UNIVERSITY OF ILLINOIS
HEALTH SERVICES FACILITIES SYSTEM

Annual Financial Report

June 30, 2018

(With Independent Auditors' Report Thereon)

UNIVERSITY OF ILLINOIS
HEALTH SERVICES FACILITIES SYSTEM

Annual Financial Report

June 30, 2018

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UNIVERSITY OF ILLINOIS SYSTEM

Office of the Vice President, Chief Financial Officer and Comptroller
349 Henry Administration Building, 506 South Wright Street • Urbana, Illinois 61801

December 19, 2018

Holders of University of Illinois
Health Services Facilities System Revenue Bonds
and The Board of Trustees of the University of Illinois:

I am pleased to transmit the Annual Financial Report of the University of Illinois Health Services Facilities System for the fiscal year ended June 30, 2018. This report supplements the Annual Financial Report of the University of Illinois.

The Health Services Facilities System continues to have to a strong financial position thanks to an increase in patient revenue realization and appropriation support from the State of Illinois. Through effective and efficient utilization of resources, prudent decision-making and a commitment to excellence by medical professionals, administrators and staff, the Health Services Facilities System continued to advance its mission in fiscal year 2018.

The 2018 financial statements and accompanying notes appearing on pages 5 through 34 have been audited by CliftonLarsonAllen LLP, Independent Certified Public Accountants, as special assistants to the Auditor General of the State of Illinois, whose report on the financial statements appears on pages 2 through 4.

CliftonLarsonAllen LLP will also prepare a report for the year ended June 30, 2018, containing special data requested by the Auditor General and another report covering their audit of the compliance of the University with applicable state and federal laws and regulations for the year ended June 30, 2018. These reports, which include some data related to the Health Services Facilities System, are not contained herein and are primarily for the use of the Auditor General and state and federal agencies.

Very truly yours,

Avijit Ghosh,
Vice President, Chief Financial Officer and Comptroller

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CliftonLarsonAllen LLP
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INDEPENDENT AUDITORS' REPORT

Honorable Frank J. Mautino
Auditor General, State of Illinois
and Board of Trustees
University of Illinois

Report on the Financial Statements

As Special Assistant Auditors for the Auditor General, we have audited the accompanying financial statements of the business-type activities of the University of Illinois Health Services Facilities System (the System), a segment of the University of Illinois, as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of 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 financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the 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 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 financial statements.

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

Honorable Frank J. Mautino
Auditor General, State of Illinois
and Board of Trustees
University of Illinois

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities for the System as of June 30, 2018, and the changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1(a), the financial statements of the System are intended to present the financial position, the changes in financial position, and cash flows of only that portion of the business-type activities of University of Illinois that is attributable to the transactions of the System. They do not purport to, and do not, present fairly the financial position of University of Illinois as of June 30, 2018, and its changes in financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Report on Summarized Comparative Information

We have previously audited the Systems' 2017 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated January 30, 2018. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2017, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Schedule of University of Illinois Health Services Facilities System Proportionate Share of the Net Pension Liability on page 33 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management has omitted the Management's Discussion and Analysis that accounting principles generally accepted in the United States of America required to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Honorable Frank J. Mautino
Auditor General, State of Illinois
and Board of Trustees
University of Illinois

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report under separate cover dated December 19, 2018, 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 solely describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Peoria, Illinois
December 19, 2018

UNIVERSITY OF ILLINOIS
HEALTH SERVICES FACILITIES SYSTEM

Statement of Net Position

June 30, 2018
(with summarized comparative information for June 30, 2017)

Assets and Deferred Outflow of Resources	**2018**	**2017**
Current assets:		
Claim on cash and on pooled investments	$ 226,745,816	$ 183,050,780
Restricted claim on cash and on pooled investments	1,102,400	1,115,900
Restricted cash and cash equivalents	38,045	25,760
Accrued investment income	801,777	631,917
Patient accounts receivable, net	162,101,942	154,960,372
Receivable from the State of Illinois	39,588,800	
Other receivables	10,233,948	9,135,817
Inventories	6,247,287	6,172,549
Prepaid expenses, deposits, and other assets	2,450,673	1,503,907
Total current assets	449,310,688	356,597,002
Noncurrent assets:		
Restricted claim on cash and on pooled investments	21,758,266	12,913,356
Restricted cash and cash equivalents	38,268	2,540,005
Restricted investments	5,504,215	17,317,772
Capital assets, net of accumulated depreciation	203,372,257	201,619,437
Total noncurrent assets	230,673,006	234,390,570
Deferred outflow of resources	3,291,265	4,666,875
Total assets and deferred outflow of resources	$ 683,274,959	$ 595,654,447
Liabilities and Net Position		
Current liabilities:		
Accounts payable	$ 72,268,217	$ 49,208,878
Accrued payroll	14,085,435	13,818,349
Accrued interest payable	1,140,445	1,141,660
Estimated third-party settlements	68,921,214	61,520,168
Unearned revenues		97,816
Current maturities of long-term debt	3,837,115	4,649,688
Current portion of accrued compensated absences	2,137,664	2,173,300
Total current liabilities	162,390,090	132,609,859
Noncurrent liabilities:		
Long-term debt, net of current maturities	105,612,770	109,449,884
Accrued compensated absences, net of current portion	24,366,519	22,830,419
Derivative instrument – swap liability	1,868,697	3,071,874
Total noncurrent liabilities	131,847,986	135,352,177
Total liabilities	294,238,076	267,962,036
Net investment in capital assets	101,825,277	100,076,640
Restricted:		
Expendable for capital projects	19,558,832	17,046,888
Expendable for debt service	15,641	13,091
Unrestricted	267,637,133	210,555,792
Total net position	389,036,883	327,692,411
Total liabilities and net position	$ 683,274,959	$ 595,654,447

See accompanying notes to financial statements.

UNIVERSITY OF ILLINOIS
HEALTH SERVICES FACILITIES SYSTEM

Statement of Revenues, Expenses and Changes in Net Position

Year ended June 30, 2018
(with summarized comparative information for year ended June 30, 2017)

	2018	2017
Operating revenues:		
Net patient service revenues	$ 721,081,781	$ 672,724,981
Revenues recognized on behalf of the System	28,018,039	29,197,700
Other revenues	42,198,886	37,540,591
Total operating revenues	791,298,706	739,463,272
Operating expenses:		
Salaries and wages	332,524,265	315,690,489
Fringe benefits	323,092,114	298,438,110
Supplies and general expenses	393,141,666	369,687,746
Administrative services	13,056,116	13,859,481
Depreciation and amortization	21,498,679	20,845,815
Total operating expenses	1,083,312,840	1,018,521,641
Operating loss	(292,014,134)	(279,058,369)
Nonoperating revenues (expenses):		
On-behalf for fringe benefits	316,872,252	292,263,906
State appropriations	57,595,400	20,177,300
Transfer of State appropriations to the University of Illinois Hospital Services Fund	(20,000,000)	(20,177,300)
Net (decrease) increase in fair value of investments	(656,800)	1,000,999
Interest on capital asset related debt	(4,365,815)	(4,054,283)
Investment income (net of related expenses)	3,535,130	2,766,745
Loss on disposal of capital assets	(59,105)	(127,993)
Other nonoperating revenues, net	437,544	60,472
Net nonoperating revenues	353,358,606	291,909,846
Increase in net position	61,344,472	12,851,477
Net position, beginning of year	327,692,411	314,840,934
Net position, end of year	$ 389,036,883	$ 327,692,411

See accompanying notes to financial statements.

UNIVERSITY OF ILLINOIS
HEALTH SERVICES FACILITIES SYSTEM

Statement of Cash Flows

Year ended June 30, 2018
(with summarized comparative information for year ended June 30, 2017)

	2018	2017
Cash flows from operating activities:		
Patient services	$ 721,341,257	$ 692,151,157
Payments to suppliers	(375,326,575)	(349,726,756)
Payments for administrative services	(13,056,116)	(13,859,481)
Payments to employees	(316,608,178)	(298,235,420)
Payments for benefits	(4,719,398)	(4,498,704)
Other receipts	41,002,939	43,207,867
Net cash provided by operating activities	52,633,929	69,038,663
Cash flows from noncapital financing activities:		
State appropriations	18,006,600	
Other receipts	71,636	59,459
Net cash provided by noncapital financing activities	18,078,236	59,459
Cash flows from capital and related financing activities:		
Purchases of capital assets	(25,523,432)	(32,362,219)
Principal paid on capital debt and leases	(4,285,066)	(5,341,043)
Interest paid on capital debt and leases	(5,388,700)	(5,500,640)
Net cash used in capital and related financing activities	(35,197,198)	(43,203,902)
Cash flows from investing activities:		
Interest on investments	3,365,269	2,614,528
Pooled cash allocated (to) from University related to unrealized (losses) gains	(671,509)	1,035,109
Purchases of investments	(2,972,270)	(26,397,491)
Sales of investments	14,800,537	38,208,655
Net cash provided by investing activities	14,522,027	15,460,801
Net increase in cash and cash equivalents	50,036,994	41,355,021
Cash and cash equivalents, beginning of year	199,645,801	158,290,780
Cash and cash equivalents, end of year	$ 249,682,795	$ 199,645,801

(Continued)

UNIVERSITY OF ILLINOIS
HEALTH SERVICES FACILITIES SYSTEM

Statement of Cash Flows

Year ended June 30, 2018
(with summarized comparative information for year ended June 30, 2017)

	2018	2017
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	$ (292,014,134)	$ (279,058,369)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization expense	21,498,679	20,845,815
Provision for uncollectible accounts	26,308,488	40,593,579
On-behalf for fringe benefits	316,872,252	292,263,906
Changes in assets and liabilities:		
Patient receivables	(33,450,058)	(25,722,893)
Other receivables	(1,098,131)	5,704,432
Inventories	(74,738)	(117,708)
Prepaid expenses, deposits, and other assets	(946,766)	(329,319)
Accounts payable and accrued expenses	6,734,643	8,665,386
Estimated third-party settlements	7,401,046	4,555,490
Accrued compensated absences	1,500,464	1,675,500
Unearned revenues	(97,816)	(37,156)
Net cash provided by operating activities	$ 52,633,929	$ 69,038,663
Noncash investing, capital, and financing activities:		
On-behalf for fringe benefits	$ 316,872,252	$ 292,263,906
State appropriation	20,000,000	20,177,300
Transfers to University of Illinois Hospital Services Fund	(20,000,000)	(20,177,300)
Other capital asset adjustments	21,620	49,875
Net interest capitalized	1,173,769	1,577,172
(Decrease) increase of capital assets obligations in accounts payable	(3,408,217)	3,647,612
Loss on disposal of capital assets	$ (59,105)	$ (127,993)

See accompanying notes to financial statements.

(1) Organization and Summary of Significant Accounting Policies

Organization

The University of Illinois Health Services Facilities System (System) comprises the University of Illinois Hospital (Hospital) and associated clinical facilities providing patient care at, but not limited to, the University of Illinois at Chicago Medical Center. The System is a tertiary care facility located in Chicago, Illinois offering a full range of clinical services. The System does not include the operations of the University of Illinois' Medical Service Plans or Colleges of Medicine. Management of the System is the responsibility of the University of Illinois (University).

The System was established by a Bond Resolution (Resolution) of the Board of Trustees (Board) of the University of Illinois adopted on January 22, 1997. These financial statements have been prepared to satisfy the requirements of the 1997B, 2008 and 2013 bond indentures. The financial balances and activities of the System are also included in the University's financial statements. The financial statements of the System are prepared in accordance with U.S. generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The System is not a separate legal entity and has not presented management's discussion and analysis.

The financial statements include certain prior year comparative information that has been derived from the System's 2017 financial statements. Such information does not include all of the information required to constitute a presentation in conformity with U.S. generally accepted accounting principles. Accordingly, such information should be read in conjunction with the System's financial statements for the year ended June 30, 2017.

Significant Accounting Policies

(a) Financial Statement Presentation and Basis of Accounting

The System prepared its financial statements as a Business Type Activity, as defined by GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*, using the economic resources measurement focus and the accrual basis of accounting. Business Type Activities are those financed in whole or in part by fees charged to external parties for goods and services.

Under the accrual basis, revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Advances are classified as unearned revenues.

(b) Cash and Cash Equivalents

The Statement of Cash Flows details the change in the cash and cash equivalents balance for the fiscal year. Cash and all liquid investments with original maturities of ninety days or less are defined as cash and cash equivalents.

(c) Investments

Investments are reported at fair value in accordance with guidelines defined by GASB Statement No. 72. Fair value is determined for the System's investments based upon a framework described in Note 2(f). Bank deposits and money market funds are recorded at cost.

Changes in fair value during the reporting period are reported as a net increase (decrease) in the fair value of investments. Net investment income includes interest, dividends, and realized gains and losses.

(d) Inventories

Inventories of pharmaceutical and other supplies are stated at the lower of cost, determined using the first-in, first-out method, or market.

(e) Capital Assets

Capital assets are recorded at cost or, if donated, at acquisition value at the date of a gift. Depreciation of capital assets is calculated on a straight-line basis over the estimated useful lives (see below) of the respective assets. The System's policy requires the capitalization of land and collection purchases regardless of cost, equipment over $5,000, software, easements, buildings and improvements over $100,000 and infrastructure over $1,000,000. The System does not capitalize collections, such as works of art or historical treasures, which are held for public exhibition, education or research in furtherance of public service rather than capital gain, unless they were previously capitalized as of June 30, 1999. Proceeds from the sale, exchange or other disposal of any item belonging to a collection must be applied to the acquisition of additional items for the same collection.

Estimated useful lives for capital assets are as follows:

	Useful life (in years)		Useful life (in years)
Buildings:		Improvements other than buildings:	
Shell	50	Site improvements	20
Service systems	25	Infrastructure	25
Fixed equipment	15		
Remodeling	25		
Intangibles:		Moveable equipment:	
Software	5 – 10	Equipment	3 – 20

(f) Deferred Outflow of Resources

Under hedge accounting, the University has determined that the interest rate swap agreement on the System's bonds payable, as a hedging derivative instrument, is an effective hedge. Accordingly, changes in the fair value of the interest rate swap, since being associated with the related outstanding bonds, is reported as a deferred outflow of resources on the accompanying Statement of Net Position. Additionally, an interest rate swap reassigned to new debt, after a refunding of debt that the swap previously hedged, normally has an other than zero fair value upon the reassociation. For a swap with a fair value of other than zero upon reassociation with a hedgeable item, the fair value is amortized as an adjustment to interest expense in a systematic manner.

Losses on refundings for the System's bonds are reported as deferred outflow of resources on the accompanying Statement of Net Position. The losses on refundings are amortized over the life of the debt using the straight-line method.

Deferred Outflow of Resources						
		Beginning balance	Additions	Deductions	Change in fair value	Ending balance
Interest rate swap agreement that hedges Series 2008 bonds	$	2,347,705	78,300		(1,203,177)	$ 1,222,828
Unamortized deferred loss on refunding		2,319,170		(250,733)		2,068,437
Total deferred outflow of resources	$	4,666,875	78,300	(250,733)	(1,203,177)	$ 3,291,265

(g) Compensated Absences

Accrued compensated absences for System personnel are charged as an operating expense, using the vested method, based on earned but unused vacation and sick leave days including the System's share of Social Security and Medicare taxes. The estimated outstanding liability at June 30, 2018 was $26,504,183.

(h) Premiums

Premiums for the System's bonds are reported within long-term debt and amortized over the life of the debt issue using the straight-line method.

(i) Net Position

The System's resources are classified into net position categories and reported in the Statement of Net Position. These categories are defined as (a) Net investment in capital assets – capital assets net of accumulated depreciation and related outstanding debt balances attributable to the acquisition, construction, or improvement of those assets, (b) Restricted – net position subject to externally imposed restrictions that can be fulfilled by actions of the System pursuant to those stipulations or that expire by the passage of time, and (c) Unrestricted – net position not subject to externally imposed stipulations but may be designated for specific purposes by action of management or the Board. The System first applies resources included in restricted net position when an expense or outlay is incurred for purposes for which resources in both restricted and unrestricted net positions are available.

(j) Classification of Revenues

The Statement of Revenues, Expenses and Changes in Net Position classifies the System's fiscal year activity as operating and nonoperating. Operating revenues generally result from exchange transactions such as payments received for providing goods and services.

Certain revenue sources that the System relies on for operations including on-behalf payments for fringe benefits and investment income are defined by GASB Statement No. 35 as nonoperating. In addition, transactions related to capital and financing activities are components of net nonoperating revenues.

In fiscal year 2018, $20,000,000 was appropriated by the State to be transferred to the University of Illinois Hospital Services Fund, which is a special fund established in the State of Illinois Treasury pursuant to the State Finance Act, 30 ILCS 105/6z-30. This fund is owned and operated by the Illinois Department of Healthcare and Family Services. It is not part of or a related organization of the University.

Other operating revenues of the System include capitation payments from Health Maintenance Organizations (HMOs) to provide medical services to subscribers, revenues from laboratory services provided to external organizations, cafeteria/gift shop sales and other sources.

(k) Patient Services Revenue

The System has agreements with third-party payors that provide for payments to the System at amounts different from its established rates. Payment arrangements include prospectively determined rates, discounted charges and per diem payments. Patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated adjustments under reimbursement agreements with third-party payors, some of which are subject to audit by administrating agencies. These adjustments are accrued on an estimated basis and are adjusted in future periods.

The System provides allowances for uncollectible accounts receivable based upon management's best estimate of uncollectible accounts, considering type, age, collection history, and any other factors as considered appropriate.

(l) Charity Care

The policy of the System is to treat patients in immediate need of medical services without regard to their ability to pay for such services. The System provides care without charge or at amounts less than its established rates to patients who meet the criteria of its charity care policy. This policy defines charity care and provides guidelines for assessing a patient's ability to pay. Eligibility is based on patient qualification, financial resources and service criteria. Because the System does not pursue collection of amounts determined to be charity care, they are not reported as revenue.

The System maintains records to identify and monitor the level of charity care provided. These records include the amount of estimated costs for services rendered and supplies furnished under its charity care policy. The estimated cost of charity care using the System's cost-to-charge ratio was $18,397,000 for fiscal year 2018, an increase of 37% from the prior year, primarily due to accelerated charity reviews being performed, an increase in the number of patients qualifying for charity care and patients who qualified under the presumptive requirement of the System's financial assistance policy who were either declined Medicaid coverage or were previously covered by Medicaid but are now uninsured. The ratio of costs to charges is calculated based on the System's total operating expenses. Unreimbursed costs of providing care to Medicare and Medicaid patients are not included as charity care.

(m) Classification of Expenses

The majority of the System's expenses are exchange transactions which GASB defines as operating expenses for financial statement presentation. Nonoperating expenses include transfers of State appropriations and capital financing costs.

(n) On-Behalf for Fringe Benefits

In accordance with GASB Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*, the System reported expenses incurred by the State of Illinois (State) on behalf of the System related to State group insurance and retirement programs, including postemployment benefits, for System employees and its retirees of $316,872,252 for the year ended June 30, 2018.

On-behalf for fringe benefits are classified as nonoperating revenues and the corresponding expenses are reported in fringe benefits of the System as operating expenses.

(o) Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions and pension expense, information about the plan net position of the State Universities Retirement System (SURS) and additions to/deductions from SURS' plan net position has been determined on the same basis as they are reported by SURS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

For the purposes of financial reporting, the State and participating employers are considered to be under a special funding situation. A special funding situation is defined as a circumstance in which a non-employer entity is legally responsible for making contributions directly to a pension plan that is used to provide pensions to the employees of another entity or entities and either (1) the amount of the contributions for which the non-employer entity is legally responsible is not dependent upon one or more events unrelated to pensions or (2) the non-employer is the only entity with a legal obligation to make contributions directly to a pension plan. The State is considered a non-employer contributing entity. Participating employers are considered employer contributing entities.

(p) Use of Estimates

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

(q) New Accounting Pronouncements

The System adopted the provisions of GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions,* which was effective for periods beginning after June 15, 2017. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit other postemployment benefits (OPEB), this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed. Implementation of this pronouncement required a change to the System's footnote 8(b) disclosures and an increase in on-behalf for fringe benefits.

The System adopted the provisions of GASB Statement No. 81, *Irrevocable Split-Interest Agreements,* which was effective for periods beginning after December 15, 2016. The objective of this Statement is to improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Implementation of this pronouncement did not impact the System's financial statements.

The System adopted the provisions of GASB Statement No. 85, *Omnibus 2017,* which was effective for periods beginning after June 15, 2017. The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and OPEB). Implementation of this pronouncement did not impact the System's financial statements.

The System adopted the provisions of GASB Statement No. 86, *Certain Debt Extinguishment Issues,* which was effective for periods beginning after June 15, 2017. The primary objective of this Statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources – resources other than the proceeds of refunding debt – are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. Implementation of this pronouncement did not impact the System's financial statements.

(2) Cash, Cash Equivalents and Investments

The System has cash and certain investments that are pooled with other University funds for the purpose of securing a greater return on investment and providing an equitable distribution of investment return. Income is distributed based upon average quarterly balances invested in the investment pool.

Nearly all of the University's investments are managed by external professional investment managers, who have full discretion to manage their portfolios subject to investment policy and manager guidelines established by the University, and in the case of mutual funds and other commingled vehicles, in accordance with the applicable prospectus or limited partnership agreement.

The Board follows the State of Illinois Uniform Prudent Management of Institutional Funds Act, 760 ILCS 51/1-11, when managing the University's investments. The Board fulfills its fiduciary responsibility for the management of investments, including endowment farm real estate, by adopting policies to maximize investment return with a prudent level of risk.

The following details the carrying value of the System's cash, cash equivalents, and investments as of June 30, 2018:

U.S. government treasuries	$	4,004,501
U.S. government securities		1,499,714
Money market funds		76,313
Subtotal		5,580,528
Claim on cash and pooled investments		249,606,482
Total cash, cash equivalents and investments	$	255,187,010

(a) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with its investment policy, the University employs multiple investment managers, of which each has specific maturity assignments related to the operating funds. The funds are structured with different layers of liquidity. Funds expected to be used within one year are invested using the Barclay's Capital 90-Day and Bank of America Merrill Lynch 12-month Treasury Bill Index as performance benchmarks. Core operating funds are invested in longer maturity investments. Core operating funds investment managers' performance benchmarks are the Barclays Capital one-year to three-year Government Bond Index, the Barclays Capital one-year-to-three-year Government Credit Bond Index, the Barclays Capital Intermediate Government Credit Bond Index and the Barclays Capital Intermediate Aggregate Bond Index.

The System's non-pooled investments and maturities as of June 30, 2018 were as follows:

		Maturities - Less than 1 year
U.S. government treasuries	$	4,004,501
U.S. government securities		1,499,714
Money market funds		76,313
Total cash equivalents and investments	$	5,580,528

Claim on cash and on pooled investments represents the System's share of participation in the University's operating internal investment pool. At June 30, 2018, the University's operating internal investment portfolio had an effective duration for its interest-bearing securities of 1.5 years.

(b) Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The University's investment policy requires that the University's short-term operating funds be invested in fixed income securities and other short-term fixed income instruments (e.g., money markets). Fixed income securities shall be rated investment grade or better by one or more nationally recognized statistical rating organizations. Securities not covered by the investment grade standard are allowed if, in the manager's judgment, those instruments are of comparable credit quality. Securities that fall below the stated minimum credit requirements subsequent to initial purchase may be held at the manager's discretion.

The University reports the credit ratings of fixed income securities and short-term instruments using Standard and Poor's and Moody's ratings. Securities with split ratings or with a different rating assignment are disclosed using the rating indicative of the greatest degree of risk. At June 30, 2018, the University's operating internal investment pool and non-pooled investments primarily consisted of securities with quality ratings of A or better.

(c) Custodial Credit Risk

Custodial credit risk is the risk that in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Exposure to custodial credit risk relates to investment securities that are held by someone other than the University and are not registered in the University's name. The University investment policy does not limit the value of investments that may be held by an outside party. At June 30, 2018, the System's investments and deposits had no custodial credit risk exposure.

(d) Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the University's investment in a single issuer. The University's investment policy provides that the total operating funds portfolio will be broadly diversified across securities in a manner that is consistent with fiduciary standards of diversification. Issuer concentrations are limited to 5% per issuer of the total market value of the portfolio at the time of purchase, or in the case of securitized securities, an individual issuance trust. These concentration limits do not apply to investments in money market funds, tri-party repurchase agreements or obligations of, or issues guaranteed by, the U.S. Treasury, U.S. agencies or U.S. government sponsored enterprises.

As of June 30, 2018, not more than 5% of the University's total investments were invested in securities of any one issuer, excluding money market funds, tri-party repurchase agreements or obligations of, or issues guaranteed by, the U.S. Treasury, U.S. agencies or U.S. government sponsored enterprises.

(e) Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. The University does not have an overarching policy related to foreign currency risk; however, under each investment manager's respective fund agreement, the portfolio's foreign currency exposure may be unhedged or hedged back into U.S. dollars. The University's operating fund investments generally are not exposed to foreign currency risk.

The University invests in non-U.S. developed and emerging markets through commingled funds invested in non-U.S. equities, private equity and absolute return strategies. As these funds are reported in U.S. dollars, both price changes of the underlying securities in local markets and changes to the value of local currencies relative to the U.S. dollar are embedded in investment returns.

(f) Investments and Fair Value Measurements

Accounting guidance for fair value establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The fair value hierarchy is as follows:

Level 1 - Quoted prices (unadjusted) for identical assets or liabilities in active markets that the System has the ability to access as of the measurement date. Level 1 inputs would also include investments valued at prices in active markets that the System has access to where transactions occur with sufficient frequency and volume to provide reliable pricing information.

Level 2 - Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 - Significant unobservable inputs that reflect a reporting entity's own assumptions about what market participants would use in pricing an asset or liability.

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Investments may be classified as Level 1 when the values are based upon unadjusted quoted prices in active markets for identical assets and generally include active listed equities. Publicly-traded investments that have no or insignificant restrictions are classified in Level 1 of the fair value hierarchy. Level 1 securities would include exchange traded equities.

Investments may be classified as Level 2 when the values include inputs that are directly observable for an asset (including quoted prices for similar assets), as well as inputs that are not directly observable for the asset. These inputs are derived principally from or corroborated by observable market data through correlation or by other means (market-corroborated inputs). The concept of market-corroborated inputs is intended to incorporate observable market data (such as interest rates and yield curves that are observable at commonly quoted intervals) based upon an assessment of factors relevant to the asset or liability. Level 2 securities include US Treasury bonds and bills, US government agencies, international government bonds and agencies, nongovernment mortgage-backed securities, asset backed securities, corporate bonds, commercial paper, and municipal bonds.

Investments may be classified as Level 3 when the values include inputs that are unobservable and Level 1 and Level 2 inputs are not available. The values are based upon the best information available under the circumstances and may include management's own data. Level 3 securities include certain types of inactively traded corporate bonds and equities.

The following table summarizes assets measured at fair value as of June 30, 2018, segregated by the level of the valuation inputs within the hierarchy utilized to measure fair value:

Fair Value Measurements as of June 30, 2018		
Investments in which fair value was measured based on significant other observable inputs (Level 2):		
U.S. government treasuries	$	4,004,501
U.S. government securities		1,499,714
Investments subject to fair value hierarchy		5,504,215
Investments measured at cost:		
Money market funds		76,313
Total cash equivalents and investments	$	5,580,528

(3) Capital Assets

Net interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Net interest of $1,173,769 was capitalized during the year ended June 30, 2018. The capital assets of the System are not pledged to secure outstanding indebtedness of the Board.

Capital asset activity for the year ended June 30, 2018 is summarized as follows:

Capital assets

	Beginning balance	Additions	Retirements	Transfers	Ending balance
Nondepreciable capital assets:					
Land	$ 770,917				$ 770,917
Construction in process	20,132,568	13,546,431		(27,947,936)	5,731,063
Total nondepreciable capital assets	20,903,485	13,546,431		(27,947,936)	6,501,980
Depreciable capital assets:					
Buildings	261,020,381			26,339,450	287,359,831
Leasehold improvements	2,320,152				2,320,152
Equipment	159,425,381	9,764,173	(906,196)		168,283,358
Software	43,753,575			1,608,486	45,362,061
Total depreciable capital assets	466,519,489	9,764,173	(906,196)	27,947,936	503,325,402
Less accumulated depreciation:					
Buildings	118,332,218	8,923,369			127,255,587
Leasehold improvements	2,220,091	28,588			2,248,679
Equipment	132,327,525	9,257,398	(847,091)		140,737,832
Software	32,923,703	3,289,324			36,213,027
Total accumulated depreciation	285,803,537	21,498,679	(847,091)	—	306,455,125
Total depreciable capital assets, net	180,715,952	(11,734,506)	(59,105)	27,947,936	196,870,277
Total capital assets, net	$ 201,619,437	1,811,925	(59,105)	—	$ 203,372,257

(4) Long-Term Obligations

During fiscal year 1997, the University issued $25,000,000 of Health Services Facilities System Revenue Bonds Series 1997B. The bonds are variable rate bonds which bear interest at a rate determined weekly and paid monthly. Proceeds from the bonds were used to finance the costs of a new ambulatory care facility in Chicago, a medical office building in Rockford, Illinois and to pay costs incidental to the issuance of the bonds.

During fiscal year 2008, the University issued $41,215,000 Variable Rate Demand Health Services Facilities System Revenue Refunding Bonds, Series 2008. The bonds are variable rate bonds which bear interest at a rate determined weekly. Proceeds from the bonds funded the redemption of the Variable Rate Demand Health Services Facilities System Revenue Refunding Bonds, Series 2007 on July 28, 2008 and paid costs incidental to the issuance of the bonds. The difference between the reacquisition price and net carrying amount of the old debt, loss on refunding, was $4,485,000. This loss is deferred and amortized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter.

During fiscal year 2014, the University issued $70,785,000 Health Services Facilities System Revenue Bonds, Series 2013. The bonds are fixed rate bonds which bear interest payable on April 1 and October 1 of each year. Proceeds from the bonds are being used to finance the costs of certain construction, renovation and equipment purchases for the System and to pay costs incidental to the issuance of the Series 2013 Bonds. The bond premium, $591,216, is deferred and amortized over the remaining life of the issue.

Long-term obligations activity for the year ended June 30, 2018 was as follows:

Long–term obligations

Series	Rate on June 30 outstanding debt	Fiscal year maturity dates	Beginning balance	Additions	Deductions	Ending balance	Current portion
Bonds payable:							
1997B	Variable	2019 – 2027	$ 12,400,000	$	$ (1,000,000)	$ 11,400,000	$ 1,100,000
2008	Variable	2019 – 2027	29,060,000		(2,485,000)	26,575,000	2,520,000
2013	5% to 6.25%	2028 – 2043	70,785,000			70,785,000	
			112,245,000	—	(3,485,000)	108,760,000	3,620,000
Unamortized premium			513,439		(20,335)	493,104	20,334
	Total bonds payable		112,758,439	—	(3,505,335)	109,253,104	3,640,334
Other obligations			1,341,133		(1,144,352)	196,781	196,781
	Total long–term debt		114,099,572	—	(4,649,687)	109,449,885	3,837,115
Compensated absences			25,003,719	3,446,770	(1,946,306)	26,504,183	2,137,664
	Total long–term obligations		$ 139,103,291	$ 3,446,770	$ (6,595,993)	$ 135,954,068	$ 5,974,779

The bonds do not constitute obligations of the State of Illinois. Bond principal and interest payments are funded from revenues pledged from (a) System net revenues, principally consisting of all charges, income and revenues received from the continued use and operation of the System remaining after providing sufficient funds for the reasonable and necessary cost of currently maintaining, repairing, insuring and operating the System, (b) Medical Service Plan (MSP) revenues net of bad debt expense and contractual allowances and (c) College of Medicine tuition revenue. These revenues for the year ended June 30, 2018 are as follows:

System net revenues	$	76,985,159
Adjusted MSP revenues		238,535,817
College of Medicine student tuition		53,784,043
Total	$	369,305,019

The table below shows the amount of revenues pledged for future principal and interest payments on the bonds:

Pledged revenues					
Bond issue(s)	**Purpose**	**Source of revenue pledged**	**Future revenues pledged**[1]	**Term of commitment**	**Debt service to pledged revenues (current year)**
Series 1997B, 2008 and 2013	Additions to System and Refunding	System net revenues, MSP revenues net of bad debt and contractual allowances, College of Medicine tuition	$ 191,973,056	2043	2.40%

1 Total estimated future principal and interest payments on debt

The resolutions authorizing the bonds provides for the establishment of separate funds as follows: Revenue Fund, Project Fund, Repair and Replacement Reserve, Equipment Reserve, Bond and Interest Sinking Fund and Development Reserve. All income and revenues received from the continued use and operation of the System, as provided for by the Bond Resolution, are to be deposited in the Revenue Fund and used to pay necessary operation and maintenance expenses of the System. The Bond Resolution also requires transfers to funds as follows:

Project Fund – at the discretion of the University Comptroller, amounts not needed to complete construction and renovation projects specified in the Bond Resolution are required to be transferred either to the Repair and Replacement Reserve or to the Bond and Interest Sinking Fund.

Repair and Replacement Reserve – an amount calculated as specified in the Bond Resolution to provide for the cost of unusual maintenance and repairs.

Equipment Reserve – an amount approved by the Board for the acquisition of movable equipment to be installed in the facilities constituting the System. The reserve may not exceed 20% of the book value of the movable equipment of the System.

Bond and Interest Sinking Fund – amounts transferred into the Bond and Interest Sinking Fund sufficient to pay principal and interest as it becomes due on the outstanding bonds.

Development Reserve – an amount approved by the Board for System development. No transfers were authorized by the Board during the year ended June 30, 2018, and there was not a balance in the reserve at June 30, 2018.

The System made all required transfers for the year ended June 30, 2018.

After fulfillment of the provisions described above, the surplus, if any, remaining in the Revenue Fund may be used at the Board's option (a) to redeem bonds of the System which are subject to early redemption, (b) to improve or add facilities to the System, or (c) for any other lawful purpose.

Assets restricted by Bond Resolution were held for the following purposes at June 30, 2018:

Restricted assets:		
Cash and investments	$	28,441,194
Purpose:		
Capital projects, bond projects	$	7,726,277
Repair and replacement reserve		19,558,831
Bond and interest sinking fund		1,156,086
Total assets limited as to use		28,441,194
Less amounts required for current liabilities		(1,140,445)
Total for long-term use	$	27,300,749

(a) Health Services Facilities System Variable Rate Debt and Interest Rate Swap Agreement

Demand Provisions

The System's Series 1997B and 2008 bonds mature serially through October 2026. These bonds have variable interest rates that are adjusted periodically (i.e., daily, weekly, or monthly), generally with interest paid at the beginning of each month. The bonds are subject to purchase on the demand of the holder at a price equal to principal plus accrued interest on seven days' notice and delivery to the University's remarketing agents. The University pays the remarketing agent fees on the outstanding bond balance. If the remarketing agent is unable to resell any bonds that are "put" to the agent, the University has a standby bond purchase agreement with a liquidity facility entity. The University has several such agreements, with the fees on the Bond Purchase Commitment (formula based on outstanding bonds plus pro forma interest). The University, in the event a liquidity facility is utilized, has reimbursement agreements with associated financial entities. Generally, the payback period, in which the initial payment is due 366 days after the agreement takes effect, is five to seven years, at an interest rate initially set at slightly above prime or the federal funds rate.

The required future interest payments for these variable rate bonds have been calculated using the current interest rate, based upon short-term tax-exempt rates, or the synthetic fixed rate, as illustrated in the table below:

Variable rate bonds at June 30, 2018

Bond issues	Interest rate at June 30, 2018	Remarketing agent	Remarketing fee	Liquidity facility: Bank	Liquidity facility: Expiration	Liquidity facility: Insured by	Liquidity facility: Fee
HSFS, Series 1997B	1.55%	JPMorgan Securities	0.070%	Wells Fargo	May 30, 2019	Letter of Credit	0.72%
HSFS, Series 2008	1.49	Goldman Sachs	0.070	Wells Fargo	May 30, 2019	Letter of Credit	0.72

Interest Rate Swap Agreement

In fiscal year 2009, the University entered into a variable-to-fixed interest rate swap agreement with Loop Financial Products I LLC (Loop). The purpose of this interest rate swap was to hedge the Series 2008 debt by effectively changing the variable interest rate on the bonds to a synthetic fixed rate. When the swap agreement was entered, the notional amount of the swap was $40,875,000. In accordance with the swap agreement, the University makes monthly payments to the counterparty (Loop) equal to 3.534% of the notional amount and receives monthly payments from Loop equal to 68% of the one-month London Interbank Offered Rate (LIBOR). The swap will terminate in October 2026. As of June 30, 2018, the notional amount of the swap was $26,360,000.

The University engaged a third-party consultant to determine the fair value of the swap agreement. The fair value provided by the consultant was derived from proprietary models based upon well-recognized financial principles and reasonable estimates about relevant market conditions. The fair value (Level 2 measurement) is recognized as a noncurrent liability and was $1,868,697 as of June 30, 2018.

In connection with the interest rate swap agreement, the University may be exposed to various types of risk:

Credit Risk – As of June 30, 2018, the University was not exposed to credit risk because the swap had a negative fair value. If interest rates change and the fair value of the swap becomes positive, the University would be exposed to credit risk in the amount of the derivative's fair value. The counterparty may have to post collateral in the University's favor in certain conditions, and the University would never be required to post collateral in the counterparty's favor.

Interest Rate Risk – During fiscal year 2018, low interest rates exposed the University to interest rate risk, which adversely affected the fair value of the swap agreement.

Termination Risk – The swap is scheduled to terminate in October 2026. The University has the option to terminate the swap early. The University or Loop may terminate the swap if the other party fails to perform under the terms of the contract. The University may terminate the swap if both credit ratings of the counterparties fall below BBB+ as issued by Standard & Poor's and Baa1 as issued by Moody's Investors Service. As of June 30, 2018, the counterparty (Loop) credit rating by Standard & Poor's was A- and by Moody's Investors Service was Baa1.

If the swap is terminated, the Series 2008 variable-rate bonds would no longer carry a synthetic fixed interest rate. In addition, if at the time of termination, the swap has a negative fair value, the University would be liable to Loop for a payment equal to the swap's fair value.

Basis Risk – The swap exposes the University to basis risk should the relationship between LIBOR and the variable weekly rate determined by the remarketing agent change, changing the synthetic rate on the bonds. If a change occurs that results in the difference in rates widening, the expected cost savings may not be realized.

Other Risks – Since the swap agreement extends to the maturity of the Series 2008 bonds, it does not expose the University to rollover risk. In addition, the University is not exposed to foreign currency risk associated with this swap agreement. The University is not exposed to market access risk as of June 30, 2018. However, if the University decides to issue refunding bonds and credit is more costly at that time, it could be exposed to market access risk.

(b) Debt Service Requirements

Future estimated debt service requirements for the Series 1997B, 2008 and 2013 Bonds at June 30, 2018 were as follows:

	Principal	Interest
2019	$ 3,620,000	$ 5,297,537
2020	3,755,000	5,188,656
2021	3,900,000	5,076,093
2022	4,045,000	4,959,136
2023	4,200,000	4,838,177
2024 - 2028	21,180,000	22,229,488
2029 - 2033	16,250,000	18,312,681
2034 - 2038	21,955,000	12,610,750
2039 - 2043	29,855,000	4,700,538
Total debt service	108,760,000	$ 83,213,056
Unamortized premium	493,104	
Total bonds payable	$ 109,253,104	

The required debt service for the variable rate Series 1997B and 2008 Bonds has been calculated using the current interest rate of 1.55% and 1.49%, respectively, over the remaining life of the bonds.

Using the actual rate in effect as of June 30, 2018 (1.49% for Series 2008), debt service requirements of the Series 2008 variable rate debt and net swap payments, assuming current interest rates remain the same for their term, were as follows. As rates vary, variable-rate bond interest payments and net swap payments will also vary.

Health Services Facilities System Revenue Refunding Bonds, Series 2008
Variable-Rate Debt Service Requirements

	Variable rate bonds		Interest rate	
	Principal	Interest	swaps, net	Total
2019	$ 2,520,000	395,967	479,700	$ 3,395,667
2020	2,655,000	358,420	425,419	3,438,839
2021	2,700,000	318,860	370,500	3,389,360
2022	2,845,000	278,630	312,372	3,436,002
2023	2,900,000	236,239	253,436	3,389,675
2024 - 2027	12,955,000	490,136	363,066	13,808,202
Total	$ 26,575,000	2,078,252	2,204,493	$ 30,857,745

Another obligation consists of a third-party financing arrangement for equipment, which has a maturity date through 2019 and an interest rate of 1.64%.

As of June 30, 2018, future minimum payments under other obligations are as follows:

		Principal		Interest
2019	$	196,781	$	3,235
Total minimum payments – other obligations	$	196,781	$	3,235

(5) Operating Leases

The System leases various real property and equipment under operating lease agreements, including leases renewed on an annual basis. Total rental expense under these agreements was $2,005,031 for the year ended June 30, 2018.

As of June 30, 2018, future minimum payments under operating leases are as follows:

2019	$	1,323,180
2020		1,185,806
2021		631,157
2022		561,640
2023		212,606
2024 - 2026		253,571
Total minimum payments – operating leases	$	4,167,960

(6) Patient Accounts Receivable

Patient accounts receivable as of June 30, 2018, reported as current assets, consisted of the following amounts:

Patient accounts receivable, net of contractual allowances and charity care:		
Medicaid managed care	$	137,123,638
HMO/PPO		99,030,979
Medicaid		35,793,871
Commercial insurance		33,308,399
Medicare managed care		28,514,323
Medicare		22,585,162
Self-pay and other		13,745,875
Total		370,102,247
Less allowance for uncollectible accounts		(208,000,305)
Total patient accounts receivable, net	$	162,101,942

The System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2018 was as follows:

Medicaid managed care	37.1	%
HMO/PPO	26.8	
Medicaid	9.7	
Commercial insurance	9.0	
Medicare managed care	7.7	
Medicare	6.0	
Self-pay and other	3.7	
	100.0	%

(7) Net Patient Service Revenues

Approximately 93% of the System's net patient service revenue was derived from Medicare, Medicaid and managed care programs for the year ended June 30, 2018. Reimbursement under these programs provided payments to the System at amounts different from its established rates, based on a specific amount per case, or a contracted price, for rendering services to program beneficiaries. The System records contractual allowances in the current period representing the difference between charges for services rendered and the expected payments under these programs, and adjusts them in future periods as final settlements through cost reports or other means as determined.

Net patient service revenue for the fiscal year ending June 30, 2018 was as follows:

Medicaid managed care	$	804,249,774
HMO/PPO		629,109,385
Medicare		516,823,441
Medicaid		172,656,223
Medicare managed care		200,895,608
Commercial insurance		64,016,332
Self-pay and other		120,401,998
Total gross revenue		2,508,152,761
Less:		
Contractual allowances		(1,760,762,492)
Provision for uncollectible accounts		(26,308,488)
Net patient revenue	$	721,081,781

A summary of the payment arrangements with major third-party payers follows:

Medicare and Medicare Managed Care – Inpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient services are paid at prospectively determined rates that are based on the patients' diagnosis. Outpatient payments to the Hospital are based on a predetermined package rate based on services provided to patients. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary. The System's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2012. For the fiscal year ended June 30, 2018, changes in estimates related to the settlement of cost reports have been recognized as an increase in net patient service revenue of approximately $2,014,000 as a result of settled cost reports and changes in estimates related to services rendered in previous years.

Medicaid and Medicaid Managed Care – Services are reimbursed at prospectively determined rates. Medicaid payment methodologies and rates for services rendered are subject to change and the amount of funding available to the University of Illinois Hospital Services Fund. Such changes could have a significant effect on the System's revenues.

HMO/PPO – The System has payment agreements with certain health maintenance organizations (HMOs) and preferred provider organizations (PPOs). The basis for payment under these agreements includes prospectively determined rates-per-discharge, discounts from established charges, prospectively determined daily rates and capitated per-member per-month rates.

(8) Retirement and Postemployment Benefits

(a) Retirement Benefits

General Information about the Pension Plan

Plan Description: The University contributes to the State Universities Retirement System of Illinois (SURS), a cost-sharing multiple-employer defined benefit plan with a special funding situation whereby the State makes substantially all actuarially determined required contributions on behalf of the participating employers. SURS was established July 21, 1941 to provide retirement annuities and other benefits for staff members and employees of State universities, certain affiliated organizations, and certain other State educational and scientific agencies and for survivors, dependents and other beneficiaries of such employees. SURS is considered a component unit of the State's financial reporting entity and is included in the State's financial reports as a pension trust fund. SURS is governed by Chapter 40, Act 5. Article 15 of the *Illinois Compiled Statutes*. SURS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by accessing the website at www.surs.org.

Benefits Provided: A traditional benefit plan was established in 1941. Public Act 90-0448 enacted effective January 1, 1998, established an alternative defined benefit program known as the portable benefit package. The traditional and portable plan Tier 1 refers to members that began participation prior to January 1, 2011. Public Act 96-0889 revised the traditional and portable benefit plans for members who begin participation on or after January 1, 2011, and who do not have eligible Illinois reciprocal system services. The revised plan is referred to as Tier 2. New employees are allowed 6 months after their date of hire to make an irrevocable election. A summary of the benefit provisions as of June 30, 2017 can be found in the SURS' comprehensive annual financial report (CAFR) Notes to the Financial Statements.

Eligible employees must participate upon initial employment. Employees are ineligible to participate if (a) employed after having attained age 68; (b) employed less than 50% of full time; or (c) employed less than full time and attending classes with an employer. Of those University employees ineligible to participate, the majority are students at the University.

Contributions: The State is primarily responsible for funding SURS on behalf of the individual employers at an actuarially determined amount. Public Act 88-0593 provides a Statutory Funding Plan consisting of two parts: (i) a ramp-up period from 1996 to 2010 and (ii) a period of contributions equal to a level percentage of the payroll of active members of the System to reach 90% of the total Actuarial Accrued Liability by the end of Fiscal Year 2045. Employer contributions from "trust, federal, and other funds" are provided under Section 15-155(b) of the Illinois Pension Code and require employers to pay contributions which are sufficient to cover the accruing normal costs on behalf of applicable employees. The employer normal cost for fiscal year 2017 and 2018 respectively, was 12.53% and 12.46% of employee payroll. The normal cost is equal to the value of current year's pension benefit and does not include any allocation for past unfunded liability or interest on the unfunded liability. Plan members are required to contribute 8.0% of their annual covered salary. The contribution requirements of plan members and employers are established and may be amended by the Illinois General Assembly.

Participating employers make contributions toward separately financed specific liabilities under Section 15-139.5(e) of the Illinois Pension Code (relating to contributions payable due to the employment of "affected annuitants" or specific return to work annuitants) and Section 15-155(g) (relating to contributions payable due to earning increases exceeding 6% during the final rate of earnings period).

Pension Liabilities, Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

Net Pension Liability: The net pension liability was measured as of June 30, 2017. At June 30, 2017, SURS reported a net pension liability of $25,481,105,995.

Employer Proportionate Share of Net Pension Liability: The amount of the proportionate share of the net pension liability to be recognized for the System is $0. The proportionate share of the State's net pension liability associated with the System is $2,068,800,122. This amount should not be recognized in the financial statement. The net pension liability and total pension liability as of June 30, 2017 was determined based on the June 30, 2016 actuarial valuation rolled forward. The basis of allocation used in the proportionate share of net pension liability is the actual reported pensionable earnings made to SURS during fiscal year 2017.

Pension Expense: At June 30, 2017 SURS reported a collective net pension expense of $2,412,918,129.

Employer Proportionate Share of Pension Expense: The employer proportionate share of collective pension expense should be recognized similarly to on-behalf payments as both revenue and matching expenditure in the financial statements. The basis of allocation used in the proportionate share of collective pension expense is the actual reported pensionable contributions made to SURS during fiscal year 2017. As a result, the University recognized on-behalf revenue and pension expense of $1,040,720,544 for fiscal year ended June 30, 2018, of which $195,903,879 was related to the System.

Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions: Deferred outflows of resources are the consumption of net position by SURS that is applicable to future reporting periods.

SURS Collective Deferred Outflows and Deferred Inflows of Resources by Sources

		Deferred Outflows of Resources		Deferred Inflows of Resources
Difference between expected and actual experience	$	139,193,227	$	1,170,771
Changes in assumption		205,004,315		259,657,577
Net difference between projected and actual earnings on pension plan investments		94,620,827		
Total	$	438,818,369	$	260,828,348

SURS Collective Deferred Outflows and Deferred Inflows of Resources by Year to be Recognized in Future Pension Expense

Year Ending June 30		Net Deferred Outflows of Resources
2018	$	55,589,850
2019		187,874,276
2020		90,475,551
2021		(155,949,656)
2022		-
Thereafter		-
Total	$	177,990,021

Assumptions and Other Inputs

Actuarial assumptions: The actuarial assumptions used in the June 30, 2017 valuation were based on the results of an actuarial experience study for the period June 30, 2010 – 2014. The total pension liability in the June 30, 2017 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.75 percent
Salary increases	3.75 to 15.00 percent, including inflation
Investment rate of return	7.25 percent beginning with the actuarial valuation as of June 30, 2014

Mortality rates were based on the RP2014 Combined Mortality Table with projected generational mortality and a separate mortality assumption for disabled participants.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return were adopted by the plan's trustees after considering input from the plan's investment consultant(s) and actuary(s). For each major asset class that is included in the pension plan's target asset allocation as of June 30, 2017, these best estimates are summarized in the following table:

Asset Class	Target Allocation	Weighted Average Long-Term Expected Real Rate of Return
U.S. Equity	23%	6.08%
Private Equity	6%	8.73%
Non-U.S. Equity	19%	7.34%
Global Equity	8%	6.85%
Fixed Income	19%	1.38%
Treasury-Inflation Protected Securities	4%	1.17%
Emerging Market Debt	3%	4.14%
Real Estate REITS	4%	5.75%
Direct Real Estate	6%	4.62%
Commodities	2%	4.23%
Hedged Strategies	5%	3.95%
Opportunity Fund	1%	6.71%
Total	100%	5.20%
Inflation		2.75%
Expected Arithmetic Return		**7.95%**

Discount Rate: A single discount rate of 7.09% was used to measure the total pension liability. This single discount rate was based on an expected rate of return on pension plan investments of 7.250% and a municipal bond rate of 3.56% (based on the weekly rate closest to but not later than the measurement date of the 20-Year Bond Buyer Index as published by the Federal Reserve). The projection of cash flows used to determine this single discount rate were the amounts of contributions attributable to current plan members and assumed that plan member contributions will be made at the current contribution rate and that employer contributions will be made at rates equal to the statutory contribution rates under SURS' funding policy. Based on these assumptions, the pension plan's fiduciary net position and future contributions were sufficient to finance the benefit payments through the year 2073. As a result, the long-term expected rate of return on pension plan investments was applied to projected benefit payments through the year 2073, and the municipal bond rate was applied to all benefit payments after that date.

Sensitivity of the SURS' Net Pension Liability to Changes in the Discount Rate: Regarding the sensitivity of the net pension liability to changes in the single discount rate, the following presents the plan's net pension liability, calculated using a single discount rate of 7.09%, as well as what the plan's net pension liability would be if it were calculated using a single discount rate that is 1-percentage-point lower or 1-percentage-point higher:

1% Decrease 6.09%	Current Single Discount Rate Assumption 7.09%	1% Increase 8.09%
$30,885,146,279	$25,481,105,995	$20,997,457,586

Additional information regarding the SURS basic financial statements including the Plan Net Position can be found in the SURS comprehensive annual financial report by accessing the website at www.SURS.org.

(b) Postemployment Benefits

Plan description: The State Employees Group Insurance Act of 1971 ("Act"), as amended, authorizes the Illinois State Employees Group Insurance Program ("SEGIP") to provide health, dental, vision, and life insurance benefits for certain retirees and their dependents. Substantially all of the University's full-time employees are members of SEGIP. Members receiving monthly benefits from the General Assembly Retirement System ("GARS"), Judges Retirement System ("JRS"), State Employees' Retirement System of Illinois ("SERS"), Teachers' Retirement System ("TRS"), and State Universities Retirement System of Illinois ("SURS") are eligible for these other post-employment benefits ("OPEB"). The eligibility provisions for the SURS members were defined within Note 8(a). The University's employees can only be eligible members of the SURS.

The Department of Central Management Services administers these benefits for annuitants with the assistance of the public retirement systems sponsored by the State (GARS, JRS, SERS, TRS and SURS). The State recognizes SEGIP OPEB benefits as a single-employer defined benefit plan. The plan does not issue a stand-alone financial report.

Benefits provided: The health, dental, and vision benefits provided to and contribution amounts required from annuitants are the result of collective bargaining between the State and the various unions representing the State's and the State universities' employees in accordance with limitations established in the Act. Therefore, the benefits provided and contribution amounts are subject to periodic change. Coverage through SEGIP becomes secondary to Medicare after Medicare eligibility has been reached. Members must enroll in Medicare Parts A and B to receive the subsidized SEGIP premium available to Medicare eligible participants. The Act requires the State to provide life insurance benefits for annuitants equal to their annual salary as of the last day of employment until age 60, at which time, the benefit amount becomes $5,000.

Funding policy and annual other postemployment benefit cost: OPEB offered through SEGIP are financed through a combination of retiree premiums, State contributions and Federal government subsidies from the Medicare Part D program. Contributions are deposited in the Health Insurance Reserve Fund, which covers both active State employees and retirement members. Annuitants may be required to contribute towards health and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed health care plan. Annuitants who retired prior to January 1, 1998, and who are vested in the State Employee's Retirement System do not contribute toward health and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State allowing those annuitants with twenty or more years of credited service to not have to contribute towards health and vision benefits. All annuitants are required to pay for dental benefits regardless of retirement date. The Director of Central Management Services shall, on an annual basis, determine the amount the State shall contribute toward the basic program of group health benefits. State contributions are made primarily from the General Revenue Fund on a pay-as-you-go basis. No assets are accumulated or dedicated to funding the retiree health insurance benefit and a separate trust has not been established for the funding of OPEB.

For fiscal year 2018, the annual cost of the basic program of group health, dental, and vision benefits before the State's contribution was $10,926.24 ($6,145.92 if Medicare eligible) if the annuitant chose benefits provided by a health maintenance organization and $14,939.04 ($5,165.04 if Medicare eligible) if the annuitant chose other benefits. The State is not required to fund the plan other than the pay-as-you-go amount necessary to provide the current benefits to retirees.

(9) Related-Party Transactions

The University charged the System for administrative and other services totaling $13,056,116 in fiscal year 2018. These charges represent a portion of the estimated administrative and other service costs incurred by the University in support of the System. An additional $28,018,039 was paid by the University on behalf of the System for salaries and other costs for the year ended June 30, 2018, in exchange for System services and facilities provided, and are recognized as operating expenses (salaries and general) and operating revenues.

The System provides funds to the College of Medicine to support programmatic initiatives that benefit the System's strategic goals and to pay for salaries of physicians and staff in the College of Medicine who serve as medical directors and physician leaders of the System under various agreements. During fiscal year 2018, approximately $38.9 million was recognized in salaries and wages and supplies and general expenses by the System under these agreements.

The System provides funds to the University's College of Pharmacy under various arrangements to pay for salaries of clinical pharmacists, faculty and residents and to support programs that benefit the System's clinical operations. During fiscal year 2018, approximately $10.5 million was recognized in salaries and wages and supplies and general expenses under these arrangements.

The System contracts with the College of Pharmacy to provide certain pharmacy services related to the Federal drug discount program under Section 340b of the Public Health Service Act, under which the System is a covered entity and purchases drugs for dispensing to eligible outpatients. During fiscal year 2018, the System paid approximately $9.4 million to the College of Pharmacy for these services.

The College of Pharmacy also provides various community benefit programs to patients and constituents of the System. During fiscal year 2018, the System paid approximately $5.3 million to the College of Pharmacy to support these programs.

Most healthcare services rendered by physicians at the University are charged, billed and collected through the MSP. For ambulatory care services, there is a charge for both professional and technical components. Based on the underlying agreements between the MSP and the System, the System remits certain funds collected to the MSP. Total MSP remittances from the System for the year ended June 30, 2018 relating to the delivery of ambulatory care were approximately $18.4 million.

During 2018, various departments within the College of Medicine agreed to reimburse the System for a portion of the expenses related to the resident and fellowship training program. This reimbursement, which totaled $3.5 million, has been reflected in the financial statements as a reduction of the related expenses.

(10) Commitments and Contingencies

(a) Commitments

At June 30, 2018, the System had commitments on various construction projects and contracts for repairs and renovation of health services facilities of $9,285,206.

(b) Contingencies

The University (including the System) is involved in regulatory audits arising in the normal course of business.

In 2016, the System received notices from Medicare requiring that it provide documentation for certain claims as part of the Recovery Audit Contractor (RAC) program. The System has responded to these requests. Review of claims through the RAC program may result in a liability to Medicare which could have a material impact on the System's net patient service revenues.

The University (including the System) is a defendant in a number of legal actions primarily related to medical malpractice. These legal actions have been considered in estimating the University's accrued self-insurance liability, which covers hospital and medical professional/general liability; estimated general and contractual liability, and workers' compensation liability. At June 30, 2018, the University's total accrued self-insurance liability was $235,048,295.

The University's accrued self-insurance liability includes $167,816,970 at June 30, 2018, for the most probable and reasonably estimable ultimate cost of medical malpractice liabilities. Ultimate cost consists of amounts estimated by the University's risk management division and actuaries for asserted claims, unasserted claims arising from reported incidents, expected litigation expenses and amounts determined by actuaries using relevant industry data and System specific data to cover projected losses for claims incurred but not yet reported. The System contributes to the University's self-insurance reserve through annual assessments. Therefore, no liability related to medical malpractice claims is included in the System's financial statements, but the entire self-insurance liability is reflected in the University's financial statements.

In 2004, the Office of the Inspector General of the U.S. Department of Health and Human Services (OIG) conducted an audit of the Medicaid disproportionate share hospital (DSH) programs in ten states for the years 1997 through 2000, including the State of Illinois. The OIG's audit report indicated that the State of Illinois' Medicaid DSH payments exceeded hospital-specific limits, and that the Federal share of those overpayments was $145.8 million, of which $140.3 million related to payments made to the University's hospital. The Illinois Department of Healthcare and Family Services (IDHFS) believes it followed guidelines published by the U. S. Centers for Medicare and Medicaid Services (CMMS) and that its methodology for calculating the hospital-specific limit had consistently been approved by CMMS. However, on July 25, 2016, CMMS issued a formal notice to IDHFS that it had adopted the OIG's recommendation and was requesting repayment by IDHFS of the $140.3 million associated with the University's hospital. In January 2017, IDHFS filed an appeal notice with the U.S. Department of Health and Human Services Departmental Appeals Board. On April 2, 2018, the Departmental Appeals Board rendered a decision in favor of CMMS, sustaining the disallowance of DSH payments to the State as calculated by OIG. In June 2018, IDHFS filed a motion with the Departmental Appeals Board to reconsider its decision. Please refer to note 11 for activity subsequent to June 30, 2018 related to the audit and its appeals process.

(11) Subsequent Events

In September 2018, IDHFS notified the System that it will not seek recovery of the $140.3 million disallowance from the System or University in the event any further administrative or legal challenges by IDHFS are unsuccessful in whole or in part, settled or exhausted without a favorable decision. The University has agreed to continue to take any actions or steps requested by IDHFS in support of IDHFS's further appeals of this matter.

Required Supplementary Information
Year Ended June 30, 2018

Schedule of University of Illinois Health Services Facilities System Proportionate Share of the Net Pension Liability	Fiscal Year 2017	Fiscal Year 2016	Fiscal Year 2015	Fiscal Year 2014
(a) Proportion Percentage of the Collective Net Pension Liability	0%	0%	0%	0%
(b) Proportion Amount of the Collective Net Pension Liability	$0	$0	$0	$0
(c) Portion of Nonemployer Contributing Entities' Total Proportion of Collective Net Pension Liability associated with Employer	$2,068,800,122	$2,016,718,081	$1,770,601,518	$1,546,893,194
Total (b) + (c)	$2,068,800,122	$2,016,718,081	$1,770,601,518	$1,546,893,194
Employer defined benefit Covered Payroll*	$274,251,179	$265,271,833	$253,062,776	$260,376,968
Proportion of Collective Net Pension Liability associated with Employer as a percentage of DB covered payroll	754.35%	760.25%	699.67%	594.10%
SURS Plan Net Position as a Percentage of Total Pension Liability	42.04%	39.57%	42.37%	44.39%

* GASB Statement #82 amended GASB Statements #67 & #68 to require the presentation of covered payroll, defined as payroll on which contributions to a pension plan are based, and ratios that use that measure. For the SURS plans, the covered payroll are those employees within the defined benefit plan.

(Continued)

Changes of benefit terms. There were no benefit changes recognized in the Total Pension Liability as of June 30, 2017.

Changes of assumptions. In accordance with Illinois Compiled Statutes, an actuarial review is to be performed at least once every three years to determine the reasonableness of actuarial assumptions regarding the retirement, disability, mortality, turnover, interest and salary of the members and benefit recipients of SURS. An experience review for the years June 30, 2010 to June 30, 2014 was performed in February 2015, resulting in the adoption of new assumptions as of June 30, 2015.

- Mortality rates. Change from the RP 2000 Mortality table projected to 2017, sex distinct, to the RP-2014 mortality tables with projected generational mortality improvement. Change to a separate mortality assumption for disabled participants.

- Salary increases. Change assumption to service-based rates, ranging from 3.75 percent to 15.00 percent based on years of service, with underlying wage inflation of 3.75 percent.

- Normal retirement rates. Change to retirement rates at ages younger than 60, age 66, and ages 70-79 to reflect observed experiences.

- Early retirement rates. Change to a slight increase to the rates at ages 55 and 56.

- Turnover rates. Change to produce lower expected turnover for members with less than 10 years of service and higher turnover for members with more than 10 years of service than the currently assumed rates.

- Disability rates. Decrease rates and have separate rates for males and females to reflect observed experience.

- Dependent assumption. Maintain the current assumption on marital status that varies by age and sex and the assumption that males are three years older than their spouses.

*Note: The System implemented GASB No. 68 in fiscal year 2015. The information above is presented for as many years as available. The Schedule is intended to show information for 10 years.