benefit plans for the years ended December 31, 2017 and 2016, respectively.

## UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

The System also has nonqualified deferred compensation plans for certain employees. The System contributed and expensed \$4,889 and \$4,370 to the deferred compensation plans for the years ended December 31, 2017 and 2016, respectively.

### **(13) Investments in Joint Ventures**

The System has invested in a number of joint ventures to provide specialty healthcare services which are recorded on the equity method of accounting. During 1997, the System entered into an agreement with Southwest Community Health System and certain of its affiliated entities, including Southwest General Health Center (Southwest). The agreement has been amended and restated as of January 1, 2011 and is effective for 10 years. The agreement provides that 50% of the voting members of Southwest's board of trustees shall be selected for appointment by the System and that the System is entitled to 50% of the annual net income as defined in the agreement. Earnings under the Southwest joint venture for the years ended December 31, 2017 and 2016 were \$6,446 and \$3,366, respectively. Total investment in Southwest amounted to \$72,020 and \$65,574 at December 31, 2017 and 2016, respectively. Total investments for all joint ventures, including Southwest, amounted to \$83,459 and \$79,441 at December 31, 2017 and 2016, respectively, and are included in noncurrent other assets on the consolidated balance sheets.

### **(14) Care Assurance**

Various subsidiaries of the System participate in the State of Ohio's Care Assurance Program, which was established in 1988 to assist Ohio hospitals that had a disproportionate amount of uncompensated care. Under the program, Ohio hospitals, including the System's hospitals, are assessed an amount which forms a pool of funds to be matched with federal Medicaid funds for payments to hospitals. Total net revenues recorded by the System under the Care Assurance Program totaled \$20,234 and \$17,844 in the years ending December 31, 2017 and 2016, respectively. The System records the net proceeds in net patient service revenue.

### **(15) Litigation and Contingencies**

The System is involved in litigation arising in the ordinary course of business. Claims have been asserted against the System and are currently in various stages of litigation. It is the opinion of management that estimated costs accrued are adequate to provide for potential losses resulting from pending or threatened litigation.

### **(16) Special Charges**

The System incurred \$470 and \$3,764 in special charges during the years ending 2017 and 2016, respectively. The special charges related primarily to severance, impairments, and restructuring costs.

### **(17) Purchase Commitments**

The System has commitments to purchase goods and services with the following minimum contractual obligations as follows: 2018 – \$38,794; 2019 – \$34,290; 2020 – \$31,315; 2021 – \$8,623; and 2022 – \$5,224; and 2023 and thereafter – \$6,011. Purchases under these or similar contracts totaled \$97,689 and \$152,583 in the years ending December 31, 2017 and 2016, respectively, and met the provisions of the agreement.

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

**(18) Income Taxes**

The System has certain taxable subsidiaries that have incurred net losses for federal income tax purposes. The System acquired three hospitals and their respective entities in 2015 that increased these net losses. Cumulative losses available totaled approximately \$727,064 and \$632,318 at December 31, 2017 and 2016, respectively. The losses are available to offset future taxable income and expire in varying amounts through the year 2037. A tax benefit has not been recorded in the consolidated financial statements at December 31, 2017 and 2016 due to the uncertainty of realizing those benefits in the future.

On December 22, 2017, the Tax Cuts and Jobs Act (the Act) was signed into law. The Act contains various provisions affecting both for-profit and not-for-profit entities. Not-for-profit entities are impacted in part by the inclusion of new excise tax on excess compensation for covered employees, changes to unrelated business income, as well as their ability to advance refund bonds. In addition, not-for-profit entities may be impacted through certain for-profit subsidiaries and/or joint ventures based on the Act's provisions for tax rates, measurement of deferred taxes, as well as other limitations on deductions. Management of the System is currently assessing the overall impact of the Act and its impact on the consolidated financial statements.

**(19) Functional Expenses**

The System provides healthcare services, medical education, and performs medical research. Expenses related to these functions were as follows:

	<u>2017</u>	<u>2016</u>
Healthcare services	\$ 2,881,118	2,850,799
Medical education	154,975	157,788
Medical research	108,821	114,955
General and administrative	607,519	537,430
Special charges	470	3,764
Total expenses	<u>\$ 3,752,903</u>	<u>3,664,736</u>

**(20) Related Parties**

Certain members of the System's Board of Directors serve as management of companies that provide products and/or services to the System or with which the System has a contract or other relationship (e.g., schools). Two members of the System's Board of Directors are employees: the Chief Executive Officer and a physician employed by one of the entities in the System.

**UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(In thousands of dollars)

The System's management believes that transactions with related parties are entered into upon terms comparable to those that would be available from unaffiliated third parties. Related party transactions are reviewed by the Audit & Compliance Committee.

**(21) Subsequent Events**

Management has evaluated subsequent events through March 21, 2018, which represents the date the consolidated financial statements were available for issuance, to ensure that the consolidated financial statements include appropriate disclosures of events both recognized in the consolidated financial statements as of December 31, 2017, and events which occurred subsequent to December 31, 2017, but were not recognized in the consolidated financial statements. Other than the issue disclosed in the following paragraph, there were no other material subsequent event matters identified for disclosure in these consolidated financial statements.

In the first quarter of 2018, an unexpected equipment failure occurred at our Fertility Clinic, which stored eggs and embryos of patients. As of the date the consolidated financial statements were available to be issued, the investigation of the cause of the failure remained ongoing. Multiple lawsuits have been filed against the System and some of its wholly owned entities; some of the complaints include class action allegations and the System has notified its insurance carriers. The amount of loss incurred by the System in connection with this failure cannot be reasonably estimated at the date the consolidated financial statements were available for issuance.

## **SUPPLEMENTARY INFORMATION**



KPMG LLP  
One Cleveland Center  
Suite 2600  
1375 East Ninth Street  
Cleveland, OH 44114-1796

## Independent Auditors' Report on Supplementary Information

The Board of Directors  
University Hospitals Health System, Inc.:

We have audited the consolidated financial statements of University Hospitals Health System, Inc and its subsidiaries as of and for the years ended December 31, 2017 and 2016, and have issued our report thereon dated March 21, 2018, which contained an unmodified opinion on those consolidated financial statements. Our audit was performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included in Schedules 1 through 4 is presented for the purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

**KPMG LLP**

Cleveland, Ohio  
March 21, 2018

## UNIVERSITY HOSPITALS HEALTH SYSTEMS, INC.

## Supplementary Information – Balance Sheet

December 31, 2017

(In thousands of dollars)

Assets	Obligated group	Nonobligated group	Eliminations	Consolidated
Current assets:				
Cash and cash equivalents	\$ 192,386	9,396	—	201,782
Patient accounts receivable, net	426,996	137,878	—	564,874
Other receivables	44,503	21,997	(16,579)	49,921
Other current assets	138,222	25,143	—	163,365
Total current assets	<u>802,107</u>	<u>194,414</u>	<u>(16,579)</u>	<u>979,942</u>
Investments	1,664,186	83,305	—	1,747,491
Property and equipment, net	1,513,250	150,467	—	1,663,717
Other assets:				
Investments in affiliates	339,837	3,037	(246,568)	96,306
Beneficial interest in Foundations	113,820	61,193	—	175,013
Perpetual trusts	209,633	1,213	—	210,846
Other	144,547	13,758	(13,566)	144,739
Total other assets	<u>807,837</u>	<u>79,201</u>	<u>(260,134)</u>	<u>626,904</u>
Total assets	<u>\$ 4,787,380</u>	<u>507,387</u>	<u>(276,713)</u>	<u>5,018,054</u>
<b>Liabilities and Net Assets</b>				
Current liabilities:				
Current installments of long-term debt	\$ 23,726	10	—	23,736
Accounts payable and accrued expenses	365,983	48,547	—	414,530
Other current liabilities	68,969	28,075	(16,579)	80,465
Estimated amounts due to third party payors	18,659	4,508	—	23,167
Total current liabilities	<u>477,337</u>	<u>81,140</u>	<u>(16,579)</u>	<u>541,898</u>
Long-term debt, less current installments	1,245,310	20,700	(13,566)	1,252,444
Revolving credit commitment	40,000	—	—	40,000
Other liabilities	582,025	94,121	—	676,146
Total liabilities	<u>2,344,672</u>	<u>195,961</u>	<u>(30,145)</u>	<u>2,510,488</u>
Net assets:				
Unrestricted	1,738,444	246,568	(246,568)	1,738,444
Temporarily restricted	302,902	62,709	—	365,611
Permanently restricted	401,362	2,149	—	403,511
Total net assets	<u>2,442,708</u>	<u>311,426</u>	<u>(246,568)</u>	<u>2,507,566</u>
Total liabilities and net assets	<u>\$ 4,787,380</u>	<u>507,387</u>	<u>(276,713)</u>	<u>5,018,054</u>

See accompanying independent auditors' report on supplementary information and notes to supplementary information.

## UNIVERSITY HOSPITALS HEALTH SYSTEMS, INC.

## Supplementary Information – Schedule of Operations

Year ended December 31, 2017

(In thousands of dollars)

	<u>Obligated group</u>	<u>Nonobligated group</u>	<u>Eliminations</u>	<u>Consolidated</u>
Unrestricted revenues:				
Patient service revenue (net of contractual allowances and discounts)	\$ 2,596,130	1,191,663	—	3,787,793
Provision for bad debts	<u>(59,931)</u>	<u>(52,589)</u>	—	<u>(112,520)</u>
Net patient service revenue less provision for bad debts	2,536,199	1,139,074	—	3,675,273
Other revenue	<u>169,142</u>	<u>209,518</u>	<u>(157,262)</u>	<u>221,398</u>
Total unrestricted revenues	<u>2,705,341</u>	<u>1,348,592</u>	<u>(157,262)</u>	<u>3,896,671</u>
Expenses:				
Salaries, wages and employee benefits	1,271,253	957,798	(7,900)	2,221,151
Purchased services	147,570	223,537	(103,590)	267,517
Patient care supplies	515,274	139,690	—	654,964
Other supplies	32,351	13,244	—	45,595
Insurance	16,669	41,393	(20,137)	37,925
Other	273,436	80,050	(25,487)	327,999
Depreciation and amortization	135,711	16,011	—	151,722
Interest	45,541	167	(148)	45,560
Special charges	<u>219</u>	<u>251</u>	<u>—</u>	<u>470</u>
	<u>2,438,024</u>	<u>1,472,141</u>	<u>(157,262)</u>	<u>3,752,903</u>
Net operating income (loss)	267,317	(123,549)	—	143,768
Nonoperating revenues (expenses):				
Investment income	128,026	46	—	128,072
Other-than-temporary decline in investments	(1,841)	(181)	—	(2,022)
Change in fair value of derivative instruments	4,463	—	—	4,463
Gain (loss) on disposition of business unit	2,625	(13)	—	2,612
Other nonservice periodic pension costs	<u>(23,521)</u>	<u>—</u>	<u>—</u>	<u>(23,521)</u>
Excess (deficiency) of revenues over expenses	<u>\$ 377,069</u>	<u>(123,697)</u>	<u>—</u>	<u>253,372</u>

See accompanying independent auditors' report on supplementary information and notes to supplementary information.

## UNIVERSITY HOSPITALS HEALTH SYSTEMS, INC.

## Supplementary Information – Balance Sheet

December 31, 2016

(In thousands of dollars)

<b>Assets</b>	<b>Obligated group</b>	<b>Nonobligated group</b>	<b>Eliminations</b>	<b>Consolidated</b>
Current assets:				
Cash and cash equivalents	\$ 230,490	34,037	—	264,527
Patient accounts receivable, net	424,752	125,305	—	550,057
Other receivables	75,096	120,130	(123,354)	71,872
Other current assets	124,461	24,694	—	149,155
Total current assets	<u>854,799</u>	<u>304,166</u>	<u>(123,354)</u>	<u>1,035,611</u>
Investments	1,448,440	80,240	—	1,528,680
Property and equipment, net	1,488,894	129,119	—	1,618,013
Other assets:				
Investments in affiliates	391,999	4,950	(305,786)	91,163
Beneficial interest in Foundations	101,855	56,130	—	157,985
Perpetual trusts	189,904	1,111	—	191,015
Other	134,440	13,109	—	147,549
Total other assets	<u>818,198</u>	<u>75,300</u>	<u>(305,786)</u>	<u>587,712</u>
Total assets	<u>\$ 4,610,331</u>	<u>588,825</u>	<u>(429,140)</u>	<u>4,770,016</u>
<b>Liabilities and Net Assets</b>				
Current liabilities:				
Current installments of long-term debt	\$ 23,095	95	—	23,190
Accounts payable and accrued expenses	367,842	53,393	—	421,235
Other current liabilities	124,819	72,136	(123,354)	73,601
Estimated amounts due to third party payors	22,573	2,152	—	24,725
Total current liabilities	<u>538,329</u>	<u>127,776</u>	<u>(123,354)</u>	<u>542,751</u>
Long-term debt, less current installments	1,271,933	152	—	1,272,085
Revolving credit commitment	40,000	—	—	40,000
Other liabilities	606,074	94,160	—	700,234
Total liabilities	<u>2,456,336</u>	<u>222,088</u>	<u>(123,354)</u>	<u>2,555,070</u>
Net assets:				
Unrestricted	1,506,683	307,554	(305,786)	1,508,451
Temporarily restricted	281,450	57,671	—	339,121
Permanently restricted	365,862	1,512	—	367,374
Total net assets	<u>2,153,995</u>	<u>366,737</u>	<u>(305,786)</u>	<u>2,214,946</u>
Total liabilities and net assets	<u>\$ 4,610,331</u>	<u>588,825</u>	<u>(429,140)</u>	<u>4,770,016</u>

See accompanying independent auditors' report on supplementary information and notes to supplementary information.

## UNIVERSITY HOSPITALS HEALTH SYSTEMS, INC.

## Supplementary Information – Schedule of Operations

Year ended December 31, 2016

(In thousands of dollars)

	<u>Obligated group</u>	<u>Nonobligated group</u>	<u>Eliminations</u>	<u>Consolidated</u>
Unrestricted revenues:				
Patient service revenue (net of contractual allowances and discounts)	\$ 2,535,044	1,124,121	—	3,659,165
Provision for bad debts	<u>(41,233)</u>	<u>(47,909)</u>	—	<u>(89,142)</u>
Net patient service revenue less provision for bad debts	2,493,811	1,076,212	—	3,570,023
Other revenue	<u>164,946</u>	<u>199,236</u>	<u>(144,633)</u>	<u>219,549</u>
Total unrestricted revenues	<u>2,658,757</u>	<u>1,275,448</u>	<u>(144,633)</u>	<u>3,789,572</u>
Expenses:				
Salaries, wages and employee benefits	1,232,582	929,557	(7,909)	2,154,230
Purchased services	167,266	209,165	(97,955)	278,476
Patient care supplies	499,927	109,975	—	609,902
Other supplies	38,175	14,332	—	52,507
Insurance	19,879	41,000	(18,606)	42,273
Other	267,659	88,064	(20,163)	335,560
Depreciation and amortization	124,864	15,752	—	140,616
Interest	47,394	14	—	47,408
Special charges	<u>2,791</u>	<u>973</u>	—	<u>3,764</u>
	<u>2,400,537</u>	<u>1,408,832</u>	<u>(144,633)</u>	<u>3,664,736</u>
Net operating income (loss)	258,220	(133,384)	—	124,836
Nonoperating revenues (expenses):				
Investment income	25,237	(4)	—	25,233
Other-than-temporary decline in investments	(4,815)	(553)	—	(5,368)
Change in fair value of derivative instruments	10,456	—	—	10,456
Loss on extinguishment of debt	(8,156)	—	—	(8,156)
Gain on disposition of business unit	4,039	—	—	4,039
Other nonservice periodic pension costs	<u>(20,514)</u>	<u>—</u>	<u>—</u>	<u>(20,514)</u>
Excess (deficiency) of revenues over expenses	<u>\$ 264,467</u>	<u>(133,941)</u>	<u>—</u>	<u>130,526</u>

See accompanying independent auditors' report on supplementary information and notes to supplementary information.

## UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Supplementary Information

December 31, 2017 and 2016

(In thousands of dollars)

### (1) Basis of Presentation

In the accompanying supplementary information, the Obligated group includes the following:

- University Hospitals Health System, Inc. (the System)
- University Hospitals Cleveland Medical Center (UHCMC)
- University Hospitals Geauga Medical Center
- University Hospitals Ahuja Medical Center, Inc.
- Parma Community General Hospital Association d/b/a University Hospitals Parma Medical Center
- EMH Regional Hospital Medical Center d/b/a University Hospitals Elyria Medical Center
- University Hospitals St. John Medical Center

Certain affiliated or controlled entities of the System required to be consolidated with the System in accordance with accounting principles generally accepted in the United States of America are presented in the supplementary information as Nonobligated group totals. Entities included in the Nonobligated group include the following:

- University Hospitals Health Care Enterprises, Inc.
- University Hospitals Regional Hospitals Richmond Medical Center Campus
- University Hospitals Conneaut Medical Center
- University Hospitals Geneva Medical Center
- University Hospitals Regional Hospitals Bedford Medical Center Campus
- University Hospitals Health System MCO, Inc. d/b/a University Hospitals CompCare
- University Hospitals Medical Group, Inc.
- University Hospitals Holdings, Inc.
- Western Reserve Assurance Company Ltd., SPC
- University Hospitals Samaritan Medical Center
- University Hospitals Portage Medical Center