



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

Consolidated Financial Statements and Schedules

December 31, 2013 and 2012

(With Independent Auditors' Reports Thereon)



KPMG LLP  
Suite 1000  
401 Commerce Street  
Nashville, TN 37219-2422

## **Independent Auditors' Report**

The Board of Directors  
University Health System, Inc.:

We have audited the accompanying consolidated financial statements of University Health System, Inc. and subsidiaries (UHS), which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### ***Management's Responsibility for the Financial Statements***

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

### ***Auditors' Responsibility***

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to UHS' 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 UHS' internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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



***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of University Health System, Inc. and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

**KPMG LLP**

Nashville, Tennessee  
March 24, 2014

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

Consolidated Balance Sheets

December 31, 2013 and 2012

<b>Assets</b>	<b>2013</b>	<b>2012</b>
Current assets:		
Cash and cash equivalents	\$ 69,613,960	64,459,130
Short-term investments	8,156,626	16,213,189
Current portion of assets limited as to use	287,713	205,534
Patient accounts receivable, net of allowance for doubtful accounts of \$41,228,000 and \$40,393,000 at December 31, 2013 and 2012, respectively	73,347,066	72,489,282
Other receivables	6,937,231	6,647,541
Estimated third-party settlements	16,236,867	19,998,341
Inventories	5,354,591	5,507,111
Prepaid expenses and other current assets	1,197,047	1,440,648
Total current assets	181,131,101	186,960,776
Assets limited as to use, less current portion	14,858,078	11,034,902
Long-term investments	158,122,081	136,115,854
Property and equipment, net	205,459,364	203,440,802
Deferred financing costs, net of accumulated amortization of \$517,000 and \$425,000 at December 31, 2013 and 2012, respectively	1,988,326	2,080,017
Investments in affiliated organizations	2,333,408	2,647,094
Other assets	7,491,651	5,880,407
Total assets	\$ 571,384,009	548,159,852
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Current portion of long-term debt	\$ 12,347,046	10,325,303
Accounts payable	55,096,388	48,189,513
Accrued payroll and related liabilities	33,638,885	30,267,632
Accrued expenses and other current liabilities	21,673,184	20,687,411
Estimated third-party settlements	8,011,395	7,988,998
Total current liabilities	130,766,898	117,458,857
Long-term debt, less current portion	268,344,281	271,352,198
Other liabilities	19,391,004	15,735,586
Total liabilities	418,502,183	404,546,641
Net assets:		
Unrestricted	144,384,710	135,492,995
Temporarily restricted	3,033,780	3,004,377
Permanently restricted	5,463,336	5,115,839
Total net assets	152,881,826	143,613,211
Total liabilities and net assets	\$ 571,384,009	548,159,852

See accompanying notes to consolidated financial statements.

**UNIVERSITY HEALTH SYSTEM, INC.  
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Consolidated Statements of Operations

Years ended December 31, 2013 and 2012

	<u><b>2013</b></u>	<u><b>2012</b></u>
Revenue:		
Net patient service revenue	\$ 657,185,061	599,093,457
Provision for doubtful accounts	<u>(62,306,309)</u>	<u>(61,277,376)</u>
Net patient service revenue less provision for doubtful accounts	594,878,752	537,816,081
Other revenue	<u>36,565,036</u>	<u>36,995,804</u>
Total revenue	<u>631,443,788</u>	<u>574,811,885</u>
Operating expenses:		
Salaries, wages, and benefits	273,738,240	256,646,078
Medical supplies and drugs	164,893,472	139,614,343
Purchased services	88,648,028	78,773,484
Graduate medical education reimbursed to the University	31,806,637	31,120,692
Insurance and other	29,149,125	28,148,288
Interest	12,277,022	12,218,668
Depreciation and amortization	<u>25,931,840</u>	<u>24,490,737</u>
Total operating expenses	<u>626,444,364</u>	<u>571,012,290</u>
Operating income	<u>4,999,424</u>	<u>3,799,595</u>
Nonoperating gains:		
Contributions	1,922,094	3,606,812
Investment income	5,899,369	7,958,604
Change in fair value of derivative instrument	<u>(3,929,172)</u>	<u>3,995,761</u>
Total nonoperating gains, net	<u>3,892,291</u>	<u>15,561,177</u>
Revenue and gains in excess of expenses and losses	<u><u>\$ 8,891,715</u></u>	<u><u>19,360,772</u></u>

See accompanying notes to consolidated financial statements.

**UNIVERSITY HEALTH SYSTEM, INC.  
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Consolidated Statements of Changes in Net Assets

Years ended December 31, 2013 and 2012

	<b>Unrestricted net assets</b>	<b>Temporarily restricted net assets</b>	<b>Permanently restricted net assets</b>	<b>Total net assets</b>
Balance at December 31, 2011	\$ 116,132,223	3,134,867	5,053,322	124,320,412
Revenue and gains in excess of expenses and losses	19,360,772	—	—	19,360,772
Contributions	—	2,273,242	62,517	2,335,759
Net assets released from restriction used in operations	—	(2,403,732)	—	(2,403,732)
Balance at December 31, 2012	135,492,995	3,004,377	5,115,839	143,613,211
Revenue and gains in excess of expenses and losses	8,891,715	—	—	8,891,715
Contributions	—	1,921,787	347,497	2,269,284
Net assets released from restriction used in operations	—	(1,892,384)	—	(1,892,384)
Balance at December 31, 2013	\$ <u>144,384,710</u>	<u>3,033,780</u>	<u>5,463,336</u>	<u>152,881,826</u>

See accompanying notes to consolidated financial statements.

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

Years ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Cash flows from operating activities:		
Increase in total net assets	\$ 9,268,615	19,292,799
Adjustments to reconcile increase in total net assets to net cash provided by operating activities:		
Depreciation and amortization	25,931,840	24,490,737
Provision for doubtful accounts	62,306,309	61,277,376
Equity in earnings of affiliated organizations	(2,039,077)	(1,281,993)
Imputed interest on capital lease obligation	1,975,737	1,865,592
Changes in unrealized gains on trading securities	(2,435,254)	(2,909,056)
Realized losses (gains) on trading securities	1,098,461	(795,476)
Change in fair value of derivative instrument	3,929,172	(3,995,761)
Amortization of financing costs	91,691	91,960
Amortization of bond premium	(385,886)	(431,599)
Gain on sale of assets, net	729,391	(75,357)
Changes in assets and liabilities affecting operating activities:		
Patient accounts receivable	(63,164,093)	(65,704,320)
Other receivables	(289,690)	(1,862,372)
Estimated third-party settlements	3,783,871	927,198
Inventories	152,520	679,508
Prepaid expenses and other assets	(1,367,643)	(2,730,256)
Accounts payable	3,937,616	790,025
Accrued payroll and related liabilities	3,371,253	2,490,762
Accrued expenses and other liabilities	712,019	4,334,473
Net cash provided by operating activities	<u>47,606,852</u>	<u>36,454,240</u>
Cash flows from investing activities:		
Proceeds from sale or maturity of investments	307,054,849	243,358,754
Purchases of investments	(323,573,075)	(249,958,175)
Purchases of property and equipment	(19,793,617)	(30,776,548)
Proceeds from the sale of assets	1,197	1,228
Capital distributions from affiliated organization	<u>2,352,763</u>	<u>1,235,756</u>
Net cash used in investing activities	<u>(33,957,883)</u>	<u>(36,138,985)</u>
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	2,493,960	21,994,846
Payments of long-term debt	<u>(10,988,099)</u>	<u>(11,339,053)</u>
Net cash (used in) provided by financing activities	<u>(8,494,139)</u>	<u>10,655,793</u>
Increase in cash and cash equivalents	5,154,830	10,971,048
Cash and cash equivalents at beginning of year	<u>64,459,130</u>	<u>53,488,082</u>
Cash and cash equivalents at end of year	<u>\$ 69,613,960</u>	<u>64,459,130</u>

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

Years ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest, net of amount capitalized of \$269,798 and \$160,497, respectively	\$ 11,448,645	11,767,814
Noncash investing activities:		
Assets and liabilities resulting from equipment purchases:		
Equipment	\$ 8,887,373	788,828
Accounts payable	2,969,259	536,931
Capital lease	5,918,114	251,897

See accompanying notes to consolidated financial statements.



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

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

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

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

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

**University Health System, Inc. and University of Tennessee Medical Center**

The Medical Center, an operating division of UHS, is an academic medical center delivering tertiary medical care to a 21-county region in eastern Tennessee. The Medical Center is a regional referral center for eastern Tennessee, western North Carolina, and southeastern Kentucky. The Medical Center is licensed for 581 acute care beds and has been designated by the State of Tennessee (State) as a Level 1 adult and pediatric Trauma Center, supported by five aeromedical helicopters. The State has also designated the Medical Center as a Regional Perinatal Center for high-risk pregnancy.

**UHS Ventures, Inc.**

UHSV, a Tennessee nonprofit taxable organization and wholly owned subsidiary of UHS, has a 25% ownership interest in ContinuumRx. The purpose of ContinuumRx is to provide home infusion therapy services and other pharmacy and pharmacy-related services. ContinuumRx is accounted for using the equity method.

**Regional Trauma Service, LLC**

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

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Also, see note 9, *Investments in Affiliated Organizations*.

**(b) Use of Estimates**

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Specifically, laws and regulations governing the Medicare and TennCare programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

**(c) Cash and Cash Equivalents**

UHS considers all highly liquid, interest-bearing investments with a maturity of three months or less when purchased to be cash equivalents.

**(d) Investments and Investment Income**

Investments held by UHS are classified as trading securities and are reported at fair value in the consolidated balance sheets. Fair values are based on quoted market prices.

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

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

Assets limited as to use primarily include assets held by trustees in endowment funds and nonqualified deferred compensation plan assets. Amounts required to meet current liabilities and current capital expenditure budget requirements have been reclassified as current assets in the accompanying consolidated balance sheets at December 31, 2013 and 2012.

**(f) Inventories**

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

**(g) Property and Equipment**

Property and equipment acquisitions are recorded at cost or, if donated, at fair value at the date of receipt. Depreciation is calculated on the straight-line basis over the estimated useful lives of the respective assets, except for leasehold improvements, which are amortized over the shorter of the expected useful life of the asset or related lease term. Buildings under capital lease obligations are amortized using the straight-line method over 20 years or longer (note 9). Such amortization is

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included in depreciation and amortization in the accompanying consolidated financial statements. Interest expense related to construction projects is capitalized during the construction period.

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

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

**(i) *Deferred Financing Costs***

Deferred financing costs consist of bond issuance costs and are amortized using the interest method or the straight-line method (which approximates the interest method) over the related terms of the debt.

**(j) *Net Assets***

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

*Unrestricted net assets* – Net assets that are not subject to donor-imposed stipulations.

*Temporarily restricted net assets* – Net assets subject to donor-imposed stipulations that are available for use either by the passage of time or by actions of UHS.

*Permanently restricted net assets* – Net assets subject to donor-imposed stipulations that they be maintained permanently by UHS. Generally, the donors of these assets permit UHS to use all or part of the income earned on related investments for general or specific purposes.

**Endowment** – On January 1, 2008, UHS adopted Financial Accounting Standards Board (FASB) Staff Position (FSP) FAS 117-1, *Endowments of Not-for-Profit Organizations*, Accounting Standards Codification (ASC) 958-205, *Not-for-Profit Entities — Presentation of Financial Statements*. ASC 958-205 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). Effective July 1, 2007, the State adopted legislation that incorporates the provisions outlined in UPMIFA. UHS' endowments consist solely of donor-restricted endowment funds. UHS' endowments consist of 16 individual funds established for a variety of purposes.

UHS has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations

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

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

UHS has a policy of annually approving for distribution investment income on endowments unless the endowment specifically states that the income should be accumulated in the fund until a maximum level is reached in the fund. For the years ended December 31, 2013 and 2012, there was approximately \$142,000 and \$146,000, investment income earned, appropriated, and recognized as unrestricted revenue and gains, respectively.

From time to time, it is possible that the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires UHS to retain as a fund of perpetual duration. These deficiencies could result from unfavorable market fluctuations that occur shortly after the investment of new permanently restricted contributions. There were no such deficiencies as of December 31, 2013 or 2012.

Revenues are reported as increases in unrestricted net assets, unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets, unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets. Donor-restricted contributions, whose restrictions are met in the same reporting period as the contributions are recorded as increases in unrestricted net assets.

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**(k) *Noncontrolling Interest***

UHS adopted the provisions of ASC 810-10-65-1, *Consolidation*, regarding noncontrolling interest in consolidated financial statements. This guidance requires UHS to clearly identify and present ownership interest in subsidiaries held by parties other than UHS in the consolidated financial statements within the net assets section. It also requires the amounts of consolidated revenues and gains in excess of expenses and losses attributable to UHS and to the noncontrolling interest to be clearly identified and presented on the face of the consolidated statements of operations.

**(l) *Consolidated Statements of Operations***

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

**(m) *Net Patient Service Revenue***

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered and includes estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. On the basis of historical experience, a significant portion of UHS' uninsured patients will be unable or unwilling to pay for the services provided. Therefore, UHS records a significant provision for doubtful accounts related to uninsured patients. This provision for doubtful accounts is presented on the consolidated statements of operations as a component of net patient revenue.

**(n) *Charity Care***

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

**(o) *Derivative Financial Instrument***

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

**(p) *Income Taxes***

UHS has been recognized as a tax-exempt organization pursuant to Section 501(a) of the Internal Revenue Code as an entity described under Section 501(c)(3). RTS is a single member limited liability company disregarded as an entity separate from UHS for federal tax purposes. UHSV is a Tennessee nonprofit corporation that is not exempt from federal taxes. Income tax expense for

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UHSV for the years ended December 31, 2013 and 2012 was not significant and was offset by operating losses in prior years for tax purposes.

**(q) Fair Value Measurements**

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

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

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

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

*Debt* – The fair value of long-term debt issued through the Health, Educational, and Housing Facilities Board of the County of Knox, based on quoted market prices for the same or similar issues, was approximately \$272,786,000, and \$271,845,000 at December 31, 2013 and 2012, respectively. The carrying amount of other long-term debt reported in note 9 and on the consolidated balance sheets approximates the related fair value.

**(r) Reclassifications**

Certain 2012 amounts have been reclassified to conform to 2013 consolidated financial statement presentation.

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

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

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

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

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

**(3) Charity Care**

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

The Medical Center maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone and estimated costs incurred for services and supplies furnished under its charity care policy and equivalent service statistics. Costs incurred are estimated based on the ratio of departmental costs to gross charges plus overhead. The following information measures the approximate level of charity care provided during the years ended December 31, 2013 and 2012:

	<u><b>2013</b></u>	<u><b>2012</b></u>
Charges foregone, based on established rates	\$ 60,488,000	41,177,000
Estimated costs incurred, less payments received	14,631,000	10,254,000

For the years ended December 31, 2013 and 2012, 2,826 and 3,174 patients received charity care, respectively. The charges foregone related to these patients were approximately 2.8% and 2.2% of gross patient revenue for each year, respectively. UHS also provided other community benefit, for which the value has not been quantified.

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**(4) Investments**

Investments at December 31, 2013 and 2012 include the following:

	<u>2013</u>	<u>2012</u>
Cash equivalents	\$ —	246,686
Money market funds	4,990,301	10,936,121
Corporate obligations	87,793,085	77,141,092
U.S. Treasury and agency obligations	43,422,521	49,077,031
Municipal obligations	1,430,551	—
Mutual funds	28,642,249	14,928,113
	<u>166,278,707</u>	<u>152,329,043</u>
Less short-term investments	<u>8,156,626</u>	<u>16,213,189</u>
Long-term investments	<u>\$ 158,122,081</u>	<u>136,115,854</u>

Investment income comprises the following for the years ended December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Interest income	\$ 4,562,576	4,254,072
Realized (loss) gain on sales of securities, net	(1,098,461)	795,476
Unrealized gain on securities	<u>2,435,254</u>	<u>2,909,056</u>
	<u>\$ 5,899,369</u>	<u>7,958,604</u>

**(5) Net Patient Service Revenue**

UHS has contractual agreements with third-party payors who reimburse UHS at amounts different from its established rates. Some of these payors also provide cost-based reimbursement for certain services, for which final settlement is determined based on the payors' audits of annual reports submitted by UHS.

Substantially, all acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates. Those rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. Medicare reimbursement reports have been audited, and final settlements have been determined by the Medicare Fiscal Intermediary through the year ended December 31, 2010. Periods for which final settlements have not been made are subject to audit by program representatives. In the opinion of management, adequate provision has been made in the accompanying consolidated financial statements for the effects of estimated final settlements.

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



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

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

Revenue from the Medicare and TennCare programs accounted for approximately 42% and 14%, respectively, of UHS' net patient service revenue for the years ended December 31, 2013 and 2012. Laws and regulations governing the Medicare and TennCare programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Net patient service revenue increased approximately \$1,828,000 and \$119,000 in 2013 and 2012, respectively, due to final settlements and revised estimated settlements in excess of amounts previously recorded, removal of allowances previously estimated that are no longer necessary as a result of final settlements, and years that are no longer subject to audits, reviews, and investigations.

UHS grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of gross Medical Center receivables from patients and third-party payors at December 31, 2013 and 2012 was as follows:

	<b>2013</b>	<b>2012</b>
Medicare	33%	34%
TennCare/Medicaid	28	26
Other third-party payors	29	27
Other agencies	3	3
Patients	7	10
	<u>100%</u>	<u>100%</u>

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the consolidated statements of operations is as follows for the years ended December 31, 2013 and 2012:

	<b>2013</b>	<b>2012</b>
Gross patient service revenue	\$ 2,089,932,786	1,852,130,080
Less:		
Contractual adjustments and other discounts	<u>(1,432,747,725)</u>	<u>(1,253,036,623)</u>
Net patient service revenue before provision for doubtful accounts	657,185,061	599,093,457
Less provision for doubtful accounts	<u>(62,306,309)</u>	<u>(61,277,376)</u>
Net patient service revenue	<u>\$ 594,878,752</u>	<u>537,816,081</u>

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**(6) Meaningful Use Incentives**

The American Recovery and Reinvestment Act of 2009 (ARRA) established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record (EHR) technology. The Medicare incentive payments are paid out to qualifying hospitals and physician groups over four consecutive years on a transitional schedule. To qualify for Medicare incentives, hospitals and physician groups must meet EHR “meaningful use” criteria that become more stringent over three stages as determined by Centers for Medicare & Medicaid Services (CMS). Medicaid programs and payment schedules vary from state to state.

For fiscal years ended June 30, 2013 and 2012, UHS recorded \$2,920,000 and \$3,952,000, respectively, in other operating revenue related to the EHR and meaningful use incentives. These incentives have been recognized following the grant accounting model, recognizing income ratably over the applicable reporting period as management becomes reasonably assured of meeting the required criteria.

Amounts recognized represent management’s best estimates for payments ultimately expected to be received based on estimated discharges, charity care, and other input data. Subsequent changes to these estimates will be recognized in other operating revenue in the period in which additional information is available. Such estimates are subject to audit by the federal government or its designee.

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

Assets limited as to use at December 31, 2013 and 2012 include the following:

	<u>2013</u>	<u>2012</u>
Endowment funds – held for investment:		
Money market funds	\$ 332,887	268,694
Corporate bonds	2,285,440	2,165,962
Mutual funds	3,853,247	3,226,629
	<u>6,471,574</u>	<u>5,661,285</u>
Other	8,674,217	5,579,151
	<u>15,145,791</u>	<u>11,240,436</u>
Less current portion	287,713	205,534
	<u>\$ 14,858,078</u>	<u>11,034,902</u>

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**(8) Property and Equipment**

Property and equipment at December 31, 2013 and 2012 are summarized as follows:

	<b>2013</b>	<b>2012</b>
Land	\$ 2,614	2,614
Buildings	16,818	16,818
Equipment	178,019,676	163,461,675
Leasehold improvements	221,868,559	210,045,354
Buildings under capital lease obligation	15,500,439	15,500,439
	<u>415,408,106</u>	<u>389,026,900</u>
Less accumulated depreciation and amortization	<u>215,044,277</u>	<u>193,476,049</u>
	200,363,829	195,550,851
Construction in progress	<u>5,095,535</u>	<u>7,889,951</u>
Property and equipment, net	<u><u>\$ 205,459,364</u></u>	<u><u>203,440,802</u></u>

UHS had outstanding commitments under construction contracts for renovation projects totaling approximately \$1,734,000 and \$2,132,000 at December 31, 2013 and 2012, respectively, which are expected to be financed primarily from project funds (note 9).

**(9) Investments in Affiliated Organizations**

UHS and its subsidiaries have investments in DL/UHS, Inc. (the Partnership) and UTMCHCS.

***DL/UHS, Inc.***

UHS and Dynacare Laboratory Management Limited entered into an agreement for ownership in the Partnership to operate an efficient, cost-effective, and competitive laboratory service organization. The Partnership provides UHS with laboratory testing required for its patients, as well as referral laboratory services. UHS' ownership interest is 5% and is accounted for using the equity method. UHS' investment in the Partnership at December 31, 2013 and 2012 was approximately \$997,000 and \$1,122,000, respectively.

Under a services agreement renewed in 2010, UHS agreed to pay a flat base rate per lab test performed. The term of the agreement is for 51 months through 2014. For the years ended December 31, 2013 and 2012, UHS incurred costs of approximately \$13,253,000 and \$12,119,000, respectively, related to this agreement. As of December 31, 2013 and 2012, UHS had accounts payable to the Partnership of approximately \$3,315,000 and \$3,320,000, respectively.

The Partnership entered into an operating lease with UHS for the space occupied by the laboratory on UHS' premises. The term of the lease was renewed in 2011 with a term of 51 months through 2014, and a payment of approximately \$55,000 due the first day of each month.

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Under an employee services agreement, the Partnership agreed to reimburse UHS for the actual cost of laboratory employees. These costs were approximately \$3,216,000 and \$3,351,000 for the years ended December 31, 2013 and 2012, respectively. As of December 31, 2013 and 2012, UHS had accounts receivable from the Partnership of approximately \$666,000 and \$323,000, respectively.

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

UHSV was a 33% owner of UTMCHCS with Tennessee Health Care Group, LLC (67%). The purpose of UTMCHCS is to provide home health and hospice services. Effective July 1, 2010, UTMCHCS was transferred to UHS. The investment is accounted for using the equity method. For the years ended December 31, 2013 and 2012, UHS' share of UTMCHCS earnings was approximately \$465,000 and \$651,000, respectively. UHS received distributions of approximately \$501,000 and \$691,000 during the years ended December 31, 2013 and 2012, respectively. UHS' investment in UTMCHCS at December 31, 2013 and 2012 was \$898,000 and \$934,000, respectively.

Under an employee services agreement, UTMCHCS agreed to reimburse UHS for the actual cost of home health and hospice employees. These costs were approximately \$679,000 and \$853,000 for the years ended December 31, 2013 and 2012, respectively. As of December 31, 2013 and 2012, UHS had accounts receivable from UTMCHCS of approximately \$170,000 and \$188,000, respectively.

**(10) Long-Term Debt**

Long-term debt at December 31, 2013 and 2012 is summarized as follows:

	<b>2013</b>	<b>2012</b>
Revenue bonds, 2010 Series	\$ 50,000,000	49,059,604
Revenue bonds, 2007 Series, net of unamortized premium of approximately \$2,324,000 and \$2,710,000 at December 31, 2013 and 2012, respectively	210,563,893	215,709,779
Capital lease obligations	17,600,105	15,377,698
Other	2,527,329	1,530,420
	<u>280,691,327</u>	<u>281,677,501</u>
Less current portion	<u>12,347,046</u>	<u>10,325,303</u>
	<u>\$ 268,344,281</u>	<u>271,352,198</u>

**(a) Revenue Bonds**

**2010 Series**

On December 1, 2010, the Health, Educational, and Housing Facilities Board of the County of Knox issued on behalf of UHS, \$50 million Revenue Bonds, Series 2010. Under the terms of the bond indenture, the proceeds, together with other financing sources, will be used to (i) finance or reimburse the costs of additions and improvements to Medical Center, (ii) capitalize a portion of the interest on the Bonds, and (iii) pay a portion of the costs of issuance of the Series 2010 Bonds. The

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Revenue Bonds, Series 2010, were issued as tax-exempt bonds and bear interest, payable semiannually, at a variable rate equal to 67.00% of the sum of the 30-day LIBOR plus 1.15%, plus 0.20%. The principal matures in varying annual amounts. The Revenue Bonds, 2010 Series, constitute serial bonds due January 1, 2043, subject to installments commencing on January 1, 2014.

Under the terms of the bond indenture, the Revenue Bonds, 2010 Series, are subject to tender by the owners thereof for purchase on the interest payment date immediately preceding the seventh anniversary of the effective date of the bond indenture.

UHS has three years from the effective date to drawdown the total proceeds of the bonds and complete the Medical Center additions and improvements. As of December 31, 2013, UHS had drawn down \$50,000,000 to pay for these projects.

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

The Revenue Bonds, 2010 Series, are subject to redemption at the option of UHS, in whole or in part, at any time, at the redemption price of 100% plus accrued interest.

**2007 Series**

During 2007, UHS advance refunded the Revenue Bonds, Series 1999, with the proceeds of the Revenue Bonds, 2007 Series. The Series 2007 bonds were issued by the Health, Educational, and Housing Facilities Board of the County of Knox on behalf of UHS on April 27, 2007. Under the terms of the bond indenture, the proceeds, together with certain other funds, were used to (i) advance refund the Revenue Bonds, Series 1999, (ii) refinance certain taxable debt, (iii) pay a portion of the costs of acquiring, constructing, renovating, and equipping certain hospital facilities, (iv) fund capitalized interest on a portion of the project, and (v) pay the costs of issuing the Series 2007 Bonds. The Revenue Bonds, 2007 Series, were issued as tax-exempt bonds and bear interest, payable semiannually, at 4.00% to 5.25%. The principal matures in varying annual amounts. The Revenue Bonds, 2007 Series, constitute serial bonds due April 1, 2017, subject to redemption through sinking fund installments commencing on April 1, 2008, and term bonds due April 1, 2021, 2027, and 2036, subject to redemption through sinking fund installments commencing on April 1, 2020, 2022, and 2028, respectively.

Under the terms of the bond indenture, the Medical Center is required to maintain certain covenants, including a minimum debt service coverage ratio, as defined, of 1.10, as long as the Revenue Bonds, 2007 Series, are outstanding.

The Revenue Bonds, 2007 Series, maturing on or after April 1, 2017 are subject to redemption at the option of UHS, in whole or in part at any time, at the redemption price of 100% plus accrued interest.

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UHS is not required to fund a debt service reserve fund. If UHS' days cash on hand falls below 60 days during the life of the bonds, UHS will be required to fund a debt service reserve fund, which can be released if days cash on hand increases above 60 days.

**(b) Capital Lease Obligations**

Pursuant to the Lease and Transfer Agreement (note 2), UHS acquired a leasehold interest in the real property of the Medical Center from the University for a term of 50 years. The guaranteed lease payment of \$50 million will be paid subject to an inflation index tied to the change in net Medical Center operating revenue through 2019, as defined, in annual payments equal to the lesser of (1) 20% of UHS' annual net operating income, as defined; or (2) \$3 million, subject to the index. The payment of \$50 million is guaranteed by March 15, 2020. In 2019, UHS and the University will negotiate an annual lease payment for the remaining 30 years of the lease.

UHS initially recorded an asset and capital lease obligation for the real property in the amount of approximately \$15,500,000, which represents the net present value of the guaranteed \$50 million discounted at 5.75% from December 31, 2019. The capital lease obligation is increased monthly by interest expense and is reduced by lease payments, if any. For the years ended December 31, 2013 and 2012, the lease payment required under the agreement was approximately \$2,466,000 and \$2,872,000, respectively. The 2013 amount was due by March 15, 2014 and is included in current portion of long-term debt in the accompanying consolidated financial statements at December 31, 2013.

UHS entered into three capital lease obligations in 2013 and four capital lease obligations in 2012 for Medical Center equipment. The terms of the leases range from three to six years at interest rates ranging from 0.75% to 8.8%.

At December 31, 2013 and 2012, the gross amounts of property and equipment and related accumulated amortization recorded under capital leases were as follows:

	<u>2013</u>	<u>2012</u>
Buildings	\$ 15,500,439	15,500,439
Equipment	25,439,891	19,659,509
	40,940,330	35,159,948
Less accumulated amortization	26,519,602	22,631,166
	<u>\$ 14,420,728</u>	<u>12,528,782</u>

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

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Scheduled principal payments on long-term debt at December 31, 2013 are as follows:

	<b>Revenue bonds</b>	<b>Capital lease obligations</b>	<b>Other</b>	<b>Total</b>
2014	\$ 5,330,000	5,551,398	1,465,648	12,347,046
2015	5,600,000	2,809,167	604,125	9,013,292
2016	5,880,000	1,280,539	346,099	7,506,638
2017	6,175,000	863,834	101,611	7,140,445
2018	6,485,000	543,490	9,846	7,038,336
2019 and thereafter	228,770,000	21,111,471	—	249,881,471
Less amounts representing:				
Interest under capital lease obligation	—	(14,559,794)	—	(14,559,794)
Unamortized premium on long-term debt	2,323,893	—	—	2,323,893
	<u>\$ 260,563,893</u>	<u>17,600,105</u>	<u>2,527,329</u>	<u>280,691,327</u>

**(11) Derivative Instrument**

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

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

	<b>May 2006 interest rate swap</b>
Effective date	May 26, 2006
Associated fixed-rate debt	2007 Series
Term	23 years
Notional amount	\$ 176,000,000
Rate UHS pays	SIFMA <sup>(1)</sup>
Rate UHS receives	68.00% of three-month LIBOR <sup>(2)</sup> plus 0.425%

<sup>(1)</sup> SIFMA represents the Bond Market Association Municipal Swap Index

<sup>(2)</sup> LIBOR represents the London Interbank Offered Rate

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The fair value of the swap is the estimated amount UHS would receive or pay to terminate the swap agreement at the reporting date, taking into account current interest rates. The fair value as of December 31, 2013 and 2012 of approximately \$(4,355,000) and \$(426,000), respectively, is included in other liabilities in the consolidated balance sheets. The change in the fair value of the derivative instrument was approximately \$(3,929,000) and \$3,996,000, respectively, in 2013 and 2012 and is included in nonoperating gains, net in the consolidated statements of operations. Pursuant to the swap agreement, UHS is required to post collateral equal to the fair value of the liability that exceeds \$10,000,000 as of the valuation date. The net settlement amount received on the swap of approximately \$906,000 and \$981,000 for the years ended December 31, 2013 and 2012, respectively, is included as a reduction to interest expense in the consolidated statements of operations.

**(12) Related-Party Transactions**

***The University of Tennessee***

Pursuant to the Employee Services Agreement (note 2), Medical Center employees as of July 28, 1999 were leased by UHS from the University and retained all University benefits for which they were eligible at that date. For the years ended December 31, 2013 and 2012, UHS paid approximately \$56,947,000 and \$61,340,000, respectively, to the University for salaries, wages, and benefits, including retirement benefits, of the leased employees.

Pursuant to the Affiliation Agreement (note 2), UHS is required to pass through to GSM certain federal and state funds earmarked for graduate medical education. For the years ended December 31, 2013 and 2012, the graduate medical education reimbursements amounted to approximately \$31,807,000 and \$31,121,000, respectively, and were recorded in the accompanying consolidated financial statements as net patient service revenue and as an offsetting amount in operating expenses. UHS had amounts due to GSM of approximately \$8,363,000 and \$7,765,000 at December 31, 2013 and 2012, respectively, which are included in accrued expenses and other current liabilities in the accompanying consolidated balance sheets.

**(13) Employee Benefit Plans**

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

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

Participants may elect to have certain percentages or dollars of their compensation withheld and contributed to the Savings Plan. Total contributions cannot exceed limitations set forth in the Employee Retirement Income Security Act (ERISA) guidelines. The employer contribution is 5% of each participant's compensation (no matching required). Employer contributions begin after the eligible employee has worked 12 months. Contributions and/or voluntary deductions are made to funds selected by the UHS Benefits Committee. The participant identifies the funds he/she wishes to participate in and participants who do not select funds are enrolled in the Target Date funds. Participants are immediately vested in their voluntary deductions and earnings. Prior to January 1, 2003, participants with one year of employment but less than two years of employment became 20%



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vested in UHS contributions, and their vested percentage increased by 20% each year of employment, thereafter until they were fully vested after five years. For participants joining UHS on or after January 1, 2003, the vesting is a five-year cliff vesting, whereby the employee becomes fully vested after five years of employment. Beginning January 1, 2007, the vesting for all active employees changed to a six-year graduated vesting. Participants with two years of employment become 20% vested in UHS contributions, and their vested percentage increases by 20% each year of employment thereafter until they are fully vested after six years. Each employee with at least three years of service on January 1, 2007, who was not 100% vested, was permitted to make an irrevocable election regarding the applicable vesting schedule. For the years ended December 31, 2013 and 2012, total UHS expenses related to the Savings Plan were approximately \$5,689,000 and \$5,440,000, respectively.

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

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

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

UHS maintains a nonqualified deferred compensation plan (Nonqualified Plan) for senior management, vice presidents and equivalents, and physicians. The employer contribution is 5% up to the Internal Revenue Service (IRS) qualified maximum and 10% after the IRS maximum. All employer contributions are subject to a seven-year vesting schedule or attainment of age 60 and contributions are made at the close of each payroll cycle.

UHS maintains a separate Nonqualified Plan for senior management. The employer contribution is 8%–10% based on the employee's position. The employer's contributions become vested according to the age of the Participant at the time the contribution was made. Contributions to a participant's account made in a year in which the participant attains the age of fifty seven (57) shall vest fully on January 1 of the year the Participant attains the age of sixty (60). For contributions made no later than the year in which the Participant attains the age of fifty eight (58) and each year thereafter shall vest fully on the last business day of the year in which the contribution is made. Contributions are made at the end of each payroll cycle.

UHS maintains a separate Nonqualified Plan for certified registered nurse anesthetists (CRNAs). The employer contribution is 5% up to the IRS qualified maximum. All employer contributions are subject to a seven-year vesting schedule or attainment of age 60 and contributions are made at the close of each payroll cycle.

For the years ended December 31, 2013 and 2012, total UHS expenses related to the Nonqualified Plans were approximately \$2,173,000 and \$1,568,000, respectively.

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**(14) Fair Values of Financial Instruments**

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

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

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

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

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The following table presents assets and liabilities that are measured at fair value on a recurring basis at December 31, 2013:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Assets:</b>				
Cash and cash equivalents	\$ 69,613,960	—	—	69,613,960
Assets limited as to use:				
Money market funds	1,190,039	—	—	1,190,039
Corporate bonds	2,285,440	—	—	2,285,440
Mutual funds	11,670,312	—	—	11,670,312
	15,145,791	—	—	15,145,791
Long-term investments:				
Cash equivalents	—	—	—	—
Money market funds	4,990,301	—	—	4,990,301
U.S. corporate bonds	—	58,615,452	—	58,615,452
Asset-backed securities	—	22,092,632	—	22,092,632
International fixed income bonds	7,085,001	—	—	7,085,001
U.S. Treasury and agency bonds	15,981,915	27,440,606	—	43,422,521
Municipal bonds	—	1,430,551	—	1,430,551
Mutual funds	28,642,249	—	—	28,642,249
	56,699,466	109,579,241	—	166,278,707
Total	\$ 141,459,217	109,579,241	—	251,038,458
<b>Liabilities:</b>				
Interest rate derivatives liability	\$ style="text-align: center;">—	(4,354,859)	—	(4,354,859)
Total	\$ style="text-align: center;">—	(4,354,859)	—	(4,354,859)

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The following table presents assets and liabilities that are measured at fair value on a recurring basis at December 31, 2012:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Assets:</b>				
Cash and cash equivalents	\$ 64,459,130	—	—	64,459,130
Assets limited as to use:				
Money market funds	967,428	—	—	967,428
Corporate bonds	2,165,962	—	—	2,165,962
Mutual funds	8,107,046	—	—	8,107,046
	<u>11,240,436</u>	<u>—</u>	<u>—</u>	<u>11,240,436</u>
Long-term investments:				
Cash equivalents	246,686	—	—	246,686
Money market funds	10,936,121	—	—	10,936,121
U.S. corporate bonds	—	49,703,810	—	49,703,810
Asset-backed securities	—	18,232,949	—	18,232,949
International fixed income bonds	9,204,333	—	—	9,204,333
U.S. Treasury and agency bonds	23,670,598	25,406,433	—	49,077,031
Mutual funds	14,928,113	—	—	14,928,113
	<u>58,985,851</u>	<u>93,343,192</u>	<u>—</u>	<u>152,329,043</u>
Total	<u>\$ 134,685,417</u>	<u>93,343,192</u>	<u>—</u>	<u>228,028,609</u>
<b>Liabilities:</b>				
Interest rate derivatives liability	\$ —	(425,687)	—	(425,687)
Total	<u>\$ —</u>	<u>(425,687)</u>	<u>—</u>	<u>(425,687)</u>

There were no transfers between any of the levels during the years ended December 30, 2013 and 2012.

**(15) Commitments and Contingent Liabilities**

**(a) Lease Obligations**

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

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The following table is a schedule by year of future minimum rentals on noncancelable operating leases with terms in excess of one year at December 31, 2013:

2014	\$	4,876,570
2015		4,113,036
2016		3,918,278
2017		3,690,852
2018		3,394,082
2019 and thereafter		18,820,278
	\$	<u>38,813,096</u>

UHS' total lease expense for the years ended December 31, 2013 and 2012 was approximately \$7,452,000 and \$6,197,000, respectively.

**(b) Risk Management Programs**

UHS purchases professional and general liability insurance, subject to certain deductibles, to cover medical malpractice and other general liability claims. Effective July 28, 2002, UHS assumed a self-insured retention to cover medical malpractice and other general liability claims. On January 1, 2005, UHS assumed a self-insured retention for workers' compensation. The insurance carrier pays claims, including the deductible on behalf of UHS, and UHS reimburses the insurance carrier on a monthly basis for paid claims. Workers' compensation claim payments made by the insurance carriers within the deductible are secured by UHS via standby letters of credit in the amounts of \$2,166,000 and \$1,512,500 issued by Wells Fargo. UHS also maintains an umbrella policy that provides \$50 million of excess liability coverage over and above the primary coverage for professional, general, automobile, workers' compensation, aviation, and ambulance liability.

There are known claims and incidents that may result in the assertion of additional claims, as well as claims from unknown incidents that may be asserted arising from services provided to patients, workers' compensation, and other risks. UHS has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accordingly, accrued professional, general, workers' compensation, and other liability losses of approximately \$20,078,000 and \$19,601,000 are recorded in accrued expenses and other liabilities in the accompanying consolidated financial statements at December 31, 2013 and 2012, respectively, which, in management's opinion, provide an adequate accrual for such claims.

**(c) Healthcare Services**

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

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

Notes to Consolidated Financial Statements

December 31, 2013 and 2012

**(16) Rentals under Operating Leases**

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

The following is a schedule, by year, of minimum future rentals on noncancelable operating leases as of December 31, 2013:

2014	\$ 3,571,920
2015	450,145
2016	211,118
2017	208,435
2018	98,018
2019 and thereafter	<u>1,053,609</u>
	<u>\$ 5,593,245</u>

**(17) Functional Expenses**

UHS provides healthcare services to residents within its geographic location. Expenses related to providing these services were as follows for the years ended December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Healthcare services	\$ 589,397,748	533,850,290
General and administrative	<u>37,046,616</u>	<u>37,162,000</u>
	<u>\$ 626,444,364</u>	<u>571,012,290</u>

**(18) Subsequent Events**

UHS has evaluated subsequent events from the balance sheet date through March 24, 2014, the date at which the consolidated financial statements were issued. No material subsequent events were identified for recognition, but the following disclosure is necessary.



KPMG LLP  
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## **Independent Auditors' Report on Supplementary Information**

The Board of Directors  
University Health System, Inc.:

We have audited the consolidated financial statements of University Health System, Inc. and subsidiaries (UHS) as of and for the years ended December 31, 2013 and 2012, and have issued our report thereon dated March 24, 2014, which contained an unmodified opinion on those consolidated financial statements. Our audit was performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information in schedules 1 and 2 is presented for the purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of UHS' management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating 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 consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

*KPMG LLP*

Nashville, Tennessee  
March 24, 2014

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

Consolidating Schedule – Balance Sheet Information

December 31, 2013

	<b>Medical Center</b>	<b>UHSV</b>	<b>RTS</b>	<b>Eliminations</b>	<b>Total</b>
Current assets:					
Cash and cash equivalents	\$ 68,722,434	697,929	193,597	—	69,613,960
Short-term investments	8,156,626	—	—	—	8,156,626
Current portion of assets limited as to use	287,713	—	—	—	287,713
Patient accounts receivable, net	73,184,903	96,323	65,840	—	73,347,066
Other receivables	7,203,088	—	4,278	(270,135)	6,937,231
Estimated third-party settlements	16,236,867	—	—	—	16,236,867
Inventories	5,354,591	—	—	—	5,354,591
Prepaid expenses and other current assets	1,197,047	—	—	—	1,197,047
Total current assets	180,343,269	794,252	263,715	(270,135)	181,131,101
Assets limited as to use, less current portion	14,858,078	—	—	—	14,858,078
Long-term investments	158,122,081	—	—	—	158,122,081
Property and equipment, net	205,459,364	—	—	—	205,459,364
Deferred financing costs, net	1,988,326	—	—	—	1,988,326
Investments in affiliated organizations	2,333,408	—	—	—	2,333,408
Other assets	7,491,651	—	—	—	7,491,651
Total assets	\$ 570,596,177	794,252	263,715	(270,135)	571,384,009
Current liabilities:					
Current portion of long-term debt	\$ 12,347,046	—	—	—	12,347,046
Accounts payable	55,070,264	633,171	79,286	(686,333)	55,096,388
Accrued payroll and related liabilities	33,638,306	579	—	—	33,638,885
Accrued expenses and other current liabilities	21,488,088	667	184,429	—	21,673,184
Estimated third-party settlements	8,011,395	—	—	—	8,011,395
Total current liabilities	130,555,099	634,417	263,715	(686,333)	130,766,898
Long-term debt, less current portion	268,344,281	—	—	—	268,344,281
Other liabilities	19,391,004	—	—	—	19,391,004
Total liabilities	418,290,384	634,417	263,715	(686,333)	418,502,183
Net assets:					
Unrestricted	143,808,677	159,835	—	416,198	144,384,710
Temporarily restricted	3,033,780	—	—	—	3,033,780
Permanently restricted	5,463,336	—	—	—	5,463,336
Total net assets	152,305,793	159,835	—	416,198	152,881,826
Commitments and contingent liabilities					
Total liabilities and net assets	\$ 570,596,177	794,252	263,715	(270,135)	571,384,009

See accompanying independent auditors' report.



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

Consolidating Schedule – Statement of Operations Information

Year ended December 31, 2013

	<b>Medical Center</b>	<b>UHSV</b>	<b>RTS</b>	<b>Eliminations</b>	<b>Total</b>
Revenue:					
Net patient service revenue	\$ 654,473,978	1,228,865	1,482,218	—	657,185,061
Provision for doubtful accounts	(62,179,073)	(44,871)	(82,365)	—	(62,306,309)
Net patient service revenue less provision for doubtful accounts	592,294,905	1,183,994	1,399,853	—	594,878,752
Other revenue	36,292,682	272,354	—	—	36,565,036
Total revenue	628,587,587	1,456,348	1,399,853	—	631,443,788
Operating expenses:					
Salaries, wages, and benefits	272,975,541	762,699	—	—	273,738,240
Medical supplies and drugs	164,820,110	73,362	—	—	164,893,472
Purchased services	86,847,562	400,613	1,399,853	—	88,648,028
Graduate medical education reimbursement	31,806,637	—	—	—	31,806,637
Insurance and other	29,086,730	62,395	—	—	29,149,125
Interest	12,277,022	—	—	—	12,277,022
Depreciation and amortization	25,931,840	—	—	—	25,931,840
Total operating expenses	623,745,442	1,299,069	1,399,853	—	626,444,364
Operating income	4,842,145	157,279	—	—	4,999,424
Nonoperating gains:					
Contributions	1,922,094	—	—	—	1,922,094
Investment income	5,899,369	—	—	—	5,899,369
Change in fair value of derivative instrument	(3,929,172)	—	—	—	(3,929,172)
Total nonoperating gains, net	3,892,291	—	—	—	3,892,291
Revenue and gains in excess of expenses and losses	\$ 8,734,436	157,279	—	—	8,891,715

See accompanying independent auditors' report.