



UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Financial Statements
and Supplementary Information

December 31, 2018 and 2017

(With Independent Auditors' Reports Thereon)

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

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KPMG LLP
One Cleveland Center
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Cleveland, OH 44114-1796

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, 2018 and 2017, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

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

KPMG LLP

Cleveland, Ohio
March 20, 2019

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Balance Sheets

December 31, 2018 and 2017

(In thousands of dollars)

Assets	2018	2017
Current assets:		
Cash and cash equivalents	\$ 288,517	201,782
Patient accounts receivable, less allowance for doubtful accounts of \$69,920 in 2017	568,227	564,874
Other receivables	70,155	49,921
Other current assets	<u>172,548</u>	<u>163,365</u>
Total current assets	1,099,447	979,942
Investments	1,737,542	1,747,491
Property and equipment, net	1,736,862	1,663,717
Other assets:		
Investments in affiliates	100,557	96,306
Beneficial interest in Foundations	162,724	175,013
Perpetual trusts	189,303	210,846
Other	<u>197,319</u>	<u>144,739</u>
Total other assets	<u>649,903</u>	<u>626,904</u>
Total assets	\$ <u><u>5,223,754</u></u>	<u><u>5,018,054</u></u>

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Balance Sheets

December 31, 2018 and 2017

(In thousands of dollars)

Liabilities and Net Assets	2018	2017
Current liabilities:		
Current installments of long-term debt	\$ 24,446	23,736
Accounts payable and accrued expenses	447,967	414,530
Other current liabilities	148,453	80,465
Estimated amounts due to third-party payors	20,569	23,167
Total current liabilities	641,435	541,898
Long-term debt, less current installments	1,227,641	1,252,444
Revolving credit line	140,000	40,000
Other liabilities	626,748	676,146
Total liabilities	2,635,824	2,510,488
Net assets:		
Without donor restrictions	1,824,631	1,738,444
With donor restrictions	763,299	769,122
Total net assets	2,587,930	2,507,566
Total liabilities and net assets	\$ 5,223,754	5,018,054

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, 2018 and 2017

(In thousands of dollars)

	<u>2018</u>	<u>2017</u>
Revenues:		
Patient service revenue (net of contractual allowances and discounts)	\$ —	3,787,793
Provision for bad debts	—	(112,520)
Net patient service revenue	<u>3,893,916</u>	<u>3,675,273</u>
Other revenue	<u>223,868</u>	<u>221,398</u>
Total revenues	<u>4,117,784</u>	<u>3,896,671</u>
Expenses:		
Salaries, wages, and employee benefits	2,325,296	2,221,151
Purchased services	281,733	267,517
Patient care supplies	723,608	654,964
Other supplies	46,359	45,595
Insurance	49,191	37,925
Other	340,792	327,999
Depreciation and amortization	163,562	151,722
Interest	46,212	45,560
Special charges	7,599	470
Total expenses	<u>3,984,352</u>	<u>3,752,903</u>
Net operating income	133,432	143,768
Nonoperating revenues (expenses):		
Net investment (loss) income	(32,772)	126,050
Change in fair value of derivative instruments	10,195	4,463
Loss on extinguishment of debt	(442)	—
Gain on disposition of business unit	—	2,612
Pension settlement costs	(42,539)	—
Other nonservice periodic pension costs	(21,496)	(23,521)
Excess of revenues over expenses	<u>\$ 46,378</u>	<u>253,372</u>

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2018 and 2017

(In thousands of dollars)

	Without donor restrictions	With donor restrictions	Total
Net assets at December 31, 2016	\$ 1,508,451	706,495	2,214,946
Excess of revenues over expenses	253,372	—	253,372
Investment income	—	9,284	9,284
Contribution and grant revenue	—	49,446	49,446
Change in beneficial interest in Foundations and perpetual trusts	—	36,859	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 net assets without donor restrictions	(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	1,063	—	1,063
	<u>229,993</u>	<u>62,627</u>	<u>292,620</u>
Increase in net assets			
Net assets at December 31, 2017	<u>1,738,444</u>	<u>769,122</u>	<u>2,507,566</u>
Excess of revenues over expenses	46,378	—	46,378
Investment income	—	10,254	10,254
Contribution and grant revenue	—	52,480	52,480
Change in beneficial interest in Foundations and perpetual trusts	—	(33,862)	(33,862)
Net assets released from restrictions used for operations	—	(31,259)	(31,259)
Pension settlement costs	42,539	—	42,539
Pension liability adjustment	(6,682)	—	(6,682)
Net assets released from restrictions for acquisition of property and equipment	3,436	(3,436)	—
Contributed capital	516	—	516
	<u>86,187</u>	<u>(5,823)</u>	<u>80,364</u>
Increase (decrease) in net assets			
Net assets at December 31, 2018	\$ <u><u>1,824,631</u></u>	<u><u>763,299</u></u>	<u><u>2,587,930</u></u>

See accompanying notes to consolidated financial statements.

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2018 and 2017

(In thousands of dollars)

	<u>2018</u>	<u>2017</u>
Operating activities:		
Change in net assets	\$ 80,364	292,620
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	163,562	151,722
Amortization of bond premium, discount, and financing costs	(477)	(233)
Provision for bad debts	—	112,520
Loss on extinguishment of debt	442	—
Change in beneficial interest in foundations and perpetual trusts	33,862	(36,859)
Net realized and unrealized investment (gains) losses	63,568	(102,257)
Pension liability adjustment	6,682	32,631
Net change attributable to investments in joint ventures	(4,251)	(5,143)
Restricted revenue and investment income	2,916	(21,529)
Gain on disposal of business unit	—	(2,612)
Net change in operating assets and liabilities:		
Patient accounts receivable	(3,353)	(127,338)
Other current assets	(29,417)	7,840
Accounts payable, accrued expenses, and other current liabilities	99,475	846
Other assets and liabilities	(111,730)	(55,524)
Net cash provided by operating activities	<u>301,643</u>	<u>246,684</u>
Investing activities:		
Acquisition of property and equipment	(236,161)	(198,685)
Proceeds from sales of investments	651,962	1,329,836
Purchases of investments	(705,581)	(1,446,392)
Net proceeds from disposal of business unit	—	3,000
Net cash used in investing activities	<u>(289,780)</u>	<u>(312,241)</u>
Financing activities:		
Proceeds from restricted revenue and investment income (loss)	(2,916)	21,529
Repayment of long-term debt	(372,794)	(75,976)
Proceeds from issuance of long-term debt	352,370	57,114
Bond issuance costs	(3,192)	—
Proceeds from revolving credit borrowing	100,000	—
Increase in treasury service agreement	1,404	145
Net cash provided by financing activities	<u>74,872</u>	<u>2,812</u>
Increase (decrease) in cash and cash equivalents	86,735	(62,745)
Cash and cash equivalents at beginning of year	<u>201,782</u>	<u>264,527</u>
Cash and cash equivalents at end of period	\$ <u>288,517</u>	\$ <u>201,782</u>
Supplemental cash flow information:		
Change in accounts payable related to property and equipment	\$ (546)	(1,259)

See accompanying notes to consolidated financial statements.

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(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. The carrying amount of cash and cash equivalents approximates fair value.

(b) 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. Effective January 1, 2018, the System changed its investment advisor and custodian. As part of this significant change, the System has designated its investments as a trading portfolio. 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 of the fund or partnership as a practical expedient.

Interest, dividends, unrealized and realized gains and losses from all investments without restrictions are recorded within nonoperating revenues on the consolidated statements of operations and changes in net assets as investment income (loss). Investment income (loss) on investments with restrictions is recorded according to the donor's intentions and reported with donor restrictions as investment income (loss) within the consolidated statements of operations and changes in net assets.

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.

(c) 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 \$2,450 and \$2,210 for the years ended December 31, 2018 and 2017, respectively.

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(In thousands of dollars)

Deferred financing costs are capitalized when incurred, and then amortized during the period in which the debt is outstanding. Net deferred financing costs totaled \$11,945 and \$9,852 for the years ended December 31, 2018 and 2017 and are reported as a component of long-term debt on the consolidated balance sheets.

(d) 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. Management has reviewed the carrying amount of these assets and has determined that they are not currently impaired.

(e) Contribution and Grant Revenue

Unconditional donor promises to give cash, marketable securities, and other assets to the System are recognized and reported at fair value net of fund-raising costs, 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 donor imposed conditions are satisfied. The System has conditional donor promises to give of \$222,239 and \$201,310 at December 31, 2018 and 2017, respectively, which have not been recognized as assets or revenues in the consolidated financial statements.

Unconditional contribution and grant revenue with no purpose or time restrictions are included in the consolidated statements of operations and changes in net assets as other revenue within net assets without donor restrictions. Contributions that are received with donor imposed restrictions that limit the use of the asset are reported in the consolidated statements of operations and changes in net assets as contribution revenue with donor restrictions. When the donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is met, net assets with donor restrictions are transferred to net assets without donor restrictions.

Contributions that have been received from various corporations, foundations, and individuals for the years ended December 31, 2018 and 2017 are reported as follows:

	<u>2018</u>	<u>2017</u>
Without donor restrictions	\$ 2,214	3,842
With donor restrictions	<u>52,480</u>	<u>49,446</u>
	<u>\$ 54,694</u>	<u>53,288</u>

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

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(In thousands of dollars)

Outstanding pledges receivable are recorded at their net present value and reported in current other assets or noncurrent other assets on the consolidated balance sheet. The balances at December 31, 2018 and 2017 are as follows:

	<u>2018</u>	<u>2017</u>
Pledges due:		
In less than one year	\$ 44,044	42,677
In one year to five years	50,716	49,336
In more than five years	<u>46,701</u>	<u>38,609</u>
	141,461	130,622
Discount	(14,655)	(11,420)
Allowance for doubtful pledges	<u>(3,013)</u>	<u>(2,849)</u>
	<u>\$ 123,793</u>	<u>116,353</u>

Amounts received from government agencies are reported in the consolidated statements of operations and changes in net assets as other revenue within net assets without donor restrictions since government grant restrictions are met in the same reporting period as revenue is recognized. Grants revenue totaled \$6,377 and \$7,803 for the years ended December 31, 2018 and 2017, respectively.

The System has elected to report restricted contributions and grants whose restrictions are met in the same reporting period as the revenue is recognized as other revenue with net assets without donor restrictions.

(f) Net Patient Service Revenue

The System's net patient service revenue is reported at the amount that reflects the consideration to which the System expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (e.g., Medicare, Medicaid, and commercial insurance carriers), and others and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, the System bills the patients and third-party payors several days after the services are performed and/or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by the System. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total actual charges. The System believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients receiving inpatient services. The System measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time is

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December 31, 2018 and 2017

(In thousands of dollars)

recognized when services are provided and the System does not believe it is required to provide additional services to the patient.

As a result of all its performance obligations relating to patient contracts being less than a year in duration, the System has elected to apply the optional exemption in Financial Accounting Standards Board (FASB) Accounting Standard Codification (ASC) Topic 606-10-50-14(a). This exemption does not require the System to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied (or partially unsatisfied) as of the end of the reporting period. These unsatisfied or partially unsatisfied performance obligations primarily relate to inpatient services at the end of the reporting period.

The System records revenue based on standard charges for services provided, reduced by variable considerations resulting from explicit contractual adjustments provided to third-party payors and implicit price concessions provided to patients as reductions from established billing rates. The System determines its estimates of explicit and implicit price concessions based on historical data from experience, market condition and other factors.

Explicit and implicit price concessions to revenue are recorded at the time the performance obligations are satisfied in exchange for providing services to patients. Any changes to these concessions, as a result of subsequent reassessment, are recognized in the period the change is identified as adjustments to net patient service revenue. The amount recognized due to changes in its estimates of explicit and implicit price concessions for the year ended December 31, 2018 is not significant. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense. There was no bad debt expense for the year ended December 31, 2018.

For the year ended December 31, 2017, the System maintained an allowance for doubtful accounts based on the expected collectability of patient accounts receivable. In evaluating the collectability of patient accounts receivable, the System considered historical collection experience and other economic factors.

The System provides care to patients who do not have the ability to pay and who qualify for charity care pursuant to the established policies of the System and the State of Ohio's Care Assurance Program (HCAP). Charity care is defined as services for which patients have the obligation to pay, but do not have the ability to do so. The charges for charity care provided by the System are entirely offset by the related implicit price concessions and therefore, are not recognized as net patient service revenue. The cost of charity care provided in 2018 and 2017 was \$46,800 and \$42,562, respectively. The System determines its estimate of the cost of charity care by applying an overall cost to charge ratio to the charges associated with patients who qualify for charity care.

(g) Other Revenue

The System's other revenue consists of contracts that vary in duration and in performance obligations. In evaluating these revenue streams that fall under ASC Topic 606 for compliance with this Topic, there were no changes to the nature, timing or extent of revenues previously recognized. Revenues are recognized when the performance obligations identified within the individual contracts are satisfied and

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(In thousands of dollars)

collections can be reasonably assured. There are certain revenue streams under Other Revenue that are not subject to this Topic.

(h) Derivative Financial Instruments

Derivative financial instruments are reported at fair value and 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 System's interest rate swap agreements are not designated as hedging instruments.

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.

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. 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 (note 9).

(i) 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, 2018 and 2017, the System does not have any uncertain tax positions.

(j) 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.

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(In thousands of dollars)

(k) 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.

(l) 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, 2018 and 2017, the amount outstanding included within accounts payable was \$63,948 and \$62,547, respectively.

(m) Recently Issued Accounting Standards

In August 2016, the FASB issued Accounting Standard Update (ASU) 2016-14, Not-for-Profit Entities (Topic 958): *Presentation of Financial Statements of Not-for-Profit Entities*. This update is intended to improve financial statement requirements by not-for-profit organizations. There are changes to qualitative and quantitative requirements in a number of areas including; net asset classification, liquidity and availability of resources, disclosing expenses by both their natural and functional classification, financial performance and cash flows. The main provision of this guidance reduces the number of net asset classes presented on the balance sheet from three to two: *with donor restrictions and without donor restrictions*. The System adopted ASU 2016-14 effective January 1, 2018 using the retrospective method of transition. As a result of adopting this standard certain prior year amounts were reclassified to conform to the presentation requirements of the standard.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which outlines a single comprehensive model for entities to recognize revenue in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 supersedes the most current revenue recognition guidance in U.S. GAAP and requires significant expanded disclosures about the nature, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments. The System adopted ASU 2014-09 on January 1, 2018 using the modified retrospective method of transition. There was no material impact to the System related to its existing revenue streams.

In June 2018, the FASB issued ASU 2018-08, *Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made (Topic 958)* which is intended to improve and clarify existing guidance on revenue recognition of grants and contracts by not-for-profit entities. The Standard addresses concerns that it is difficult to determine whether certain grants and similar contracts are exchange transactions or contributions. The distinction is important because contributions

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(In thousands of dollars)

are accounted for under Accounting Standards Codification (ASC) 958-605, Not-for-Profit Entities — Revenue Recognition, while exchanges are accounted for under other guidance (e.g., ASC 606, Revenue from Contracts with Customers). For contributions, the timing of revenue and expense recognition depends on whether they are conditional. An unconditional contribution is recognized when it is received or made, while a conditional contribution is recognized when the barriers to entitlement are overcome. This ASU is effective for fiscal years beginning after June 15, 2018, but the System early adopted it simultaneously with ASU 2014-09 using the modified retrospective method of transition. There was no material impact to the System related to adoption of this ASU.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10)* which requires entities to measure equity method investments that do not result in consolidation and are not accounted for under the equity method at fair value and recognize and changes in fair value in excess of revenues over expenses. The System adopted the ASU using the cumulative-effect method of transition. There was no cumulative effect adjustment as a result of adopting this standard.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* which requires lessees to recognize assets and liabilities on the balance sheet for all leases with lease terms greater than twelve months. ASU 2016-02 amends current guidance that requires only capital leases to be recognized on the lessee balance sheet. ASU 2016-02 also requires significantly expanded disclosures about the timing, amount and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for the System January 1, 2019. The System estimates that as a result of the adoption of ASU 2016-02 it will record a right-of-use asset and lease liability in excess of \$100 million.

(n) Reclassifications

Certain amounts included in the 2017 consolidated financial statements have been reclassified to conform to the 2018 presentation.

(3) Net Patient Service Revenue

Net patient service revenue by major payer source as of December 31, 2018 and 2017, are as follows:

	<u>2018</u>		<u>2017</u>	
Medicare	\$ 1,257,517	32%	\$ 1,230,595	33%
Medicaid	557,040	14	510,444	14
Managed Care and commercial	1,888,945	49	1,767,147	48
Self-pay	<u>190,414</u>	5	<u>167,087</u>	5
	<u>\$ 3,893,916</u>		<u>\$ 3,675,273</u>	

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. The composition of accounts receivable as of December 31, 2018 and 2017 approximates the net patient service revenue composition in the table above.

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Notes to Consolidated Financial Statements

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(In thousands of dollars)

(4) Net Assets with Donor Restrictions

Net assets with donor restrictions are available for the following purposes and the amount of beneficial interest in Foundations at December 31, 2018 and 2017 are as follows:

	<u>2018</u>	<u>2017</u>
Time/purpose restrictions:		
Capital expenditures	\$ 54,268	47,735
Education	13,057	9,193
Research	99,414	100,038
Patient care	77,791	65,338
Beneficial interest in foundations	132,050	143,307
Amounts held in perpetuity:		
Perpetual trusts	189,303	210,876
Receivables	17,025	16,557
Endowments	149,717	144,372
Beneficial interest in foundations	30,674	31,706
	<u>\$ 763,299</u>	<u>769,122</u>

During the years ended December 31, 2018 and 2017, net assets released from restrictions used for operations totaled \$31,259 and \$28,232, respectively. Net assets released from restrictions used for operations are recorded in other revenue in the consolidated statements of operations and changes in net assets. In addition, \$3,436 and \$4,979 in net assets were released from restriction for the acquisition of property and equipment in the years ended December 31, 2018 and 2017, respectively.

The System's endowment consists of 453 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 donor restricted endowment funds' original corpus, totaled \$149,717 and \$144,372 at December 31, 2018 and 2017, respectively. Board designated funds totaled \$30,268 and \$32,727 at December 31, 2018 and 2017, and are included within investments and net assets without donor restrictions.

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

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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.

	<u>Without donor restriction</u>	<u>With donor restriction</u>	<u>Total</u>
Endowment net assets, at December 31, 2016	\$ 30,005	163,563	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>(7,956)</u>
Endowment net assets, at December 31, 2017	32,727	194,760	227,487
Endowment return:			
Investment income (loss)	(1,598)	(5,627)	(7,225)
Contributions	—	5,345	5,345
Appropriation of endowment assets for expenditure	<u>(861)</u>	<u>(9,164)</u>	<u>(10,025)</u>
Endowment net assets, at December 31, 2018	\$ <u>30,268</u>	<u>185,314</u>	<u>215,582</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.

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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.

Assets and liabilities 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. 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.

Items classified as Level 3 in the fair value hierarchy include beneficial interest in Foundations, perpetual trusts, and exclude pledges of \$126,838 and \$119,202 at December 31, 2018 and 2017, respectively. 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 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. Amounts held in perpetuity as designated by donors, includes 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 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.

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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, 2018:				
Assets:				
Cash and cash equivalents	\$ 288,517	—	—	288,517
Cash and cash equivalents – pooled with investments:	33,059	—	—	33,059
Restricted cash – held by bond trustees	110,846			110,846
Fixed income securities:				
Corporate bonds	—	186,770	—	186,770
Fixed income mutual funds	535,610	—	—	535,610
Government securities	103,606	41,003	—	144,609
Total fixed income securities	<u>639,216</u>	<u>227,773</u>	<u>—</u>	<u>866,989</u>
Equities, mutual and exchange traded funds:				
Domestic mutual funds	224,411	10,878	—	235,289
International mutual funds	51,376	113,563	—	164,939
Total equities, mutual and exchange traded funds	<u>275,787</u>	<u>124,441</u>	<u>—</u>	<u>400,228</u>
Deferred compensation assets – mutual funds	18,764	—	—	18,764
Beneficial interest in Foundations	—	—	162,724	162,724
Perpetual trusts	—	—	189,303	189,303
Interest rate swaps	—	8,084	—	8,084
Total assets	<u>\$ 1,366,189</u>	<u>360,298</u>	<u>352,027</u>	<u>2,078,514</u>
Liabilities:				
Deferred compensation liabilities	\$ 18,764	—	—	18,764
Interest rate swaps	—	49,592	—	49,592
Total liabilities	<u>\$ 18,764</u>	<u>49,592</u>	<u>—</u>	<u>68,356</u>

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	<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:	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	224,311	12,191	—	236,502
International mutual funds	59,766	131,741	—	191,507
Total equities, mutual and exchange traded funds	284,077	143,932	—	428,009
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>\$ 1,266,292</u>	<u>407,165</u>	<u>385,859</u>	<u>2,059,316</u>
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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The following table summarizes the System's investments at December 31, 2018 and 2017, for which NAV was used as a practical expedient to estimate fair value:

	<u>2018</u>	<u>2017</u>
Hedge funds	\$ 220,913	218,057
Real estate	37,832	32,901
Private debt	30,338	23,568
Private equity	<u>35,200</u>	<u>28,029</u>
Total alternative investments	\$ <u>324,283</u>	<u>302,555</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, 2018 and 2017, there were no transfers into or out of Level 1, 2, or 3.

For the years ended December 31, 2018 and 2017, the reconciliation of investments with fair value measurements using significant unobservable inputs (level 3) is as follows:

	<u>Fair value measurements using significant unobservable inputs (Level 3)</u>		
	<u>Beneficial interest in Foundations</u>	<u>Perpetual trusts</u>	<u>Total</u>
Balance at December 31, 2016	\$ 157,985	191,015	349,000
Total change included in:			
Donor restricted net assets	<u>17,028</u>	<u>19,831</u>	<u>36,859</u>
Balance at December 31, 2017	175,013	210,846	385,859
Total change included in:			
Donor restricted net assets	<u>(12,289)</u>	<u>(21,543)</u>	<u>(33,832)</u>
Balance at December 31, 2018	\$ <u>162,724</u>	<u>189,303</u>	<u>352,027</u>

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(6) Investments

The composition of investments at December 31, 2018 and 2017 are as follows:

	<u>2018</u>	<u>2017</u>
Cash and cash equivalents – pooled with investments	\$ 33,059	44,093
Restricted cash - held by bond trustees	110,846	—
Fixed income securities	866,989	971,676
Equities, mutual and exchange traded funds	400,228	428,009
Alternative investments	324,283	302,555
Other	<u>2,137</u>	<u>1,158</u>
Total investments	\$ <u>1,737,542</u>	<u>1,747,491</u>

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 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.

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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, 2018 are as follows:

	<u>Carrying</u> <u>value</u>	<u>Unfunded</u> <u>commitments</u>
Less than 1 year, no contractual restrictions have been imposed	\$ 229,178	116
Subject to existing gates or restrictions	5,393	—
Limited Partnership Fund expiring in 1 – 5 years	35,967	6,661
Limited Partnership Fund expiring in 6 – 10 years	36,488	29,493
Limited Partnership Fund expiring in 11 – 12 years	17,257	52,447
	<u> </u>	<u> </u>
Total alternative investments	\$ <u>324,283</u>	<u>88,717</u>

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

	<u>2018</u>	<u>2017</u>
Without donor restriction and board designated	\$ 1,336,732	1,475,566
Swap collateral	2,937	4,850
Investments held by bond trustees	110,846	—
With donor restriction	287,027	267,075
	<u> </u>	<u> </u>
Total investments	\$ <u>1,737,542</u>	<u>1,747,491</u>

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Investment income (loss) is comprised of the following for the years ended December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Interest and dividend income:		
Without donor restriction	\$ 30,472	29,599
With donor restriction	<u>4,020</u>	<u>4,452</u>
	<u>34,492</u>	<u>34,051</u>
Net (loss) gain:		
Without donor restriction	(63,244)	98,473
With donor restriction	<u>6,234</u>	<u>4,832</u>
	<u>(57,010)</u>	<u>103,305</u>
Total (loss) income	\$ <u><u>(22,518)</u></u>	<u><u>137,356</u></u>

(7) Property and Equipment

Property and equipment, at December 31, 2018 and 2017, are summarized below:

	<u>2018</u>	<u>2017</u>
Land and land improvements	\$ 168,744	165,226
Buildings and fixed equipment	2,004,219	1,902,560
Movable equipment and furnishings	1,489,105	1,381,582
Construction in progress	<u>108,044</u>	<u>91,196</u>
	3,770,112	3,540,564
Less accumulated depreciation	<u>2,033,250</u>	<u>1,876,847</u>
Net property and equipment	\$ <u><u>1,736,862</u></u>	<u><u>1,663,717</u></u>

As of December 31, 2018, the System has made contractual commitments on construction contracts, including information technology projects, of \$69,407.

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

The System's \$225,000 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, 2018 and 2017, the average interest rate for borrowings under this credit line was 2.95% and 2.04%, respectively. As of December 31, 2018 and 2017, there were \$140,000 and \$40,000, respectively, in borrowings outstanding under the Credit Commitment reported within noncurrent liabilities in the consolidated balance sheet. The remaining available Credit Commitment is \$85,000 and \$140,000 at December 31, 2018 and 2017, respectively.

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A summary of long-term debt at December 31, 2018 and 2017 is as follows:

Series	Type	Average interest rate% for the year ended December 31, 2018	Final maturity	Amount outstanding December 31	
				2018	2017
2018A Revenue Bonds	Variable	1.62	2046	\$ 25,230	—
2018B Revenue Bonds	Variable	1.63	2047	88,505	—
2018C Revenue Bonds	Fixed	4.52	2042	60,850	—
2018D Revenue Bonds	Fixed	4.31	2039	57,355	—
2018E Revenue Bonds	Variable	2.31	2036	109,150	—
2017A Revenue Bonds	Variable	2.33	2035	—	41,000
2017B Revenue Bonds	Variable	2.38	2035	—	9,000
2016A Revenue Bonds	Fixed	3.59	2046	229,725	229,725
2015A Revenue Bonds	Variable	1.64	2045	30,000	30,000
2015B Revenue Bonds	Variable	1.70	2045	30,000	30,000
2015C Revenue Bonds	Variable	1.64	2045	40,000	40,000
2015D Revenue Bonds	Variable	2.35	2046	—	77,560
2015E Revenue Bonds	Variable	2.35	2046	—	12,285
2014A Revenue Bonds	Fixed	3.69	2044	56,145	56,145
2014B Revenue Bonds	Variable	1.64	2045	30,000	30,000
2014C Revenue Bonds	Variable	2.38	2044	—	35,000
2013A Revenue Bonds	Fixed	4.65	2029	83,455	85,560
2013B Revenue Bonds	Variable	1.70	2033	30,000	30,000
2013C Revenue Bonds	Variable	1.89	2050	—	75,000
2012A Revenue Bonds	Fixed	4.73	2041	169,550	172,090
2012B Revenue Bonds	Variable	2.55	2019	4,750	9,290
2012C Revenue Bonds	Fixed	3.71	2042	55,825	55,825
2012D Revenue Bonds	Variable	2.10	2021	13,980	18,645
2010A Revenue Bonds	Fixed	4.82	2027	47,440	51,410
2010B Revenue Bonds	Variable	1.78	2035	—	50,000
2007A Revenue Bonds	Fixed	4.85	2041	52,445	52,445
2001 Revenue Bonds	Variable	2.14	2033	10,000	10,000
Term Loan	Variable	2.90	2040	—	49,600
Note Payable	Fixed	1.50	2036	—	5,000
Other long-term debt				7,051	7,580
				<u>1,231,456</u>	<u>1,263,160</u>
Unamortized premium				34,285	24,697
Less:					
Unamortized discount				1,709	1,825
Deferred financing costs				11,945	9,852
Current installments				<u>24,446</u>	<u>23,736</u>
Long-term debt, less current installments				<u>\$ 1,227,641</u>	<u>1,252,444</u>

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, 2018.

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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.

During 2018, the System issued tax-exempt bonds totaling \$341,090 with total proceeds of \$352,320. Proceeds from these bonds totaling \$222,117 were used to refund the Series 2010B, 2014C, 2015D and E, and 2017A and B bonds and the remaining proceeds of \$130,203 were used to finance new capital projects and the cost of issuance.

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, 2018, 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.

The System's debt structure consists of 66% fixed rate debt and 34% floating rate debt, \$812,790 and \$411,615 respectively. The floating rate debt structure includes \$10,000 in daily reset self-liquidity bonds that could come due at any time, \$273,735 in variable rate remarketed obligations pricing daily and weekly, \$18,730 of bank direct purchase bonds fully amortizing through 2021, and \$109,150 in bank direct purchase bonds which renew in 2025.

A total of \$14,585 of bonds could become due in 2019. This amount represents i) variable rate bonds totaling \$4,585 backed by a bank letter of credit that could become due in 2019 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 2019 can be offset by the remaining available borrowing capacity of \$85,000 on the Credit Commitment, which is not due until January 21, 2021.

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, 2018 and 2017.

Combined current aggregate scheduled maturities of long-term debt for the five years subsequent to December 31, 2018 are as follows: 2019 – \$24,446; 2020 – \$24,220; 2021 – \$25,260; 2022 – \$26,310; 2023 – \$27,540; and 2024 and thereafter – \$1,103,680.

Cash paid for operating interest totaled \$45,514 and \$46,149 in 2018 and 2017, respectively.

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(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, 2018		Notional value at December 31	
		System pays	System receives	2018	2017
Fixed-payer	2034	3.36%	67% of 1-month LIBOR	\$ 37,500	37,500
Fixed-payer	2034	3.42	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	3.49%	67% of 1-month LIBOR	37,500	37,500
Fixed-payer	2034	3.47	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	2.30%	65% of 1-month LIBOR + 0.12%	50,000	50,000
Fixed-payer	2044	2.49	65% of 1-month LIBOR + 0.12%	50,000	50,000
Fixed-payer	2042	3.64	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	3.61%	64.11% of 5-year LIBOR	22,810	24,395
Fixed-payer	2030	5.09	91.05% of 5-year LIBOR	7,575	8,380
Fixed-payer	2030	3.62	64.09% of 5-year LIBOR	7,685	8,165
Fixed-payer	2026	3.78	70% of 1-month LIBOR	6,705	7,455
Fixed-payer	2022	3.68	70% of 1-month LIBOR	2,445	2,995
Fixed-payer	2021	3.31	70% of 1-month LIBOR	6,865	8,995
Fixed-payer	2047	1.43	70% of 1-month LIBOR	25,000	25,000
Fixed-payer	2047	1.23	70% of 1-month LIBOR	25,000	25,000
Constant Maturity payer	2038	67% of 1-month LIBOR	67% 10 yr LIBOR-.38%	50,000	—
Total Return Swap	2022	SIFMA Index +0.63%	4.85%	52,445	52,445
				<u>\$ 633,120</u>	<u>589,420</u>

In 2018, the System entered into a Constant Maturity Swap trade for a notional amount of \$50,000 with cash flows beginning in November, 2020 and a termination date of 2038.

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 0.94% to 1.81% (average rate of 1.41%) for the year ended December 31, 2018 and 0.62% to 1.71% (average rate of 0.85%) for the year ended December 31, 2017.

The net fair value of interest rate swap agreements was a liability of \$41,508 as of December 31, 2018. The net fair value for swap agreements at December 31, 2018 consisted of \$8,084 recorded in other assets and \$49,592 recorded in other liabilities within the December 31, 2018 consolidated balance sheet. The net

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(In thousands of dollars)

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.

An increase in fair value of derivative instruments in the consolidated statements of operations and changes in net assets totaled \$10,195 and \$4,463 for the years ended December 31, 2018 and 2017, respectively. Cash paid to counterparties totaled \$6,011 and \$9,350 for the years ended December 31, 2018 and 2017, respectively. Cash received from counterparties totaled \$2,007 and \$1,737 for the years ended December 31, 2018 and 2017, respectively.

The System posted collateral of \$2,937 and \$4,947 due to the decrease in swap valuations as of December 31, 2018 and 2017, 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, 2018 and 2017 totaled \$32,656 and \$35,843, respectively. Future minimum noncancelable operating lease payments with terms in excess of one year are as follows:

2019	\$	26,630
2020		19,902
2021		13,945
2022		11,506
2023		8,217
2024 and thereafter		<u>29,181</u>
	\$	<u>109,381</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 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, 2018, 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.

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(In thousands of dollars)

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 the first quarter of 2018, an unexpected equipment failure occurred at a Fertility Clinic that was operated by UH Cleveland Medical Center. Multiple claims, with multiple theories of recovery, have been filed against the System and some of its wholly owned entities; some of the lawsuits include class action allegations. In general, the lawsuits seek compensatory and punitive damages. The claims and lawsuits are being treated as professional liability claims and therefore subject to the System's professional and liability insurance policies. The System notified its insurance carriers and recorded a reserve for the anticipated resolution of these claims and a receivable from its insurance carriers equal to the amount of the reserve less its self-insured retention limits.

Beyond the claims and lawsuits noted above, there are known incidents, and there also may be unknown incidents, which may result in the assertion of additional claims for professional liability, general liability or workers compensation. 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 \$153,548 and \$160,796 at December 31, 2018 and 2017, respectively. The current portion of the reserves at December 31, 2018 and 2017, amounts to \$50,000 and \$10,000, respectively, is recorded in other current liabilities and the remaining portion is recorded in other long term liabilities.

The System does not believe the outcome of the claims and lawsuits described above would have a material adverse effect on the consolidated financial position, liquidity, or results of operations of the System, based on current knowledge and taking into account current accruals. Litigation is inherently unpredictable and judgments could be entered into that could adversely affect the System's operating results or cash flows in a particular period.

(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 net assets without donor restrictions. The System uses December 31 as the measurement date for plan assets and benefit obligations.

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(In thousands of dollars)

The amounts recognized in changes in net assets without donor restrictions at December 31, 2018 and 2017 consisted of the following:

	<u>2018</u>	<u>2017</u>
Amount recognized in net assets without donor restrictions at end of year:		
Unrecognized actuarial loss	\$ 488,440	526,693
Unrecognized prior service costs	<u>(10,890)</u>	<u>(13,288)</u>
Net amount recognized	\$ <u>477,550</u>	<u>513,405</u>

The accumulated benefit obligation for the plan was \$1,122,600 and \$1,238,505 as of December 31, 2018 and 2017, respectively. The following represents selected information about the plan as of December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Change in benefit obligation:		
Projected benefit obligation (PBO) at beginning of year	\$ 1,272,117	1,110,764
Service cost	51,610	46,178
Interest cost	41,454	38,385
Actuarial loss	(44,623)	135,301
Retiree annuity purchases	(74,205)	—
Benefits paid	<u>(84,705)</u>	<u>(58,511)</u>
Projected benefit obligation at end of year	<u>1,161,648</u>	<u>1,272,117</u>
Change in plan assets:		
Fair value of assets at beginning of year	885,732	711,108
Actual return on assets	(31,350)	117,535
Employer contribution	136,200	115,600
Retiree annuity purchases	(74,205)	—
Benefits paid	<u>(84,705)</u>	<u>(58,511)</u>
Fair value of assets at end of year	<u>831,672</u>	<u>885,732</u>
Funded status (PBO in excess of plan assets)	\$ <u>(329,976)</u>	<u>(386,385)</u>

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(In thousands of dollars)

	<u>2018</u>	<u>2017</u>
The components of net periodic pension costs included the following:		
Operating expenses:		
Service cost	\$ 51,611	46,178
Nonoperating expenses:		
Interest cost	41,454	38,385
Expected return on plan assets	(61,116)	(52,122)
Amortization of prior service costs	(2,399)	(2,398)
Settlement cost	42,539	—
Recognized net actuarial loss	<u>43,557</u>	<u>39,656</u>
Net periodic pension cost	\$ <u>115,646</u>	<u>69,699</u>

In November 2018, the System purchased a group annuity contract from an insurance company to transfer \$74,205 of the outstanding pension benefit obligations related to certain retirees and beneficiaries. As a result of the transaction, the insurance company is now required to pay and administer the retirement benefits owed to the approximately 2,700 U.S. retirees and beneficiaries, with no change to their monthly retirement benefit payment amounts. In connection with this transaction, the System recognized a pension settlement charge of \$42,539 as a nonoperating expense, primarily related to the accelerated recognition of actuarial losses included in net assets for the plan.

The amounts in net assets without donor restrictions 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>34,445</u>
Total	\$ <u>32,046</u>

The weighted average assumptions used to determine benefit obligations and net benefit cost for the years ended December 31, 2018 and 2017 were as follows:

	<u>2018</u>	<u>2017</u>
Weighted average assumptions:		
Discount rate	4.40%	3.72%
Expected return on plan assets	6.50	6.75
Rate of compensation increase	3.75	3.75

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(In thousands of dollars)

Pension assets are invested in various asset classes as follows:

	<u>2018</u>	<u>2017</u>
Asset class:		
Equities, mutual and exchange traded funds	37%	42%
Fixed income	27	26
Alternative investments	35	30
Cash and cash equivalents	1	2

The Finance 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 \$34,000 to the plan in the year ended December 31, 2019. The estimated benefit payments, which reflect expected future service, as appropriate, are expected to be paid by the System as follows: 2019 – \$73,477; 2020 – \$77,836; 2021 – \$81,105; 2022 – \$86,156; 2023 – \$89,451; and 2024 to 2028 – \$481,898.

The following tables present the System's fair value leveling hierarchy for those plan assets measured at fair value as of December 31, 2018 and 2017. Refer to note 5 for level definitions.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
December 31, 2018:				
Cash and cash equivalents	\$ 7,871	—	—	7,871
Fixed income securities:				
Corporate bonds	121,420	61,152	—	182,572
Government securities	39,046	—	—	39,046
Total fixed securities	160,466	61,152	—	221,618
Equities, mutual and exchange traded funds:				
Domestic mutual funds	79,437	8,490	—	87,927
International mutual funds	102,610	120,754	—	223,364
Total equities, mutual and exchange traded funds	182,047	129,244	—	311,291
Total	\$ 350,384	190,396	—	540,780

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(In thousands of dollars)

	<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	65,051	—	189,986
Government securities	<u>39,403</u>	—	—	<u>39,403</u>
Total fixed securities	<u>164,338</u>	<u>65,051</u>	—	<u>229,389</u>
Equities, mutual and exchange traded funds:				
Domestic mutual funds	102,967	10,537	—	113,504
International mutual funds	<u>122,872</u>	<u>134,141</u>	—	<u>257,013</u>
Total equities, mutual and exchange traded funds	<u>225,839</u>	<u>144,678</u>	—	<u>370,517</u>
Total	<u>\$ 405,630</u>	<u>209,729</u>	—	<u>615,359</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.

The following table summarizes the System's investments at December 31, 2018 and 2017, for which NAV was used as a practical expedient to estimate fair value:

	<u>2018</u>	<u>2017</u>
Alternative investments:		
Hedge funds	\$ 139,201	132,798
Real estate	83,586	79,585
Private debt	36,340	34,887
Private equity	<u>31,765</u>	<u>23,103</u>
Total alternative investments	<u>\$ 290,892</u>	<u>270,373</u>

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(In thousands of dollars)

The table below classifies the net asset value at December 31, 2018 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	\$ 151,280	232
Subject to existing gates or restrictions	16,179	—
Limited partnership fund expiring in 1–5 years	26,801	7,678
Limited partnership fund expiring in 6–10 years	68,027	39,185
Limited partnership fund expiring in 11–15 years	28,058	57,757
Limited partnership fund expiring in 15+ years	<u>547</u>	<u>18,096</u>
Total alternative investments	\$ <u>290,892</u>	<u>122,948</u>

The System sponsors various defined contribution employee benefit plans. The System contributed \$28,541 and \$28,274 to the defined contribution employee benefit plans for the years ended December 31, 2018 and 2017, respectively.

The System also has nonqualified deferred compensation plans for certain employees. The System contributed and expensed \$6,109 and \$4,889 to the deferred compensation plans for the years ended December 31, 2018 and 2017, 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, 2018 and 2017 were \$4,035 and \$6,446, respectively. Total investment in Southwest amounted to \$76,055 and \$72,020 at December 31, 2018 and 2017, respectively. Total investments for all joint ventures, including Southwest, amounted to \$86,768 and \$83,459 at December 31, 2018 and 2017, respectively, and are included in noncurrent other assets on the consolidated balance sheets.

(14) 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.

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(In thousands of dollars)

(15) Special Charges

The System incurred \$7,599 and \$470 in special charges during the years ending 2018 and 2017, respectively. The special charges related primarily to severance, impact of IT system implementation, and restructuring costs.

(16) Purchase Commitments

The System has commitments to purchase goods and services with the following minimum contractual obligations as follows: 2019 – \$36,851; 2020 – \$33,846; 2021 – \$10,928; and 2022 – \$6,757; 2023 – \$3,102 and 2024 and thereafter – \$4,725. Purchases under these or similar contracts totaled \$137,273 and \$97,689 in the years ending December 31, 2018 and 2017, respectively.

(17) Income Taxes

The System has certain taxable subsidiaries that have incurred net losses for federal income tax purposes. Cumulative losses available totaled approximately \$873,032 and \$727,064 at December 31, 2018 and 2017 respectively. The losses are available to offset future taxable income indefinitely with utilization limited to 80% of taxable income for losses arising after December 31, 2017. A potential tax benefit has not been recorded in the consolidated financial statements at December 31, 2018 and 2017 due to the uncertainty of realizing those benefits in the future.

The System recognizes 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, 2018 and 2017, the System does not have any uncertain tax positions.

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(In thousands of dollars)

(18) Functional Expenses

The System provides healthcare services, medical education, and performs medical research. Operating expenses related to these functions presented by their natural classifications were as follows for the year ended December 31, 2018:

	<u>Health Care Services</u>	<u>Academic and Research</u>	<u>Administrative Support</u>	<u>Total</u>
Salaries, wages and employee benefits	\$ 1,971,277	30,742	323,277	2,325,296
Purchased services	198,649	12,944	70,140	281,733
Patient care supplies	720,604	2,238	766	723,608
Other supplies	40,283	1,635	4,441	46,359
Insurance	49,191	—	—	49,191
Other and special charges	243,246	6,806	98,339	348,391
Depreciation and amortization	112,358	57	51,147	163,562
Interest	46,212	—	—	46,212
Total expenses	\$ <u>3,381,820</u>	<u>54,422</u>	<u>548,110</u>	<u>3,984,352</u>

Some categories of natural class expenses are attributable to more than one activity and require allocation, applied on a consistent basis. Interest is allocated based on net patient revenue. Insurance represents the professional liability insurance. Administrative support consists of corporate functions such as legal, accounting and information systems.

(19) Liquidity and Availability of Resources

As of year ended December 31, 2018, financial assets and liquidity resources available within one year for general expenditures, such as operating expenses, scheduled principal payments on debt, and capital construction costs not financed with debt, were as follows:

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(In thousands of dollars)

Financial assets:		
Cash and cash equivalents	\$	288,517
Patient accounts receivable		568,227
Other receivables		61,778
Investments		<u>1,268,240</u>
Total financial assets available within a year		2,186,762
Liquidity resources:		
Available revolving credit commitment	\$	<u>85,000</u>
Total financial assets and liquidity resources available within a year	\$	<u><u>2,271,762</u></u>

Other receivables exclude receivables that are not expected to be converted into cash within a year. As part of liquidity management, the System's policy is to structure and manage its financial assets to be available to meet its general expenditure needs. To help manage unanticipated liquidity needs, the System maintains syndicated revolving lines of credit that are drawn upon during the year to manage cash flows, as of December 31, 2018.

(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.

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 20, 2019 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, 2018, and events which occurred subsequent to December 31, 2018, but were not recognized in the consolidated financial statements. There were no reportable events.

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, 2018 and 2017, and have issued our report thereon dated March 20, 2019, 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 20, 2019

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Supplementary Information – Balance Sheet

December 31, 2018

(In thousands of dollars)

Assets	Obligated group	Other Nonobligated group	5805 Euclid Inc	Total Nonobligated group	Eliminations	Consolidated
Current assets:						
Cash and cash equivalents	\$ 280,414	2,683	5,420	8,103	—	288,517
Patient accounts receivable	410,969	157,258	—	157,258	—	568,227
Other receivables	19,744	99,160	—	99,160	(48,749)	70,155
Other current assets	145,022	27,526	—	27,526	—	172,548
Total current assets	856,149	286,627	5,420	292,047	(48,749)	1,099,447
Investments	1,653,596	83,946	—	83,946	—	1,737,542
Property and equipment, net	1,557,378	160,930	18,554	179,484	—	1,736,862
Other assets:						
Investments in affiliates	361,800	3,307	—	3,307	(264,550)	100,557
Beneficial interest in Foundations	109,111	53,613	—	53,613	—	162,724
Perpetual trusts	188,246	1,057	—	1,057	—	189,303
Other	196,777	13,621	487	14,108	(13,566)	197,319
Total other assets	855,934	71,598	487	72,085	(278,116)	649,903
Total assets	\$ 4,923,057	603,101	24,461	627,562	(326,865)	5,223,754
Liabilities and Net Assets						
Current liabilities:						
Current installments of long-term debt	\$ 24,445	1	—	1	—	24,446
Accounts payable and accrued expenses	395,695	52,270	2	52,272	—	447,967
Other current liabilities	118,205	72,821	6,176	78,997	(48,749)	148,453
Estimated amounts due to third party payors	18,603	1,966	—	1,966	—	20,569
Total current liabilities	556,948	127,058	6,178	133,236	(48,749)	641,435
Long-term debt, less current installments	1,220,526	1	20,680	20,681	(13,566)	1,227,641
Revolving credit commitment	140,000	—	—	—	—	140,000
Other liabilities	478,388	148,360	—	148,360	—	626,748
Total liabilities	2,395,862	275,419	26,858	302,277	(62,315)	2,635,824
Net assets:						
Without donor restrictions	1,824,631	266,947	(2,397)	264,550	(264,550)	1,824,631
With donor restrictions	702,564	60,735	—	60,735	—	763,299
Total net assets	2,527,195	327,682	(2,397)	325,285	(264,550)	2,587,930
Total liabilities and net assets	\$ 4,923,057	603,101	24,461	627,562	(326,865)	5,223,754

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

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Supplementary Information – Schedule of Operations

Year ended December 31, 2018

(In thousands of dollars)

	Obligated group	Other Nonobligated group	5805 Euclid Inc	Total Nonobligated group	Eliminations	Consolidated
Revenues:						
Patient service revenue	\$ 2,698,371	1,195,545	—	1,195,545	—	3,893,916
Other revenue	173,146	221,025	253	221,278	(170,556)	223,868
Total revenues	2,871,517	1,416,570	253	1,416,823	(170,556)	4,117,784
Expenses:						
Salaries, wages and employee benefits	1,334,212	999,340	—	999,340	(8,256)	2,325,296
Purchased services	125,691	266,105	40	266,145	(110,103)	281,733
Patient care supplies	577,999	145,609	—	145,609	—	723,608
Other supplies	32,121	14,238	—	14,238	—	46,359
Insurance	25,833	46,586	—	46,586	(23,228)	49,191
Other	295,817	73,737	—	73,737	(28,762)	340,792
Depreciation and amortization	145,032	18,260	270	18,530	—	163,562
Interest	46,212	—	207	207	(207)	46,212
Special charges	7,599	—	—	—	—	7,599
	2,590,516	1,563,875	517	1,564,392	(170,556)	3,984,352
Net operating income (loss)	281,001	(147,305)	(264)	(147,569)	—	133,432
Nonoperating revenues (expenses):						
Investment loss	(30,763)	(2,009)	—	(2,009)	—	(32,772)
Change in fair value of derivative instruments	10,195	—	—	—	—	10,195
Loss on extinguishment of debt	(442)	—	—	—	—	(442)
Pension settlement costs	(42,539)	—	—	—	—	(42,539)
Other nonservice periodic pension costs	(21,496)	—	—	—	—	(21,496)
Excess (deficiency) of revenues over expenses	\$ 195,956	(149,314)	(264)	(149,578)	—	46,378

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

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Supplementary Information – Balance Sheet

December 31, 2017

(In thousands of dollars)

Assets	Obligated group	Other Nonobligated group	5805 Euclid Inc	Total Nonobligated group	Eliminations	Consolidated
Current assets:						
Cash and cash equivalents	\$ 192,413	(7,109)	16,478	9,369	—	201,782
Patient accounts receivable	423,206	141,668	—	141,668	—	564,874
Other receivables	44,366	26,900	—	26,900	(21,345)	49,921
Other current assets	138,222	25,143	—	25,143	—	163,365
Total current assets	<u>798,207</u>	<u>186,602</u>	<u>16,478</u>	<u>203,080</u>	<u>(21,345)</u>	<u>979,942</u>
Investments	1,664,186	83,305	—	83,305	—	1,747,491
Property and equipment, net	1,512,659	143,265	7,793	151,058	—	1,663,717
Other assets:						
Investments in affiliates	337,974	6,974	—	6,974	(248,642)	96,306
Beneficial interest in Foundations	113,820	61,193	—	61,193	—	175,013
Perpetual trusts	209,633	1,213	—	1,213	—	210,846
Other	144,547	13,271	487	13,758	(13,566)	144,739
Total other assets	<u>805,974</u>	<u>82,651</u>	<u>487</u>	<u>83,138</u>	<u>(262,208)</u>	<u>626,904</u>
Total assets	<u>\$ 4,781,026</u>	<u>495,823</u>	<u>24,758</u>	<u>520,581</u>	<u>(283,553)</u>	<u>5,018,054</u>
Liabilities and Net Assets						
Current liabilities:						
Current installments of long-term debt	\$ 23,726	10	—	10	—	23,736
Accounts payable and accrued expenses	363,566	50,825	139	50,964	—	414,530
Other current liabilities	65,134	31,910	4,766	36,676	(21,345)	80,465
Estimated amounts due to third party payors	18,557	4,610	—	4,610	—	23,167
Total current liabilities	<u>470,983</u>	<u>87,355</u>	<u>4,905</u>	<u>92,260</u>	<u>(21,345)</u>	<u>541,898</u>
Long-term debt, less current installments	1,245,310	20	20,680	20,700	(13,566)	1,252,444
Revolving credit commitment	40,000	—	—	—	—	40,000
Other liabilities	582,025	94,121	—	94,121	—	676,146
Total liabilities	<u>2,338,318</u>	<u>181,496</u>	<u>25,585</u>	<u>207,081</u>	<u>(34,911)</u>	<u>2,510,488</u>
Net assets:						
Without donor restrictions	1,738,444	249,469	(827)	248,642	(248,642)	1,738,444
With donor restrictions	704,264	64,858	—	64,858	—	769,122
Total net assets	<u>2,442,708</u>	<u>314,327</u>	<u>(827)</u>	<u>313,500</u>	<u>(248,642)</u>	<u>2,507,566</u>
Total liabilities and net assets	<u>\$ 4,781,026</u>	<u>495,823</u>	<u>24,758</u>	<u>520,581</u>	<u>(283,553)</u>	<u>5,018,054</u>

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

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Supplementary Information – Schedule of Operations

Year ended December 31, 2017

(In thousands of dollars)

	Obligated group	Other Nonobligated group	5805 Euclid Inc	Total Nonobligated group	Eliminations	Consolidated
Revenues:						
Patient service revenue (net of contractual allowances and discounts)	\$ 2,596,130	1,191,663	—	1,191,663	—	3,787,793
Provision for bad debts	(59,931)	(52,589)	—	(52,589)	—	(112,520)
Net patient service revenue less provision for bad debts	2,536,199	1,139,074	—	1,139,074	—	3,675,273
Other revenue	169,142	209,511	7	209,518	(157,262)	221,398
Total revenues	2,705,341	1,348,585	7	1,348,592	(157,262)	3,896,671
Expenses:						
Salaries, wages and employee benefits	1,271,253	957,798	—	957,798	(7,900)	2,221,151
Purchased services	127,134	243,973	—	243,973	(103,590)	267,517
Patient care supplies	515,274	139,690	—	139,690	—	654,964
Other supplies	32,351	13,244	—	13,244	—	45,595
Insurance	16,669	41,393	—	41,393	(20,137)	37,925
Other	281,057	72,429	—	72,429	(25,487)	327,999
Depreciation and amortization	135,711	16,011	—	16,011	—	151,722
Interest	45,541	19	148	167	(148)	45,560
Special charges	219	251	—	251	—	470
	2,425,209	1,484,808	148	1,484,956	(157,262)	3,752,903
Net operating income (loss)	280,132	(136,223)	(141)	(136,364)	—	143,768
Nonoperating revenues (expenses):						
Investment income	126,185	(135)	—	(135)	—	126,050
Change in fair value of derivative instruments	4,463	—	—	—	—	4,463
Gain (loss) on disposition of business unit	2,625	(13)	—	(13)	—	2,612
Other nonservice periodic pension costs	(23,521)	—	—	—	—	(23,521)
Excess (deficiency) of revenues over expenses	\$ 389,884	(136,371)	(141)	(136,512)	—	253,372

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

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Supplementary Information

December 31, 2018 and 2017

(In thousands of dollars)

(1) Basis of Presentation

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

- University Hospitals Health System, Inc.
- University Hospitals Cleveland Medical Center
- 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 Medical Group, Inc.
- University Hospitals Holdings, Inc.
- Western Reserve Assurance Company Ltd., SPC
- University Hospitals Samaritan Medical Center
- University Hospitals Portage Medical Center
- University Hospitals Accountable Care Organization
- UH Health Solutions, LLC
- University Hospitals Home Care Services, Inc.
- UH Ventures, LLC
- 5805 Euclid, Inc.