KPMG

UNIVERSITY HEALTH SYSTEM, INC.
AND SUBSIDIARIES

Consolidated Financial Statements and Schedules

December 31, 2016 and 2015

(With Independent Auditors' Report 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, 2016 and 2015, 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, 2016 and 2015, 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 28, 2017

UNIVERSITY HEALTH SYSTEM, INC.
AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2016 and 2015

Assets		2016	2015
Current assets:			
Cash and cash equivalents	$	77,853,867	100,506,869
Short-term investments		13,018,557	14,326,862
Current portion of assets limited as to use		51,789,148	210,024
Patient accounts receivable, net of allowance for doubtful accounts of $49,256,000 and $47,380,000 at December 31, 2016 and 2015, respectively		101,490,254	87,901,648
Other receivables		6,163,186	7,389,294
Estimated third-party settlements		20,622,688	14,774,871
Inventories		8,203,797	5,899,901
Prepaid expenses and other current assets		2,509,212	2,530,802
Total current assets		281,650,709	233,540,271
Assets limited as to use, less current portion		25,769,046	21,132,962
Long-term investments		175,568,890	164,560,752
Property and equipment, net		241,240,770	230,775,887
Investments in affiliated organizations		2,586,912	2,426,827
Other assets		5,113,120	7,420,721
Total assets	$	731,929,447	659,857,420
Liabilities and Net Assets			
Current liabilities:			
Current portion of long-term debt	$	10,654,061	12,927,293
Accounts payable		77,038,481	68,998,330
Accrued payroll and related liabilities		46,850,544	44,008,118
Accrued expenses and other current liabilities		26,933,745	28,230,835
Estimated third-party settlements		6,441,672	8,011,396
Total current liabilities		167,918,503	162,175,972
Long-term debt, less current portion		349,653,858	285,633,406
Other liabilities		15,940,535	15,466,149
Total liabilities		533,512,896	463,275,527
Net assets:			
Unrestricted		185,389,160	185,247,232
Temporarily restricted		4,007,124	3,820,200
Permanently restricted		9,020,267	7,514,461
Total net assets		198,416,551	196,581,893
Total liabilities and net assets	$	731,929,447	659,857,420

See accompanying notes to consolidated financial statements.

UNIVERSITY HEALTH SYSTEM, INC.
AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended December 31, 2016 and 2015

		2016	2015
Revenue:			
Net patient service revenue	$	838,454,406	792,188,738
Provision for doubtful accounts		(52,248,393)	(55,115,686)
Net patient service revenue less provision for doubtful accounts		786,206,013	737,073,052
Other revenue		45,505,761	38,213,930
Total revenue		831,711,774	775,286,982
Operating expenses:			
Salaries, wages, and benefits		358,105,377	334,405,929
Medical supplies and drugs		235,833,200	205,569,450
Purchased services		132,832,490	118,815,890
Graduate medical education reimbursed to the University		34,445,830	32,143,192
Insurance and other		30,079,552	29,199,905
Interest		13,159,756	12,553,011
Depreciation and amortization		29,799,991	29,518,084
Total operating expenses		834,256,196	762,205,461
Operating (loss) income		(2,544,422)	13,081,521
Nonoperating gains (losses):			
Contributions		645,040	725,764
Investment income		6,627,285	1,209,827
Change in fair value of derivative instrument		(3,572,606)	3,970,597
Loss on extinguishment of debt		(1,013,369)	(422,022)
Total nonoperating gains, net		2,686,350	5,484,166
Revenue and gains in excess of expenses and losses	$	141,928	18,565,687

See accompanying notes to consolidated financial statements.

UNIVERSITY HEALTH SYSTEM, INC.
AND SUBSIDIARIES

Consolidated Statements of Changes in Net Assets

Years ended December 31, 2016 and 2015

	Unrestricted net assets	Temporarily restricted net assets	Permanently restricted net assets	Total net assets
Balance at December 31, 2014	$ 166,681,545	3,085,955	6,715,746	176,483,246
Revenue and gains in excess of expenses and losses	18,565,687	—	—	18,565,687
Contributions	—	1,308,280	799,597	2,107,877
Net assets released from restriction used in operations	—	(574,035)	(882)	(574,917)
Balance at December 31, 2015	185,247,232	3,820,200	7,514,461	196,581,893
Revenue and gains in excess of expenses and losses	141,928	—	—	141,928
Contributions	—	1,497,797	1,505,806	3,003,603
Net assets released from restriction used in operations	—	(1,310,873)	—	(1,310,873)
Balance at December 31, 2016	$ 185,389,160	4,007,124	9,020,267	198,416,551

See accompanying notes to consolidated financial statements.

UNIVERSITY HEALTH SYSTEM, INC.
AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2016 and 2015

		2016	2015
Cash flows from operating activities:			
Increase in total net assets	$	1,834,658	20,098,647
Adjustments to reconcile increase in total net assets to net cash provided by operating activities:			
Depreciation and amortization		29,799,991	29,518,084
Provision for doubtful accounts		52,248,393	55,115,686
Gifts and contributions for endowment and capital projects		(2,375,245)	—
Equity in earnings of affiliated organizations		(2,056,958)	(1,533,467)
Imputed interest on capital lease obligation		2,346,745	2,215,918
Unrealized (gains) losses on trading securities		(2,056,448)	2,657,082
Realized (gains) losses on trading securities		(288,790)	621,618
Change in fair value of derivative instrument		3,572,606	(3,970,597)
Amortization of financing costs		88,405	83,871
Amortization of bond premium		(348,207)	(319,141)
Gain on sale of assets, net		(21,983)	(57,708)
Loss on extinguishment of debt		1,013,369	422,022
Changes in assets and liabilities affecting operating activities:			
Patient accounts receivable		(65,836,999)	(61,582,594)
Other receivables		1,226,108	(1,820,630)
Estimated third-party settlements		(7,417,540)	1,220,727
Inventories		(2,303,896)	(633,941)
Prepaid expenses and other assets		2,619,542	(4,953,532)
Accounts payable		(1,497,246)	4,600,396
Accrued payroll and related liabilities		2,842,427	5,311,061
Accrued expenses and other liabilities		(1,855,359)	186,290
Net cash provided by operating activities		11,533,573	47,179,792
Cash flows from investing activities:			
Proceeds from sale or maturity of investments		257,581,239	173,348,057
Purchases of investments		(321,151,042)	(178,106,618)
Purchases of property and equipment		(32,601,592)	(34,181,914)
Proceeds from the sale of assets		1,750	603
Capital distributions from affiliated organization		1,896,875	1,521,583
Net cash used in investing activities		(94,272,770)	(37,418,289)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt		130,606,453	73,882,850
Payments of long-term debt		(71,454,569)	(63,856,190)
Payments for deferred financing costs		(1,440,934)	(221,021)
Gifts and contributions for endowment and capital projects		2,375,245	—
Net cash provided by financing activities		60,086,195	9,805,639
(Decrease) increase in cash and cash equivalents		(22,653,002)	19,567,142
Cash and cash equivalents at beginning of year		100,506,869	80,939,727
Cash and cash equivalents at end of year	$	77,853,867	100,506,869

(Continued)

UNIVERSITY HEALTH SYSTEM, INC.
AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2016 and 2015

		2016	2015
Supplemental disclosure of cash flow information:			
Cash paid for interest, net of amount capitalized of $391,633 and $250,424, respectively	$	12,145,431	10,761,362
Noncash investing activities:			
Assets and liabilities resulting from equipment purchases:			
Property, plant, and equipment	$	1,968,611	2,491,980
Accounts payable		10,717,913	698,250
Capital lease		1,968,611	1,793,730

See accompanying notes to consolidated financial statements.

(1) Summary of Significant Accounting Policies

(a) Organization, Principles of Consolidation, and Operations

University Health System, Inc. (UHS), a Tennessee nonprofit corporation, comprises the following: (1) University of Tennessee Medical Center (Medical Center); (2) UHS Ventures, Inc. (UHSV); (3) Regional Trauma Service, LLC (RTS); and (4) University Cardiology Group, LLC (UCG). 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.

(i) 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 609 acute care beds and has been designated by the State of Tennessee (State) as a Level 1 adult and pediatric Trauma Center, supported by five aeromedical helicopters. The State has also designated the Medical Center as a Regional Perinatal Center for high-risk pregnancy.

(ii) UHS Ventures, Inc.

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

(iii) 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.

(iv) University Cardiology Group, LLC

UCG, a nonprofit organization and wholly owned subsidiary of UHS, was established in 2014 to provide cardiology physician services to patients of the Medical Center.

Also, see note 8, Investments in Affiliated Organizations.

(b) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. 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, 2016 and 2015.

(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.

(Continued)

(g) Property and Equipment

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

(j) Net Assets

Net assets, 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.

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.

Endowment – UHS applies Financial Accounting Standards Board (FASB) Staff Position (FSP) FAS 117-1, *Endowments of Not-for-Profit Organizations*, and 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 of 22 individual donor-restricted endowment 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 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. 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, 2016 and 2015, there was approximately $151,000 and $149,000, 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, 2016 or 2015.

(k) Consolidated Statements of Operations

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

(l) 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 service revenue.

(m) Charity Care

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

(n) Derivative Financial Instrument

UHS has not elected to use hedge accounting with respect to its derivative financial instrument. The derivative financial instrument is recognized as an asset or 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.

(o) Income Taxes

UHS has been recognized as a tax-exempt organization pursuant to Section 501(a) of the Internal Revenue Code as an entity described under Section 501(c)(3). RTS and UCG are single member limited liability companies disregarded as entities separate from UHS for federal tax purposes. UHSV is a Tennessee nonprofit corporation that is not exempt from federal taxes. Income tax expense for UHSV for the years ended December 31, 2016 and 2015 was not significant and was offset by operating losses in prior years for tax purposes.

(p) Fair Value Measurements

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

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

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

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

(q) New Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09), which requires an entity to recognize revenue to depict the transfer of promised goods or service to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity also should disclose sufficient quantitative information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flow arising from contracts with customers. The new standard is effective for UHS for years beginning after December 31, 2017 (as amended in August by ASU No. 2015-14, *Deferral of Effective Date*). UHS has not yet completed its assessment of the impact of the new guidance on its consolidated financial statements.

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

In February 2016, the FASB issued ASU No. 2016-02, *Leases* (Topic 842) (ASU 2016-02). The amendments in ASU 2016-02 create FASB ASC Topic 842, *Leases*, and supersede the requirement in ASC Topic 840, *Leases*. ASU 2016-02 requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating lease under ASC Topic 840. Under the guidance of ASU 2016-02, a lessee should recognize in the balance sheet a liability to make lease payments (lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The accounting applied by a lessor under ASU 2016-02 is largely unchanged from that applied under Topic 840. The new standard is effective for UHS for years beginning after December 15, 2018. UHS has not yet determined the impact of the new standard on its current policies for lessee accounting.

In August 2016, the FASB issued ASU No 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities* (ASU 2016-14). ASU 2016-14 (1) reduces the number of net asset classes presented from three to two; (2) requires the presentation of expenses by functional and natural classification in one location; and (3) requires quantitative and qualitative disclosures about liquidity and availability of financial assets. The ASU is effective for annual financial statements issued for fiscal years beginning after December 15, 2017. UHS has not yet determined the impact of the new standard on its current policies.

(r) Reclassifications

Certain 2015 amounts have been reclassified to conform to the 2016 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.

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. The cost of charity care provided totaled approximately $12,447,000 and $13,851,000 for the years ended December 31, 2016 and 2015, respectively. Costs incurred are estimated based on the ratio of departmental costs to gross charges plus overhead. UHS also provided other community benefits, for which the value has not been quantified.

(4) Investments

Investments at December 31, 2016 and 2015 include the following:

		2016	2015
Money market funds	$	4,347,138	2,218,765
Corporate obligations		60,388,113	57,420,240
U.S. Treasury and agency obligations		83,034,210	68,837,856
Municipal obligations		1,950,518	1,939,977
Mutual funds and equity securities		38,867,468	48,470,776
		188,587,447	178,887,614
Less short-term investments		13,018,557	14,326,862
Long-term investments	$	175,568,890	164,560,752

Investment income comprises the following for the years ended December 31, 2016 and 2015:

		2016	2015
Interest income	$	4,282,047	4,488,527
Realized gain (loss) on sales of securities, net		288,790	(621,618)
Unrealized gain (loss) on securities, net		2,056,448	(2,657,082)
	$	6,627,285	1,209,827

(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, 2009. Periods for which final settlements have not been made are subject to audit by program representatives. In the opinion of management, adequate provision has been made in the accompanying consolidated financial statements for the effects of estimated final settlements.

(Continued)

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

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

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

Revenue from the Medicare and Tenncare programs accounted for approximately 41% and 14% respectively, of UHS' net patient service revenue for the year ended December 31, 2016. Revenue from the Medicare and TennCare programs accounted for approximately 40% and 16%, respectively, of UHS' net patient service revenue for the year ended December 31, 2015. 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 $1,286,000 and $1,116,000 in 2016 and 2015, 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, 2016 and 2015 was as follows:

	2016	**2015**
Medicare	34%	33%
TennCare/Medicaid	28	30
Other third-party payors	30	27
Other agencies	4	4
Patients	4	6
	100%	100%

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, 2016 and 2015:

		2016	2015
Gross patient service revenue	$	3,051,484,502	2,812,789,919
Less:			
Contractual adjustments and other discounts		(2,213,030,096)	(2,020,601,181)
Net patient service revenue before provision for doubtful accounts		838,454,406	792,188,738
Less provision for doubtful accounts		(52,248,393)	(55,115,686)
Net patient service revenue	$	786,206,013	737,073,052

(6) Assets Limited as to Use

Assets limited as to use at December 31, 2016 and 2015 include the following:

	2016	2015
Endowment funds – held for investment:		
Money market funds	$ 1,145,212	764,992
Corporate bonds	—	4,339,293
Mutual funds	8,316,638	3,074,569
	9,461,850	8,178,854
Nonqualified retirement funds:		
Money market funds	861,675	271,152
Mutual funds	15,234,016	12,476,956
	16,095,691	12,748,108
Project funds:		
Commercial paper	15,257,997	—
Corporate obligations	3,001,215	—
U.S. Treasury and agency obligations	4,731,582	—
Municipal obligations	3,801,680	—
Mutual funds and equity securities	24,771,659	—
	51,564,133	—
Other – money market funds	436,520	416,024
	77,558,194	21,342,986
Less current portion	51,789,148	210,024
	$ 25,769,046	21,132,962

(Continued)

(7) Property and Equipment

Property and equipment at December 31, 2016 and 2015 are summarized as follows:

		2016	2015
Land	$	1,764,427	1,764,427
Equipment		208,112,317	210,856,163
Buildings and leasehold improvements		295,844,344	264,199,255
Buildings under capital lease obligation		15,500,439	15,500,439
		521,221,527	492,320,284
Less accumulated depreciation and amortization		298,066,583	269,086,460
		223,154,944	223,233,824
Construction in progress		18,085,826	7,542,063
Property and equipment, net	$	241,240,770	230,775,887

UHS had outstanding commitments under construction contracts for renovation projects totaling approximately $26,173,000 and $7,600,000 at December 31, 2016 and 2015, respectively, which are expected to be financed primarily from project funds (note 9).

(8) Investments in Affiliated Organizations

DL/UHS, Inc.

UHS and Dynacare Laboratory Management Limited entered into an agreement for ownership in DL/UHS, Inc. (the Partnership) to operate an efficient, cost-effective, and competitive laboratory service organization. The Partnership provides UHS with laboratory testing required for its patients, as well as referral laboratory services. UHS' ownership interest is 5% and is accounted for using the equity method. For the years ended December 31, 2016 and 2015, UHS' share of the Partnership earnings was approximately $849,000 and $757,000, respectively. UHS received distributions of approximately $679,000 and $711,000 during the years ended December 31, 2016 and 2015, respectively. UHS' investment in the Partnership at December 31, 2016 and 2015 was approximately $1,258,000 and $1,088,000, 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 60 months through 2019. For the years ended December 31, 2016 and 2015, UHS incurred costs of approximately $18,824,000 and $18,650,000, respectively, related to this agreement. As of December 31, 2016 and 2015, UHS had accounts payable due to the Partnership of approximately $4,126,000 and $4,030,000, 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 automatically renewed in 2014 with a term of 60 months through 2019, and a monthly payment of approximately $60,000 due the first day of each month.

Under an employee services agreement, the Partnership agreed to reimburse UHS for the actual cost of laboratory employees. These costs were approximately $2,162,000 and $2,563,000 for the years ended December 31, 2016 and 2015, respectively. As of December 31, 2016 and 2015, UHS had accounts receivable due from the Partnership of approximately $548,000 and $1,123,000, respectively.

University of Tennessee Medical Center Home Care Services, LLC (UTMCHCS)

UHS is a 33% owner of UTMCHCS with Tennessee Health Care Group, LLC (67%). The purpose of UTMCHCS is to provide home health and hospice services. The investment is accounted for using the equity method. For the years ended December 31, 2016 and 2015, UHS' share of UTMCHCS earnings was approximately $1,208,000 and $776,000, respectively. UHS received distributions of approximately $1,156,000 and $748,000 during the years ended December 31, 2016 and 2015, respectively. UHS' investment in UTMCHCS at December 31, 2016 and 2015 was $1,078,000 and $1,026,000, respectively.

Under an employee services agreement, UTMCHCS agreed to reimburse UHS for the actual cost of home health and hospice employees who are leased. These costs were approximately $239,000 and $377,000 for the years ended December 31, 2016 and 2015, respectively. As of December 31, 2016 and 2015, UHS had accounts receivable due from UTMCHCS of approximately $18,400 and $16,800, respectively.

(9) Long-Term Debt

Long-term debt including unamortized premiums and issuance costs at December 31, 2016 and 2015 is summarized as follows:

	2016	2015
Revenue bonds, 2016 Series, net of unamortized premium of $9,581,000 at December 31, 2016	$ 119,200,102	—
Revenue bonds, 2015 Series	80,732,223	72,363,519
Revenue bonds, 2014 Series	9,916,074	9,911,977
Revenue bonds, 2007 Series, net of unamortized premium of $956,000 and $1,653,000 at December 31, 2016 and 2015, repectively	134,751,943	198,262,202
Capital lease obligations	14,165,382	15,894,967
Other	1,542,195	2,128,034
	360,307,919	298,560,699
Less current portion	10,654,061	12,927,293
	$ 349,653,858	285,633,406

(a) Revenue Bonds

(i) 2016 Series

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

UHS has three years from the effective date to draw down the total proceed of $67,187,000 of the Series 2016 bonds and complete the Medical Center additions and improvements. As of December 31, 2016, UHS had drawn down approximately $15,616,000 related to these projects.

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

(ii) 2015 Series

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

UHS has three years from the effective date to draw down the total proceeds of the Series 2015A bonds and complete the Medical Center additions and improvements. As of December 31, 2016 and 2015, UHS had drawn down approximately $23,320,000 and $14,584,000, respectively, related to 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, 2015 Series, are outstanding.

(Continued)

(iii) 2014 Series

On July 1, 2014, the Health, Educational, and Housing Facilities Board of the County of Knox issued on behalf of UHS, $10 million Revenue Bonds, Series 2014. Under the terms of the bond indenture, the proceeds, together with other financing sources, will be used to finance or reimburse the cost of additions and improvement to the Medical center. The Revenue Bonds, Series 2014, were issued as tax-exempt bonds and bear interest, payable semiannually, at the lower of daily rate, the weekly rate, the commercial paper rate, the long-term rate or the bank rate. The long-term rate is equal to LIBOR plus 80 basis points. The Revenue Bonds, Series 2014, constitute serial bonds due January 1, 2043, subject to installments commencing on January 1, 2037.

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

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

(iv) 2007 Series

During 2007, UHS advance refunded the Revenue Bonds, Series 1999, with the proceeds of the Revenue Bonds, Series 2007. 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, Series 2007, 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, Series 2007, 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, Series 2007, are outstanding.

The Revenue Bonds, Series 2007, 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.

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 subsequently increases above 60 days.

(Continued)

(b) Capital Lease Obligations

Pursuant to the Lease and Transfer Agreement (note 2), UHS acquired a leasehold interest in the real property of the Medical Center from the University for a term of 50 years. The guaranteed lease payment of $50 million will be paid subject to an inflation index tied to the change in net Medical Center operating revenue through 2019, as defined, in annual payments equal to the lesser of i) 20% of UHS' annual net operating income, as defined; or ii) $3 million, subject to the index. The payment of $50 million 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, 2016 and 2015, the lease payment required under the agreement was approximately $1,010,000 and $2,802,000, respectively. The 2016 amount was due by March 15, 2017 and is included in current portion of long-term debt in the accompanying consolidated financial statements at December 31, 2016.

UHS entered into two capital lease obligations in 2016 and five capital lease obligations in 2015 for Medical Center equipment. The terms of the leases are three years at interest rates of 3%.

At December 31, 2016 and 2015, the gross amounts of property and equipment and related accumulated amortization recorded under capital leases were as follows:

	2016	2015
Buildings	$ 15,500,439	15,500,439
Equipment	35,086,267	33,116,280
	50,586,706	48,616,719
Less accumulated amortization	38,932,799	35,451,485
	$ 11,653,907	13,165,234

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

(Continued)

Scheduled principal payments on long-term debt at December 31, 2016 are as follows:

	Revenue bonds	Capital lease obligations	Other	Total
2017	$ 6,390,000	3,708,480	555,580	10,654,060
2018	8,055,000	2,611,900	311,534	10,978,434
2019	8,435,000	919,817	310,339	9,665,156
2020	8,850,000	665,256	310,339	9,825,595
2021	9,260,000	60,840	54,403	9,375,243
2022 and thereafter	295,639,675	14,103,836	—	309,743,511
Less amounts representing:				
Interest under capital lease obligation	—	(7,904,747)	—	(7,904,747)
Unamortized issuance cost on long-term debt	(2,566,055)	—	—	(2,566,055)
Unamortized premium on long-term debt	10,536,722	—	—	10,536,722
	$ 344,600,342	14,165,382	1,542,195	360,307,919

(10) Derivative Instrument

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

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

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

(1) SIFMA represents the Bond Market Association Municipal Swap Index

(2) LIBOR represents the London Interbank Offered Rate

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, 2016 and 2015 of approximately $1,259,000 and $4,831,000, respectively, is included in other assets in the accompanying consolidated balance sheets. The change in the fair value of the derivative instrument was approximately ($3,573,000) and $3,971,000, respectively, in 2016 and 2015 and is included in nonoperating gains, net in the accompanying consolidated statements of operations. Pursuant to the swap agreement, UHS is required to post collateral equal to the fair value of the liability that exceeds $10,000,000 as of the valuation date. The net settlement amount received on the swap of approximately $914,000 and $1,064,000 for the years ended December 31, 2016 and 2015, respectively, is included as a reduction to interest expense in the consolidated statements of operations.

(11) 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, 2016 and 2015, UHS paid approximately $45,392,000 and $49,083,000, 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, 2016 and 2015, the graduate medical education reimbursements amounted to approximately $34,446,000 and $32,143,000, 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 $9,045,000 and $7,188,000 at December 31, 2016 and 2015, respectively, which are included in accrued expenses and other current liabilities in the accompanying consolidated balance sheets.

(12) Employee Benefit Plans

(a) UHS, Inc. Savings Plan

UHS maintains a 403(b) savings plan (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 in which he/she wishes to participate and participants who do not select funds are enrolled in the Target Date funds. Participants are immediately vested in their voluntary deductions and earnings. Prior to January 1, 2003, participants with one year of employment but less than two years of employment became 20%

vested in UHS contributions, and their vested percentage increased by 20% each year of employment, thereafter until they were fully vested after five years. For participants joining UHS on or after January 1, 2003, the vesting is a five-year cliff vesting, whereby the employee becomes fully vested after five years of employment. Beginning January 1, 2007, the vesting for all active employees changed to a six-year graduated vesting. Participants with two years of employment become 20% vested in UHS contributions, and their vested percentage increases by 20% each year of employment thereafter until they are fully vested after six years. Each employee with at least three years of service on January 1, 2007, who was not 100% vested, was permitted to make an irrevocable election regarding the applicable vesting schedule. For the years ended December 31, 2016 and 2015, total UHS expenses related to the Savings Plan were approximately $7,892,000 and $7,121,000, 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 for senior management, vice presidents and equivalents, and physicians. All employer contributions are subject to a seven-year vesting schedule or attainment of age 60 and contributions are made at the close of each payroll cycle.

UHS maintains a separate nonqualified plan for senior management. The employer's contributions become vested according to the age of the Participant at the time the contribution was made. Contributions to a participant's account made in a year in which the participant attains the age of fifty-seven (57) shall vest fully on January 1 of the year the Participant attains the age of sixty (60). 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). 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, 2016 and 2015, total UHS expenses related to the nonqualified plans described above were approximately $3,541,000 and $2,467,000, respectively.

(13) 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 inputs) and the lowest priority to measurements involving significant unobservable inputs (Level 3 inputs). The classification of an investment within the hierarchy is based upon the pricing transparency or ability to redeem the investment and does not necessarily correspond to the perceived risk of that investment. Inputs are used in applying various valuation techniques that are assumptions, which market participants used to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, operating statistics, specific and broad credit data, liquidity statistics, recent transactions, earnings forecasts, future cash flows, market multiples, discount rates, and other factors.

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

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

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

(Continued)

The following table presents financial instruments that are measured at fair value on a recurring basis at December 31, 2016:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 77,853,867	—	—	77,853,867
Assets limited as to use:				
Money market funds	2,541,563	—	—	2,541,563
Commercial paper	—	15,257,997		15,257,997
U.S. Corporate bonds	—	3,001,215	—	3,001,215
U.S. Treasury and agency bonds	4,731,582	—	—	4,731,582
Municipal bonds	3,801,680	—	—	3,801,680
Mutual funds and equity securities	23,452,498	24,771,659	—	48,224,157
	34,527,323	43,030,871	—	77,558,194
Interest rate derivatives asset	—	1,259,000	—	1,259,000
Investments:				
Money market funds	4,347,138	—	—	4,347,138
U.S. corporate bonds	—	39,800,139	—	39,800,139
Asset-backed securities	—	15,187,478	—	15,187,478
International fixed income bonds	5,400,496	—	—	5,400,496
U.S. Treasury and agency bonds	16,000,958	67,033,252	—	83,034,210
Municipal bonds	—	1,950,518	—	1,950,518
Mutual funds and equity securities	38,867,468	—	—	38,867,468
	64,616,060	123,971,387	—	188,587,447
Total	$ 176,997,250	168,261,258	—	345,258,508

(Continued)

The following table presents assets and liabilities that are measured at fair value on a recurring basis at December 31, 2015:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 100,506,869	—	—	100,506,869
Assets limited as to use:				
Money market funds	1,452,168	—	—	1,452,168
Corporate bonds	4,339,293	—	—	4,339,293
Mutual funds	15,551,525	—	—	15,551,525
	21,342,986	—	—	21,342,986
Interest rate derivatives asset	—	4,831,000	—	4,831,000
Investments:				
Money market funds	2,218,765	—	—	2,218,765
U.S. corporate bonds	—	45,335,939	—	45,335,939
Asset-backed securities	—	14,192,734	—	14,192,734
International fixed income bonds	12,084,301	—	—	12,084,301
U.S. Treasury and agency bonds	37,197,236	31,640,620	—	68,837,856
Municipal bonds	—	1,939,977	—	1,939,977
Mutual funds and equity securities	34,278,042	—	—	34,278,042
	85,778,344	93,109,270	—	178,887,614
Total	$ 207,628,199	97,940,270	—	305,568,469

There were no transfers among any of the levels during the years ended December 30, 2016 and 2015.

(14) 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 15 years.

The following table is a schedule by year of future minimum rentals on noncancelable operating leases with terms in excess of one year at December 31, 2016:

2017	$	5,164,277
2018		4,517,794
2019		3,908,733
2020		3,367,545
2021		2,853,592
2022 and thereafter		12,523,905
	$	32,335,846

UHS' total lease expense for the years ended December 31, 2016 and 2015 was approximately $8,074,000 and $8,175,000, 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 $2,313,000 and $2,166,000 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 $23,971,000 and $21,860,000 are recorded in accrued expenses and other liabilities in the accompanying consolidated financial statements at December 31, 2016 and 2015, 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.

(15) Rentals under Operating Leases

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

The following is a schedule, by year, of minimum future rentals on noncancelable operating leases as of December 31, 2016:

2017	$ 3,434,114
2018	3,311,182
2019	3,259,471
2020	2,846,112
2021	2,329,539
2022 and thereafter	9,504,972
	$ 24,685,390

(16) 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, 2016 and 2015:

	2016	2015
Healthcare services	$ 783,611,691	711,507,383
General and administrative	50,644,505	50,698,078
	$ 834,256,196	762,205,461

(17) Subsequent Events

On February 7, 2017, the Health, Educational, and Housing Facilities Board of the County of Knox issued on behalf of UHS, $124.5 million Revenue Bonds, Series 2017. Under the terms of the bond indenture, the proceeds will be used to i) currently refund, for interest rate cost savings, a portion of the Revenue Bonds, Series 2007 and ii) pay costs of issuing the Series 2017 Bonds and the current refunding of the Refunded Series 2007 Bonds. UHS has evaluated subsequent events from the balance sheet date through March 28, 2017, the date the consolidated financial statements were issued. No other material subsequent events were identified for recognition or disclosure.

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

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, 2016 and 2015, and have issued our report thereon dated March 28, 2017, 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 28, 2017

Schedule 1

UNIVERSITY HEALTH SYSTEM, INC.
AND SUBSIDIARIES

Consolidating Schedule – Balance Sheet Information

December 31, 2016

	Medical Center	UHSV	RTS	UCG	Eliminations	Total
Current assets:						
Cash and cash equivalents	$ 76,143,187	618,726	314,326	777,628	—	77,853,867
Short-term investments	13,018,557	—	—	—	—	13,018,557
Current portion of assets limited as to use	51,789,148	—	—	—	—	51,789,148
Patient accounts receivable, net	99,123,333	423,126	144,111	1,799,684	—	101,490,254
Other receivables	22,024,143	—	—	479	(15,861,436)	6,163,186
Estimated third-party settlements	20,622,688	—	—	—	—	20,622,688
Inventories	8,203,797	—	—	—	—	8,203,797
Prepaid expenses and other current assets	2,509,212	—	—	—	—	2,509,212
Total current assets	293,434,065	1,041,852	458,437	2,577,791	(15,861,436)	281,650,709
Assets limited as to use, less current portion	25,765,346	3,700	—	—	—	25,769,046
Long-term investments	175,568,890	—	—	—	—	175,568,890
Property and equipment, net	241,211,420	29,350	—	—	—	241,240,770
Investments in affiliated organizations	2,586,912	—	—	—	—	2,586,912
Other assets	5,113,120	—	—	—	—	5,113,120
Total assets	$ 743,679,753	1,074,902	458,437	2,577,791	(15,861,436)	731,929,447
Current liabilities:						
Current portion of long-term debt	$ 10,654,061	—	—	—	—	10,654,061
Accounts payable	76,870,218	1,041,704	186,083	75,889	(1,135,413)	77,038,481
Accrued payroll and related liabilities	45,329,280	584		16,518,590	(14,997,910)	46,850,544
Accrued expenses and other current liabilities	26,658,717	1,805	272,354	145,180	(144,311)	26,933,745
Estimated third-party settlements	6,441,672	—	—	—	—	6,441,672
Total current liabilities	165,953,948	1,044,093	458,437	16,739,659	(16,277,634)	167,918,503
Long-term debt, less current portion	349,653,858	—	—	—	—	349,653,858
Other liabilities	15,940,535	—	—	—	—	15,940,535
Total liabilities	531,548,341	1,044,093	458,437	16,739,659	(16,277,634)	533,512,896
Net assets:						
Unrestricted	199,104,021	30,809	—	(14,161,868)	416,198	185,389,160
Temporarily restricted	4,007,124	—	—	—	—	4,007,124
Permanently restricted	9,020,267	—	—	—	—	9,020,267
Total net assets	212,131,412	30,809	—	(14,161,868)	416,198	198,416,551
Commitments and contingent liabilities						
Total liabilities and net assets	$ 743,679,753	1,074,902	458,437	2,577,791	(15,861,436)	731,929,447

See accompanying independent auditors' report.

Schedule 2

UNIVERSITY HEALTH SYSTEM, INC.
AND SUBSIDIARIES

Consolidating Schedule – Statement of Operations Information

Year ended December 31, 2016

	Medical Center	UHSV	RTS	UCG	Eliminations	Total
Revenue:						
Net patient service revenue	$ 822,618,939	1,774,663	1,860,330	12,200,474	—	838,454,406
Provision for doubtful accounts	(51,012,960)	(91,120)	(186,000)	(958,313)	—	(52,248,393)
Net patient service revenue less provision for doubtful accounts	771,605,979	1,683,543	1,674,330	11,242,161	—	786,206,013
Other revenue	46,142,134	314	—	68,270	(704,957)	45,505,761
Total revenue	817,748,113	1,683,857	1,674,330	11,310,431	(704,957)	831,711,774
Operating expenses:						
Salaries, wages, and benefits	341,798,014	1,244,022	—	15,063,341	—	358,105,377
Medical supplies and drugs	235,337,961	177,636	—	321,503	(3,900)	235,833,200
Purchased services	130,021,702	414,679	1,674,330	790,435	(68,656)	132,832,490
Graduate medical education reimbursement	34,445,830	—	—	—	—	34,445,830
Insurance and other	29,656,129	135,406	—	920,418	(632,401)	30,079,552
Interest	13,159,707	49	—	—	—	13,159,756
Depreciation and amortization	29,794,346	5,645	—	—	—	29,799,991
Total operating expenses	814,213,689	1,977,437	1,674,330	17,095,697	(704,957)	834,256,196
Operating (loss) income	3,534,424	(293,580)	—	(5,785,266)	—	(2,544,422)
Nonoperating gains (losses):						
Contributions	645,040	—	—	—	—	645,040
Investment income	6,627,285	—	—	—	—	6,627,285
Change in fair value of derivative instrument	(3,572,606)	—	—	—	—	(3,572,606)
Loss on extinguishment of debt	(1,013,369)	—	—	—	—	(1,013,369)
Total nonoperating gains, net	2,686,350	—	—	—	—	2,686,350
Revenue and gains in excess of expenses and losses	$ 6,220,774	(293,580)	—	(5,785,266)	—	141,928

See accompanying independent auditors' report.