UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Financial Statements

December 31, 2012 and 2011

(With Independent Auditors' Reports Thereon)

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

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Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of University Hospitals Health System, Inc. and Subsidiaries (the System), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operations and changes in net assets, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

KPMG

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated balance sheets of the System as of December 31, 2012 and 2011, and the changes in its net assets and its cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 28, 2013 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

KPMG LLP

Cleveland, Ohio
February 28, 2013

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Balance Sheets

December 31, 2012 and 2011

(In thousands of dollars)

Assets		2012	2011
Current assets:			
Cash and cash equivalents	$	179,156	117,609
Patient accounts receivable, less allowance for doubtful accounts of $30,495 in 2012 and $32,706 in 2011		292,205	277,967
Other receivables		52,353	35,291
Assets held for disposal		3,554	6,804
Other current assets		105,401	72,460
Total current assets		632,669	510,131
Investments		816,121	785,263
Property, plant, and equipment, net		1,246,752	1,289,264
Other assets:			
Investments in affiliates		97,467	87,206
Beneficial interest in Foundation		55,322	70,949
Perpetual trusts		168,842	157,937
Other		159,715	166,168
Total other assets		481,346	482,260
Total assets	$	3,176,888	3,066,918

See accompanying notes to consolidated financial statements.

Liabilities and Net Assets		2012	2011
Current liabilities:			
Current installments of long-term debt	$	13,933	14,300
Short-term borrowings		—	15,000
Accounts payable and accrued expenses		277,233	254,882
Other current liabilities		63,608	63,055
Estimated amounts due to third-party payors		22,109	12,315
Total current liabilities		376,883	359,552
Long-term debt, less current installments		952,609	907,361
Revolving credit borrowing		20,000	105,000
Other liabilities		468,077	395,017
Total liabilities		1,817,569	1,766,930
Net assets:			
Unrestricted		827,356	816,194
Temporarily restricted		225,971	194,156
Permanently restricted		305,992	289,638
Total net assets		1,359,319	1,299,988
Total liabilities and net assets	$	3,176,888	3,066,918

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2012 and 2011

(In thousands of dollars)

		2012	2011
Unrestricted revenues:			
Net patient service revenue	$	2,158,652	2,027,722
Provision for bad debts		(54,983)	(57,304)
Net patient service revenue less provision for bad debts		2,103,669	1,970,418
Other revenue		162,667	156,654
Total unrestricted revenues		2,266,336	2,127,072
Expenses:			
Salaries, wages, and employee benefits		1,290,837	1,243,081
Purchased services		137,364	136,027
Patient care supplies		318,174	296,390
Other supplies		34,500	37,317
Insurance		40,915	24,189
Other expenses		225,600	196,873
Depreciation and amortization		104,694	101,382
Interest		46,044	44,991
Special charges		3,374	1,112
		2,201,502	2,081,362
Net operating income		64,834	45,710
Nonoperating revenues (expenses):			
Investment income		33,031	39,358
Other-than-temporary decline in investments		(8,099)	(15,245)
Change in fair value of derivative instruments		3,450	(25,949)
Loss on extinguishment of debt		(38,914)	—
Excess of revenues over expenses	$	54,302	43,874

See accompanying notes to consolidated financial statements.

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2012 and 2011

(In thousands of dollars)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Net assets at December 31, 2010	$ 832,792	185,627	287,833	1,306,252
Excess of revenues over expenses	43,874	—	—	43,874
Investment income	—	3,986	99	4,085
Other support and revenue	—	44,445	10,026	54,471
Change in beneficial interest in Foundation and perpetual trusts	—	(4,212)	(8,227)	(12,439)
Net assets released from restrictions used for operations	—	(34,181)	—	(34,181)
Change in net unrealized (losses) on other-than-trading securities	(18,358)	(98)	(93)	(18,549)
Change in joint venture unrestricted net assets	253	—	—	253
Pension liability adjustment	(39,733)	—	—	(39,733)
Net assets released from restrictions for acquisition of property and equipment	1,411	(1,411)	—	—
Discontinued operations	(4,045)	—	—	(4,045)
(Decrease) increase in net assets	(16,598)	8,529	1,805	(6,264)
Net assets at December 31, 2011	816,194	194,156	289,638	1,299,988
Excess of revenues over expenses	54,302	—	—	54,302
Investment income	—	4,444	—	4,444
Other support and revenue	—	80,201	4,439	84,640
Change in beneficial interest in Foundation and perpetual trusts	—	(16,637)	11,915	(4,722)
Net assets released from restrictions used for operations	—	(29,868)	—	(29,868)
Change in net unrealized gains on other-than-trading securities	23,107	130	—	23,237
Change in joint venture unrestricted net assets	3	—	—	3
Pension liability adjustment	(72,697)	—	—	(72,697)
Net assets released from restrictions for acquisition of property and equipment	6,455	(6,455)	—	—
Discontinued operations	(8)	—	—	(8)
Increase in net assets	11,162	31,815	16,354	59,331
Net assets at December 31, 2012	$ 827,356	225,971	305,992	1,359,319

See accompanying notes to consolidated financial statements.

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2012 and 2011

(In thousands of dollars)

		2012	2011
Operating activities:			
Increase (decrease) in net assets	$	59,331	(6,264)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:			
Depreciation and amortization		104,694	101,382
Provision for bad debts		54,983	57,304
Loss on extinguishment of debt		38,914	—
Other-than-temporary decline in investments		8,099	15,245
Change in beneficial interest in Foundation and perpetual trusts		4,722	12,439
Change in net unrealized investment gains and losses		(23,237)	18,549
Pension liability adjustment		72,697	39,733
Net change attributable to investments in joint ventures		(10,391)	(8,449)
Restricted revenue and investment income received		(10,494)	(27,066)
Net change in patient accounts receivable		(67,237)	(110,186)
Net change in other current assets		(50,003)	27,492
Net change in other current liabilities		22,865	(45,414)
Net change in operating assets and liabilities		27,075	(43,837)
Net activity attributable to discontinued operations		(1,687)	9,975
Net cash provided by operating activities		230,331	40,903
Investing activities:			
Acquisition of property, plant, and equipment		(62,066)	(156,444)
Distributions from joint ventures, net		—	5,000
Proceeds from sales of investments		325,020	324,964
Purchases of investments		(340,131)	(325,746)
Net cash used in investing activities		(77,177)	(152,226)
Financing activities:			
Proceeds from restricted revenue and investment income		10,494	27,066
Repayment of long-term debt		(55,424)	(29,602)
Defeasance of long-term debt		(265,384)	—
Proceeds from issuance of long-term debt		322,059	20,000
Payment of bond issuance costs		(3,352)	—
(Repayment of) proceeds from revolving credit borrowing		(85,000)	105,000
Repayment of short-term borrowings		(15,000)	(25,000)
Net cash (used in) provided by financing activities		(91,607)	97,464
Increase (decrease) in cash and cash equivalents		61,547	(13,859)
Cash and cash equivalents at beginning of year		117,609	131,468
Cash and cash equivalents at end of period	$	179,156	117,609

See accompanying notes to consolidated financial statements.

(1) Organization and Principles of Consolidation

University Hospitals Health System, Inc. (the System) is the parent of various corporations involved in the delivery of healthcare services, including a network of physicians, outpatient centers, hospitals, wellness, occupational health, skilled nursing, elder health, rehabilitation, and home care services that operate in the Northeast Ohio region. University Hospitals Cleveland Medical Center d/b/a University Hospitals Case Medical Center (UHCMC) is the System's major subsidiary. The System provides certain management and planning services to its subsidiaries. The System also has investments in multiple healthcare systems (see note 13), which are being accounted for under the equity method.

The consolidated financial statements include the accounts of the System and its subsidiaries. All significant intercompany transactions have been eliminated in the consolidated financial statements.

(2) Summary of Significant Accounting Policies

(a) Cash and Cash Equivalents

The System considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. The carrying amount of cash and cash equivalents approximates fair value.

(b) Concentrations of Credit Risk

Financial instruments that potentially subject the System to concentrations of credit risk consist principally of cash, cash equivalents, and patient accounts receivable. The System invests its cash equivalents in highly rated financial instruments including time deposits, U.S. Treasury bonds and notes, government-backed mortgage securities, and corporate notes.

The System's concentration of credit risk relating to patient accounts receivable is limited by the diversity and number of the System's patients and payors. Patient accounts receivable consist of amounts due from governmental programs, commercial insurance companies, other group insurance companies, and private pay patients. Combined revenues from the Medicare and Medicaid programs accounted for approximately 44% and 43% of the System's net patient service revenue for the years ended December 31, 2012 and 2011, respectively. Excluding governmental programs, no one payor source represents more than 15% of the System's patient accounts receivable. The System maintains an allowance for doubtful accounts based on the expected collectibility of patient accounts receivable considering historical collection experience and other economic factors.

(c) Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value on the consolidated balance sheets and are classified as other-than-trading securities.

The System has alternative investments that include private equity, real estate, hedge funds, and distressed debt. Certain investments in alternative investments, where the System's ownership percentage is greater than 3%, are accounted for using the equity method of accounting. Income from

(Continued)

these investments is recorded within the consolidated statements of operations and changes in net assets as investment income. The cost method is used for certain alternatives when the System owns less than 3% of the investment. The System has elected the fair value option on several alternative investments (see note 5). Unrealized gains and losses from these investments are recorded within the consolidated statement of changes in net assets and realized gains and losses are recorded within the consolidated statements of operations as investment income.

Investment income on unrestricted investments, including realized gains and losses, is reported as investment income in nonoperating revenue on the consolidated statements of operations and changes in net assets. Unrealized gains and losses on unrestricted investments recorded at fair value are reported within the consolidated statements of changes in net assets. Investment income on temporarily and permanently restricted investments, including realized and unrealized gains and losses, is recorded according to the donor’s intentions and as restricted investment income within the consolidated statements of changes in net assets.

Other-than-temporary declines result from decreases in the fair market values of debt, equity, and alternative investments below the cost basis in these securities. Other-than-temporary declines for unrestricted investments are recorded in the consolidated statements of operations and changes in net assets. Other-than-temporary losses for temporarily and permanently restricted net assets are recorded within restricted investment income in the consolidated statements of changes in net assets. Other-than-temporary declines also result in a new cost basis for the investment.

(d) Costs of Borrowing

Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Capitalized interest totaled $298 and $2,970 for the years ended December 31, 2012 and 2011, respectively. Deferred financing costs are capitalized when incurred, and then amortized during the period in which the debt is outstanding.

(e) Property and Equipment and Other Long-Lived Assets

Additions and improvements to property and equipment are capitalized at cost. Expenditures for maintenance and repairs are charged to expense as incurred. Depreciation on plant and equipment is computed on the straight-line basis over the estimated useful lives of the respective assets. Buildings and improvements are depreciated over estimated useful lives ranging generally from 5 to 40 years. Leasehold improvements are depreciated over the lesser of the life of the asset or the term of the lease. Estimated useful lives of equipment vary generally from 3 to 20 years.

Long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted cash flows expected to be generated by the asset. The impairment loss recognized is measured by the amount by which the carrying value of the asset exceeds the fair value of the asset. There were no impaired assets identified in 2012 or 2011.

(In thousands of dollars)

(f) Gifts, Private Grants, Bequests, and Pledges

Donors contribute cash, marketable securities, and other assets. Unrestricted contributions are included in the consolidated statements of operations and changes in net assets as unrestricted gifts and are recorded net of fundraising costs in other revenue. Contributions that are received with restrictions that limit the use of the donated asset are reported as either temporarily or permanently restricted in the consolidated statements of net assets as other support and revenue. These donations are recorded at fair value at the time of the contribution.

Gifts, private grants, and bequests that have been received from various corporations, foundations, and individuals for the years ended December 31, 2012 and 2011 are as follows:

		2012	2011
Unrestricted	$	1,567	1,043
Temporarily restricted		80,201	44,445
Permanently restricted		4,439	10,026
	$	86,207	55,514

Pledges are recorded at fair value as receivables in the year made and reported as either temporarily or permanently restricted in the consolidated statements of changes in net assets as other support and revenue. Conditional donor promises to give and indications of intentions to give are not recognized until the condition is satisfied. Pledges due in less than one year are classified as other current assets. Pledges due in more than one year are classified as other long-term assets on the consolidated balance sheets.

Outstanding pledges receivable from various corporations, foundations, and individuals are recorded at their net present value using the London Interbank Offered Rate (LIBOR), which approximates 2%, as the discount rate at the time of pledge commitment. The balances at December 31, 2012 and 2011 are as follows:

		2012	2011
Pledges due:			
In less than one year	$	48,958	25,248
In one year to five years		60,787	56,249
In more than five years		46,313	12,932
		156,058	94,429
Discount		(14,796)	(3,140)
Allowance for doubtful pledges		(3,123)	(1,871)
	$	138,139	89,418

The System has conditional donor promises to give of $124,041 and $120,523 at December 31, 2012 and 2011, respectively, which are not recognized as assets in the accompanying consolidated balance sheets.

The System has entered into an affiliation agreement with Case Western Reserve University School of Medicine with the primary goal of supporting innovative, high-quality programs in medical education, biomedical research, and clinical care. In order to meet this goal, the parties will collaborate on many clinical and academic programs and jointly recruit and fund clinical chairs and faculty. In 2008, the System established a unified faculty practice plan by employing faculty physicians and purchasing certain tangible assets.

In connection with the affiliation agreement with Case Western Reserve University School of Medicine, the System has estimated conditional commitments of $83,963 at December 31, 2012 that are not recorded as liabilities as these commitments are contingent upon future performance for the years 2013 through 2015.

(g) Government Grants

Amounts received from government agencies are reported in the consolidated statements of operations and changes in net assets as other revenue. Grants received totaled $11,615 and $13,874 for the years ended December 31, 2012 and 2011, respectively.

(h) Charity Care and Provision for Bad Debts

Throughout the admission, billing, and collection processes, certain patients are identified by the System as qualifying for charity care. The System provides care to these patients without charge or at amounts less than its established rates. Charity care includes those patients required to be identified in connection with the System’s participation in the State of Ohio’s Care Assurance Program. Under this Program, patients who are Ohio residents without any or adequate health insurance coverage and who are at or below 100% of the federally defined poverty level are eligible to receive Medicaid covered services free of charge. The charges forgone for charity care provided by the System are not reported as net patient service revenue or as patient accounts receivable. The System accepts all patients covered by Medicare and Medicaid and treats patients requiring emergency care regardless of their ability to pay.

The uncompensated cost of charity care is estimated by applying an overall cost to charge ratio to the charges associated with patients who qualify for charity care. Uncompensated costs of charity care totaled $53,237 and $47,111 for the years ended December 31, 2012 and 2011, respectively.

In addition, the System provides services to other medically indigent patients under various state Medicaid programs. Such programs pay providers amounts that are less than the established charges for the services provided to the recipients. The uncompensated costs associated with these state programs is estimated as the total direct and indirect costs in excess of the payments received for the services provided. Services provided to Medicaid recipients (including Medicaid recipients who are participants in a Medicaid managed care plan) represented approximately 22% of the System’s patient activity for 2012 and 2011.

The System also provides other uncompensated care and community benefits. In furtherance of its exempt purpose to benefit the community, the System operates an inner city medical clinic to serve the healthcare needs of the community; operates emergency rooms open to the public 24 hours per day, 7 days per week; maintains research facilities for the study of disease and injuries; provides facilities for teaching and training various medical personnel; facilitates the advancement of medical and surgical education; provides community screenings for the detection of various diseases such as breast and colorectal cancer; sponsors cancer support groups; provides various community health education classes, speeches, television appearances, and articles published in newspapers and magazines; and undertakes other types of community benefit activities.

In addition to charity care and insufficient funding from the Medicaid program, there are significant losses related to self-pay patients who fail to make payment for services rendered or insured patients who fail to remit co-payments and deductibles as required under applicable health insurance arrangements. The provision for bad debts represents revenues for services provided that are deemed to be uncollectible. Provision for bad debts totaled $54,983 and $57,304 for the years ended December 31, 2012 and 2011, respectively.

(i) Excess of Revenues over Expenses

The consolidated statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets, which, consistent with industry practice, are excluded from excess of revenues over expenses, include unrealized gains and losses on other-than-trading securities, certain changes in joint venture net assets, assets acquired using funds restricted by the donor for the purpose of acquiring such assets, adjustments for pension accounting (see note 12), and activity from discontinued operations (see note 14).

(j) Derivative Financial Instruments

Derivative financial instruments are utilized by the System to manage: (i) interest rate risk; (ii) the fixed and floating interest rate mix of the System’s total debt portfolio; and (iii) related overall cost of borrowing. The interest rate swap agreements involve the periodic exchange of payments without the exchange of the notional amount upon which the payments are based. The System does not use financial instruments for trading purposes. The related amount of payables to counterparties under swap agreements is included in other liabilities and the related amount of receivables from counterparties under swap agreements is included in other assets on the consolidated balance sheets (see note 9).

Derivative financial instruments are recorded on the consolidated balance sheets at their respective fair value. Gains and losses on derivative financial instruments are recorded in the change in fair value of derivative instruments within the consolidated statements of operations and changes in net assets. The net amount paid or received under the swap agreements is recorded as interest expense in the consolidated statements of operations and changes in net assets.

The System minimizes credit risk related to derivative financial instruments by requiring high credit standards for its counterparties and periodic settlements. The counterparties to these contractual arrangements are financial institutions that carry investment-grade credit ratings with which the

System also has other financial relationships. The System is exposed to credit loss in the event of nonperformance by these counterparties. To mitigate credit exposure, the swap agreements contain certain collateral provisions applicable to both the System and the counterparties.

(k) Income Taxes

The System and most of its subsidiaries, including UHCMC, are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code (Code) and are exempt from federal income taxes pursuant to Section 501(a) of the Code. The System also has certain subsidiaries that are taxable for federal income tax purposes (see note 19).

The System adopted Accounting Standards Codification (ASC) Subtopic 740-10, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*. The interpretation addresses the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the consolidated financial statements. Under ASC Subtopic 740-10, the System must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the consolidated financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. ASC Subtopic 740-10 also provides guidance on derecognition, classification, interest and penalties on income taxes, and accounting in interim periods and requires increased disclosures. As of December 31, 2012 and 2011, the System does not have any uncertain tax positions.

(l) Costs Expected to Be Incurred in Connection with a Loss Contingency

Liabilities for asserted claims and assessments are recorded when an unfavorable outcome of a matter is deemed to be both probable and the loss contingency is reasonably estimable.

(m) Use of Estimates

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

(n) Recently Issued Accounting Guidance

The System adopted Accounting Standards Update (ASU) 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Healthcare Entities*. The guidance required changes to the presentation of the consolidated statements of operations and changes in net assets by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue. Enhanced disclosures concerning policies for recognizing revenue and assessing bad debts are also required (see note 3).

The effect of applying the guidance in ASU 2011-07 as described above were made to the 2011 accompanying financial statements to conform to the 2012 presentation. These reclassifications had no impact on the changes in net assets or excess of revenues over expenses previously reported.

The Medicaid and Medicare Electronic Health Records (EHR) Incentive Programs (the Programs) provide incentive payments to eligible hospitals and professionals as they adopt, implement, upgrade, or demonstrate meaningful use of certified EHR technology in their first year of participation and demonstrate meaningful use for up to five remaining participation years. The System accounts for the Programs using International Accounting Standards 20, *Accounting for Grants and Disclosures of Government Assistance*. The System recognizes revenue when there is reasonable assurance that the System will comply with the conditions and will receive the Programs' incentive payments. For the years ended December 31, 2012 and 2011, the System recognized approximately $16,000 and $7,554, respectively, as other revenue related to Medicaid and Medicare EHR incentives, which have been received or are expected to be received based on certifications prepared by management under the appropriate attestation guidelines.

(o) Reclassifications

Certain amounts included in the 2011 consolidated financial statements have been reclassified to conform to the 2012 presentation.

(3) Net Patient Service Revenue

The System and certain of its subsidiary corporations have agreements with third party payors (e.g., Medicare, Medicaid, and commercial insurance carriers) that provide for payments and reimbursement at amounts different from the System's established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third party payors. Adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as settlements are determined. Adjustments for the Medicare, Medicaid, and Champus/Tricare program resulted in net patient service revenue increasing by approximately $15,553 and $7,831 for the years ended December 31, 2012 and 2011, respectively.

Laws and regulations governing the Medicare and Medicaid 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. The System believes that it is in compliance, in all material respects, with all applicable laws and regulations.

Due to a renegotiation of a contract with a third-party payor in 2008, the System recognized as revenue $14,360 of deferred net patient service revenue for the year ended December 31, 2011. This amount is recorded in net patient service revenue within the 2011 consolidated statement of operations and changes in net assets.

Patients' accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectibility of patients' accounts receivable, the System analyzes its past history and identifies trends to estimate the appropriate allowance for doubtful accounts. Management regularly reviews data about the

(In thousands of dollars)

System's major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, the System analyzes contractually due amounts and provides an allowance for doubtful accounts, if necessary (e.g., for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients, those with no third-party coverage, the System records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is written-off against the allowance for doubtful accounts.

The System's allowance for uncollectible accounts decreased to 86% of self pay accounts receivable at December 31, 2012, from 89% of self pay accounts receivable at December 31, 2011. The System has experienced an increase in charity care and bad debt write-offs as a result of high unemployment, loss of employer-sponsored insurance plans, and rising patient responsibilities due in part to high deductible and high co-pay insurance plans. The System did not change its charity care or uninsured discount policies during fiscal years 2012 or 2011. The System does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors.

The System recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the System recognizes revenue on the basis of its standard rates for services provided. On the basis of historical experience, a significant portion of the System's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the System records a significant provision for bad debts related to uninsured patients in the period the services are provided. The percentage of patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), derived from these major payor sources as of December 31, 2012 and 2011 are as follows:

	2012	**2011**
Third party	92%	93%
Self-pay	8	7
	100%	100%

(In thousands of dollars)

(4) Net Assets

Temporarily restricted net assets are used to differentiate resources, the use of which is restricted by donors or grantors to a specific time period or purpose, from resources on which no restrictions have been placed or that arise from the general operations of the System. Temporarily restricted gifts, which include unrestricted pledges, are recorded as an addition to temporarily restricted net assets in the period received. Temporarily restricted net assets are available for the following purposes at December 31, 2012 and 2011:

		2012	2011
Capital expenditures	$	37,966	46,018
Education		6,294	8,572
Research		74,841	35,197
Patient care		71,286	52,148
Beneficial interest in foundation		35,584	52,221
	$	225,971	194,156

Permanently restricted net assets consist of amounts held in perpetuity as designated by donors, including the System's portion of beneficial interests in several perpetual trusts. Investment income on temporarily and permanently restricted investments, including realized gains and losses, is recorded according to the donor intentions. Changes in unrealized gains and losses on temporarily and permanently restricted investments are recognized directly in net assets.

Net assets are released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors. Net assets released from restrictions used for operations totaled $29,868 and $34,181 during 2012 and 2011, respectively. Net assets released from restrictions are recorded in other revenue in the consolidated statements of operations and changes in net assets. In addition, $6,455 and $1,411 in net assets were released for the acquisition of property and equipment in 2012 and 2011, respectively.

The System's endowment consists of 355 individual funds established for a variety of purposes. Endowments include both donor-restricted funds and funds designated by the Board of Directors (the Board) to function as endowments. Net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions. The System's permanently restricted endowment funds are donor restricted, which totaled $106,213 and $101,149 at December 31, 2012 and 2011, respectively. Board designated funds are unrestricted and totaled $17,654 at December 31, 2012 and 2011, and are included within unrestricted and board designated investments.

The System's investment policy establishes a limited number of investment pools with a specific purpose of aggregating various System funds' investments according to their risk tolerance. Asset allocation is reviewed quarterly with respect to: i) System tolerance for risk based on its financial condition and need for cash from investments to support operations; ii) expected asset class return, risk, and correlation characteristics; iii) changes in accounting guidance or tax law; and iv) changes in bond covenants or other restrictions. Management of the System is responsible to ensure the proper allocation of funds according to the specific needs, timing of cash flows, and risk tolerance of each fund.

(In thousands of dollars)

The System's spending practices are intended to comply with the donor's wishes and meet all applicable laws and regulations including the Uniform Prudent Management of Institutional Funds Act. Spending must be for a purpose that is consistent with the documented intent of the donor. The System generally appropriates an amount not to exceed 5% of the endowment fund's fair value for annual spending subject to spending guidelines and restrictions per the System's policy. The fair value of the endowment fund is determined quarterly and averaged over a period of a rolling thirty-six months.

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment net assets, at January 1, 2011	$ 17,654	—	89,646	107,300
Investment return:				
Investment income	—	1,213	3	1,216
Net appreciation	—	—	3	3
Total investment return	—	1,213	6	1,219
Contributions	—	—	11,497	11,497
Appropriation of endowment assets for expenditure	—	(1,213)	—	(1,213)
Endowment net assets, at December 31, 2011	17,654	—	101,149	118,803
Investment return:				
Investment income	—	1,090	—	1,090
Net appreciation	—	—	—	—
Total investment return	—	1,090	—	1,090
Contributions	—	—	5,064	5,064
Appropriation of endowment assets for expenditure	—	(1,090)	—	(1,090)
Endowment net assets, at December 31, 2012	$ 17,654	—	106,213	123,867

(5) Fair Value Measurements

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

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

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

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

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

Investments in Level 2 are primarily comprised of corporate bonds, international bonds, asset-backed securities, and U.S. agency bonds. Level 2 inputs primarily consist of quotes from independent pricing vendors based on recent trading activity, and other relevant information including matrix pricing, market corroborated pricing, yield curves, and other indices that are used when Level 1 inputs are not available.

(In thousands of dollars)

Items classified as Level 3 in the fair value hierarchy include certain alternative investments, beneficial interests, perpetual trusts, as well as the initial recognition of pledges.

	Level 1	Level 2	Level 3	Total
December 31, 2012:				
Assets:				
Cash and cash equivalents	$ 179,156	—	—	179,156
Cash and cash equivalents – pooled with investments:				
Cash equivalents	4,844	33,142	—	37,986
Short term bond instruments	—	2,562	—	2,562
Total cash and cash equivalents	4,844	35,704	—	40,548
Fixed income securities:				
Corporate bonds	2	75,422	—	75,424
Fixed income mutual funds	106,139	96,986	—	203,125
Government securities	93,959	43,054	—	137,013
Total fixed income securities	200,100	215,462	—	415,562
Equities, mutual and exchange traded funds:				
U.S. equities	87,462	—	—	87,462
International equities	16,458	—	—	16,458
Mutual and exchange traded funds	62,715	11,978	—	74,693
Total equities, mutual and exchange traded funds	166,635	11,978	—	178,613
Alternative investments:				
Hedge funds	—	—	81,458	81,458
Real estate	—	—	6,029	6,029
Distressed debt	—	—	3,280	3,280
Total alternative investments	—	—	90,767	90,767

(In thousands of dollars)

Deferred compensation assets	$	16,940	—	—	16,940
RBC Foundation		—	—	55,322	55,322
Pledges		—	—	141,262	141,262
Perpetual trusts		—	—	168,842	168,842
Derivative financial instruments		—	2,694	—	2,694
Total assets	$	567,675	265,838	456,193	1,289,706
December 31, 2012:					
Liabilities:					
Deferred compensation liabilities	$	16,940	—	—	16,940
Derivative financial instruments		—	61,412	—	61,412
Total liabilities	$	16,940	61,412	—	78,352

		Level 1	Level 2	Level 3	Total
December 31, 2011:					
Assets:					
Cash and cash equivalents	$	117,609	—	—	117,609
Cash and cash equivalents – pooled with investments:					
Cash equivalents		16,226	67,019	—	83,245
Short term bond instruments		—	22,217	—	22,217
Total cash and cash equivalents		16,226	89,236	—	105,462
Fixed income securities:					
Corporate bonds		—	93,936	—	93,936
Fixed income mutual funds		4,278	141,329	—	145,607
Government securities		71,095	63,376	—	134,471
Total fixed income securities		75,373	298,641	—	374,014

(In thousands of dollars)

		Level 1	Level 2	Level 3	Total
Equities, mutual and exchange traded funds:					
U.S. equities	$	72,888	—	—	72,888
International equities		14,985	—	—	14,985
Mutual and exchange traded funds		40,457	10,098	—	50,555
Other		27	—	—	27
Total equities, mutual and exchange traded funds		128,357	10,098	—	138,455
Alternative investments					
Hedge funds		—	—	69,742	69,742
Real estate		—	—	1,718	1,718
Total alternative investments		—	—	71,460	71,460
Deferred compensation assets	$	14,342	—	—	14,342
RBC Foundation		—	—	70,949	70,949
Pledges		—	—	91,289	91,289
Perpetual trusts		—	—	157,937	157,937
Derivative financial instruments		—	467	—	467
Total assets	$	351,907	398,442	391,635	1,141,984
Liabilities:					
Deferred compensation liabilities	$	14,342	—	—	14,342
Derivative financial instruments		—	62,635	—	62,635
Total liabilities	$	14,342	62,635	—	76,977

Deferred compensation assets are comprised of Level 1 mutual funds.

The System has various interest rate swaps as of December 31, 2012 consisting of fixed-payor and fixed spread basis swaps. Fair values for the System's interest rate swaps are provided on a monthly basis by the System's independent financial advisor and counterparties. Monthly valuations are derived by pricing models, which use market inputs such as LIBOR, Securities Industry and Financial Markets Association (SIFMA) Swap Index, and bond coupon rates provided by various inter-broker sources. The resulting combination of market data feeds, specific structuring characteristics such as the amortization of notional amounts, effective dates, payment frequencies, day counts, credit risk, and indices, are factored into the pricing model to determine the fair market value of the System's interest rate swaps.

The System elected the fair value option on several of its alternative investments made since 2010. The fair value option election was made in order to take advantage of fair market value increases expected to occur over the life of the investment. The System holds several alternative investments that are recorded under the cost or equity methods of accounting. The System will continue to record previously entered into alternative investments under the cost or equity methods as appropriate. The System uses net asset value to approximate fair value for alternative investments.

Rainbow Babies & Children's Foundation (RBC Foundation) operates for the exclusive benefit of UHCMC, and variance power was not explicitly given to RBC Foundation by the donors. Therefore, the System is required to record its beneficial interest in the net assets of RBC Foundation. The investment in RBC's Foundation is categorized as a Level 3 item. The primary input utilized in calculating the RBC Foundation's fair value is its net assets, which represents fair market valuation of certain equity, debt, and other instruments held by RBC Foundation. The System records 100% of the RBC Foundation's net assets at approximate fair market value.

The System utilizes the Income Approach to initially recognize pledges. This approach uses valuation techniques to convert future amounts to a single present amount. The System uses a discounted cash flow model to fair value promises to give. LIBOR, which approximates 2%, is used as the discount rate within the discounted cash flow model. The System also considers past collection experience and creditworthiness of the donor in estimating the future cash flows of promises to give. LIBOR is considered the key input in the model and the System has determined that LIBOR is the best measure of the rate of return appropriate for the expected term of the promises to give.

(In thousands of dollars)

Permanently restricted net assets consist of amounts held in perpetuity as designated by donors, including the System's portion of beneficial interests in several perpetual trusts held and administered by others in which the System is an income beneficiary. Perpetual trusts are measured at fair market value by the external trustee, which approximates the present value of expected future cash flows. Perpetual trusts utilize significant unobservable inputs determined by the external trustees in estimating fair market value.

	Fair value measurements using significant unobservable inputs (Level 3)						
				Alternative investments			
	RBC Foundation	Pledges	Perpetual trusts	Hedge funds	Real estate	Distressed debt	Total
Balance at December 31, 2010	$ 75,459	83,666	165,866	15,000	—	—	339,991
Additions	—	44,914	—	56,529	1,869	—	103,312
Total gains or losses included in:							
Realized (losses)	—	—	—	(2,133)	(67)	—	(2,200)
Unrealized gains	—	—	—	346	203	—	549
Total change included in:							
Temporarily restricted net assets	(4,212)	—	—	—	—	—	(4,212)
Permanently restricted net assets	(298)	—	(7,929)	—	—	—	(8,227)
Dispositions	—	—	—	—	(287)	—	(287)
Payments	—	(37,130)	—	—	—	—	(37,130)
Write-offs	—	(1,138)	—	—	—	—	(1,138)
Change in discount	—	977	—	—	—	—	977
Balance at December 31, 2011	70,949	91,289	157,937	69,742	1,718	—	391,635
Additions	—	92,897	—	10,000	4,856	3,628	111,381
Total gains or losses included in:							
Realized gains (losses)	—	—	—	(1,054)	37	(467)	(1,484)
Unrealized gains	—	—	—	2,770	541	119	3,430
Total change included in:							
Temporarily restricted net assets	(16,637)	—	—	—	—	—	(16,637)
Permanently restricted net assets	1,010	—	10,905	—	—	—	11,915
Dispositions	—	—	—	—	(1,123)	—	(1,123)
Payments	—	(30,316)	—	—	—	—	(30,316)
Write-offs	—	(952)	—	—	—	—	(952)
Change in discount	—	(11,656)	—	—	—	—	(11,656)
Balance at December 31, 2012	$ 55,322	141,262	168,842	81,458	6,029	3,280	456,193

(In thousands of dollars)

(6) Investments

The fair value and the cost of investments at December 31, 2012 and 2011 are as follows:

	2012		2011	
	Carrying value	**Cost**	**Carrying value**	**Cost**
Cash and cash equivalents – pooled with investments	$ 40,548	40,543	105,462	105,468
Fixed income securities	415,562	399,215	374,014	360,352
Equities, mutual and exchange traded funds	178,613	143,548	138,455	120,502
Alternative investments *	90,767	86,789	71,460	70,911
Total investments at fair value	725,490	$ 670,095	689,391	$ 657,233
Alternative investments **	90,631		95,872	
Total investments	$ 816,121		785,263	

* Fair value option elected on several alternative investments, see note 5.

** See note 2(c) for the accounting treatment of these alternative investments.

The System holds certain investments in fixed income securities including domestic and international corporate bonds; U.S. Treasuries, government, and agency bonds; non-U.S. sovereign debt; and emerging market debt. The System holds common and preferred stock including investments in small cap, mid cap, and large cap companies as well as in non-U.S. equities in developed and emerging markets.

Alternative investments include private equity, real estate, hedge funds, and distressed debt. These investments are made through various Fund-of-Funds Limited Partnership structures, whereby the System is invested in a Limited Partnership, which in turn utilizes its expertise to invest in underlying Limited Partnership Funds and make certain other investments. These investments are not readily marketable and are valued utilizing the most current information provided by the general partner, subject to assessments that the value is representative of fair value.

The General Partner of each Fund-of-Funds Limited Partnership determines the fair market valuation of its underlying Limited Partnership investments. This valuation is based primarily on the quarterly internal and annual audited consolidated financial statements of the underlying Limited Partnership Funds, which report net asset value based on i) the nature and terms of each underlying investment, ii) market inputs, and iii) certain other relevant information. The System performs various measures to validate that the reported net asset value approximates the fair market value. The determination of fair market values for the alternative investments requires the General Partners and System management to make estimates and assumptions about certain inputs and other factors that are inherently uncertain. These estimates are subjective and require judgment regarding significant matters such as the amount and timing of future cash flows and the selection of discount rates that appropriately reflect market and credit risks.

(In thousands of dollars)

Assets categorized as alternative investments may be subject to liquidity restrictions such as gates. These gates prevent short-term liquidation of assets. Hedge funds may be redeemed at quarter-end requiring advanced notice ranging from 45-65 days prior written notice subject to certain limitations that may be imposed by the General Partner of the fund without notice. Private equity and private real estate funds generally have contractual terms of 10 years or greater from the time the commitment to the fund is made. While distributions of capital during this term typically occur, many of these funds have provisions that allow the General Partner to extend the final term and suspend distributions. Distressed debt funds are typically 1-5 year or 6-10 year term structures, and although some of the funds offer liquidity, the fund documents allow the General Partner to suspend redemptions if they deem necessary. Resulting from these contractual limitations on liquidity, these alternative assets are generally considered illiquid. Contractual liquidity terms of alternative investments at December 31, 2012 are as follows:

		Carrying amount	Unfunded commitments
Less than 1 year, no contractual restrictions have been imposed	$	86,750	—
Subject to existing gates or restrictions		19,559	—
Limited Partnership Fund expiring in 1 – 5 years		58,496	10,908
Limited Partnership Fund expiring in 6 – 10 years		16,593	8,223
Total alternative investments	$	181,398	19,131

Resulting from the lack of liquidity, the System has allocated its alternative investments primarily to temporarily and permanently restricted investments. The fair value of alternative investments totaled approximately $192,128 and $179,415 compared to a carrying value of $181,398 and $167,332 as of December 31, 2012 and 2011, respectively.

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

		2012	2011
Unrestricted and board designated	$	631,284	580,730
Held by bond trustee		4,749	25,582
Swap collateral		11,454	14,240
Temporarily restricted		62,436	63,562
Permanently restricted		106,198	101,149
Total investments	$	816,121	785,263

(In thousands of dollars)

Investment income is comprised of the following for the years ended December 31, 2012 and 2011:

		2012	2011
Interest and dividend income:			
Unrestricted	$	15,284	17,681
Temporarily restricted		2,264	2,349
		17,548	20,030
Net realized gains on sales of securities:			
Unrestricted		17,873	22,584
Temporarily restricted		2,180	1,637
Permanently restricted		—	99
		20,053	24,320
(Losses) from alternative investments		(126)	(907)
	$	37,475	43,443

(7) Property, Plant, and Equipment

Property, plant, and equipment, at cost, at December 31, 2012 and 2011, are summarized below:

		2012	2011
Land and land improvements	$	106,626	101,349
Buildings and fixed equipment		1,465,393	1,447,611
Movable equipment and furnishings		924,551	885,592
Construction in progress		19,228	20,595
		2,515,798	2,455,147
Less accumulated depreciation		1,269,046	1,165,883
Net property, plant, and equipment	$	1,246,752	1,289,264

As of December 31, 2012, the commitment on construction contracts, including Information Technology projects is $10,979.

In connection with the sale of a building in 2003, the System retained a repurchase option for one-half ownership interest in the property at net book value. Consequently, the System recorded a corresponding long-term asset and long-term liability of $34,613 and $36,439 at December 31, 2012 and 2011, respectively.

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

Effective October 4, 2011, the System renewed a $130,000 revolving credit facility (the Facility) in a syndicated transaction. The Facility bears interest at various rates for short-term periods. The Facility's final maturity is October 3, 2015. There were no borrowings under the Facility and the remaining available credit line was $130,000 at December 31, 2012. The average interest rate for the year ended December 31, 2012 was 1.01%. Borrowings under the Facility totaled $105,000 and the remaining available credit line was $25,000 at December 31, 2011. The $105,000 borrowing is classified as a long-term liability within the consolidated balance sheet as of December 31, 2011. The average interest rate for the year ended December 31, 2011 was 0.69%.

Effective March 29, 2012, the System amended a $100,000 revolving credit commitment with PNC Bank. The revolving credit commitment bears interest at various rates for short-term periods. The revolving credit commitment's final maturity is September 29, 2016. Borrowings under this credit agreement totaled $20,000 and the available credit line was $80,000 at December 31, 2012. The $20,000 borrowing is classified as a long-term liability within the consolidated balance sheet as of December 31, 2012. The average interest rate for borrowings under this credit line was 1.02% for the year ended December 31, 2012. There were no borrowings outstanding at December 31, 2011 involving this credit line. The average interest rate for borrowings under this credit line was 1.41% for the year ended December 31, 2011.

On February 23, 2004, the System entered into an uncommitted line of credit "money market program" for $75,000. The line bears interest for short-term periods based on LIBOR and has no stated expiration. There were no borrowings under the uncommitted line of credit at December 31, 2012 and $15,000 at December 31, 2011. The remaining available credit line was $75,000 at December 31, 2012. The average interest rate for the years ended December 31, 2012 and 2011 was 2%.

(In thousands of dollars)

A summary of long-term debt at December 31, 2012 and 2011 is as follows:

Series	Type	Average interest rate% for the year ended December 31, 2012	Final maturity	Amount outstanding December 31 2012	Amount outstanding December 31 2011
2012A	Fixed	4.70	2041	$ 182,380	—
2012B	Variable	0.95	2019	40,710	—
2012C	Fixed	3.71	2042	55,825	—
2012D	Variable	0.89	2021	195	—
2010A	Fixed	4.65	2027	81,750	87,520
2010B	Variable	1.01	2035	71,125	71,125
2009A	Fixed	6.60	2039	—	173,500
2009B	Fixed	4.88	2039	18,570	60,040
2009C	Fixed	4.54	2039	28,400	41,400
2008B	Variable	0.22	2035	47,700	47,700
2008D	Variable	0.16	2035	50,000	50,000
2008E	Variable	0.22	2035	25,000	25,000
2007A	Fixed	4.85	2046	289,460	289,460
2001	Variable	0.89	2033	10,000	10,000
1996A	Fixed	5.63	2016	—	18,720
1996B	Fixed	5.50	2019	—	28,005
Note payable	Fixed	2.00	2036	55,000	20,000
Other long-term debt				2,343	2,188
				958,458	924,658
Add unamortized premium				9,410	1,989
Less:					
Unamortized discount				1,326	4,986
Current installments				13,933	14,300
				$ 952,609	907,361

In June 2012, the System issued the 2012A Bonds totaling $182,380, which was used in conjunction with the 2009A debt service reserve fund to defease $172,000 in 2009A Bonds. The 2012A Bonds are fixed rate debt and were issued to take advantage of favorable interest rates. The 2012A Bonds were issued with a premium of $8,134 and discount of $732. The System incurred a $33,960 loss on extinguishment as a result of the transaction.

In September 2012, the System issued the 2012B Bonds totaling $40,710 in variable rate debt in order to extinguish $14,800 and $25,740 in 1996A and B Bonds, respectively. The 2012B Bonds are privately placed and were issued to take advantage of favorable interest rates. The System incurred a $336 loss on extinguishment as a result of the transaction.

In October 2012, the System issued the 2012C Bonds totaling $55,825, which was used in conjunction with the 2009B and C debt service reserve fund to extinguish $41,470 and $13,000 of the 2009B and C

Bonds. The 2012C Bonds are fixed rate debt and were issued to take advantage of favorable interest rates. The 2012C Bonds were issued with premium of $58 and a discount of $512. The System incurred a $4,618 loss on extinguishment as a result of the transaction.

In October 2012, the System has available draw down bonds. The 2012D Bonds total $23,775, which are at a variable rate and privately placed. Proceeds totaling $7,890 will be received in January 2013 and will be used with the 2009B and C debt service funds to extinguish $8,400 of the 2009C Bonds. The remaining $15,960 will be received in January 2014 and will be used with the 2009B and C debt service funds to extinguish $17,730 of the 2009B Bonds.

Effective April 15, 2011, the System entered into a note payable agreement with a regional center designated by the U.S. Citizenship and Immigration Services EB-5 Program for $50,000. The note payable bears a 2.00% interest rate. On September 23, 2011, the System increased the borrowing capacity on the note by an additional $10,000. The increased commitment bears a 1.50% interest rate. Borrowings under this agreement were $55,000 at December 31, 2012. The note payable’s principal payments begin in 2017 and its final maturity is December 2036.

On March 31, 2011, the System repaid the Series 1998A and B Bonds totaling $15,490 relating to discontinued operation activities. Refer to note 14 for further details relating to discontinued operations.

A total of $44,896 of bonds could become due in 2013. This amount represents: i) variable rate bonds totaling $34,896, which are backed by bank letters of credit, could become due in 2013 based on the repayment schedule of the bank letters of credit upon the failure to remarket these bonds and ii) $10,000 of variable rate bonds for which the System provides self-liquidity and which is not backed by a letter of credit. The total that could become due in 2013 is offset by the remaining available borrowing capacity of $80,000 on the revolving credit commitment with PNC Bank, which is not due until September 29, 2016 and the remaining borrowing capacity of $130,000 on the Facility, which is not due until October 3, 2015.

The System is party to a Master Trust Indenture, amended and restated as of June 15, 1989 (the Indenture), pursuant to which the 2012A, B, C and D were issued. The Series 2001, 2007A, the 2008B, D and E, 2009 B and C and 2010A and B, Bonds (collectively, the Revenue Bonds) are secured by the Indenture. The Revenue Bonds are general obligations of the Obligated Group. The Obligated Group consists of the System, UHCMC, University Hospitals Geauga Medical Center, and University Hospitals Ahuja Medical Center, Inc. Effective October 1, 2011, University Hospitals Bedford Medical Center was removed from and University Hospitals Ahuja Medical Center, Inc. was added to the Obligated Group. The consolidated financial statements for December 31, 2012 and 2011 are presented under the new Obligated Group structure.

In connection with the issuance of the Series 2012A, B, C and D, 2010A and B, 2009B and C, 2008B, D and E and 2007A tax-exempt bonds by the Ohio Higher Educational Facility Commission (the Commission) for the benefit of the System, the System has leased to the Commission, and the Commission has subleased to the System the certain bond-financed assets. The System does not receive rental payments under its lease to the Commission and is required only to make rental payments to the Commission at the times and in the amounts sufficient to pay principal and interest on the outstanding tax-exempt bonds under its lease from the Commission. The lease agreements expire upon repayment of all indebtedness secured by the leases.

In connection with the issuance of the Series 2001 tax-exempt bonds by Cuyahoga County (the County) for the benefit of the System, the System has leased to the County, and the County has subleased to the System, certain health care facilities of the System. The System does not receive rental payments under its lease to the County and is required only to make rental payments to the County at the times and in the amounts sufficient to pay principal and interest on the outstanding tax-exempt bonds under its lease from the County. The lease agreements expire upon repayment of all indebtedness secured by the leases.

During the term of the various agreements and leases, the System is required to make specified deposits with trustees to fund principal and interest payments due. The System is subject to certain restrictive covenants, including provisions relating to certain debt ratios, days cash on hand, and other matters. The System was in compliance with these debt covenants at December 31, 2012.

Combined current aggregate scheduled maturities of long-term debt for the five years subsequent to December 31, 2012, excluding bonds that could come due in 2013, are as follows: 2013 – $13,933; 2014 – $16,585; 2015 – $16,659; 2016 – $17,185; 2017 – $17,845; and 2018 and thereafter – $876,251. In addition, the $20,000 borrowing on the revolving credit commitment with PNC Bank at December 31, 2012 is required to be repaid by September 29, 2016.

The average interest rate included in the table above is the weighted average interest cost for the year ended December 31, 2012 for the 2001, 2008B, D, and E, 2010B, 2012B and D Bonds. The carrying value of the variable rate debt approximates their fair value. The fair value of the fixed rate debt totaled $688,484 compared to a carrying value of $656,385 as of December 31, 2012. The fair value of fixed rate debt was determined using observable inputs other than quoted market prices, which are considered Level 2 inputs (see note 5).

Cash paid for operating interest totaled $47,925 and $36,018 in 2012 and 2011, respectively.

(In thousands of dollars)

(9) Interest Rate Swap Agreements

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

Swap type	Maturity date	Year ended December 31, 2012		Notional value at December 31	
		System pays	System receives	2012	2011
Fixed-payor	2034	3.49%/3.46%	67% of 1 month LIBOR	$ 75,000	75,000
Basis	2028	SIFMA Index	67% of 1 month LIBOR + 0.47%	25,000	25,000
Basis	2028	SIFMA Index	67% of 1 month LIBOR + 0.53%	25,000	25,000
Basis	2027	SIFMA Index	61.7% of 1 month LIBOR +0.67%	25,000	25,000
Basis	2027	SIFMA Index	61.7% of 1 month LIBOR +0.62%	25,000	25,000
Fixed-payor	2034	3.42%/3.36%	67% of 1 month LIBOR	75,000	75,000
Fixed-receiver*	2012	SIFMA Index	Fixed coupon rate on 1996 A&B tendered bonds – 0.75%	—	34,170
Basis	2027	SIFMA Index	62.3% of 1 month LIBOR + 0.79%	42,500	42,500
Basis	2027	SIFMA Index	67% of 1 month LIBOR + 1.00%	50,000	50,000
Fixed-payor	2026	3.57%/3.69%	65% of 1 month LIBOR + 0.12%	100,000	100,000
Fixed-payor	2022	4.71%	SIFMA Index	28,825	30,940
Basis	2032	SIFMA Index	67% of 3 month LIBOR + 1.00%	50,000	50,000
				$ 521,325	557,610

* Terminated swap in 2012

SIFMA is an index of high-grade, tax-exempt variable rate demand obligations. SIFMA ranged from 0.06% to 0.26% (average rate of 0.16%) for the year ended December 31, 2012 and 0.07% to 0.29% (average rate of 0.18%) for the year ended December 31, 2011.

In 2011, the System entered into a basis swap whereby the System pays the SIFMA Index and receives 67% of 3 month LIBOR plus 100 basis points through December 31, 2013. The System will pay the SIFMA Index and receive 85.3% of 3 month LIBOR on this basis swap beginning January 1, 2014 and thereafter. This transaction is expected to produce interest savings over its term.

The net fair value of interest rate swap agreements totaled $(58,718) as of December 31, 2012. The net fair value for swap agreements in 2012 consisted of $2,694 recorded in other assets and $(61,412) recorded in other liabilities within the 2012 consolidated balance sheet. The net fair value for swap agreements in 2011 consisted of $467 recorded in other assets and $(62,635) recorded in other liabilities within the 2011 consolidated balance sheet.

(In thousands of dollars)

Changes in fair value of derivative instruments in the consolidated statements of operations and changes in net assets totaled $3,450 and $(25,949) for the years ended December 31, 2012 and 2011, respectively. The net amount paid or received under the swap agreements is recorded as interest expense in the consolidated statements of operations and changes in net assets. Cash paid totaled $10,435 and $9,669 for the years ended December 31, 2012 and 2011, respectively. Cash received totaled $3,827 and $3,199 for the years ended December 31, 2012 and 2011, respectively.

The System posted collateral due to the decrease in swap valuations of $11,454 and $14,240 as of December 31, 2012 and 2011, respectively. The collateral is comprised of U.S. Treasury and government securities, is limited as to use, and is recorded as an investment within the consolidated balance sheets.

(10) Operating Leases

The System leases various facilities and equipment under operating lease agreements. Lease expense in 2012 and 2011 totaled $27,763 and $22,190, respectively. Minimum operating lease payments over the next five years and thereafter are as follows:

2013	$	22,059
2014		17,510
2015		10,870
2016		8,129
2017		5,379
2018 and thereafter		23,408
	$	87,355

(11) Insurance

Prior to July 1, 2002, the System provided coverage for professional and general liability and workers' compensation claims through a combination of self-insured retentions and commercial and excess insurance policies. Western Reserve Assurance Company, Ltd. (Western Reserve), a wholly owned subsidiary of the System, commenced operations on July 1, 2002 providing professional and general liability insurance coverage on a claims-made basis for substantially all of the System. Effective July 1, 2004, Western Reserve was restructured from a single parent company to a segregated portfolio company (SPC), Western Reserve Assurance Company, Ltd., SPC (Western Reserve SPC). A SPC is an insurance company that operates as a single legal entity, which allows for assets and liabilities to be segregated between different protected portfolios of the company. The individual segregated portfolios do not, by law, have access or rights to the assets of any of the other segregated portfolios within the SPC. At December 31, 2012, the Western Reserve SPC consists of several individual segregated portfolios. Each segregated portfolio provides coverage for its respective entity's insurance programs and is consolidated into each respective entity's consolidated financial statements. Western Reserve SPC has reinsurance agreements with unrelated commercial carriers in place relative to a portion of the risks.

Various claimants have asserted professional and general liability and workers' compensation claims against the System. These claims are in various stages of processing or are in litigation. In addition, there are known incidents, and there also may be unknown incidents, which may result in the assertion of additional claims. The System has accrued the actuarial estimate of both asserted and unasserted losses primarily based on actuarially determined amounts. The System's reserves for professional, general, and workers' compensation liabilities (including incurred but not reported claims) approximated $119,839 and $117,552 at December 31, 2012 and 2011, respectively. The current portion of the reserves, which approximates $10,000 in both years, is recorded in other current liabilities and the remaining portion is recorded in other long-term liabilities. The retention limits per occurrence for the various policies written by Western Reserve SPC range from $500 to $10,000.

(In thousands of dollars)

(12) Pension Plans

The System maintains noncontributory defined benefit pension plans (the plans) for the benefit of eligible employees. The benefits are based upon years of service and the employees' compensation, as defined by the respective plans. It is the System's policy to contribute annually to the defined benefit plans amounts that are actuarially determined to provide the plans with sufficient assets to meet future benefit payment requirements.

The System recognizes the funded status (difference between the fair value of plan assets and the projected benefit obligation) of defined benefit pension plans on its consolidated balance sheets. Gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit costs are recognized as a component of unrestricted net assets. The System uses December 31, 2012 as the measurement date for plan assets and benefit obligations.

The amounts recognized in changes in unrestricted net assets at December 31, 2012 and 2011 consisted of the following:

		2012	2011
Amount recognized in unrestricted net assets at end of year:			
Unrecognized actuarial loss	$	352,199	279,305
Unrecognized prior service costs		26	223
Net amount recognized	$	352,225	279,528

(In thousands of dollars)

The accumulated benefit obligation for the plans were $633,721 and $513,933 as of December 31, 2012 and 2011, respectively. The following represents selected information about the plans for 2012 and 2011 as of December 31, 2012 and 2011:

		2012	2011
Change in benefit obligation:			
Projected benefit obligation (PBO) at beginning of year	$	533,166	464,545
Service cost		34,121	30,779
Interest cost		26,369	24,484
Actuarial loss		82,519	31,624
Benefits paid		(23,355)	(18,266)
Projected benefit obligation at end of year		652,820	533,166
Change in plan assets:			
Fair value of assets at beginning of year		394,334	311,152
Actual return on assets		23,248	1,047
Employer contribution		38,381	100,401
Benefits paid		(23,355)	(18,266)
Fair value of assets at end of year		432,608	394,334
Funded status (PBO in excess of plan assets)		(220,212)	(138,832)
Unrecognized actuarial loss		352,199	279,305
Unrecognized prior service costs		26	223
Net amount recognized	$	132,013	140,696

		2012	2011
The components of periodic pension costs included the following:			
Service cost	$	34,121	30,779
Interest cost		26,369	24,484
Expected return on plan assets		(32,271)	(26,675)
Amortization of prior service costs		197	417
Recognized net actuarial loss		18,648	17,103
Net periodic pension cost	$	47,064	46,108

(Continued)

(In thousands of dollars)

The amounts in unrestricted net assets expected to be recognized as components of net periodic pension costs in 2013 are as follows:

Amortization of prior service costs	$	8
Recognized actuarial losses		28,356
Total	$	28,364

The weighted average assumptions used to determine benefit obligations and net benefit cost for the years ended December 31, 2012 and 2011 were as follows:

	2012	**2011**
Weighted average assumptions:		
Discount rate	4.28%	5.05%
Expected return on plan assets	7.25	6.75
Rate of compensation increase (*)	3.00/3.75	3.00/3.75

(*) 3.00% for 2013 – 2015 and 3.75% thereafter

Pension assets are invested in various asset classes as follows:

	2012	**2011**
Asset class:		
Equities, mutual and exchange traded funds	15%	24%
Fixed income	31	13
Alternative investments	40	29
Cash and cash equivalents	14	34

The Investment Committee of the Board of Directors has responsibility for establishing and monitoring compliance with the investment policy governing the investment of pension assets. The investment policy is utilized as the basis for determining the long-term return assumption for the assets. Historical data, combined with future expected returns of each asset class, are the primary components utilized in developing this assumption. Additional information, such as specific manager performance and risk characteristics, is also included in the assessment of the long-term rate of return assumption.

The System expects to contribute $70,000 to the plans in 2013. The estimated benefit payments, which reflect expected future service, as appropriate, are expected to be paid by the System as follows: 2013 – $27,399; 2014 – $33,301; 2015 – $35,907; 2016 – $39,282; 2017 – $43,741; and 2018 to 2021 – $264,102.

(In thousands of dollars)

The FASB requires that the fair value hierarchy disclosures be applied to assets held within the plans. Refer to note 5 for level definitions.

	Level 1	Level 2	Level 3	Total
December 31, 2012:				
Assets:				
Cash and cash equivalents	$ 1,318	60,348	—	61,666
Fixed income securities:				
Corporate bonds	—	133,993	—	133,993
Government securities	141	532	—	673
Total fixed income securities	141	134,525	—	134,666
Equities, mutual and exchange traded funds:				
U.S. equities	12,627	—	—	12,627
International equities	8,479	—	—	8,479
Mutual and exchange traded funds	35,931	7,601	—	43,532
Total equities, mutual and exchange traded funds	57,037	7,601	—	64,638
Alternative investments:				
Hedge funds	—	—	134,642	134,642
Real estate	—	—	7,752	7,752
Distressed debt	—	—	29,244	29,244
Total alternative investments	—	—	171,638	171,638
Total assets	$ 58,496	202,474	171,638	432,608

(In thousands of dollars)

		Level 1	Level 2	Level 3	Total
December 31, 2011:					
Assets:					
Cash and cash equivalents	$	201	134,008	—	134,209
Fixed income securities:					
Corporate bonds		—	48,381	—	48,381
Government securities		487	687	—	1,174
Total fixed income securities		487	49,068	—	49,555
Equities, mutual and exchange traded funds:					
U.S. equities		10,771	—	—	10,771
International equities		6,054	—	—	6,054
Mutual and exchange traded funds		71,479	6,404	—	77,883
Total equities, mutual and exchange traded funds		88,304	6,404	—	94,708
Alternative investments:					
Hedge funds		—	—	89,078	89,078
Real estate		—	—	7,473	7,473
Distressed debt		—	—	19,311	19,311
Total alternative investments		—	—	115,862	115,862
Total assets	$	88,992	189,480	115,862	394,334

The plans held certain investments in cash and cash equivalents consisting of short-term money market instruments including commercial paper, asset backed securities, treasury bonds and bills, and short-term corporate bonds. The plans also hold certain alternative investments including hedge funds, real estate, and distressed debt. Refer to note 6 for asset valuation and liquidity restriction information. Liquidity information is included in the below chart.

(In thousands of dollars)

The table below classifies the market value at December 31, 2012 of the alternative investment portion of the plan assets into categories based on the stated contractual liquidity terms of the underlying investments:

		Fair market value	Unfunded commitments
Less than 1 year, no contractual restrictions have been imposed	$	95,276	—
Subject to existing gates or restrictions		15,712	—
Limited partnership fund expiring in 1 – 5 years		31,802	2,499
Limited partnership fund expiring in 6 – 10 years		23,883	24,952
Limited partnership fund expiring in 11 – 12 years		4,965	8,318
Total alternative investments	$	171,638	35,769

		Fair value measurements of alternative investments using significant unobservable inputs (Level 3)			
		Hedge funds	Real estate	Distressed debt	Total
Balance at January 1, 2011	$	32,954	6,015	17,108	56,077
Unrealized gains (losses)		(3,088)	124	(1,162)	(4,126)
Realized gains		377	59	1,122	1,558
Disbursements and transfers out		(2,517)	(421)	(18,367)	(21,305)
Contributions and cash receipts		61,352	1,696	20,610	83,658
Balance at December 31, 2011		89,078	7,473	19,311	115,862
Unrealized gains (losses)		5,191	(10)	(47)	5,134
Realized gains		595	94	28	717
Disbursements and transfers out		(1,004)	(1,511)	(2,292)	(4,807)
Contributions and cash receipts		40,782	1,706	12,244	54,732
Balance at December 31, 2012	$	134,642	7,752	29,244	171,638

The System sponsors various defined contribution plans. The System contributed $14,102 and $15,691 to the defined contribution plans for the years ended December 31, 2012 and 2011, respectively.

The System also has nonqualified deferred compensation plans for certain employees. The System contributed and expensed $3,857 and $3,542 to the deferred compensation plans for the years ended December 31, 2012 and 2011, respectively.

(In thousands of dollars)

(13) Investments in Joint Ventures

Investments in joint ventures are accounted for using the equity method of accounting. On December 31, 2009, the System entered into an agreement with The Sisters of Charity of St. Augustine Health System, Inc. (SCHS) changing the current structure of UHHS/CSAHS-Cuyahoga, Inc. (Cuyahoga).

Cuyahoga represented a joint-venture that previously included 50% interest in St. Vincent Charity Hospital, Canton Mercy Medical Center and St. John Medical Center (SJMC). The System is no longer in a joint-venture agreement involving St. Vincent Charity Hospital and Canton Mercy Medical Center as of December 31, 2009. The System's investment balance in SJMC consists of the investment in SJMC and the assets used to wind down the operations of the previous Cuyahoga joint-venture. The System pledged $15,000 over 3 years to support St. Vincent Charity Hospital. The final installment of the pledge was paid in 2012.

The System and SCHS each has a 50% membership in SJMC. The System entered into a management agreement with SCHS for the System to manage the operations of SJMC for a minimum of 5 years. The System committed $50,000 in capital contributions to SJMC.

During 1997, the System entered into an agreement with Southwest Community Health System and certain of its affiliated entities, including Southwest General Health Center (Southwest). The agreement also provides that 50% of the voting members of Southwest's board of trustees shall be selected for appointment by the System and that the System is entitled to 50% of the annual net income as defined in the agreement. The agreement has been amended and restated as of January 1, 2011 and is effective for 10 years. The System retained its voting and income rights of 50% within the new agreement.

Details of the System's investments in these joint ventures are as follows:

	SJMC 50%	Southwest 50%	Total
Investment at December 31, 2010	$ 29,457	40,147	69,604
Excess of revenues over expenses	3,318	8,958	12,276
Other unrestricted net asset activity	253	—	253
(Distributions)	(5,000)	(4,819)	(9,819)
Cash received and other considerations	(475)	—	(475)
Investment at December 31, 2011	27,553	44,286	71,839
Excess of revenues over expenses	968	12,518	13,486
Other unrestricted net asset activity	3	—	3
(Distributions)	(500)	(4,479)	(4,979)
Investment at December 31, 2012	$ 28,024	52,325	80,349

(In thousands of dollars)

The summary below illustrates the condensed combined financial data for SJMC, Cuyahoga and Southwest as of December 31, 2012 and 2011.

		2012	2011
Total assets	$	586,275	507,026
Total net assets		220,966	208,720
Total net revenues		481,056	466,293
Total excess of revenues over expenses		27,726	24,882

The System records its pro-rata portion of operating results as other revenue in the accompanying consolidated statements of operations and changes in net assets and records its pro-rata portion of changes in unrestricted net assets in the accompanying consolidated statements of changes in net assets.

(14) Discontinued Operations

The System evaluates its service lines periodically for strategic fit within its operations. The System sold the Heather Hill Rehabilitation Hospital, Inc. d/b/a University Hospitals Extended Care Campus (ECC) in April 2011. The proceeds of the Series 1998A and 1998B Bonds were primarily used for the acquisition of ECC assets and for the refinancing of various debt obligations of ECC. The System repaid the outstanding $15,490 in Series 1998A and B Bonds in March 2011.

Operational activity from discontinued operations is reported within the statements of changes in net assets for all periods presented, which are as follows:

		2012	2011
Total revenues	$	107	4,509
Total expenses		(115)	(8,554)
Discontinued operation	$	(8)	(4,045)

(15) Care Assurance

Various subsidiaries of the System participate in the State of Ohio's Care Assurance Program, which was established in 1988 to assist Ohio hospitals that had a disproportionate amount of uncompensated care. Under the program, Ohio hospitals, including the System's hospitals, are assessed an amount which forms a pool of funds to be matched with federal Medicaid funds for payments to hospitals. Total net revenues to the System under the Care Assurance Program totaled $12,114 and $11,531 in 2012 and 2011, respectively. Portions of the Care Assurance Program funds received are attributed to charity care, which totaled approximately $5,062 and $4,840 in 2012 and 2011, respectively. The System records the net proceeds in net patient service revenue.

(In thousands of dollars)

(16) Litigation and Contingencies

The System is involved in litigation arising in the ordinary course of business. Claims have been asserted against the System and are currently in various stages of litigation. It is the opinion of management that estimated costs accrued are adequate to provide for potential losses resulting from pending or threatened litigation. In August 2006, the System entered into a five-year Corporate Integrity Agreement that is monitored by the Office of the Inspector General; that agreement expired in August 2011.

(17) Special Charges

The System incurred $3,374 and $1,112 in special charges during 2012 and 2011, respectively. The special charges related primarily to severance, impairment, and restructuring costs.

(18) Purchase Commitments

The System has commitments to purchase goods and services with the following minimum contractual obligations as follows: 2013 – $15,159; 2014 – $12,053; 2015 – $9,480; 2016 – $5,965; 2017 – $1,201; and 2018 and thereafter – $2,047. Purchases under these contracts totaled $98,838 and $167,693 in 2012 and 2011, respectively, and met the provisions of the agreement. In 2001, the System entered into a thirty-year agreement with a utilities company, a related party, which provides utilities to certain buildings at UHCMC. The amounts purchased were $16,354 and $15,721 in 2012 and 2011, respectively.

(19) Income Taxes

The System has certain taxable subsidiaries that have incurred net losses for federal income tax purposes. Cumulative losses available totaled approximately $249,438 and $222,304 at December 31, 2012 and 2011, respectively. The losses are available to offset future taxable income and expire in varying amounts through the year 2032. The potential tax benefit of the net loss carryforward has been recorded and there is a full valuation against it at December 31, 2012 and 2011 due to the uncertainty of realizing those benefits in the future.

(20) Functional Expenses

The System provides healthcare services, medical education, and performs medical research. Expenses related to these functions were as follows:

		2012	2011
Health care services	$	1,808,933	1,702,892
Medical education		92,973	97,772
Medical research		61,599	64,280
General and administrative		234,623	215,306
Special charges		3,374	1,112
Total expenses	$	2,201,502	2,081,362

(21) Related Parties

Certain members of the System's Board of Directors serve as management of companies that provide services to the System, including certain banking, investment management, and supplier relationships. Also, certain members of the System's Board of Directors are physicians who serve as medical directors or provide other services in the System. The System's management believes that transactions with related parties are entered into only upon terms comparable to those that would be available from unaffiliated third parties.

(22) Subsequent Events

Management evaluated all activity of the System through February 28, 2013. In January 2013, the System received $7,890 in 2012D Bond issuance proceeds, which was used with the 2009C debt service fund to extinguish $8,400 of the 2009C Bonds. There have been no additional events subsequent to the date of these consolidated financial statements that would require additional disclosure.

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Report of Federal Award Expenditures in
Accordance with OMB Circular A-133

Federal Entity Identification Number: 34-0714775

Year ended December 31, 2012

(With Independent Auditors' Reports Thereon)

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Report on Federal Award Expenditures in
Accordance with OMB Circular A-133

Year ended December 31, 2012

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UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Schedule of Expenditures of Federal Awards

Year ended December 31, 2012

Federal Grantor/Program/Grant	Pass-through grantor	CFDA Number	Expenditures
RESEARCH & DEVELOPMENT CLUSTER			
U.S. Department of Defense			
Risk and Resilience Project		12.420	$ 2,156,418
Total Research & Development Cluster			2,156,418
FEDERAL TRANSIT CLUSTER			
U.S. Department of Transportation			
Greater Cleveland Regional Transit Authority Intermodel Facility Project	Greater Cleveland Regional Transit Authority	20.500	23,251
Total Federal Transit Cluster			23,251
HIGHWAY SAFETY CLUSTER			
U.S. Department of Transportation			
Reaching Parents of Tweens to Increase Tween Seat Belt Use		20.609	1,945
Safe Communities Program – Cuyahoga County	Ohio Department of Public Safety	20.600	133,312
Safe Communities Program – Geneva	Ohio Department of Public Safety	20.600	29,919
Ohio Buckles Buckeyes	Ohio Department of Health	20.600	36,945
OVI Task Force – Countywide OVI Task Force Program	Ohio Department of Public Safety	20.601 and 20.608	256,021
Click It or Ticket	Ohio Department of Public Safety	20.600	48,950
Cuyahoga County Occupant Protection – Emphasis on Minority Communities Grant	Ohio Department of Public Safety	20.600	99,423
Total Highway Safety Cluster			606,515
OTHER PROGRAMS			
U.S. Department of Health and Human Services:			
Ryan White Title III Grant	Health Resources and Services Administration	93.918	504,453
Ryan White Title IV Grant	Health Resources and Services Administration	93.153	44,276
Poison Control Center	Health Resources and Services Administration	93.253	221,389
Clinical Interventions to Increase Organ Procurement	Health Resources and Services Administration	93.134	8,295
Transforming Pediatric Ambulatory Care: The Physician Extension Team (PET)	Centers for Medicare & Medicaid Services (CMS)	93.610	293,372
Reducing Catheter-Associated Urinary Tract Infections in NICHE Hospitals	Agency for Healthcare Research and Quality (AHRQ)	93.226	13,319
Hospital Bioterrorism Preparedness Grant – Bedford	Center for Health Affairs	93.889	26,417
Hospital Bioterrorism Preparedness Grant – Geauga	Center for Health Affairs	93.889	47,536
Hospital Bioterrorism Preparedness Grant – Rainbow Babies and Children's Hospital	Center for Health Affairs	93.889	35,030
Hospital Bioterrorism Preparedness Grant – Geneva	Center for Health Affairs	93.889	22,894
Hospital Bioterrorism Preparedness Grant – Richmond	Center for Health Affairs	93.889	29,463
Hospital Bioterrorism Preparedness Grant – UHCMC	Center for Health Affairs	93.889	53,840
Hospital Bioterrorism Preparedness Grant – Conneaut	Center for Health Affairs	93.889	26,892
Disaster Preparedness Grant – Ahuja	Center for Health Affairs	93.889	20,894
Disaster Preparedness Grant – Geauga	Center for Health Affairs	93.889	15,000
Disaster Preparedness Grant – Conneaut	Center for Health Affairs	93.889	200
Poison Control Bioterrorism Preparedness Grant	Cincinnati Children's Hospital Research Foundation	93.889	136,340
Total CFDA # 93.889			414,506
Maternal and Child Health Services Block Grant (Perinatal Grant)	Ohio Department of Health	93.994	58,717
Help Me Grow	Ohio Department of Health	84.181 and 93.558	65,420
MedTapp Quality Program	Ohio Department of Health	93.778	82,128
Safe Routes to Schools	Ohio Department of Transportation	20.205	514
Ryan White Title I Grant	Cuyahoga County Board of Commissioners	93.914	492,878
State Rural Hospital FLEX/SHIP Grant – Conneaut	Ohio Hospital Association	93.241	15,837
Moms First	Office of Criminal Justice Service	93.926	25,701
Center for Childhood Diabetes and Obesity at Rainbow Babies and Children's Hospital	Centers for Disease Control and Prevention	93.946	51,309
OHIP Critical Access and Small Rural Hospital – Conneaut	Ohio Health Information Partnership	93.718	584
OHIP Critical Access and Small Rural Hospital – Geneva	Ohio Health Information Partnership	93.718	18,000
Total CFDA # 93.718			18,584
Total U.S. Department of Health and Human Services			2,310,698
Total Federal Award Expenditures			$ 5,096,882

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

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Notes to Schedule of Expenditures of Federal Awards

Year ended December 31, 2012

(1) General

The accompanying schedule of expenditures of federal awards presents the activity of all federal financial assistance programs of University Hospitals Health System, Inc. (System) for the year ended December 31, 2012. Federal awards received directly from federal agencies as well as federal awards passed through other government agencies are included in the accompanying schedule.

(2) Basis of Presentation

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

(3) Relationship to Financial Statements

All federal financial assistance receipts are reported as grants and contracts from governmental agencies in the System's consolidated financial statements.

During the year ended December 31, 2012, the System passed through to subrecipients $1,492,441 of federal funding.

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1375 East Ninth Street
Cleveland, OH 44114-1796

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

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the consolidated financial statements of University Hospitals Health System, Inc. and subsidiaries (the System), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operations and changes in net assets, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated February 28, 2013.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

KPMG LLP

Cleveland, Ohio
February 28, 2013

KPMG LLP
One Cleveland Center
Suite 2600
1375 East Ninth Street
Cleveland, OH 44114-1796

Independent Auditors' Report on Compliance for Each Major Federal Program; Report on Internal Control Over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*

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

Report on Compliance for Each Major Federal Program

We have audited University Hospitals Health System, Inc. and subsidiaries' (the System) compliance with the types of compliance requirement described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the System's major federal programs for the year ended December 31, 2012. The System's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the System's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the System's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

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

Opinion on Each Major Federal Program

In our opinion, the System complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2012.

Report on Internal Control Over Compliance

Management of the System's is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the System's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over compliance.

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

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133

We have audited the consolidated financial statements of the System as of and for the year ended December 31, 2012, and have issued our report thereon dated February 28, 2013, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditure of federal awards is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Cleveland, Ohio
September 26, 2013

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Schedule of Findings and Questioned Costs

Year ended December 31, 2012

(1) Summary of Auditor's Results

(a)	The type of report issued on the consolidated financial statements:	Unmodified opinion
(b)	Significant deficiencies in internal control were disclosed by the audit of the consolidated financial statements:	None reported
	Material weaknesses:	No
(c)	Noncompliance which is material to the consolidated financial statements:	No
(d)	Significant deficiencies in internal control over major programs:	None reported
	Material weaknesses:	No
(e)	The type of report issued on compliance for major programs:	Unmodified opinions
(f)	Any audit findings which are required to be reported under Section 510(a) of OMB Circular A-133:	No
(g)	Major programs:	
	U.S. Department of Health and Human Services:	
	Poison Control Bioterrorism Preparedness Grant pass through Cincinnati Children's Hospital Research Foundation - CFDA No. 93.889	
	Pass through Center for Health Affairs - CFDA No. 93.889:	
	Hospital Bioterrorism Preparedness Grant - UHCMC	
	Hospital Bioterrorism Preparedness Grant - Bedford	
	Hospital Bioterrorism Preparedness Grant - Conneaut	
	Hospital Bioterrorism Preparedness Grant - Rainbow Babies and Children's Hospital	
	Hospital Bioterrorism Preparedness Grant - Geauga	
	Hospital Bioterrorism Preparedness Grant - Geneva	
	Hospital Bioterrorism Preparedness Grant - Richmond	
	Disaster Preparedness Grant - Ahuja	
	Disaster Preparedness Grant - Geauga	
	Disaster Preparedness Grant - Conneaut	
	Research and Development Cluster - U.S. Department of Defense Risk and Resilience Project - CFDA No. 12.420	
(h)	Dollar threshold used to distinguish between Type A and Type B programs:	$ 300,000
(i)	Auditee qualified as low-risk auditee under Section 530 of OMB Circular A-133:	Yes

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

None.

(3) Findings and Questioned Costs Relating to Federal Awards

None.