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UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Report of Federal Award Expenditures in
Accordance with Uniform Guidance

Federal Entity Identification Number: 34-0714775

Year ended December 31, 2019

(With Independent Auditors’ Reports Thereon)

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Report on Federal Award Expenditures in
Accordance with Uniform Guidance

Year ended December 31, 2019

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UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Schedule of Expenditures of Federal Awards

Year ended December 31, 2019

Federal grantor/program/grant	CFDA Number	Pass-through grantor	Pass-through identifying number	Expenditures passed through to subrecipients	Expenditures
Highway Safety Cluster:					
U.S. Department of Transportation:					
OVI Task Force – Countywide OVI Task Force Program	20.616	Ohio Department of Public Safety	OVI-2019-University Hospitals Clev-00005, 00006	$ —	176,927
Ohio Buckles Buckeyes	20.616	Ohio Department of Health	01830024BB0219, 01830024BB0320	—	52,328
Total CFDA 20.616				—	229,255
Safe Communities Program – Cuyahoga County	20.600	Ohio Department of Public Safety	SC-2019-University Hospitals Clev-00026, SC-2020-Univ Hosp Clev-00017	—	103,589
Safe Communities Program – Geneva	20.600	Ohio Department of Public Safety	SC-2019-UHHS Memorial Hospital of-00006, SC-2020-UH GMCenter-0029	—	32,916
Total CFDA 20.600				—	136,505
Total Highway Safety Cluster				—	365,760
Research and Development Cluster					
U.S. Department of Defense:					
Risk and Resilience Project	12.420			659,217	979,125
Total Research and Development Cluster				659,217	979,125
Other Programs:					
U.S. Department of Health and Human Services:					
Ryan White Title III Grant	93.918			—	522,476
Ryan White Title IV Grant	93.153			—	332,214
Ohio Children's Trust Fund	93.590	Ohio Department for Job & Family Services	G-1819-22-0330, G-2021-22-0188	—	50,536
ODH Injury Prevention – Child Injury Prevention	93.991	Ohio Department of Health	01830024IC0119, 01830024IC0220	—	152,903
Community and Economic Development Healthy Food Financing Initiative Grant	93.570	Midtown Cleveland	90EE1147-01-02	—	9,262
HIV Emergency Relief Project Grants	93.914	Cuyahoga County District Board of Commissioners	H89HA23812, H89HA23812	—	1,014,008
ECHO Training Model Grant	93.788	Ohio Department of Mental Health and Addiction Service	1900720	—	56,502
Small Rural Hospital Improvement Grant Program (SHIP) – Geneva	93.301	Ohio Department of Health	5 H3HRH00045-17-00, H3HRH00045	—	19,807
Small Rural Hospital Improvement Grant Program (SHIP) – Conneaut	93.301	Ohio Department of Health	5 H3HRH00045-17-00, H3HRH00045	—	10,170
Total CFDA 93.301				—	29,977
Progesterone (Federal)	93.778	Ohio Department of Health	G-1819-05-0094; ODM 201804	—	11,895
Maternal Opiate Medical Supports Plus/Neonatal Abstinence Syndrome	93.778	The Ohio State University	G-2021-05-0069; ODM 202010	—	54,472
Maternal Opiate Medical Supports Plus/Neonatal Abstinence Syndrome	93.778	Ohio Department of Health	G-2021-05-0069; ODM 202010	—	905
Neonatal Abstinence Syndrome (NAS)	93.778	Ohio Department of Health	G-1819-05-0094; ODM 201836	—	17,843
Neonatal Abstinence Syndrome (NAS)	93.778	The Ohio State University	G-1819-05-0094; ODM 201836	—	14,003
Maternal Opiate Medical Supports (MOMS)	93.778	Ohio Department of Health	G-1819-05-0094; ODM 201810	—	8,921
Maternal Opiate Medical Supports (MOMS)	93.778	The Ohio State University	G-1819-05-0094; ODM 201810	—	34,081
Total CFDA 93.778				—	142,120
Disaster Preparedness Grant – Ahuja	93.889	Center for Health Affairs	93.889/01860052RP1219, 93.889/01860052RP1320	—	13,448
Disaster Preparedness Grant – Elyria	93.889	Center for Health Affairs	93.889/01860052RP1219, 93.889/01860052RP1320	—	13,826
Disaster Preparedness Grant – Amherst	93.889	Center for Health Affairs	93.889/01860052RP1219, 93.889/01860052RP1320	—	1,774
Disaster Preparedness Grant – Parma	93.889	Center for Health Affairs	93.889/01860052RP1219, 93.889/01860052RP1320	—	13,998
Disaster Preparedness Grant – St. John	93.889	Center for Health Affairs	93.889/01860052RP1219, 93.889/01860052RP1320	—	11,565
Disaster Preparedness Grant – Geauga	93.889	Center for Health Affairs	93.889/01860052RP1219, 93.889/01860052RP1320	—	6,973
Disaster Preparedness Grant – Richmond	93.889	Center for Health Affairs	93.889/01860052RP1219, 93.889/01860052RP1320	—	9,955
Disaster Preparedness Grant – Bedford	93.889	Center for Health Affairs	93.889/01860052RP1219, 93.889/01860052RP1320	—	10,848
Disaster Preparedness Grant – Conneaut	93.889	Center for Health Affairs	93.889/01860052RP1219, 93.889/01860052RP1320	—	7,000
Disaster Preparedness Grant – Geneva	93.889	Center for Health Affairs	93.889/01860052RP1219, 93.889/01860052RP1320	—	7,006
Disaster Preparedness Grant – UHCMC	93.889	Center for Health Affairs	93.889/01860052RP1219, 93.889/01860052RP1320	—	800
Disaster Preparedness Grant – Samaritan	93.889	Center for Health Affairs	93.889/01860052RP1219, 93.889/01860052RP1320	—	31,565
Disaster Preparedness Grant – Portage	93.889	Center for Health Affairs	93.889/01860052RP1219, 93.889/01860052RP1320	—	34,231
Eastern Great Lakes Pediatric Consortium for Disaster Response	93.889	Center for Health Affairs	93.889/01860052RP1219, 93.889/01860052RP1320	—	98,842
Total CFDA 93.889				—	261,831
Expanding Access to Medication Assisted Treatment for Opioid Use Disorder by Educating and Training Medical Students	93.243	Northeast Ohio Medical University	1H79T1081669-01	—	15,573
Moms First	93.926	Office of Criminal Justice Service	H49MC00082	—	20,696
Total U.S. Department of Health and Human Services				—	2,608,098
The Victims of Crime Act (VOCA) – Antifragility Initiative (Peds ED)	16.575	Ohio Attorney General	2019-VOCA-132131508, 2020-VOCA-132920768	—	380,924
The Victims of Crime Act (VOCA) – Adult SANE/Peds SANE	16.575	Ohio Attorney General	2019-VOCA-132131452, 132131455, 2020-VOCA-132920775, 132920790	—	325,380
Total CFDA 16.575				—	706,304
Total Federal Award Expenditures				$ 659,217	4,659,287

See accompanying independent auditors' report and notes to the schedule of expenditures of federal awards.

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Schedule of Expenditures of Federal Awards

Year ended December 31, 2019

(1) General

The accompanying schedule of expenditures of federal awards presents the activity of all federal financial assistance programs of University Hospitals Health System, Inc. and its subsidiaries (the System) for the year ended December 31, 2019. Federal awards received directly from federal agencies as well as federal awards passed through other government agencies are included in the accompanying schedule.

The System did not use the 10% de minimis indirect cost rate allowed by the Uniform Guidance.

(2) Basis of Presentation

The accompanying schedule of expenditures of federal awards is presented using the accrual basis of accounting. Funds received under various government grant programs are recognized as support over the grant period as expenditures are incurred.

(3) Relationship to Financial Statements

All federal financial assistance receipts are reported as other revenue in the System's consolidated financial statements.

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Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

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

We have audited, in accordance with the 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, the consolidated financial statements of University Hospitals Health System, Inc. and its subsidiaries (the System), which comprise the consolidated balance sheet as of December 31, 2019, and the related consolidated statement of operations and changes in net assets, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon, which included an emphasis of matter paragraph related to the adoption of a new accounting standard, dated April 1, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We identified a deficiency in internal control, described in the accompanying schedule of findings and questioned costs as item 2019-001 that we consider to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

University Hospitals Health System, Inc.'s Response to Finding

The System's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The System's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the response.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Cleveland, Ohio
April 1, 2020

KPMG LLP
One Cleveland Center
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1375 East Ninth Street
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Independent Auditors' Report on Compliance for Each Major Federal Program; Report on Internal Control Over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

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

Report on Compliance for Each Major Federal Program

We have audited University Hospitals Health System Inc. and subsidiaries (the System)'s compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on the System's major federal program for the year ended December 31, 2019. The System's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for the System's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the System's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of the System's compliance.

Opinion on the Major Federal Program

In our opinion, the System complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2019.

Report on Internal Control over Compliance

Management of the System is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the System's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the consolidated financial statements of the System as of and for the year ended December 31, 2019, and have issued our report thereon dated April 1, 2020, which contained an unmodified opinion on those consolidated financial statements. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance 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 schedule of expenditures of federal awards is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Cleveland, Ohio
September 29, 2020

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Schedule of Findings and Questioned Costs

Year ended December 31, 2019

(1) Summary of Auditor’s Results

(a) Type of report issued on whether the consolidated financial statements were prepared in accordance with generally accepted accounting principles: **Unmodified**

(b) Internal control deficiencies over financial reporting disclosed by the audit of the consolidated financial statements:

- Material weaknesses: **No**
- Significant deficiencies: **Yes**

(c) Noncompliance material to the consolidated financial statements: **No**

(d) Internal control deficiencies over major programs disclosed by the audit:

- Material weaknesses: **No**
- Significant deficiencies: **None Reported**

(e) Type of report issued on compliance for major programs: **Unmodified**

(f) Audit findings that are required to be reported in accordance with 2 CFR 200.516(a): **No**

(g) Major program:

- CFDA 93.914 HIV Emergency Relief Project Grants

(h) Dollar threshold used to distinguish between Type A and Type B programs: **$750,000**

(i) Auditee qualified as a low-risk auditee: **Yes**

(2) Findings Related to the Financial Statements Reported in Accordance with *Government Auditing Standards*

Significant Deficiency Finding 2019-001

Criteria

Title 2 U.S. Code of Federal Regulations Part 200 (2 CFR 200), *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, Subpart F, Section 200.508(b) states “the auditee must prepare appropriate financial statements, including schedule of expenditure of federal awards in accordance with 200.510 Financial Statements.”

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control-Integrated Framework (2013) principle 4 states “The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with the objectives.”

The System has a responsibility for adopting sound accounting policies and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the consolidated financial statements and to provide reasonable assurance against the possibility of misstatements that are material to the consolidated financial statements.

Condition

The process owner and control operator, did not have the appropriate experience and detailed knowledge of FASB Accounting Standard Codification (ASC) 958 and the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA), to detect and correct errors in the reporting of investment income and gains/losses arising from donor-restricted endowments and the endowment rollforward disclosure.

Cause and Effect

As a result of the above condition, certain amounts related to endowment assets held by the System and related investment income were incorrectly classified and reported in prior periods.

There was no effect on the 2019 consolidated financial statements as a result of this position.

Recommendation

We recommend the System revise their policy and procedures document to inform all individuals involved in the recording and review of donor-restricted endowment activity of the relevant reporting requirements as defined by UPMIFA and ASC 958. This revised policy may also include a reconciliation of financial statement disclosures to internal endowment schedules and to statements received from the third party endowment administrator. We also recommend the System undertake to provide the control operator with the appropriate training related to the requirements of UPMIFA and ASC 958.

Views of Responsible Officials

In 2019, the System has revised its policy and procedures regarding the reporting of investment income and gains/losses arising from donor-restricted endowments and related footnote disclosures in accordance with UPMIFA and ASC 958 requirements. The revised policy enhances the existing reconciliation procedures. Additionally, all process owners/operators will receive the appropriate training support related to the requirements of UPMIFA and ASC 958, as part of the revised policy.

(3) Findings and Questioned Costs Relating to Federal Awards

None.

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Financial Statements
and Supplementary Information

December 31, 2019 and 2018

(With Independent Auditors' Reports Thereon)

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

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Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of University Hospitals Health System, Inc. and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, 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 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 Hospitals Health System, Inc. and its subsidiaries as of December 31, 2019 and 2018, and the results of their operations 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 2 to the consolidated financial statements, the System has changed its method of accounting for leasing transactions as of January 1, 2019 due to the adoption of Financial Accounting Standards Board's Accounting Standards Update No. 2016-02, *Leases (Topic 842)*, as amended. 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 April 1, 2020 on our consideration of the System's internal control over financial reporting and 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 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 System's internal control over financial reporting and compliance.

KPMG LLP

Cleveland, Ohio
April 1, 2020

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Balance Sheets

December 31, 2019 and 2018

(In thousands of dollars)

Assets		**2019**	**2018**
Current assets:			
Cash and cash equivalents	$	260,859	288,517
Patient accounts receivable		540,993	568,227
Other receivables		49,243	70,155
Other current assets		191,487	172,548
Total current assets		1,042,582	1,099,447
Investments		1,807,298	1,737,542
Property and equipment, net		1,830,992	1,736,862
Other assets:			
Investments in affiliates		112,789	100,557
Beneficial interest in Foundations		157,937	162,724
Perpetual trusts		209,498	189,303
Other		266,918	197,319
Total other assets		747,142	649,903
Total assets	$	5,428,014	5,223,754

(Continued)

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Balance Sheets

December 31, 2019 and 2018

(In thousands of dollars)

Liabilities and Net Assets		**2019**	**2018**
Current liabilities:			
Current installments of long-term debt	$	24,237	24,446
Accounts payable and accrued expenses		483,568	447,967
Other current liabilities		138,020	148,453
Estimated amounts due to third-party payors		18,402	20,569
Total current liabilities		664,227	641,435
Long-term debt, less current installments		1,201,038	1,227,641
Revolving credit line		40,000	140,000
Other liabilities		822,951	626,748
Total liabilities		2,728,216	2,635,824
Net assets:			
Without donor restrictions		1,823,574	1,794,625
With donor restrictions		876,224	793,305
Total net assets		2,699,798	2,587,930
Total liabilities and net assets	$	5,428,014	5,223,754

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, 2019 and 2018

(In thousands of dollars)

		2019	2018
Revenues:			
Net patient service revenue	$	4,040,909	3,893,916
Other revenue		255,696	223,868
Total revenues		4,296,605	4,117,784
Expenses:			
Salaries, wages, and employee benefits		2,458,351	2,325,296
Purchased services		286,767	281,733
Patient care supplies		824,412	723,608
Other supplies		42,649	46,359
Insurance		44,931	49,191
Other		352,699	340,792
Depreciation and amortization		182,192	163,562
Interest		44,126	46,212
Special charges		1,742	7,599
Losses in excess of insurance		93,070	—
Total expenses		4,330,939	3,984,352
Net operating (loss) income		(34,334)	133,432
Nonoperating revenues (expenses):			
Net investment income (loss)		157,555	(19,593)
Change in fair value of derivative instruments		(28,287)	10,195
Loss on extinguishment of debt		—	(442)
Pension settlement costs		—	(42,539)
Other nonservice periodic pension costs		(23,334)	(21,496)
Excess of revenues over expenses	$	71,600	59,557

See accompanying notes to consolidated financial statements.

(Continued)

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2019 and 2018

(In thousands of dollars)

	Without donor restrictions	With donor restrictions	Total
Net assets at December 31, 2017	$ 1,695,259	812,307	2,507,566
Excess of revenues over expenses	59,557	—	59,557
Investment loss	—	(2,925)	(2,925)
Contributions	—	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
Increase (decrease) in net assets	99,366	(19,002)	80,364
Net assets at December 31, 2018	1,794,625	793,305	2,587,930
Excess of revenues over expenses	71,600	—	71,600
Investment income	—	32,954	32,954
Contributions	—	68,448	68,448
Change in beneficial interest in Foundations and perpetual trusts	—	15,408	15,408
Net assets released from restrictions used for operations	—	(32,697)	(32,697)
Pension liability adjustment	(45,712)	—	(45,712)
Net assets released from restrictions for acquisition of property and equipment	1,194	(1,194)	—
Contributed capital	1,867	—	1,867
Increase in net assets	28,949	82,919	111,868
Net assets at December 31, 2019	$ 1,823,574	876,224	2,699,798

See accompanying notes to consolidated financial statements.

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2019 and 2018

(In thousands of dollars)

		2019	2018
Operating activities:			
Change in net assets	$	111,868	80,364
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities:			
Depreciation and amortization		182,741	163,562
Amortization of bond premium, discount, and financing costs		(2,818)	(477)
Loss on extinguishment of debt		—	442
Change in beneficial interest in foundations and perpetual trusts		(15,409)	33,862
Net realized and unrealized investment (gains) losses		(141,736)	63,568
Pension liability adjustment		45,712	6,682
Net change attributable to investments in joint ventures		(12,234)	(4,251)
Restricted revenue and investment income		624	2,916
Net change in operating assets and liabilities:			
Patient accounts receivable		27,234	(3,353)
Other current assets and receivables		1,973	(29,417)
Accounts payable, accrued expenses, and other current liabilities		23,076	99,475
Other assets and liabilities		78,725	(111,730)
Net cash provided by operating activities		299,756	301,643
Investing activities:			
Acquisition of property and equipment		(276,024)	(236,161)
Proceeds from sales of investments		1,370,272	651,962
Purchases of investments		(1,409,138)	(594,735)
Net cash used in investing activities		(314,890)	(178,934)
Financing activities:			
Proceeds from restricted revenue and investment income (loss)		(624)	(2,916)
Repayment of long-term debt		(24,430)	(372,794)
Proceeds from issuance of long-term debt		—	352,370
Bond issuance costs		436	(3,192)
(Payments on) proceeds from revolving credit borrowing		(100,000)	100,000
Increase in treasury service agreement		1,248	1,404
Net cash (used in) provided by financing activities		(123,370)	74,872
(Decrease) increase in cash, cash equivalents, and restricted cash		(138,504)	197,581
Cash, cash equivalents, and restricted cash at beginning of year		399,363	201,782
Cash, cash equivalents, and restricted cash at end of year		260,859	399,363
Restricted cash		—	(110,846)
Total cash and cash equivalents	$	260,859	288,517
Supplemental cash flow information:			
Change in accounts payable related to property and equipment		844	546

See accompanying notes to consolidated financial statements.

(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.

Cash equivalents that are held by outside investment managers and are pooled with other investments are classified as investments. Cash, cash equivalents, and investments that are restricted per contractual or regulatory requirements are classified as donor restricted or trustee held funds.

(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. 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 the 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 as investment income (loss) with donor restrictions 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) Long-term Debt – 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 $1,934 and $2,450 for the years ended December 31, 2019 and 2018, respectively.

Deferred financing costs are capitalized when incurred, and then amortized during the period in which the debt is outstanding. Net deferred financing costs totaled $10,771 and $11,945 for the years ended December 31, 2019 and 2018 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 property 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 impaired as of December 31, 2019.

(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.

A contribution, gift or grant is conditional if an agreement includes a barrier that must be overcome and either a right of return of assets transferred or a right of release of a promisor’s obligation to transfer assets. The presence of both a barrier and a right of return or right of release indicates that a recipient is not entitled to the contribution until it has overcome the barrier(s) in the agreement. Conditional promises to give are not recognized until they become unconditional, that is, when the barrier(s) in the agreement are overcome. The System has received conditional promises to give of $246,840 and $222,239 at December 31, 2019 and 2018, 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 restricted for the acquisition of capital assets are released from restrictions when the capital asset is placed in service.

(In thousands of dollars)

Contributions that have been received from various corporations, foundations, and individuals for the years ended December 31, 2019 and 2018 are reported as follows:

		2019	2018
Without donor restrictions	$	3,631	2,214
With donor restrictions		68,448	52,480
	$	72,079	54,694

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, 2019 and 2018 are as follows:

		2019	2018
Pledges due:			
In less than one year	$	56,535	44,044
In one year to five years		64,262	50,716
In more than five years		45,581	46,701
		166,378	141,461
Discount		(16,236)	(14,655)
Allowance for doubtful pledges		(3,655)	(3,013)
	$	146,487	123,793

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 $6,391 and $6,377 for the years ended December 31, 2019 and 2018, 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. Net patient service 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 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 consideration 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 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 amounts recognized due to changes in estimates of explicit and implicit price concessions for the years ended December 31, 2019 and 2018 is not significant. Subsequent changes that are determined to be the result of an adverse change in the payor’s ability to pay are recorded as bad debt expense. There was no bad debt expense for the years ended December 31, 2019 and 2018.

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 estimated cost of charity care provided in the years ended December 31, 2019 and 2018 was $49,612 and $46,800, respectively. The System determines its estimate of the cost of charity care

(Continued)

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. Revenues are recognized when the performance obligations identified within the individual contracts are satisfied and collections can be reasonably assured.

(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 17).

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.

(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.

(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, 2019 and 2018, the amount outstanding included within accounts payable was $65,196 and $63,948, respectively.

(m) Leases

Starting January 1, 2019, the System accounts for leases in accordance with ASC Topic 842, *Leases*. The System determines if an arrangement is or contains a lease at contract inception. The System recognizes a right-of-use (ROU) asset and a lease liability at the lease commencement date.

For operating leases, the lease liability is initially and subsequently measured at the present value of the unpaid lease payments at the lease commencement date. The ROU asset is subsequently measured throughout the lease term at the carrying amount of the lease liability, plus initial direct costs, plus (minus) any prepaid (accrued) lease payments, less the unamortized balance of lease incentives received. Lease expenses for lease payments are recognized on a straight-line basis over the lease term.

For finance leases, the lease liability is initially measured the same manner as operating leases, and is subsequently measured at amortized cost using the effective-interest method. The ROU asset is subsequently amortized using the straight-line method from the lease commencement date to the earlier of the end of its useful life or lease term, unless the lease transfers ownership to the System or the System is reasonably certain to exercise an option to purchase the underlying asset. Amortization of the ROU asset and interest expense of the lease liability are recognized and presented separately.

The System has elected not to recognize ROU assets and lease liabilities for short-term leases that have a term of 12 months or less. The System recognizes the lease payments associated with its short-term leases as an expense on a straight-line basis over the lease term.

(Continued)

Several key estimates and judgments are used to determine the ROU assets including the discount rate used to discount the unpaid lease payments to present value, the lease term (the noncancelable period plus any additional periods covered by either a System option to extend (or not to terminate) the lease that the System is reasonably certain to exercise, or an option to extend (or not to terminate) the lease controlled by the lessor), and lease payments (including fixed payments owed over the lease term and the exercise price of a System option to purchase the underlying asset if the System is reasonably certain to exercise the option).

ASC 842 requires a lessee to discount its unpaid lease payments using the interest rate implicit in the lease or, if that rate cannot be readily determined, its incremental borrowing rate. Generally, the System cannot determine the interest rate implicit in the lease because it does not have access to the lessor's estimated residual value or the amount of the lessor's deferred initial direct costs. Therefore, the System uses its incremental borrowing rate as the discount rate for the lease. The System's incremental borrowing rate for a lease is the rate of interest it would have to pay on a collateralized basis to borrow an amount equal to the lease payments under similar terms. Because the System does not generally borrow on a collateralized basis, it uses published index interest rates it would pay for noncollateralized borrowings as an input to deriving an appropriate incremental borrowing rate, adjusted for the amount of the lease payments, the lease term and the effect on that rate of designating specific collateral with a value equal to the unpaid lease payments for that lease.

The System monitors anything that requires a reassessment. If needed, an adjustment is made to the ROU asset's carrying amount unless doing so would reduce the carrying amount of the ROU asset to less than zero. In that case, the adjustment amount would be recorded in profit or loss.

Operating and finance lease ROU assets are included in other assets within the consolidated balance sheet. The current portion of operating and finance lease liabilities is included in other current liabilities and the long-term portion is presented within other liabilities.

(n) Recently Issued Accounting Standards

In February 2016, the FASB issued Accounting Standard Update (ASU) 2016-02 *Leases (Topic 842)*. The new standard establishes a ROU model that requires a lessee to recognize a ROU asset and lease liability on the balance sheet for all leases with a term longer than 12 months. Leases will be classified as either operating or finance with classification affecting the pattern and classification of expense recognition in the consolidated statement of operations.

The new standard was adopted by the System on January 1, 2019. The System elected the option to apply the transition requirements in Topic 842 at the effective date of January 1, 2019. All leases that existed at the effective date were recognized and measured using a modified retrospective approach. Financial information has not been updated and the disclosures required under the new standard have not been provided for dates and periods before January 1, 2019. The new standard provides a number of optional practical expedients in transition. The System elected the 'package of practical expedients', which permits the System not to reassess under the new standard prior conclusions about lease identification, lease classification and initial direct costs. The System did not elect the use-of-hindsight or the practical expedient pertaining to land easements; the latter not being applicable to the System. The impact of the adoption on the consolidated financial statements was an increase on January 1, 2019 in other assets to record the ROU asset and an increase in other current and other liabilities to record the lease liability for finance and operating leases of approximately $95,000 on the consolidated balance sheet.

(In thousands of dollars)

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. The System adopted ASU 2016-18 on January 1, 2019, using a retrospective transition approach. This update was intended to reduce diversity in the presentation of restricted cash and restricted cash equivalents in the financial statements. Restricted cash and restricted cash equivalents are to be included as components of total cash, cash equivalents, and restricted cash as presented on the consolidated statement of cash flows. The System is required to reconcile the total of cash, cash equivalents, and restricted cash to those amount presented on the consolidated balance sheet. For the years ended December 31, 2019 and 2018, the System added $0 and $110,846, respectively, of restricted cash to the total cash, cash equivalents and restricted cash presented in the consolidated statements of cash flows.

(o) Reclassifications

Certain amounts included in the 2018 consolidated financial statements have been reclassified to conform to the 2019 presentation.

(3) Net Patient Service Revenue and Accounts Receivable

Net patient service revenue by major payer source as of December 31, 2019 and 2018, are as follows:

	2019		2018	
Medicare	$ 1,309,154	32 %	$ 1,257,517	32 %
Medicaid	565,891	14	557,040	14
Managed care and commercial	2,011,852	50	1,888,945	49
Self-pay	154,012	4	190,414	5
	$ 4,040,909		$ 3,893,916	

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.

Net accounts receivable by major payer source as of December 31, 2019 and 2018, are as follows:

	2019		2018	
Medicare	$ 109,611	20 %	$ 120,246	21 %
Medicaid	67,298	13	71,956	13
Managed care and commercial	314,804	58	323,895	57
Self-pay	49,280	9	52,130	9
	$ 540,993		$ 568,227	

(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, 2019 and 2018 are as follows:

		2019	2018
Time/purpose restrictions:			
Capital expenditures	$	53,931	54,750
Education		42,976	18,864
Research		125,266	115,916
Patient care		108,789	85,006
Beneficial interest in foundations		125,455	132,050
Amounts held in perpetuity:			
Perpetual trusts		209,498	189,303
Receivables		18,201	17,025
Endowments		159,626	149,717
Beneficial interest in foundations		32,482	30,674
	$	876,224	793,305

The System's endowment consists of 395 individual funds established for a variety of purposes. Endowments include both donor-restricted funds and board-designated endowment funds. Net assets associated with endowment funds and board-designated endowment funds, are classified and reported based on the existence or absence of donor-imposed restrictions. The System's donor restricted endowment funds' original corpus, totaled $159,626 and $149,717 at December 31, 2019 and 2018, respectively. Board designated funds totaled $31,269 and $28,701 at December 31, 2019 and 2018, 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 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.

(In thousands of dollars)

		Without donor restriction	With donor restriction	Total
Endowment net assets, at December 31, 2017	$	14,072	173,484	187,556
Endowment return:				
Investment loss		(460)	(5,006)	(5,466)
Contributions		475	5,331	5,806
Appropriation of endowment assets for expenditure		—	(8,173)	(8,173)
Endowment net assets, at December 31, 2018		14,087	165,636	179,723
Endowment return:				
Investment income		2,538	29,549	32,087
Contributions (transfers)		(193)	10,064	9,871
Appropriation of endowment assets for expenditure		(2,538)	(7,840)	(10,378)
Endowment net assets, at December 31, 2019	$	13,894	197,409	211,303

Certain amounts related to endowment assets held by the System and related investment income were incorrectly classified and reported in prior periods. To correct this error, the System reduced net assets without donor restrictions by $30,006 and $43,816, and increased net assets with donor restrictions by the same amount in the consolidated balance sheets as of December 31, 2018 and December 31, 2017, respectively. Net investment loss in nonoperating income was reduced by $13,179 and investment income with donor restrictions was decreased by the same amount in the consolidated statements of operations and changes in net assets for the year ended December 31, 2018.

(Continued)

(In thousands of dollars)

Additionally, the amounts reported in the rollforward of endowment assets in this footnote were corrected as follows:

	(As reported)			(As corrected)		
	Without donor restriction	With donor restriction	Total	Without donor restriction	With donor restriction	Total
Endowment net assets, at December 31, 2017	$ 32,727	194,760	227,487	$ 14,072	173,484	187,556
Investment income (loss)	(1,598)	(5,627)	(7,225)	(460)	(5,006)	(5,466)
Contributions	—	5,345	5,345	475	5,331	5,806
Appropriation of endowment assets for expenditure	(861)	(9,164)	(10,025)	—	(8,173)	(8,173)
Endowment net assets, at December 31, 2018	$ 30,268	185,314	215,582	$ 14,087	165,636	179,723

The System assessed the impact of these corrections on the consolidated financial statements and determined that the errors were immaterial.

(5) Fair Value Measurements

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

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

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

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

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

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 $150,142 and $126,838 at December 31, 2019 and 2018, 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.

(In thousands of dollars)

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

		Level 1	Level 2	Level 3	Total
December 31, 2019:					
Assets:					
Cash and cash equivalents	$	260,859	—	—	260,859
Cash equivalents – pooled with investments:		100,135	—	—	100,135
Fixed income securities:					
Corporate bonds		—	186,015	—	186,015
Fixed income mutual funds		542,013	—	—	542,013
Government securities		116,895	49,808	—	166,703
Total fixed income securities		658,908	235,823	—	894,731
Equities, mutual and exchange traded funds:					
Domestic mutual funds		346,777	—	—	346,777
International mutual funds		214,010	—	—	214,010
Total equities, mutual and exchange traded funds		560,787	—	—	560,787
Deferred compensation assets – mutual funds		24,336	—	—	24,336
Beneficial interest in Foundations		—	—	157,937	157,937
Perpetual trusts		—	—	209,498	209,498
Interest rate swaps		—	5,849	—	5,849
Total assets	$	1,605,025	241,672	367,435	2,214,132
Liabilities:					
Deferred compensation liabilities	$	24,336	—	—	24,336
Interest rate swaps		—	75,645	—	75,645
Total liabilities	$	24,336	75,645	—	99,981

(In thousands of dollars)

		Level 1	Level 2	Level 3	Total
December 31, 2018:					
Assets:					
Cash and cash equivalents	$	288,517	—	—	288,517
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		639,216	227,773	—	866,989
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		275,787	124,441	—	400,228
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	$	1,366,189	360,298	352,027	2,078,514
Liabilities:					
Deferred compensation liabilities	$	18,764	—	—	18,764
Interest rate swaps		—	49,592	—	49,592
Total liabilities	$	18,764	49,592	—	68,356

(In thousands of dollars)

The following table summarizes the System's investments at December 31, 2019 and 2018, for which NAV was used as a practical expedient to estimate fair value:

		2019	2018
Hedge funds	$	152,245	220,913
Real estate		33,309	37,832
Private debt		16,239	30,338
Private equity		43,285	35,200
Total alternative investments	$	245,078	324,283

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, 2019 and 2018, there were no transfers into or out of Level 1, 2, or 3.

For the years ended December 31, 2019 and 2018, the reconciliation of investments with fair value measurements using significant unobservable inputs (level 3) is as follows:

		Fair value measurements using significant unobservable inputs (Level 3)		
		Beneficial interest in Foundations	Perpetual trusts	Total
Balance at December 31, 2017	$	175,013	210,846	385,859
Total change included in:				
Donor restricted net assets		(12,289)	(21,543)	(33,832)
Balance at December 31, 2018		162,724	189,303	352,027
Total change included in:				
Donor restricted net assets		(4,787)	20,195	15,408
Balance at December 31, 2019	$	157,937	209,498	367,435

(In thousands of dollars)

(6) Investments

The composition of investments at December 31, 2019 and 2018 are as follows:

		2019	2018
Cash equivalents – pooled with investments	$	100,135	33,059
Restricted cash – held by bond trustees		—	110,846
Fixed income securities		894,731	866,989
Equities, mutual and exchange traded funds		560,787	400,228
Alternative investments		245,078	324,283
Other		6,567	2,137
Total investments	$	1,807,298	1,737,542

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.

(In thousands of dollars)

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, 2019 are as follows:

		Carrying value	Unfunded commitments
Less than 1 year, no contractual restrictions have been imposed	$	106,924	1,875
Limited Partnership Fund expiring in 1–5 years		23,298	10,068
Limited Partnership Fund expiring in 6–10 years		99,042	32,589
Limited Partnership Fund expiring in 11–12 years		15,814	33,018
Total alternative investments	$	245,078	77,550

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

		2019	2018
Without donor restriction and board designated	$	1,452,816	1,336,732
Swap collateral		6,364	2,937
Investments held by bond trustees		—	110,846
With donor restriction		348,118	287,027
Total investments	$	1,807,298	1,737,542

Investment income (loss) is comprised of the following for the years ended December 31, 2019 and 2018:

		2019	2018
Interest and dividend income:			
Without donor restriction	$	40,769	30,472
With donor restriction		5,060	4,020
		45,829	34,492
Net realized and change in unrealized gains (losses):			
Without donor restriction		116,786	(50,065)
With donor restriction		27,894	(6,945)
		144,680	(57,010)
Total income (loss)	$	190,509	(22,518)

(In thousands of dollars)

(7) Property and Equipment

Property and equipment, at December 31, 2019 and 2018, are summarized below:

		2019	2018
Land and land improvements	$	172,982	168,744
Buildings and fixed equipment		2,069,651	2,004,219
Movable equipment and furnishings		1,687,515	1,489,105
Construction in progress		105,430	108,044
		4,035,578	3,770,112
Less accumulated depreciation		2,204,586	2,033,250
Net property and equipment	$	1,830,992	1,736,862

As of December 31, 2019, the System has made contractual commitments on construction contracts, including information technology projects, of $89,983.

(8) Long-Term Debt

The System's $250,000 revolving credit commitment (the Credit Commitment), is a syndicated commitment with a maturity date of August 29, 2024. The Credit Commitment bears interest at various rates for short-term periods. For the years ended December 31, 2019 and 2018, the average interest rate for borrowings under this credit line was 3.27% and 2.95%, respectively. As of December 31, 2019 and 2018, there were $40,000 and $140,000, respectively, in borrowings outstanding under the Credit Commitment reported within noncurrent liabilities in the consolidated balance sheet. The remaining available Credit Commitment is $210,000 and $85,000 at December 31, 2019 and 2018, respectively.

(In thousands of dollars)

A summary of long-term debt at December 31, 2019 and 2018 is as follows:

Series	Type	Average interest rate % for the years ended December 31, 2019 and 2018	Final maturity	Amount outstanding December 31 2019	Amount outstanding December 31 2018
2018A Revenue Bonds	Variable	1.44, 1.62	2046	$ 25,230	25,230
2018B Revenue Bonds	Variable	1.47, 1.63	2047	83,920	88,505
2018C Revenue Bonds	Fixed	4.52	2042	60,850	60,850
2018D Revenue Bonds	Fixed	4.31	2039	57,355	57,355
2018E Revenue Bonds	Variable	1.67, 2.31	2036	107,490	109,150
2016A Revenue Bonds	Fixed	3.59	2046	229,725	229,725
2015A Revenue Bonds	Variable	1.69, 1.64	2045	30,000	30,000
2015B Revenue Bonds	Variable	1.68, 1.70	2045	30,000	30,000
2015C Revenue Bonds	Variable	1.70, 1.64	2045	40,000	40,000
2014A Revenue Bonds	Fixed	3.69	2044	56,145	56,145
2014B Revenue Bonds	Variable	1.69, 1.64	2045	30,000	30,000
2013A Revenue Bonds	Fixed	4.65	2029	81,525	83,455
2013B Revenue Bonds	Variable	1.68, 1.70	2033	30,000	30,000
2012A Revenue Bonds	Fixed	4.73	2041	165,270	169,550
2012B Revenue Bonds	Variable	2.96, 2.55	2019	—	4,750
2012C Revenue Bonds	Fixed	3.71	2042	55,825	55,825
2012D Revenue Bonds	Variable	2.30, 2.10	2021	9,015	13,980
2010A Revenue Bonds	Fixed	4.82	2027	45,100	47,440
2007A Revenue Bonds	Fixed	4.85	2041	52,445	52,445
2001 Revenue Bonds	Variable	2.19, 2.14	2033	10,000	10,000
Other long-term debt				5,713	7,051
				1,205,608	1,231,456
Unamortized premium				32,025	34,285
Less:					
Unamortized discount				1,587	1,709
Deferred financing costs				10,771	11,945
Current installments				24,237	24,446
Long-term debt, less current installments				$ 1,201,038	1,227,641

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 years ended December 31, 2019 and 2018.

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 and recognized a liability of $7,114 in connection with this 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 will ultimately be forgiven by the lender and is recognizing that forgiveness as other revenue over the seven year performance period. During the year ended December 31, 2019 the System recognized $1,524 of other revenue as a result of the NMTC transaction. At December 31, 2019 and 2018 the remaining liability amounts of $5,590 and $7,114 are included in long-term debt.

The System's debt structure consists of 67% fixed rate debt and 33% floating rate debt, $804,240 and $395,655 respectively. The floating rate debt structure includes $10,000 in daily reset self-liquidity bonds that could come due at any time, $269,150 in variable rate remarketed obligations pricing daily and weekly, $9,015 of bank direct purchase bonds fully amortizing through 2021, and $107,490 in bank direct purchase bonds which renew in 2025.

This System has $109,150 of bonds outstanding that are backed by bank letters of credit. Based on the repayment schedules of the bank letters of credit, $12,279 could become due in 2022 upon failure to remarket these bonds. The total that could become due in 2022 can be offset by the remaining available borrowing capacity of $210,000 on the Credit Commitment, which is due August 29, 2024.

The System also has a total of $130,000 of variable rate bonds outstanding which are not supported by a credit facility or liquidity facility. These bonds are remarketed daily or weekly and, subject to certain notice requirements, the holders have the right to tender the bonds for purchase at any time. In the event of a failure to remarket tendered bonds, the bonds are returned to the tendering holder thereof, the interest on the bonds converts to a stepped-up interest rate and the bonds become subject to term-out provisions which require the System to redeem those bonds on a special mandatory redemption date which is between 30 and 36 months from the date the nonremarketed bonds were originally tendered by the holder.

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, 2019 and 2018.

Combined current aggregate scheduled maturities of long-term debt for the five years subsequent to December 31, 2019 are as follows: 2020 – $24,237; 2021 – $25,260; 2022 – $26,310; 2023 – $27,540; 2024 – $28,875; and 2025 and thereafter – $1,073,386.

(In thousands of dollars)

Cash paid for interest totaled $39,874 and $45,514 in 2019 and 2018, respectively.

(9) Interest Rate Swap Agreements

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

	Maturity	Year ended December 31, 2019			Notional value at December 31	
Swap type	date	System pays	System receives		2019	2018
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
Basis	2028	SIFMA Index	67% of 1-month LIBOR + 0.53%		—	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		21,160	22,810
Fixed-payer	2030	5.09 %	91.03% of 5-year LIBOR		6,720	7,575
Fixed-payer	2030	3.62 %	64.09% of 5-year LIBOR		7,185	7,685
Fixed-payer	2026	3.78 %	70% of 1-month LIBOR		5,920	6,705
Fixed-payer	2022	3.68 %	70% of 1-month LIBOR		1,870	2,445
Fixed-payer	2021	3.31 %	70% of 1-month LIBOR		4,290	6,865
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	50,000
Total return swap	2022	SIFMA Index +0.63%	Bond Coupon		52,445	52,445
Rate lock	2049	1.83 %	100% of 3-month LIBOR		75,000	—
				$	651,180	633,120

In December 2019, the System entered into a Libor Swap Rate Lock trade for a notional amount of $75,000.

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.

SIFMA is an index of high-grade, tax-exempt variable rate demand obligations. SIFMA ranged from 1.06% to 2.3% (average rate of 1.46%) for the year ended December 31, 2019 and 0.94% to 1.81% (average rate of 1.41%) for the year ended December 31, 2018.

The net fair value of interest rate swap agreements was a liability of $69,796 as of December 31, 2019. The net fair value for swap agreements at December 31, 2019 consisted of $5,849 recorded in other assets and $75,645 recorded in other liabilities within the December 31, 2019 consolidated balance sheet. 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.

A decrease in fair value of derivative instruments in the consolidated statements of operations and changes in net assets totaled $28,287 for the year ended December 31, 2019. An increase in fair value of derivative instruments in the consolidated statements of operations and changes in net assets totaled $10,195 for the year ended December 31, 2018. Cash paid to counterparties totaled $5,015, and $6,011 for the years ended December 31, 2019 and 2018, respectively. Cash received from counterparties totaled $4,429 and $2,007 for the years ended December 31, 2019 and 2018, respectively.

The System posted collateral of $6,364 and $2,937 due to the decrease in swap valuations as of December 31, 2019 and 2018, respectively. The collateral is comprised of cash and U.S. Treasury and government securities, is limited as to use, and is recorded as a restricted investment within the consolidated balance sheets.

(10) Leases

The System leases medical office buildings, office space and equipment. The remaining lease term for leases primarily range from 1-50 Years. Many leases contain renewal options. For those contracts where options are reasonably certain to be exercised, the System recognizes renewal options as part of the ROU assets and lease liabilities.

At December 31, 2019, lease assets and liabilities were recorded in the consolidated balance sheet as follows (in thousands):

Lease type	Balance sheet classification		
Assets:			
Operating	Other assets	$	92,031
Total assets		$	92,031
Liabilities:			
Current			
Operating	Other current liabilities	$	21,523
Noncurrent			
Operating	Other liabilities		70,995
Total Liabilities		$	92,518

The components of lease cost for the year ended December 31, 2019 were as follows (in thousands):

Operating lease cost	$	26,246
Finance lease cost		37
Short-term lease cost		163
Total lease cost	$	26,446

Oher information related to leases as of December 31, 2019 was as follows:

Supplemental cash flow information:		
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flow from operating leases	$	27,278
Weighted average remaining lease term:		
Operating leases		7.77 years
Weighted average discount rate:		
Operating leases		2.63 %

Future maturities of lease liabilities under noncancelable leases as of December 31, 2019 are as follows:

		Operating
2020	$	23,448
2021		17,499
2022		14,586
2023		10,865
2024		8,619
2025 and thereafter		27,999
Total undiscounted future lease payments		103,016
Less present value discount		(10,498)
	$	92,518

(In thousands of dollars)

Minimum noncancelable operating lease payments with terms in excess of one year as of December 31, 2018 were as follows:

2019	$	26,630
2020		19,902
2021		13,945
2022		11,506
2023		8,217
2024 and thereafter		29,181
	$	109,381

(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, 2019, the Western Reserve SPC consists of several individual segregated portfolios. Each segregated portfolio provides coverage for its respective entity's insurance programs and is consolidated into each respective entity's consolidated financial statements. Western Reserve SPC has reinsurance agreements with unrelated commercial carriers in place relative to a portion of the risks.

Various claimants have asserted professional and general liability and workers' compensation claims against the System. These claims are in various stages of processing or are in litigation.

In 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. As of the date of this report more than ninety-six percent of filed claims related to the fertility clinic matter have been settled. The System notified its insurance carriers and recorded a reserve for the anticipated resolution of these claims. The System received amounts from its insurance carriers equal to its re-insurance coverage.

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 $210,209 and $153,548 at December 31, 2019 and 2018, respectively. The current portion of the reserves at December 31, 2019 and 2018, amounts to $35,000 and $50,000, respectively, is recorded in other current liabilities and the remaining portion is recorded in other long term liabilities.

(In thousands of dollars)

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.

The amounts recognized in changes in net assets without donor restrictions at December 31, 2019 and 2018 consisted of the following:

		2019	2018
Amount recognized in net assets without donor restrictions at end of year:			
Unrecognized actuarial loss	$	531,744	488,440
Unrecognized prior service costs		(8,491)	(10,890)
Net amount recognized	$	523,253	477,550

(In thousands of dollars)

The accumulated benefit obligation for the plan was $1,306,354 and $1,122,600 as of December 31, 2019 and 2018, respectively. The following represents selected information about the plan as of December 31, 2019 and 2018:

		2019	2018
Change in benefit obligation:			
Projected benefit obligation (PBO) at beginning of year	$	1,161,648	1,272,117
Service cost		48,318	51,610
Interest cost		46,906	41,454
Actuarial (gain) loss		161,999	(44,623)
Retiree annuity purchases		—	(74,205)
Benefits paid		(64,700)	(84,705)
Projected benefit obligation at end of year		1,354,171	1,161,648
Change in plan assets:			
Fair value of assets at beginning of year		831,672	885,732
Actual return on assets		139,868	(31,350)
Employer contribution		32,500	136,200
Retiree annuity purchases		—	(74,205)
Benefits paid		(64,700)	(84,705)
Fair value of assets at end of year		939,340	831,672
Funded status (PBO in excess of plan assets)	$	(414,831)	(329,976)

		2019	2018
The components of net periodic pension costs included the following:			
Operating expenses:			
Service cost	$	48,318	51,611
Nonoperating expenses:			
Interest cost		46,906	41,454
Expected return on plan assets		(55,618)	(61,116)
Amortization of prior service costs		(2,399)	(2,399)
Settlement cost		—	42,539
Recognized net actuarial loss		34,445	43,557
Net periodic pension cost	$	71,652	115,646

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.

(In thousands of dollars)

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, 2019 are as follows:

Amortization of prior service costs	$	(2,399)
Recognized actuarial losses		46,854
Total	$	44,455

The weighted average assumptions used to determine benefit obligations and net benefit cost for the years ended December 31, 2019 and 2018 were as follows:

	2019	2018
Weighted average assumptions:		
Discount rate – benefit obligation	3.28 %	4.40 %
Discount rate – service cost	4.25	3.56
Discount rate – interest cost	4.17	3.32
Expected return on plan assets	6.50	6.50
Rate of compensation increase	3.75	3.75

Pension assets are invested in various asset classes as follows:

	2019	2018
Asset class:		
Equities, mutual and exchange traded funds	46 %	37 %
Fixed income	22	27
Alternative investments	27	35
Cash and cash equivalents	5	1

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.

(In thousands of dollars)

The System expects to contribute $87,800 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: 2020 – $81,035; 2021 – $85,369; 2022 – $89,128; 2023 – $92,106; 2024 – $97,756; and 2025 to 2029 – $501,688.

The following tables present the System's fair value leveling hierarchy for those plan assets measured at fair value as of December 31, 2019 and 2018. Refer to note 5 for level definitions.

	Level 1	Level 2	Level 3	Total
December 31, 2019:				
Cash and cash equivalents	$ 46,366	—	—	46,366
Fixed income securities:				
Corporate bonds	117,061	53,897	—	170,958
Government securities	32,232	—	—	32,232
Total fixed securities	149,293	53,897	—	203,190
Equities, mutual and exchange traded funds:				
Domestic mutual funds	161,490	—	—	161,490
International mutual funds	276,566	—	—	276,566
Total equities, mutual and exchange traded funds	438,056	—	—	438,056
Total	$ 633,715	53,897	—	687,612

(In thousands of dollars)

	Level 1	Level 2	Level 3	Total
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

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, 2019 and 2018, for which NAV was used as a practical expedient to estimate fair value:

	2019	2018
Alternative investments:		
Hedge funds	$ 113,908	139,201
Real estate	71,301	83,586
Private debt	21,260	36,340
Private equity	45,259	31,765
Total alternative investments	$ 251,728	290,892

(In thousands of dollars)

The table below classifies the net asset value at December 31, 2019 for the alternative investment portion of the plan assets into categories based on the stated contractual liquidity terms of the underlying investments:

		Net asset value	Unfunded commitments
Less than 1 year, no contractual restrictions have been imposed	$	61,251	4,500
Subject to existing gates or restrictions		17,601	—
Limited partnership fund expiring in 1–5 years		12,189	7,535
Limited partnership fund expiring in 6–10 years		130,850	51,613
Limited partnership fund expiring in 11–15 years		26,852	35,137
Limited partnership fund expiring in 15+ years		2,985	15,686
Total alternative investments	$	251,728	114,471

The System sponsors various defined contribution employee benefit plans. The System contributed $30,781 and $28,541 to the defined contribution employee benefit plans for the years ended December 31, 2019 and 2018, respectively.

The System also has nonqualified deferred compensation plans for certain employees. The System contributed and recognized as expense $6,316 and $6,109 to the deferred compensation plans for the years ended December 31, 2019 and 2018, 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. Total investment in Southwest amounted to $83,683 and $76,055 at December 31, 2019 and 2018, respectively. Total net earnings under the Southwest joint venture for the years ended December 31, 2019 and 2018 are shown below.

		2019	2018
Earnings	$	16,797	9,162
Distribution		(9,169)	(5,127)
Net earnings	$	7,628	4,035

Total investments for all joint ventures, including Southwest, amounted to $112,789 and $100,557 at December 31, 2019 and 2018, 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.

(15) Special Charges

The System incurred $1,742 and $7,599 in special charges during the years ending 2019 and 2018, 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: 2020 – $48,353; 2021 – $23,860; 2022 – $15,526; and 2023 – $6,259; 2024 – $3,404 and 2025 and thereafter – $4,014. Purchases under these or similar contracts totaled $169,844 and $137,273 in the years ending December 31, 2019 and 2018, 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 $911,609 and $873,032 at December 31, 2019 and 2018 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, 2019 and 2018 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.

(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 years ended December 31, 2019 and 2018:

	December 31, 2019			
	Health care services	Academic and research	Administrative support	Total
Salaries, wages and employee benefits	$ 2,056,291	32,200	369,860	2,458,351
Purchased services	200,127	12,993	73,647	286,767
Patient care supplies	821,421	1,672	1,319	824,412
Other supplies	36,376	1,367	4,906	42,649
Insurance	44,931	—	—	44,931
Other and special charges	247,714	7,578	99,149	354,441
Depreciation and amortization	120,876	11	61,305	182,192
Interest	44,126	—	—	44,126
Losses in excess of Insurance	93,070	—	—	93,070
Total expenses	$ 3,664,932	55,821	610,186	4,330,939

	December 31, 2018			
	Health care services	Academic and research	Administrative support	Total
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	$ 3,381,820	54,422	548,110	3,984,352

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.

(In thousands of dollars)

(19) Liquidity and Availability of Resources

As of year ended December 31, 2019 and 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:

		2019	2018
Financial assets:			
Cash and cash equivalents	$	260,859	288,517
Patient accounts receivable		540,993	568,227
Other receivables		32,572	61,778
Investments		1,323,681	1,268,240
Total financial assets available within a year		2,158,105	2,186,762
Liquidity resources:			
Available revolving credit commitment		210,000	85,000
Total financial assets and liquidity resources available within a year	$	2,368,105	2,271,762

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, 2019.

(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 April 1, 2020 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, 2019, and events which occurred subsequent to December 31, 2019, but were not recognized in the consolidated financial statements.

On March 11, 2020 the COVID-19 outbreak was declared a pandemic by the World Health Organization. Although not yet measurable, the spread of COVID-19 will adversely impact certain operating revenues, medical claims, labor and supplies expenses. Additionally, subsequent to December 31, 2019, there has been instability in the financial markets resulting in significant declines in certain markets between January 1, 2020 and April 1, 2020. Management is monitoring market conditions and the related realized and unrealized losses on investments. Due to the volatility in the global economy and the financial markets as of the date of this report, there is uncertainty regarding the long-term impact market conditions will have on the System's investment portfolio.

In January 2020, the System issued tax-exempt bonds totaling $564,325. Proceeds from these bonds totaling $311,515 were used to refund the Series 2007A, 2010A, 2012C and D, 2014A and 2018B and E bonds and the remaining proceeds of $252,810 will be used to finance new capital projects and the cost of issuance.

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Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

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

We have audited, in accordance with the 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, the consolidated financial statements of University Hospitals Health System, Inc. and its subsidiaries (the System), which comprise the consolidated balance sheet as of December 31, 2019, and the related consolidated statement of operations and changes in net assets, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon, which included an emphasis of matter paragraph related to the adoption of a new accounting standard, dated April 1, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We identified a deficiency in internal control, described in the accompanying schedule of findings and questioned costs as item 2019-001 that we consider to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

University Hospitals Health System, Inc.'s Response to Finding

The System's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The System's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the response.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Cleveland, Ohio
April 1, 2020

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Schedule of Findings and Questioned Costs

Year ended December 31, 2019

Finding 2019-001

Criteria

Title 2 U.S. Code of Federal Regulations Part 200 (2 CFR 200), *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, Subpart F, Section 200.508(b) states “the auditee must prepare appropriate financial statements, including schedule of expenditure of federal awards in accordance with 200.510 Financial Statements.”

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control-Integrated Framework (2013) principle 4 states “The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with the objectives.”

The System has a responsibility for adopting sound accounting policies and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the consolidated financial statements and to provide reasonable assurance against the possibility of misstatements that are material to the consolidated financial statements.

Condition

The process owner and control operator, did not have the experience and detailed knowledge of FASB Accounting Standard Codification (ASC) 958 and the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA), to detect and correct errors in the reporting of investment income and gains/losses arising from donor-restricted endowments and the endowment rollforward disclosure.

Cause and Effect

As a result of the above condition, certain amounts related to endowment assets held by the System and related investment income were incorrectly classified and reported in prior periods.

There was no effect on the 2019 consolidated financial statements as a result of this position.

Recommendation

We recommend the System revise their policy and procedures document to inform all individuals involved in the recording and review of donor-restricted endowment activity of the relevant reporting requirements as defined by UPMIFA and ASC 958. This revised policy would also include a reconciliation of financial statement disclosures to internal endowment schedules and to statements received from the third party endowment administrator. We also recommend the System ensures that the control operator is provided the appropriate training related to the requirements of UPMIFA and ASC 958.

Views of Responsible Officials

In 2019, the System has revised its policy and procedures regarding the reporting of investment income and gains/losses arising from donor-restricted endowments and related footnote disclosures in accordance with UPMIFA and ASC 958 requirements. The revised policy will also enhance the existing reconciliation procedures. All process owners/operators will receive the appropriate training support related to the requirements of UPMIFA and ASC 958, as part of the revised policy