



**UNIVERSITY HEALTH SYSTEM, INC.  
AND SUBSIDIARIES**

Consolidated Financial Statements

December 31, 2018 and 2017

(With Independent Auditors' Report Thereon)



KPMG LLP  
Suite 2000  
303 Peachtree Street, N.E.  
Atlanta, GA 30308-3210

## Independent Auditors' Report

The Board of Directors  
University Health System, Inc.:

### Report on the Consolidated Financial Statements

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

#### *Management's Responsibility for the Consolidated 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 consolidated financial position of University Health System, Inc. and its subsidiaries as of December 31, 2018 and 2017, and the results of their operations, the changes in their net assets and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.



*Emphasis of Matter*

As discussed in note 1(q) to the consolidated financial statements, in 2018, the Health System adopted new accounting guidance in connection with its implementation of Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*, (Topic 606) and FASB ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. Our opinion is not modified with respect to this matter.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated March 26, 2019 on our consideration of the Health System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the effectiveness of the Health System's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Health System's internal control over financial reporting and compliance.

KPMG LLP

Atlanta, Georgia  
March 26, 2019

**UNIVERSITY HEALTH SYSTEM, INC.  
AND SUBSIDIARIES**

Consolidated Balance Sheets

December 31, 2018 and 2017

(In thousands)

<b>Assets</b>	<b>2018</b>	<b>2017</b>
Current assets:		
Cash and cash equivalents	\$ 85,502	53,665
Short-term investments	8,164	9,891
Current portion of assets limited as to use	789	19,150
Patient accounts receivable, net	99,008	104,980
Other receivables	11,058	9,206
Estimated third-party settlements	17,988	19,441
Inventories	9,541	8,579
Prepaid expenses and other current assets	3,459	2,969
Total current assets	235,509	227,881
Assets limited as to use, less current portion	30,985	32,466
Long-term investments	188,330	187,152
Property and equipment, net	295,439	294,349
Investments in affiliated organizations	2,400	2,485
Other assets	8,203	7,765
Total assets	\$ 760,866	752,098
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Current portion of long-term debt	\$ 10,329	8,498
Accounts payable	88,682	91,137
Accrued payroll and related liabilities	46,731	50,955
Accrued expenses and other current liabilities	29,455	19,832
Estimated third-party settlements	7,281	6,442
Total current liabilities	182,478	176,864
Long-term debt, less current portion	354,051	360,809
Other liabilities	16,220	17,473
Total liabilities	552,749	555,146
Net assets:		
Without donor restrictions	193,717	183,623
With donor restrictions	14,400	13,329
Total net assets	208,117	196,952
Commitments and contingencies		
Total liabilities and net assets	\$ 760,866	752,098

See accompanying notes to consolidated financial statements.

**UNIVERSITY HEALTH SYSTEM, INC.  
AND SUBSIDIARIES**

Consolidated Statements of Operations

Years ended December 31, 2018 and 2017

(In thousands)

	<b>2018</b>	<b>2017</b>
Revenue:		
Patient care service revenue, net	\$ 836,367	789,185
Other revenue	62,883	53,850
Total revenue	899,250	843,035
Operating expenses:		
Salaries, wages, and benefits	381,957	379,439
Supplies and stores	263,001	248,738
Purchased services	127,875	126,753
Graduate medical education reimbursement	38,019	33,708
Insurance and other	33,021	28,978
Depreciation and amortization	31,195	29,450
Interest	13,745	12,297
Total operating expenses	888,813	859,363
Operating income (loss)	10,437	(16,328)
Nonoperating gains (losses):		
Contributions used for purchase of property and equipment	1,161	941
Investment income	3,595	12,657
Net unrealized (loss) gain	(5,641)	332
Change in fair value of interest rate swap	542	1,526
Loss on extinguishment of debt	—	(894)
Total nonoperating (losses) gains, net	(343)	14,562
Revenue and gains in excess of (less than) expenses and losses	\$ 10,094	(1,766)

See accompanying notes to consolidated financial statements.

**UNIVERSITY HEALTH SYSTEM, INC.  
AND SUBSIDIARIES**

Consolidated Statements of Changes in Net Assets

Years ended December 31, 2018 and 2017

(In thousands)

	<b>Net assets without donor restrictions</b>	<b>Net assets with donor restrictions</b>	<b>Total net assets</b>
Balance at December 31, 2016	\$ 185,389	13,027	198,416
Revenue and gains less than expenses and losses	(1,766)	—	(1,766)
Contributions and other	—	1,591	1,591
Net assets released from restriction used in operations	—	(1,289)	(1,289)
Balance at December 31, 2017	183,623	13,329	196,952
Revenue and gains in excess of expenses and losses	10,094	—	10,094
Contributions and other	—	1,737	1,737
Net assets released from restriction used in operations	—	(666)	(666)
Balance at December 31, 2018	<u>\$ 193,717</u>	<u>14,400</u>	<u>208,117</u>

See accompanying notes to consolidated financial statements.

**UNIVERSITY HEALTH SYSTEM, INC.  
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Consolidated Statements of Cash Flows

Years ended December 31, 2018 and 2017

(In thousands)

	<b>2018</b>	<b>2017</b>
Cash flows from operating activities:		
Increase (decrease) in total net assets	\$ 11,165	(1,464)
Adjustments to reconcile increase (decrease) in total net assets to net cash provided by operating activities:		
Depreciation and amortization	31,195	29,450
Gifts and contributions for endowment and capital projects	(857)	(895)
Equity in earnings of affiliated organizations	(2,289)	(2,737)
Imputed interest on capital lease obligation	2,632	2,485
Net unrealized loss (gain)	5,641	(332)
Realized gains on trading securities	(1,173)	(9,412)
Change in fair value of derivative instrument	(542)	(1,526)
Amortization of financing costs	198	212
Amortization of bond premium	(1,466)	(1,531)
Loss (gain) on sale of assets, net	118	(28)
Loss on extinguishment of debt	—	894
Changes in assets and liabilities affecting operating activities:		
Patient accounts receivable	6,650	(1,397)
Other receivables	(1,748)	(5,135)
Estimated third-party settlements	2,292	1,181
Inventories	(962)	(375)
Prepaid expenses and other assets	(1,167)	(1,585)
Accounts payable	4,732	3,742
Accrued payroll and related liabilities	(4,224)	4,098
Accrued expenses and other liabilities	9,049	(1,406)
Net cash provided by operating activities	59,244	14,239
Cash flows from investing activities:		
Proceeds from sale or maturity of investments	315,949	996,573
Purchases of investments	(301,200)	(969,342)
Purchases of property and equipment	(36,367)	(78,277)
Proceeds from the sale of assets	—	36
Capital distributions from affiliated organization	2,374	2,838
Net cash used in investing activities	(19,244)	(48,172)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	1,241	154,159
Payments of long-term debt	(10,261)	(144,209)
Payments for deferred financing costs	—	(1,101)
Gifts and contributions for endowment and capital projects	857	895
Net cash (used in) provided by financing activities	(8,163)	9,744
Increase (decrease) in cash and cash equivalents	31,837	(24,189)
Cash and cash equivalents at beginning of year	53,665	77,854
Cash and cash equivalents at end of year	\$ 85,502	53,665

**UNIVERSITY HEALTH SYSTEM, INC.  
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Consolidated Statements of Cash Flows  
Years ended December 31, 2018 and 2017  
(In thousands)

	<u>2018</u>	<u>2017</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest, net of amount capitalized of \$284 and \$1,818, respectively	\$ 13,857	11,282
Noncash investing activities:		
Assets and liabilities resulting from equipment purchases:		
Property and equipment	\$ 4,856	4,289
Accounts payable	4,410	2,992
Capital lease	446	1,297

See accompanying notes to consolidated financial statements.

**UNIVERSITY HEALTH SYSTEM, INC.  
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Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(In thousands)

**(1) Summary of Significant Accounting Policies**

**(a) Organization, Principles of Consolidation, and Operations**

University Health System, Inc. (UHS), a Tennessee nonprofit corporation, comprises the following: (1) University of Tennessee Medical Center (Medical Center); (2) UHS Ventures, Inc. (UHSV); (3) Regional Trauma Service, LLC (RTS); (4) University Cardiology Group, LLC (UCG); (5) University Health Network, LLC (UHN); and (6) UT Urgent Care Centers (UTUCC). All significant intercompany balances and transactions have been eliminated in consolidation. The mission of UHS is to serve as a regional healthcare provider, as well as a research and educational facility.

UHS was created on December 21, 1998 for the purpose of restructuring the operation, management, and governance of the Medical Center, and to negotiate agreements with The University of Tennessee (the University) to facilitate the restructuring. Effective July 29, 1999, UHS acquired certain assets and the operations of the Medical Center from the University, and the Medical Center became an operating division of UHS. Prior to July 29, 1999, the Medical Center operated as a budget entity of the University.

UHS entered into the following agreements to acquire the operations of the Medical Center from the University: (1) the Lease and Transfer Agreement, whereby UHS leases certain real property and acquired certain personal property from the University; (2) the Employee Services Agreement, whereby UHS leases certain of the Medical Center's employees from the University; and (3) the Affiliation Agreement, whereby UHS and the University agree to continue the Medical Center's historical relationship with the University of Tennessee Graduate School of Medicine (GSM). The effective date of the transfer of Medical Center operations to UHS was July 29, 1999. The transaction was accounted for as a purchase. The restructuring of Medical Center's operations and the transfer agreements are explained in more detail in note 2.

*(i) UHS and Medical Center*

The Medical Center, an operating division of UHS, is an academic medical center delivering tertiary medical care to a 21-county region in eastern Tennessee. The Medical Center is a regional referral center for eastern Tennessee, western North Carolina, and southeastern Kentucky. The Medical Center is licensed for 669 acute care beds and has been designated by the State of Tennessee (State) as a Level 1 adult and pediatric Trauma Center, supported by five aeromedical helicopters. The State has also designated the Medical Center as a Regional Perinatal Center for high-risk pregnancy.

*(ii) UHSV*

UHSV, a Tennessee nonprofit taxable organization and wholly owned subsidiary of UHS, has a 11.1% ownership interest in ContinuumRx. The purpose of ContinuumRx is to provide home infusion therapy services and other pharmacy and pharmacy-related services. ContinuumRx is accounted for using the equity method. Through August 2018, UHSV had three after-hour clinics to provide medical services to East Tennessee residents of Knox, Blount, Loudon, Sevier, and surrounding counties and a rural health clinic in Claiborne County. Effective September 1, 2018, ownership of the three after-hour clinics was fully transferred to UTUCC.

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(In thousands)

*(iii) RTS*

RTS, a nonprofit organization and wholly owned subsidiary of UHS, was established to provide physician services to patients of the Medical Center who have suffered a traumatic injury.

*(iv) UCG*

UCG, a nonprofit organization and wholly owned subsidiary of UHS, was established to provide cardiology physician services to patients of the Medical Center.

*(v) UHN*

UHN, a nonprofit organization and wholly owned subsidiary of UHS, was established to provide a clinically integrated network that spans the entire episode of care.

*(vi) UTUCC*

UTUCC, a nonprofit organization and wholly owned subsidiary of UHS, was established in 2018 to serve the urgent care needs of the general public.

Also, see note 8, *Investments in Affiliated Organizations*.

**(b) Use of Estimates**

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Significant items subject to such estimates and assumptions include the determination of the allowances for uncollectible accounts, implicit price concessions and contractual adjustments, estimated third-party settlements, useful lives assigned to capital assets, and reserves for workers' compensation and professional and general liability costs.

In addition, laws and regulations concerning government programs, including Medicare and TennCare/Medicaid, are complex and subject to varying interpretation. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge UHS' compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon UHS. In addition, the contracts UHS has with commercial payors also provide for retroactive audit and review of claims.

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(In thousands)

**(c) Cash and Cash Equivalents**

UHS considers all highly liquid, interest-bearing investments with a maturity of three months or less when purchased, excluding amounts limited as to use by board, management, or donor designation and amounts included in certain debt reserve funds, to be cash equivalents.

**(d) Investments and Investment Income**

Investments held by UHS are classified as trading securities. Investment income on borrowed funds held by a trustee, to the extent not reinvested during a construction period, is recorded as other revenue. Investment income or loss, including realized and unrealized gains or losses, from all other investments is recorded as nonoperating gains (losses) unless restricted by donors.

**(e) Assets Limited as to Use**

Assets limited as to use primarily include assets held by trustees in endowment funds, nonqualified deferred compensation plan assets, and project funds. Amounts required to meet current liabilities and current capital expenditure budget requirements have been classified as current assets in the accompanying consolidated balance sheets.

**(f) Inventories**

Supply inventories are stated at the lower of cost or net realizable value, determined on the weighted average cost basis or on the first-in, first-out basis. Pharmacy inventories are stated at the lower of cost or net realizable value, determined on the first-in, first-out basis.

**(g) Property and Equipment**

Property and equipment acquisitions are recorded at cost or, if donated, at fair value at the date of receipt. Depreciation is calculated on the straight-line basis over the estimated useful lives of the respective assets, except for leasehold improvements, which are amortized over the shorter of the expected useful life of the asset or related lease term. Buildings under capital lease obligations are amortized using the straight-line method over 20 years or longer (note 9). Such amortization is included in depreciation and amortization expense in the accompanying consolidated financial statements. Interest expense related to qualified construction projects is capitalized during the construction period.

**(h) Impairment of Long-Lived Assets**

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are separately presented in the consolidated balance sheets and reported at the lower of the carrying amount or fair value less costs to sell and are no longer depreciated.

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(In thousands)

**(i) Deferred Financing Costs**

Deferred financing costs consist of bond issuance costs and are amortized over the terms of the related debt. Such unamortized amounts are reflected as a component of long-term debt in the accompanying consolidated balance sheets.

**(j) Net Assets**

Net assets, revenue, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. The net assets of UHS and changes therein are classified and reported as follows:

*Net assets without donor restrictions* – Net assets that are not subject to donor-imposed stipulations.

*Net assets with donor restrictions* – Net assets subject to donor-imposed stipulations that are available for use either by the passage of time or for specific purposes; certain of these net assets are subject to donor-imposed stipulations that they be maintained permanently by UHS. Generally, the donors of these assets permit UHS to use all or part of the income earned on related investments for general or specific purposes.

Revenue is reported as increases in net assets without donor restrictions, unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in net assets without donor restrictions. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in net assets without donor restrictions, unless their use is restricted by explicit donor stipulation or by law. Expirations of donor restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications from net assets with donor restrictions to net assets without donor restrictions. Donor-restricted contributions, whose restrictions are met in the same reporting period as the contributions are recorded, are reported as increases in net assets without donor restrictions.

Regarding endowments, UHS applies Financial Accounting Standards Board (FASB) Staff Position FAS 117-1, *Endowments of Not-for-Profit Organizations*, and Accounting Standards Codification (ASC) Subtopic 958-205, *Not-for-Profit Entities – Presentation of Financial Statements*. ASC Subtopic 958-205 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). Effective July 1, 2007, the State adopted legislation that incorporates the provisions outlined in UPMIFA. UHS' endowment consists of 23 individual donor-restricted endowment funds established for a variety of purposes.

**UNIVERSITY HEALTH SYSTEM, INC.  
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(In thousands)

UHS has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, UHS considers the endowment corpus to be (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the donor gift instrument at the time the accumulation is added to the fund. The endowment corpus is classified as net assets with donor restrictions in perpetuity. The remaining portion of the donor-restricted endowment fund that is not considered to be the endowment corpus is classified as net assets with donor restrictions until those amounts are approved for expenditure by UHS in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, UHS considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund, (2) the purposes of UHS and the donor-restricted endowment fund, (3) general economic conditions, (4) the possible effect of inflation and deflation, (5) the expected total return from income and the appreciation of investments, (6) other resources of UHS, and (7) the investment policies of UHS.

UHS has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period. Under this policy, as approved by the board of directors, the endowment assets are invested in equities, fixed income, and cash equivalents.

UHS has a policy of annually approving for distribution investment income on endowments unless the endowment specifically states that the income should be accumulated in the fund until a maximum level is reached in the fund. For the years ended December 31, 2018 and 2017, there was approximately \$263 and \$187, of investment income earned, appropriated, and recognized as investment income in the accompanying consolidated statements of operations, respectively.

From time to time, it is possible that the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires UHS to retain as a fund of perpetual duration. These deficiencies could result from unfavorable market fluctuations that occur shortly after the investment of new restricted contributions whose corpus is to be held in perpetuity. There were no such deficiencies as of December 31, 2018 or 2017.

**(k) Consolidated Statements of Operations**

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as revenue and expenses. Peripheral or incidental transactions are reported as nonoperating gains and losses.

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(In thousands)

**(I) Patient Care Service Revenue**

Patient care service revenue is reported at the amount that reflects the consideration to which UHS expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. Generally, UHS bills the patients and third-party payors several days after the services are performed 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 UHS. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. UHS 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 in UHS' hospital receiving inpatient acute care services or patients receiving services in UHS' outpatient centers. UHS measures the performance obligation from admission into the hospital, or the commencement of an outpatient service, to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or completion of the outpatient services. Revenue for performance obligations satisfied at a point in time is generally recognized when goods are provided to UHS' patients and customers in a retail setting (e.g., pharmaceuticals) as a component of other revenue in the accompanying consolidated statements of operations and UHS does not believe it is required to provide additional goods or services related to that sale.

Because all of its performance obligations relate to contracts with a duration of less than one year, UHS has elected to apply the optional exemption provided in FASB ASC Paragraph 606-10-50-14a and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to previously are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

UHS determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with UHS's policy, and implicit price concessions provided to patients. UHS determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience.

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(In thousands)

Consistent with UHS' mission, care is provided to patients regardless of their ability to pay. Therefore, UHS has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances (e.g., co-pays and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts UHS expects to collect based on its collection history with those patients.

Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor, and UHS' historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (i.e., as new information becomes available), or as years are settled or are no longer subject to such audits, reviews, and investigations.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. UHS also provides services to uninsured patients and offers those uninsured patients a discount, either by policy or law, from standard charges. UHS estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient care service revenue in the period of the change. For the years ended December 31, 2018 and 2017, additional revenue of \$5,197 and \$5,471, respectively, was recognized due to changes in its estimates of implicit price concessions, discounts, and contractual adjustments for performance obligations satisfied in prior years. The additional revenue primarily represents patient account recoveries that were previously written off as uncollectible. 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.

***(m) Charity Care***

UHS provides care to patients who meet criteria under its charity care policy without charge or at amounts less than its established rates. UHS does not report as revenue the charges that qualify as charity care because UHS does not pursue collection of those amounts.

***(n) Derivative Financial Instrument***

UHS has not elected to use hedge accounting with respect to its derivative financial instrument. The derivative financial instrument is recognized as an asset or a liability in the consolidated balance sheets at fair value. UHS includes the accrued differential interest payment or receipt on its derivative in operating income. The estimated gain or loss on the fair value of the derivative is included in nonoperating (losses) gains, net in the consolidated statements of operations.

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(In thousands)

**(o) Income Taxes**

UHS has been recognized as a tax-exempt organization pursuant to Section 501(a) of the Internal Revenue Code as an entity described under Section 501(c)(3). RTS, UCG, UHN, and UTUCC are single member limited liability companies disregarded as entities separate from UHS for federal tax purposes. UHSV is a Tennessee nonprofit corporation that is not exempt from federal income taxes. Income tax expense for UHSV for the years ended December 31, 2018 and 2017 was not significant and was offset by operating losses in prior years for tax purposes.

**(p) Fair Value Measurements**

The following methods and assumptions were used by management in estimating fair values for financial instruments:

Current assets and current liabilities – The carrying amounts reported in the accompanying consolidated balance sheets for current assets and liabilities approximate their fair value because of the short-term nature of these accounts.

Investments and assets limited as to use – The carrying amounts reported in the accompanying consolidated balance sheets for long-term investments and assets limited as to use are at fair value, which is based on quoted market prices.

Derivative instrument – The fair value of UHS' derivative instrument is derived from a discounted cash flow analysis based on terms of the contract and the interest rate curve. UHS' derivative instrument is recorded at fair value.

**(q) New Accounting Pronouncements**

In May 2014, the FASB issued ASC Topic No. 606, *Revenue from Contracts with Customers* (ASC 606). ASC 606 outlines a single comprehensive model for recognizing revenue as performance obligations, defined in a contract with a customer as goods or services transferred to the customer in exchange for consideration, are satisfied. As a result, amounts previously classified as the provision for bad debts in the consolidated statement of operations is now reflected as implicit price concessions and therefore included as a reduction to net operating revenue. For the years ended December 31, 2018 and 2017, UHS recorded approximately \$58,791 and \$52,365, respectively, of implicit price concessions as a direct reduction of patient care service revenue that would have been recorded as provision for bad debt prior to the adoption of ASC 606. For the years ended December 31, 2018 and 2017, UHS recorded approximately \$63,443 and \$68,046, respectively, as a direct reduction of patient accounts receivable that would have been reflected as allowance for uncollectible accounts prior to the adoption of ASC 606. ASC 606 also requires expanded disclosures regarding UHS' revenue recognition policies and significant judgments employed in the determination of revenue. UHS adopted ASC 606 with a retrospective approach in 2018. Other than these changes in presentation and disclosure, the adoption of ASC 606 did not have a material impact on the accompanying consolidated balance sheets or consolidated statements of operations and changes in net assets for the years ended December 31, 2018 and 2017.

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In January 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-01, *Recognition and Measurement of Financial Assets and Liabilities* (ASU 2016-01). ASU 2016-01 addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The ASU is effective for not-for-profit entities for fiscal years beginning after December 15, 2018, with early adoption restricted to certain provisions and within certain time periods. Under the ASU, not-for-profit entities are no longer required to disclose fair value information concerning financial instruments measured at amortized cost, such as long-term debt. This provision of ASU 2016-01 may be early adopted for financial statements, which have not yet been issued or made available for issuance. UHS implemented the aforementioned provision during fiscal year 2016. UHS is currently evaluating the impact of the remaining provisions of the new standard on its currently policies for recognition and measurement of financial assets and liabilities.

In February 2016, the FASB issued ASU No. 2016-02, *Leases* (Topic 842) (ASU 2016-02). The amendments in ASU 2016-02 create FASB ASC Topic 842, *Leases*, and supersede the requirements in ASC Topic 840, *Leases*. ASU 2016-02 requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under ASC Topic 840. Under the guidance of ASU 2016-02, a lessee should recognize in the balance sheet a liability to make lease payments (lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The accounting applied by a lessor under ASU 2016-02 is largely unchanged from that applied under Topic 840. The new standard is effective for UHS for years beginning after December 15, 2018. UHS is currently evaluating the impact of the new standard on its current policies for lessee accounting.

In August 2016, the FASB issued ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities* (ASU 2016-14). ASU 2016-14 (1) reduces the number of net asset classes presented from three to two, (2) requires the presentation of expenses by functional and natural classification in one location, and (3) requires quantitative and qualitative disclosures about liquidity and availability of financial assets. The ASU is effective for annual financial statements issued for fiscal years beginning after December 15, 2017. UHS implemented the provisions of ASU 2016-14 effective January 1, 2018 and has included the required disclosures in notes 16 and 17. UHS' adoption of the standard did not have a material impact on its consolidated financial statements.

**(r) Reclassifications**

Certain 2017 amounts have been reclassified to conform to the 2018 consolidated financial statement presentation. These reclassifications have not changed the results of operations or cash flows of prior periods.

**(2) Acquisition of Medical Center Operations from the University**

During 1999, UHS entered into the Lease and Transfer Agreement, the Employee Services Agreement, and the Affiliation Agreement to acquire the operations of the Medical Center from the University.

Under terms of the Lease and Transfer Agreement, UHS purchased, on July 29, 1999, all of the operating assets of the Medical Center, including all personal property, equipment, inventory, current assets, fund reserves, and other assets used by the Medical Center, other than real property. The real property used by the Medical Center is leased from the University to UHS for a term of 50 years.

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Under terms of the Employee Services Agreement, existing UHS employees and all employees hired subsequent to July 28, 1999 are UHS employees. All other Medical Center employees as of July 28, 1999 are leased by UHS from the University and retain all university benefits. The Employee Services Agreement continues until the earlier of the termination of the Lease and Transfer Agreement or the separation from service of the last leased university employee.

The Affiliation Agreement governs the continued relationship between GSM and UHS. UHS will pass through certain federal and state funds earmarked for graduate medical education (note 11). The Medical Center will continue to be the primary teaching site for GSM.

**(3) Charity Care**

UHS provides services to patients who meet the criteria of its charity care policy without charge or at amounts less than its established rates. The criteria for charity care considers household income in relation to the federal poverty guidelines and the equity value of real property assets. UHS provides qualifying services without charge for patients with adjusted gross income equal to or less than 200% of the poverty guidelines. For patients with adjusted gross income between 200% and 300% of the poverty guidelines, a partial charity write-off can be applied. If the patient's household income exceeds 300% of the poverty guidelines, the patient may still receive charity care services under the UHS' catastrophic medical policies.

UHS maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone and estimated costs incurred for services and supplies furnished under its charity care policy and equivalent service statistics. The cost of charity care provided totaled approximately \$17,272 and \$14,160 for the years ended December 31, 2018 and 2017, respectively. Costs incurred are estimated based on the ratio of department costs to gross charges plus overhead. UHS also provided other community benefits, for which the value has not been quantified.

**(4) Patient Care Service Revenue**

UHS has determined that the nature, amount, and uncertainty of revenue and cash flows are affected by the following factors: payors and service lines. The following tables provide details of these factors.

The composition of patient care service revenue, net by primary payor for the years ended December 31, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
Medicare	\$ 379,292	349,451
TennCare	126,459	114,905
Other third-party payors	326,434	321,199
Patients	<u>4,182</u>	<u>3,630</u>
	<u>\$ 836,367</u>	<u>789,185</u>

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Revenue from patient's deductibles and coinsurance are included in the preceding categories based on the primary payor.

The composition of patient care service revenue, net based on the System's lines of business for the years ended December 31, 2018 and 2017 are as follows:

	2018	2017
Services lines:		
Hospital – inpatient	\$ 386,867	363,730
Hospital – outpatient	357,108	335,750
Physician services	92,392	89,705
	\$ 836,367	789,185

Substantially, all acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates. Those rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. Medicare reimbursement reports have been audited, and final settlements have been determined by the Medicare Fiscal Intermediary through the year ended December 31, 2009. Periods for which final settlements have not been made are subject to audit by program representatives. In the opinion of management, adequate provision has been made in the accompanying consolidated financial statements for the effects of estimated final settlements.

Effective January 1, 1994, the State replaced the existing Medicaid program with its TennCare program for providing healthcare to the poor and uninsured. TennCare beneficiaries enroll directly with a managed care organization (MCO) to provide their healthcare needs. These MCOs contract directly with healthcare providers to provide services to their enrollees. The basis for payment to UHS includes per diem rates, rates per discharge, and discounts from established charges.

UHS also has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to UHS under these agreements includes per diem rates, rates per discharge, and discounts from established charges.

Pursuant to the Affiliation Agreement (note 2), UHS is required to pass through to GSM certain federal and state funds earmarked for graduate medical education.

Revenue from the Medicare and TennCare programs accounted for approximately 45% and 15% respectively, of UHS' net patient care service revenue for the year ended December 31, 2018. Revenue from the Medicare and TennCare programs accounted for approximately 44% and 14%, respectively, of UHS' net patient care service revenue for the year ended December 31, 2017. Patient care service revenue increased (decreased) by approximately \$784 and \$(176) in 2018 and 2017, respectively, due to final settlements and revised estimated settlements in excess of amounts previously recorded, removal of allowances previously estimated that are no longer necessary as a result of final settlements, and years that are no longer subject to audits, reviews, and investigations.

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UHS grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of gross UHS receivables from patients and third-party payors at December 31, 2018 and 2017 was as follows:

	<u>2018</u>	<u>2017</u>
Medicare	35 %	35 %
TennCare/Medicaid	22	27
Other third-party payors	33	28
Other agencies	5	3
Patients	5	7
	<u>100 %</u>	<u>100 %</u>

A reconciliation of the amount of services provided to patients at established rates to patient care service revenue, as presented in the accompanying consolidated statements of operations, is as follows for the years ended December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Gross patient service revenue	\$ 3,364,771	3,158,930
Less:		
Contractual adjustments, implicit price concessions, and other discounts	<u>(2,528,404)</u>	<u>(2,369,745)</u>
Patient care service revenue, net	<u>\$ 836,367</u>	<u>789,185</u>

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**(5) Investments**

Investments at December 31, 2018 and 2017 include the following:

	<u>2018</u>	<u>2017</u>
U.S. Treasury and agency obligations	\$ 102,649	98,863
U.S. corporate bonds	31,272	33,638
Asset-backed securities	10,854	18,500
Mortgage-backed securities	9,212	—
International fixed-income bonds	6,111	6,757
Mutual funds and equity securities	34,415	37,280
Money market funds	1,981	1,264
Commercial paper	—	741
	<u>196,494</u>	<u>197,043</u>
Less short-term investments	<u>8,164</u>	<u>9,891</u>
Long-term investments	<u>\$ 188,330</u>	<u>187,152</u>

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**(6) Assets Limited as to Use**

Assets limited as to use at December 31, 2018 and 2017 include the following:

	<u>2018</u>	<u>2017</u>
Endowment funds – held for investment:		
Money market funds	\$ 615	1,194
Mutual funds	11,632	11,150
	<u>12,247</u>	<u>12,344</u>
Nonqualified retirement funds:		
Money market funds	1,939	1,786
Mutual funds	16,367	18,121
	<u>18,306</u>	<u>19,907</u>
Project funds:		
Commercial paper	—	2,327
Corporate obligations	—	13,446
U.S. Treasury and agency obligations	—	3,123
	<u>—</u>	<u>18,896</u>
Other – money market and mutual funds	1,221	469
	<u>31,774</u>	<u>51,616</u>
Less current portion	789	19,150
	<u>\$ 30,985</u>	<u>32,466</u>

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**(7) Property and Equipment**

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

	<u>2018</u>	<u>2017</u>
Land	\$ 3,557	3,557
Equipment	189,571	222,239
Buildings and leasehold improvements	402,475	319,824
Buildings under capital lease obligation	<u>15,500</u>	<u>15,500</u>
	611,103	561,120
Less accumulated depreciation and amortization	<u>327,662</u>	<u>325,113</u>
	283,441	236,007
Construction in progress	<u>11,998</u>	<u>58,342</u>
Property and equipment, net	<u>\$ 295,439</u>	<u>294,349</u>

UHS had outstanding commitments under construction contracts for renovation projects totaling approximately \$895 and \$27,909 at December 31, 2018 and 2017, respectively, which are expected to be financed primarily from project funds and operations (note 9).

**(8) Investments in Affiliated Organizations**

*DL/UHS, Inc.*

UHS and Dynacare Laboratory Management Limited entered into an agreement for ownership in DL/UHS, Inc. (the Partnership) to operate an efficient, cost-effective, and competitive laboratory service organization. The Partnership provides UHS with laboratory testing required for its patients, as well as referral laboratory services. UHS' ownership interest is 5% and is accounted for using the equity method. For the years ended December 31, 2018 and 2017, UHS' share of the Partnership earnings was approximately \$884 and \$1,010, respectively. UHS received distributions of approximately \$828 and \$1,171 during the years ended December 31, 2018 and 2017, respectively. UHS' investment in the Partnership at December 31, 2018 and 2017 was approximately \$1,153 and \$1,097, respectively.

Under a services agreement renewed at the end of 2014, UHS agreed to pay a flat base rate per lab test performed. The term of the agreement is for 60 months through 2019. For the years ended December 31, 2018 and 2017, UHS incurred costs of approximately \$17,854 and \$18,817, respectively, related to this agreement. As of December 31, 2018 and 2017, UHS had accounts payable due to the Partnership of approximately \$4,378 and \$4,269, respectively.

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The Partnership entered into an operating lease with UHS for the space occupied by the laboratory on UHS' premises. The term of the lease was automatically renewed at the end of 2014 with a term of 60 months through 2019, and a monthly payment of approximately \$60 due the first day of each month.

Under an employee services agreement, the Partnership agreed to reimburse UHS for the actual cost of laboratory employees. These costs were approximately \$1,644 and \$2,033 for the years ended December 31, 2018 and 2017, respectively. As of December 31, 2018 and 2017, UHS had accounts receivable due from the Partnership of approximately \$568 and \$820, respectively, which is included in other receivables in the accompanying consolidated balance sheets.

Condensed financial information of Dynacare LLC is as follows:

	<b>2018</b>	<b>2017</b>
	(Unaudited)	
Revenue	\$ 75,045	74,406
Expenses	57,362	54,203
Net income	\$ 17,683	20,203

*University of Tennessee Medical Center Home Care Services, LLC*

UHS is a 33% owner of University of Tennessee Medical Center Home Care Services, LLC (UTMCHCS) with Tennessee Health Care Group, LLC (67%). The purpose of UTMCHCS is to provide home health and hospice services. The investment is accounted for using the equity method. For the years ended December 31, 2018 and 2017, UHS' share of UTMCHCS earnings was approximately \$1,405 and \$1,727, respectively. UHS received distributions of approximately \$1,484 and \$1,605 during the years ended December 31, 2018 and 2017, respectively. UHS' investment in UTMCHCS at December 31, 2018 and 2017 was \$1,122 and \$1,200, respectively.

Under an employee services agreement, UTMCHCS agreed to reimburse UHS for the actual cost of home health and hospice employees who are leased. These costs were approximately \$203 and \$265 for the years ended December 31, 2018 and 2017, respectively. As of December 31, 2018 and 2017, UHS had accounts receivable due from UTMCHCS of approximately \$54 and \$27, respectively, which is included in other receivables in the accompanying consolidated balance sheets.

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Condensed financial information of UTMCHCS is as follows:

	<b>2018</b>	<b>2017</b>
	(Unaudited)	
Financial position:		
Current assets	\$ 13,692	13,831
Property, plant, and equipment, net	101	77
Other assets	6,761	6,669
Total assets	\$ 20,554	20,577
Current liabilities	\$ 782	565
Other liabilities – minority interest	303	373
Total liabilities	1,085	938
Stockholders' equity	19,469	19,639
Total liabilities and stockholders' equity	\$ 20,554	20,577
Results of operations:		
Revenue	\$ 30,034	28,961
Expenses	27,182	25,454
Net income	\$ 2,852	3,507

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**(9) Long-Term Debt**

Long-term debt, including unamortized premiums and issuance costs at December 31, 2018 and 2017, is summarized as follows:

	<b>2018</b>	<b>2017</b>
Revenue bonds, 2017 Series, net of unamortized premium and issuance cost of \$6,155 and \$6,970 at December 31, 2018 and 2017, respectively	\$ 124,335	129,340
Revenue bonds, 2016 Series, net of unamortized premium and issuance cost of \$7,213 and \$7,677 at December 31, 2018 and 2017, respectively	116,388	118,422
Revenue bonds, 2015 Series, net of unamortized premium and issuance cost of \$(195) and \$(204) at December 31, 2018 and 2017, respectively	88,615	89,021
Revenue bonds, 2014 Series, net of unamortized premium and issuance cost of \$76 and \$80 at December 31, 2018 and 2017, respectively	9,924	9,920
Capital lease obligations	13,331	12,415
Notes payable	11,787	10,189
	364,380	369,307
Less current portion	10,329	8,498
	\$ 354,051	360,809

**(a) Revenue Bonds**

*(i) 2017 Series*

On February 1, 2017, the Health, Educational, and Housing Facilities Board of the County of Knox issued on behalf of UHS \$124.5 million Revenue Bonds, Series 2017. Under the terms of the bond indenture, the proceeds, together with other financing sources, were used to (i) refund a portion of the Series 2007 Bonds and (ii) pay costs of issuing the Series 2017 Bonds. The Revenue Bonds, Series 2017 were issued as tax-exempt bonds and bear interest, payable semiannually, at a rates ranging from 2% to 5%. The Revenue Bonds, Series 2017 constitute serial bonds due April 1, 2036, subject to installments commencing on April 1, 2017.

Under the terms of the bond indenture, the Medical Center is required to maintain certain covenants, including a minimum debt service coverage ratio, as defined, of 1.10 as long as the Revenue Bonds, Series 2017 are outstanding.

The Revenue Bonds, Series 2017 are subject to redemption at the option of UHS, in whole or in part, at any time, at the redemption price of 100% plus accrued interest.

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*(ii) 2016 Series*

On November 17, 2016, the Health, Educational, and Housing Facilities Board of the County of Knox issued on behalf of UHS \$110.9 million Revenue Bonds, Series 2016. Under the terms of the bond indenture, the proceeds, together with other financing sources, will be used to (i) refund a portion of the Series 2007 Bonds (ii) pay costs of acquiring, constructing, reconstructing, improving, equipping, furnishing, bettering, and/or extending The Medical Center, (iii) fund capitalized interest, and (iv) pay costs of issuing the Series 2016 Bonds. The Revenue Bonds, Series 2016 were issued as tax-exempt bonds and bear interest, payable semiannually, at rates ranging from 3% to 5%. The Revenue Bonds, Series 2016 constitute serial bonds due September 1, 2047, subject to installments commencing on March 1, 2017.

UHS has three years from the effective date to draw down the total nonrefunding portion of the proceeds of \$67,187 of the Series 2016 bonds and complete the Medical Center's additions and improvements. As of December 31, 2018 and 2017, UHS had drawn down approximately \$67,187 and \$48,770, respectively, related to these projects.

Under the terms of the bond indenture, the Medical Center is required to maintain certain covenants, including a minimum debt service coverage ratio, as defined, of 1.10 as long as the Revenue Bonds, Series 2016 are outstanding.

The Revenue Bonds, Series 2016 are subject to redemption at the option of UHS, in whole or in part, at any time, at the redemption price of 100% plus accrued interest.

*(iii) 2015 Series*

On June 25, 2015, the Health, Educational, and Housing Facilities Board of the County of Knox issued on behalf of UHS \$32 million Revenue Bonds, Series 2015A, and \$58 million Revenue Bonds, Series 2015B which were used to (i) finance or reimburse the cost of additions and improvements to the Medical Center, (ii) finance the acquired outpatient care facility in Sevierville, Tennessee, and (iii) advance refund the Revenue Bonds, Series 2010. The Revenue Bonds, Series 2015A were issued as tax-exempt bonds and bear interest, payable semiannually, at a variable rate equal to 67.00% of LIBOR plus 1.03, which resulted in a 2.6983% average interest rate for the year ended December 31, 2018. The Revenue Bonds, Series 2015B were issued as tax-exempt bonds and bear interest, payable semiannually, at a fixed rate equal to 2.5129%. The Revenue Bonds, Series 2015A constitute serial bonds due July 1, 2045, subject to installments commencing on July 1, 2037. The Revenue Bonds, Series 2015B constitute serial bonds due July 1, 2045, subject to installments commencing on July 1, 2016.

Under the terms of the bond indenture, UHS is required to maintain certain covenants, including a minimum debt service coverage ratio, as defined, of 1.20 and days cash on hand, as defined, of not less than 60 days, as long as the Revenue Bonds, 2015 Series are outstanding.

The Revenue Bonds, Series 2015 are subject to redemption at the option of UHS, in whole or in part, at any interest payment date, at the redemption price of 100% plus accrued interest plus a prepayment fee.

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*(iv) 2014 Series*

On July 1, 2014, the Health, Educational, and Housing Facilities Board of the County of Knox issued on behalf of UHS \$10 million Revenue Bonds, Series 2014. Under the terms of the bond indenture, the proceeds, together with other financing sources, were used to finance or reimburse the cost of additions and improvement to the Medical Center. The Revenue Bonds, Series 2014 were issued as tax-exempt bonds and bear interest, payable semiannually, at the lower of daily rate, the weekly rate, the commercial paper rate, the long-term rate, or the bank rate. The long-term rate is equal to 79% of LIBOR plus 70 basis points, which resulted in a 2.6671% average interest rate for the year ended December 31, 2018. The Revenue Bonds, Series 2014 constitute serial bonds due January 1, 2043, subject to installments commencing on January 1, 2037.

Under the terms of the bond indenture, UHS is required to maintain certain covenants, including a minimum debt service coverage ratio, as defined, of 1.20 and days cash on hand, as defined, of not less than 60 days, as long as the Revenue Bonds, Series 2010 are outstanding.

The Revenue Bonds, Series 2014 are subject to redemption at the option of UHS, in whole or in part, at any time, at the redemption price of 100% plus accrued interest.

***(b) Capital Lease Obligations***

Pursuant to the Lease and Transfer Agreement (note 2), UHS acquired a leasehold interest in the real property of the Medical Center from the University for a term of 50 years. The guaranteed lease payment of \$50 million will be paid subject to an inflation index tied to the change in net Medical Center operating revenue through 2019, as defined, in annual payments equal to the lesser of (i) 20% of UHS' annual net operating income, as defined, or (ii) \$3 million, subject to the index. The payment of \$50 million will be negotiated through future annual lease payments for the remaining 30 years of the lease.

UHS initially recorded an asset and capital lease obligation for the real property in the amount of approximately \$15,500, which represents the net present value of the guaranteed \$50 million discounted at 5.75% from December 31, 2019. The capital lease obligation is increased monthly by interest expense and is reduced by lease payments, if any. For the year ended December 31, 2018, the lease payment required under the agreement was approximately \$2,030. No lease payment amounts were due under the agreement for the year ended December 31, 2017. The 2018 amount was due by March 15, 2019 and is included in current portion of long-term debt in the accompanying consolidated balance sheet at December 31, 2018.

A second amendment to the UT Lease and Transfer Agreement was executed on January 10, 2019. The amendment extends the term of the agreement to July 29, 2099. Any remaining payment due on March 15, 2021 may be paid in full, or UHS may elect to make the remaining payment under the original agreement over a period not to exceed five years. Under the terms of the amendment, additional lease payments will be due through 2049 subject to certain terms and conditions.

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UHS has entered into one capital lease obligation in 2018 and two capital lease obligations in 2017 for Medical Center equipment. The terms of the leases range from three to five years at interest rates ranging from 1.4% to 13.2%.

At December 31, 2018 and 2017, the gross amounts of property and equipment and related accumulated amortization recorded under capital leases were as follows:

	<b>2018</b>	<b>2017</b>
Buildings	\$ 15,500	15,500
Equipment	34,808	34,539
	50,308	50,039
Less accumulated amortization	43,876	41,560
	\$ 6,432	8,479

Amortization of assets held under capital leases is included in depreciation and amortization expense in the accompanying consolidated statements of operations.

**(c) Notes Payable**

On September 8, 2017, UHS entered into a 10-year \$10,725 note payable with Pinnacle Bank. The note has a fixed-interest rate of 4.09% and a maturity date of September 15, 2027. At December 31, 2018, \$10,189 was outstanding on this note.

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Scheduled principal payments on long-term debt at December 31, 2018 are as follows:

	<u>Revenue bonds</u>	<u>Capital lease obligations</u>	<u>Notes payable</u>	<u>Total</u>
2019	\$ 6,400	3,104	825	10,329
2020	6,695	268	758	7,721
2021	7,010	259	758	8,027
2022	7,335	259	758	8,352
2023	7,700	86	644	8,430
2024 and thereafter	291,025	12,142	8,044	311,211
Less amounts representing:				
Interest under capital lease obligations	—	(2,787)	—	(2,787)
Unamortized issuance cost on long-term debt	(2,330)	—	—	(2,330)
Unamortized premium on long-term debt	15,427	—	—	15,427
	<u>\$ 339,262</u>	<u>13,331</u>	<u>11,787</u>	<u>364,380</u>

**(10) Derivative Instrument**

UHS has executed a derivative financial instrument in the normal course of its business but does not use it for trading purposes. UHS has one interest rate swap agreement that is designed to mitigate the fixed-rate interest risk associated with its indebtedness.

The following table summarizes the general terms of UHS' swap agreement:

	<u>May 2006 interest rate swap</u>
Effective date	May 26, 2006
Term	23 years
Notional amount	\$ 176,000
Rate UHS pays	SIFMA <sup>(1)</sup>
Rate UHS receives	68.00% of three-month LIBOR <sup>(2)</sup> plus 0.425%

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- (1) SIFMA represents the Bond Market Association Municipal Swap Index.
- (2) LIBOR represents the London Interbank Offered Rate.

The fair value as of December 31, 2018 and 2017 of approximately \$3,327 and \$2,785, respectively, is included in other assets in the accompanying consolidated balance sheets. The change in the fair value of the derivative instrument was approximately \$542 and \$1,526 in 2018 and 2017, respectively, and is included in nonoperating gains, net in the accompanying consolidated statements of operations. Pursuant to the swap agreement, UHS is required to post collateral equal to the fair value of the liability that exceeds \$7,500 as of the valuation date. The net settlement amount received on the swap of approximately \$1,035 and \$752 for the years ended December 31, 2018 and 2017, respectively, is included as a reduction to interest expense in the consolidated statements of operations.

**(11) Related-Party Transactions**

*The University*

Pursuant to the Employee Services Agreement (note 2), the Medical Center's employees as of July 28, 1999 were leased by UHS from the University and retained all university benefits for which they were eligible at that date. For the years ended December 31, 2018 and 2017, UHS paid approximately \$38,472 and \$42,775, respectively, to the University for salaries, wages, and benefits, including retirement benefits, of the leased employees.

Pursuant to the Affiliation Agreement (note 2), UHS is required to pass through to GSM certain federal and state funds earmarked for graduate medical education. For the years ended December 31, 2018 and 2017, the graduate medical education reimbursements amounted to approximately \$38,019 and \$33,708, respectively, and were recorded in the accompanying consolidated financial statements as patient care service revenue and as an offsetting amount in operating expenses. UHS had amounts due to GSM of approximately \$7,158 and \$6,519 at December 31, 2018 and 2017, respectively, which are included in accrued expenses and other current liabilities in the accompanying consolidated balance sheets.

**(12) Employee Benefit Plans**

**(a) UHS, Inc. Savings Plan**

UHS maintains a 403(b) savings plan (the Savings Plan) to provide its employees a tax-sheltered annuity. All employees of UHS who work 20 or more hours per week or more than 1,000 hours per calendar year and have attained age 18 are eligible to participate in the Savings Plan from the first day of employment.

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Participants may elect to have certain percentages or dollars of their compensation withheld and contributed to the Savings Plan. Total contributions cannot exceed limitations set forth in the Employee Retirement Income Security Act guidelines. The employer contribution is 5% of each participant's compensation (no matching required). Employer contributions begin after the eligible employee has worked 12 months. Contributions and/or voluntary deductions are made to funds selected by the UHS Benefits Committee. The participant identifies the funds in which he/she wishes to participate and participants who do not select funds are enrolled in the target date funds. Participants are immediately vested in their voluntary deductions and earnings. Prior to January 1, 2003, participants with one year of employment but less than two years of employment became 20% vested in UHS contributions, and their vested percentage increased by 20% each year of employment thereafter until they were fully vested after five years. For participants joining UHS on or after January 1, 2003, the vesting is a five-year cliff vesting whereby the employee becomes fully vested after five years of employment. Beginning January 1, 2007, the vesting for all active employees changed to a six-year graduated vesting. Participants with two years of employment become 20% vested in UHS contributions, and their vested percentage increases by 20% each year of employment thereafter until they are fully vested after six years. Each employee with at least three years of service on January 1, 2007, who was not 100% vested, was permitted to make an irrevocable election regarding the applicable vesting schedule. For the years ended December 31, 2018 and 2017, total UHS expenses related to the Savings Plan were approximately \$8,027 and \$8,076, respectively.

Participants are eligible to receive the vested value of their account upon reaching the age of 59½, death, disability, or termination of employment. Hardship distributions may be requested from the employee's voluntary deductions but not the employer's contributions. Participants may elect to receive a lump-sum payment or payments over a period of time not to exceed the life expectancy of the participant or the joint life expectancy of the participant and his or her beneficiary.

As discussed in note 11, employees leased from the University retain all university benefits. Leased employees are not eligible to participate in the Savings Plan.

**(b) UHS, Inc. Nonqualified Plans**

UHS maintains a nonqualified deferred compensation plan for senior management, vice presidents and equivalents, and physicians. All employer contributions are subject to a seven-year vesting schedule or attainment of age 60, and contributions are made at the close of each payroll cycle.

UHS maintains a separate nonqualified plan for senior management. The employer's contributions become vested according to the age of the Participant at the time the contribution was made. Contributions to a participant's account made in a year in which the participant attains the age of fifty-seven (57) shall vest fully on January 1 of the year the Participant attains the age of sixty (60). Contributions made no later than the year in which the Participant attains the age of fifty-eight (58), and each year thereafter, shall vest fully on the last business day of the year in which the contribution is made. Contributions are made at the end of each payroll cycle.

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UHS maintains a separate nonqualified plan for certified registered nurse anesthetists. All employer contributions are subject to a seven-year vesting schedule or attainment of age 60, and contributions are made at the close of each payroll cycle.

For the years ended December 31, 2018 and 2017, total UHS expenses related to the nonqualified plans described above were approximately \$4,354 and \$4,923, respectively.

**(13) Fair Value of Financial Instruments**

The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer or settle a liability in an orderly transaction among market participants at the measurement date. ASC Topic 820, *Fair Value Measurement*, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to measurements involving significant unobservable inputs (Level 3 inputs). The classification of an investment within the hierarchy is based upon the pricing transparency or ability to redeem the investment and does not necessarily correspond to the perceived risk of that investment. Inputs are used in applying various valuation techniques that are assumptions, which market participants used to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, operating statistics, specific and broad credit data, liquidity statistics, recent transactions, earnings forecasts, future cash flows, market multiples, discount rates, and other factors.

Assets and liabilities measured and reported at fair value are classified within the fair value hierarchy as follows:

- Level 1 – Valuations are based on quoted market prices in active markets.
- Level 2 – Investments that trade in markets that are considered to be active but are based on dealer quotations or alternative pricing sources supported by observable inputs or investments that trade in markets that are not considered to be active but are valued based on quoted market prices, dealer quotations, or alternative pricing sources supported by observable inputs
- Level 3 – Investments classified within Level 3 have significant unobservable inputs as they trade infrequently or not at all.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety.

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The following table presents financial instruments that are measured at fair value on a recurring basis at December 31, 2018:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 85,502	—	—	85,502
Assets limited as to use:				
Money market funds	2,960	—	—	2,960
Mutual funds and equity securities	<u>28,814</u>	<u>—</u>	<u>—</u>	<u>28,814</u>
	<u>31,774</u>	<u>—</u>	<u>—</u>	<u>31,774</u>
Interest rate derivative asset	—	3,327	—	3,327
Investments:				
Money market funds	1,981	—	—	1,981
U.S. corporate bonds	—	31,272	—	31,272
Asset-backed securities	—	10,854	—	10,854
Mortgage-backed securities	—	9,212	—	9,212
International fixed-income bonds	6,111	—	—	6,111
U.S. Treasury and agency bonds	93,770	8,879	—	102,649
Mutual funds and equity securities	<u>34,415</u>	<u>—</u>	<u>—</u>	<u>34,415</u>
	<u>136,277</u>	<u>60,217</u>	<u>—</u>	<u>196,494</u>
Total	<u>\$ 253,553</u>	<u>63,544</u>	<u>—</u>	<u>317,097</u>

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The following table presents financial instruments that are measured at fair value on a recurring basis at December 31, 2017:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 53,665	—	—	53,665
Assets limited as to use:				
Money market funds	3,449	—	—	3,449
Commercial paper	—	2,327	—	2,327
U.S. corporate bonds	—	13,446	—	13,446
U.S. Treasury and agency bonds	3,123	—	—	3,123
Mutual funds and equity securities	29,271	—	—	29,271
	<u>35,843</u>	<u>15,773</u>	<u>—</u>	<u>51,616</u>
Interest rate derivative asset	—	2,785	—	2,785
Investments:				
Money market funds	1,264	—	—	1,264
Commercial paper	—	741	—	741
U.S. corporate bonds	—	33,638	—	33,638
Asset-backed securities	—	18,500	—	18,500
International fixed-income bonds	6,757	—	—	6,757
U.S. Treasury and agency bonds	84,791	14,072	—	98,863
Mutual funds and equity securities	37,280	—	—	37,280
	<u>130,092</u>	<u>66,951</u>	<u>—</u>	<u>197,043</u>
Total	<u>\$ 219,600</u>	<u>85,509</u>	<u>—</u>	<u>305,109</u>

There were no transfers among any of the levels during the year ended December 30, 2018 or 2017.

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**(14) Commitments and Contingencies**

**(a) Lease Obligations**

UHS leases certain buildings and equipment. These leases are classified as operating leases and have lease terms ranging from 1 to 10 years.

The following table is a schedule by year of future minimum rentals on noncancelable operating leases with terms in excess of one year at December 31, 2018:

2019	\$	6,376
2020		5,588
2021		4,843
2022		3,661
2023		3,134
2024 and thereafter		<u>12,748</u>
	\$	<u><u>36,350</u></u>

UHS' total lease expense for the years ended December 31, 2018 and 2017 was approximately \$9,577 and \$9,132, respectively.

**(b) Risk Management Programs**

UHS purchases professional and general liability insurance, subject to certain deductibles, to cover medical malpractice and other general liability claims. Effective July 28, 2002, UHS assumed a self-insured retention to cover medical malpractice and other general liability claims. On January 1, 2005, UHS assumed a self-insured retention for workers' compensation. The insurance carrier pays claims, including the deductible on behalf of UHS, and UHS reimburses the insurance carrier on a monthly basis for paid claims. Workers' compensation claim payments made by the insurance carriers within the deductible are secured by UHS via standby letters of credit in the amounts of \$2,313 and \$213 issued by Wells Fargo. UHS also maintains an umbrella policy that provides \$50 million of excess liability coverage over and above the primary coverage for professional, general, automobile, workers' compensation, aviation, and ambulance liability.

There are known claims and incidents that may result in the assertion of additional claims, as well as claims from unknown incidents that may be asserted arising from services provided to patients, workers' compensation, and other risks. UHS has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accordingly, accrued professional, general, workers' compensation, and other liability losses of approximately \$22,904 and \$23,280 are recorded in accrued expenses and other liabilities in the accompanying consolidated financial statements at December 31, 2018 and 2017, respectively, which, in management's opinion, provide an adequate accrual for such claims.

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**(c) Healthcare Services**

The federal government has been given substantial resources and authority to conduct fraud and abuse investigations, and substantial fines and penalties have been established for offenders. Management continues to implement policies, procedures, and a compliance overview organizational structure to enforce and monitor compliance with government statutes and regulations. UHS' compliance with such laws and regulations is subject to future government review and interpretations, as well as regulatory actions unknown or unasserted at this time.

**(15) Rentals under Operating Leases**

UHS leases certain office space to physician groups and a laboratory service company. These leases are classified as operating leases and have lease terms of one to eight years.

The following is a schedule, by year, of minimum future rentals on noncancelable operating leases as of December 31, 2018:

2019		\$	3,606
2020			3,067
2021			2,496
2022			2,103
2023			2,157
2024 and thereafter			5,355
		\$	18,784

**(16) Functional Expenses**

UHS provides healthcare services to residents within its geographic location. Expenses related to providing these services on a functional basis were as follows for the years ended December 31, 2018 and 2017:

	2018		2017	
	Healthcare	Admin	Healthcare	Admin
Salaries, wages, and benefits	\$ 350,720	31,237	347,271	32,168
Medical supplies and drugs	262,525	476	247,852	886
Purchased services	110,740	17,134	110,148	16,604
Graduate medical education reimbursed to the University	38,019	—	33,708	—
Insurance and other	31,878	1,144	27,962	1,016
Depreciation and amortization	28,218	2,977	26,640	2,810
Interest	12,433	1,312	11,123	1,174
	\$ 834,533	54,280	804,704	54,658

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**(17) Availability of Resources and Liquidity**

UHS has \$194,000 of financial assets available within one year of the consolidated balance sheet date to meet cash needs for general expenditure consisting of cash of \$86,000; patient accounts receivable, net of \$100,000; and short-term investments of \$8,000. None of the financial assets are subject to donor or other contractual restrictions that make them unavailable for general expenditure within one year of the balance sheet date. Patient accounts receivable is expected to be collected within one year. UHS has a goal to maintain financial assets, which consist of cash and short-term investments, on hand to meet 60 days of normal operating expenses, which are, on average, approximately \$140,000. UHS has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, as part of its liquidity management, UHS invests cash in excess of daily requirements in various short-term investments, including certificate of deposits and short-term treasury instruments.

**(18) Subsequent Events**

On March 8, 2019, UHS, along with Tennova Healthcare and Kindred Healthcare collectively announced their intent to create a joint venture to construct and operate a 57-bed inpatient rehabilitation hospital on land currently owned by Tennova in Knoxville, TN. Each of the three joint venture partners will own a one-third interest in the newly created inpatient rehabilitation hospital, which will provide care for patients across an 11-county region suffering from impairments resulting from medical events such as stroke, serious spinal cord and brain injury, neurologic illness, major multiple trauma, and orthopedic conditions with complex or profound impairments. The joint venture partners have jointly filed a Certificate of Need application with the Health Services and Development Agency of the State of Tennessee, which seeks to relocate 57 licensed inpatient rehabilitation beds from Tennova hospitals to the new inpatient rehabilitation facility.

UHS has evaluated subsequent events from the consolidated balance sheet date through March 26, 2019, the date the consolidated financial statements were available to be issued, and determined there are no other items to disclose.