DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES

Consolidated Financial Statements and Supplementary Schedules

June 30, 2020 and 2019

(With Independent Auditors' Report Thereon)

DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES

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KPMG LLP
Suite 400
300 North Greene Street
Greensboro, NC 27401

Independent Auditors' Report

Board of Directors
Duke University Health System, Inc.:

We have audited the accompanying consolidated financial statements of Duke University Health System, Inc. and Affiliates (the Health System), which comprise the consolidated balance sheets as of June 30, 2020 and 2019, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 Health System'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 Health System's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Duke University Health System, Inc. and Affiliates as of June 30, 2020 and 2019, and the results of their operations, their changes in net assets, and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in note 2(o) to the consolidated financial statements, the Health System adopted Financial Accounting Standards Board Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 842)* in 2020. Our opinion is not modified with respect to this matter.

As discussed in note 2(o) to the consolidated financial statements, the Health System adopted ASU No. 2014-19, *Revenue from Contracts with Customers (Topic 606)* and ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities* in 2019. Our opinion is not modified with respect to this matter.

Other Matters

Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information in schedules 1 and 2 is presented for the purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of 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 information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

KPMG LLP

September 29, 2020

DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES

Consolidated Balance Sheets

June 30, 2020 and 2019

(In thousands)

Assets		**2020**	**2019**
Current assets:			
Cash and cash equivalents	$	157,803	250,947
Patient accounts receivable, net		430,091	460,543
Other receivables		41,078	37,473
Inventories of drugs and supplies		126,416	101,939
Short-term investments		815,345	562,095
Assets limited as to use		18,386	17,334
Other assets		44,765	39,348
Total current assets		1,633,884	1,469,679
Assets limited as to use		79,788	86,438
Investments		3,237,433	3,244,196
Property and equipment, net		2,036,271	1,751,195
Right-of-use operating lease assets		328,662	—
Other noncurrent assets		51,512	49,568
Total assets	$	7,367,550	6,601,076
Liabilities and Net Assets			
Current liabilities:			
Accounts payable	$	202,280	188,316
Accrued salaries, wages, and vacation payable		230,053	203,879
Estimated third-party payor settlements, net		306,175	5,024
Current portion of postretirement and postemployment benefit obligations		8,026	7,404
Current portion of indebtedness		25,970	24,925
Current portion of finance lease liabilities		8,250	3,105
Current portion of operating lease liabilities		25,178	—
Current portion of estimated professional liability costs		18,386	17,334
Other current liabilities		32,765	38,275
Total current liabilities		857,083	488,262
Postretirement and postemployment benefit obligations, net of current portion		798,265	470,164
Indebtedness, net of current portion		1,556,010	1,574,392
Finance lease liabilities, net of current portion		164,802	130,012
Operating lease liabilities, net of current portion		313,131	—
Estimated professional liability costs, net of current portion		25,978	31,180
Derivative instruments		100,098	77,028
Other noncurrent liabilities		68,600	49,816
Total liabilities		3,883,967	2,820,854
Net assets:			
Without donor restrictions		3,424,023	3,719,573
With donor restrictions		59,560	60,649
Total net assets		3,483,583	3,780,222
Total liabilities and net assets	$	7,367,550	6,601,076

See accompanying notes to consolidated financial statements.

DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES

Consolidated Statements of Operations

Years ended June 30, 2020 and 2019

(In thousands)

	2020	2019
Revenues, gains, and other support without donor restrictions:		
Net patient service revenue	$ 3,669,150	3,631,391
Other revenue	282,396	205,395
Total revenues, gains, and other support	3,951,546	3,836,786
Expenses:		
Salaries, wages, and benefits	1,874,479	1,711,393
Medical supplies	999,746	934,185
Interest	39,334	55,445
Depreciation and amortization	168,406	162,958
Other operating expenses	744,681	711,077
Total expenses	3,826,646	3,575,058
Operating income	124,900	261,728
Non-operating (loss) income:		
Investment (loss) income	(10,623)	153,383
Non-operating components of net periodic benefit cost	16,823	21,785
Loss on extinguishment of debt	(10,179)	—
Other	1,302	69
Total non-operating (loss) income	(2,677)	175,237
Excess of revenues over expenses	122,223	436,965
Change in funded status of defined benefit plans	(301,059)	(182,487)
Net assets released from restrictions for purchase of property and equipment	717	550
Transfers to the University, net	(117,431)	(96,556)
(Decrease) increase in net assets without donor restrictions	$ (295,550)	158,472

See accompanying notes to consolidated financial statements.

DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2020 and 2019

(In thousands)

	2020	2019
Net assets without donor restrictions:		
Excess of revenue over expenses	$ 122,223	436,965
Change in funded status of defined benefit plans	(301,059)	(182,487)
Net assets released from restrictions for purchase of property and equipment	717	550
Transfers to the University, net	(117,431)	(96,556)
(Decrease) increase in net assets without donor restrictions	(295,550)	158,472
Net assets with donor restrictions:		
Contributions for restricted purposes	6,064	5,694
Transfers (to) from the University, net	(335)	200
Net assets released from restrictions used for operations	(4,937)	(4,004)
Net assets released from restrictions for purchase of property and equipment	(717)	(550)
Net realized and unrealized (losses) gains	(1,164)	682
(Decrease) increase in net assets with donor restrictions	(1,089)	2,022
(Decrease) increase in net assets	(296,639)	160,494
Net assets, beginning of year	3,780,222	3,619,728
Net assets, end of year	$ 3,483,583	3,780,222

See accompanying notes to consolidated financial statements.

DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES

Consolidated Statements of Cash Flows

Years ended June 30, 2020 and 2019

(In thousands)

	2020	2019
Cash flows from operating activities:		
(Decrease) increase in net assets	$ (296,639)	160,494
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	168,406	162,958
Investment loss (income)	11,702	(154,061)
Loss on the extinguishment of debt	10,179	—
Net (gain) loss on other investments and disposals of property and equipment	(1,207)	1,347
Transfers to the University, net	117,766	96,356
Donor-restricted contributions for long-term investment and capital projects and associated investment income	(625)	(512)
(Increase) decrease in:		
Patient accounts receivable, net	30,452	(39,562)
Other receivables	(2,966)	(1,046)
Inventories of drugs and supplies	(24,477)	(8,645)
Right-of-use operating lease assets	(30,063)	—
Other assets	(6,411)	(4,962)
Increase (decrease) in:		
Accounts payable	2,048	12,205
Other current liabilities	(6,629)	(8,070)
Accrued salaries, wages and vacation payable	26,174	14,677
Estimated third-party payor settlements payable	301,151	3,178
Postretirement and postemployment benefit obligation	328,723	195,400
Estimated professional liability costs	(4,150)	3,106
Operating lease liabilities	39,710	—
Other noncurrent liabilities	18,785	9,885
Net cash provided by operating activities	681,929	442,748
Cash flows from investing activities:		
Capital expenditures	(419,861)	(331,423)
Decrease (increase) in assets limited as to use	1,326	(1,077)
Sales of investments	1,961,183	1,931,156
Purchases of investments	(2,192,096)	(1,945,262)
Decrease (increase) in other assets	855	(4,640)
Net cash used in investing activities	(648,593)	(351,246)

(Continued)

DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES

Consolidated Statements of Cash Flows

Years ended June 30, 2020 and 2019

(In thousands)

		2020	2019
Cash flows from financing activities:			
Payments on indebtedness and bank borrowings	$	(321,861)	(23,760)
Proceeds from finance leasing program		13,578	—
Proceeds from issuance of indebtedness		299,432	—
Bond issuance costs		(2,295)	—
Proceeds from restricted contributions and associated investment income		625	512
Payments on finance lease liabilities in 2020 and capital lease obligations in 2019		(5,046)	(3,342)
Transfers to the University, net		(110,913)	(91,922)
Net cash used in financing activities		(126,480)	(118,512)
Net decrease in cash and cash equivalents		(93,144)	(27,010)
Cash and cash equivalents, beginning of year		250,947	277,957
Cash and cash equivalents, end of year	$	157,803	250,947
Supplemental disclosure of cash flow information:			
Cash paid for interest, net of amount capitalized	$	44,945	60,726
Supplemental disclosures of noncash investing/financing activities:			
Change in fixed asset payables as of June 30	$	12,123	9,623
Net transfers payable between the Health System and the University		781	1,959
Net transfers to the University of property and equipment		8,031	3,405

See accompanying notes to consolidated financial statements.

(1) Description of Organization, Related Parties, and the Private Diagnostic Clinic

(a) Duke University Health System, Inc. (the Health System)

The Health System is a North Carolina nonprofit corporation organized and controlled by Duke University (the University). The Health System includes three hospitals operated as divisions and several subsidiaries and controlled affiliates, the most significant of which follow:

- **Duke University Hospital (DUH)** – a quaternary care teaching hospital located on the campus of the University in Durham, North Carolina, licensed for 979 acute care and specialty beds, leased from the University, operated by the Health System and providing patient care and serving as a site for medical education provided by the Duke University School of Medicine (School of Medicine or SOM) and clinical research conducted by the School of Medicine.
- **Duke Regional Hospital (DRH)** – a full service community hospital located in Durham, North Carolina, licensed for 369 acute care beds and providing patient care; DRH is owned by Durham County, North Carolina and leased to the Durham County Hospital Corporation which has in turn subleased DRH to the Health System.
- **Duke Raleigh Hospital (DRaH)** – a community hospital located in Raleigh, North Carolina, licensed for 186 acute care beds, leased from the University, operated by the Health System and providing patient care.
- **Duke University Affiliated Physicians, Inc. (DUAP)** – a North Carolina nonprofit corporation, doing business as Duke Primary Care, consisting of twenty-eight primary care physician practices located in Alamance, Chatham, Durham, Franklin, Granville, Orange, Vance, and Wake Counties, North Carolina, nine urgent care centers located in Durham, Orange, and Wake Counties, four pediatric practices in Durham and Wake Counties, seven diabetes education sites in Durham, Vance, and Wake Counties co-located in primary care sites and three behavioral health sites in Durham, Granville and Wake counties co-located in primary care sites.
- **Durham Casualty Company, Ltd. (DCC)** – a wholly owned subsidiary of the Health System, domiciled in Bermuda, insuring a portion of the medical malpractice risks and patient general liability, privacy/cyber liability, and international liability risks of Health System clinical providers and the Private Diagnostic Clinic (PDC).

The Health System also includes other less significant separately incorporated affiliates and subsidiaries and unincorporated divisions, including Watts College of Nursing, Inc., not listed above whose accounts are included in the accompanying consolidated financial statements. All significant intercompany accounts and transactions are eliminated in consolidation. The Health System's accounts are included in the consolidated financial statements of the University.

(b) The University

Pursuant to a lease and operating agreement between the University and the Health System, the Health System acquired, or has acquired the right to operate, certain assets of the University for the operation of the Health System and has assumed all of the University's liabilities and obligations related to the transferred assets. Under the Health System's current Master Trust Indenture, the

(In thousands)

owners of Health System bonds look solely to the Health System for repayment of those obligations. The operating agreement between the University and the Health System provides for certain common administrative services, human resources policy and practice, fiduciary responsibility, investment policies, and support for the School of Medicine.

Certain shared administrative and general service expenses are incurred by the University for the benefit of the Health System. These are included within other operating expenses in the accompanying consolidated statements of operations and amounted to approximately $41,876 and $41,663 in fiscal years 2020 and 2019, respectively.

(c) School of Medicine (SOM)

The SOM is organized and operated as part of the University and is not included in the Health System's consolidated financial statements. The Health System provides support to the SOM in the form of cash (and some noncash) equity transfers. Examples of transfers to the SOM include but are not limited to support of specific initiatives, specific departments, or general support for the Chancellor for Health Affairs or a departmental chair. For the years ended June 30, 2020 and 2019, net unrestricted transfers to the University are as follows:

		2020	2019
Transfers to the School of Medicine, net	$	100,527	84,233
Transfers to the University, net		8,873	8,918
Total funded transfers, net		109,400	93,151
Fixed assets and other unfunded transfers, net		8,031	3,405
Unrestricted transfers to the University, net	$	117,431	96,556

The Health System plans to transfer $139,759 in cash (and some noncash) equity transfers to the University in fiscal year 2021.

(d) Private Diagnostic Clinic, PLLC (PDC)

The PDC is a professional limited liability company consisting of physicians practicing primarily within Health System facilities and PDC clinics. The purpose of the PDC is to provide a structure separate from the University and the Health System in which the members of the physician faculty of the SOM may engage in the private practice of medicine and still serve as members of the faculty of the University conducting clinical teaching and medical research. The PDC, under agreements with the University and the Health System, occupies and utilizes certain of the Health System's facilities. With the exception of a small number of individuals performing administrative services for the Health System, PDC physicians are not employed by the Health System. The PDC is not included in the Health System's or the University's consolidated financial statements.

(Continued)

(In thousands)

The Health System has numerous agreements with the PDC. Many are for services related to clinical operations such as professional service agreements (PSA) for physician staffing of certain Health System facilities, medical directors, and lab services. The Health System, through its Patient Revenue Management Organization (PRMO), has contractual responsibility for the billing and accounts receivable operations of the PDC. DCC is the principal source of malpractice, privacy/cyber, and international liability insurance for the PDC. The PDC subleases from the Health System, at market rates, clinical and administrative space owned by the University and leased to the Health System, and leases from the Health System, at market rates, space owned by the Health System. The Health System also subleases to the PDC, at full cost, leased space from nonaffiliated third parties. The following table summarizes the PDC-related revenue included in other operating revenue in the Health System's accompanying consolidated statements of operations:

		2020	2019
Billing and collection services	$	42,095	40,810
Revenue under service agreements		61,319	62,304
DCC malpractice insurance premiums		10,580	11,405
Rental income		11,428	9,679
Total	$	125,422	124,198

For the years ended June 30, 2020 and 2019, other operating expenses in the Health System's consolidated statements of operations include PDC-related expenses under service agreements of $182,080 and $161,840, respectively. The Health System has net payables to the PDC of $7,071 and $7,625 as of June 30, 2020 and 2019, respectively, related to various transactions.

(e) DUMAC, Inc. (DUMAC)

DUMAC, a separate nonprofit support corporation organized and controlled by the University, manages the investment portfolios of the Health System and the University. DUMAC manages multiple investment pools on behalf of the Health System and the University including the Health System Pool (HSP), the Long Term Pool (LTP), and the Health System Liquidity Management Account (LMA). DUMAC also manages the investment assets of the Employees' Retirement Plan of the University (ERP).

(2) Summary of Significant Accounting Policies

Significant accounting policies of the Health System are as follows:

(a) Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with original maturities of three months or less. Cash and cash equivalents that are invested in the HSP, LTP, and LMA are reported within short-term and noncurrent investments as these funds are not typically used for current operating needs.

(b) Short-Term Investments

Short-term investments include debt securities and other instruments with maturities of one year or less from the balance sheet date and are not included in cash and cash equivalents.

(c) Investments

(i) Reporting

Investments are classified as trading securities. As such, investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in excess of revenues over expenses in the accompanying consolidated statements of operations unless the income or loss is restricted by donor or law.

(ii) Valuation

Investments are recorded in the consolidated financial statements at estimated fair value. For investments made directly by the Health System whose values are based on quoted market prices in active markets, the market price of the investment is used to report fair value. For shares in mutual funds, fair values are based on share prices reported by the funds as of the last business day of the fiscal year. The Health System's interests in alternative investment funds such as fixed income, equities, hedged strategies, private capital, and real assets are generally reported at the net asset value (NAV) reported by the fund managers. Unless it is probable that all or a portion of the investment will be sold for an amount other than NAV, the Health System has concluded that NAV is an appropriate practical expedient to estimate fair value.

(iii) Derivatives

Derivatives are used by the Health System and external investment managers to manage market risks. The most common derivative strategies employed are total return swaps, futures contracts, forward contracts, and credit default index swaps. These derivative instruments are recorded at their respective fair values (note 9).

(d) Assets Limited as to Use

Assets limited as to use include funds on deposit with bond trustees, donor restricted receivables, investments and other assets, and investments required to settle estimated professional liability costs recorded in DCC.

(e) Property and Equipment

Property and equipment acquisitions are recorded at original cost or, where original cost data is not available, at estimates of original cost. Property and equipment acquired under finance leases is initially valued and recorded based on the present value of minimum lease payments. Costs associated with the development and installation of internal-use software may be capitalized or expensed. These costs are expensed if they are incurred in the preliminary project or post-implementation/operation stages and capitalized if they are incurred in the application development stage and meet certain capitalization requirements. Depreciation and amortization is calculated on the straight-line basis over

the estimated useful lives of the respective assets, except for leasehold improvements and property and equipment held under finance leases, which are amortized over the shorter of the expected useful life of the asset or related lease term. The estimated useful lives by asset type are as follows:

Asset type	Useful life
Buildings and utilities	10–50 years
Furnishings and equipment	3–20 years
Computer software	5–10 years

Gains and losses from the disposal of property and equipment are included in other operating expenses in the accompanying consolidated statements of operations. The portion of interest on the DUHS 2017 taxable bonds associated with the funding of qualifying assets is capitalized during the construction period, and interest capitalization will continue over the life of the bonds while qualifying capital projects are ongoing. Total interest cost of $17,741 and $8,497 was capitalized in fiscal years 2020 and 2019, respectively, and is included in property and equipment, net in the accompanying consolidated balance sheets.

(f) Asset Impairment

The Health System assesses the recoverability of long lived assets by determining whether the carrying value of these assets can be recovered through undiscounted future operating cash flows generated by these assets. The amount of impairment, if any, is measured by comparison of the fair value of the assets to their carrying value. Fair value is determined using market data, if available, or projected discounted future operating cash flows using a discount rate reflecting the Health System's weighted average cost of capital.

(g) Net Assets

Net assets, revenues, gains, and losses are classified based on the existence or absence of donor imposed restrictions. Accordingly, net assets of the Health System and changes therein are classified and reported as follows:

Net assets without donor restrictions – Net assets available for use in operations that are free from donor-imposed stipulations. All revenues, gains, and losses that are not restricted by donors are included in this classification. All expenses are reported as decreases in net assets without donor restrictions.

Net assets with donor restrictions – Net assets subject to donor-imposed stipulations. Some donor restrictions are temporary in nature that will be met either by actions of the Health System or the passage of time. Other donor-imposed restrictions are perpetual in nature, where the donor specifies that the resources be maintained in perpetuity. Net assets with donor restrictions are restricted for health education, capital expenditures, and other specified purposes.

Expirations of donor restrictions on net assets (i.e., the donor stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported in other revenue in the consolidated statements of operations. Contributions for acquisitions or construction of property and equipment are released from restrictions in the period in which the assets are placed into service and are excluded from excess of revenues over expenses in the consolidated statements of operations.

(h) Excess of Revenues over Expenses

Changes in net assets without donor restrictions that are excluded from excess of revenues over expenses include certain nonperiodic defined benefit plan accounting adjustments, permanent transfers of assets to and from affiliates for other than goods and services, and contributed capital assets and capital assets acquired using contributions, which by donor imposed restriction, must be used for the purposes of acquiring long lived assets.

(i) Net Patient Service Revenue

Net patient service revenue relates to contracts with patients in which the performance obligations are to provide health care services to patients. The Health System recognizes revenues over time as services (inputs) are provided to patients in the period in which services are rendered. The Health System deems the use of this input method to be a faithful depiction of the transfer of services to the patient over the performance obligation period.

The contractual relationships with patients usually involve a third-party payor, and transaction prices for the services provided are dependent upon the terms provided by or negotiated with third-party payors. The Health System has agreements with third-party payors that provide for payments to the Health System at amounts that are generally less than its established rates. The Health System determines the transaction price based on its established charges for goods and services less explicit and implicit price concessions. Explicit price concessions are contractual adjustments provided to third-party payors and published policy discounts applied to uninsured patients. Implicit price concessions represent differences between amounts billed and the estimated consideration the Health System expects to receive from patients, which are primarily based on historical collection experience. The Health System generally bills third-party payors and patients within five days after services are rendered and/or patients are discharged from the hospital. Accordingly, net patient service revenue is reported at the estimated net realizable amounts to be received from patients, third-party payors, and others, 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 retroactively adjusted in future periods as changes to estimates become known and tentative and final settlement adjustments are identified.

The Health System adopted Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* as of July 1, 2018. See (o) below for additional details upon adoption. ASU 2014-09 provides several practical expedients that the Health System applies related to its contracts with patients as follows:

i. The Health System applies the portfolio approach as a practical expedient allowed under ASC 606-10-10-4 to account for most of its patient contracts as a collective group rather than individually. The Health System does not expect the impact to the consolidated financial statements when applying the revenue recognition guidance under ASU 2014-09 for net patient service revenue to differ materially using the portfolio approach than if applied at an individual contract level. The Health System groups contracts based on similar expected payment patterns. Portfolio groupings include the following categories: hospital or professional; inpatient or outpatient; primary, secondary, and current payor responsibilities and activities. These groupings are also stratified based on aging of related receivables.

ii. The Health System has elected the practical expedient allowed under ASC 606-10-32-18 to not adjust the transaction price for the effects of a significant financing component as payment is expected to be received from patients and third-party payors within one year from the date patients receive services. In certain circumstances, the Health System enters into payment arrangements with patients that allow payments in excess of one year. In these arrangements, the financing component is not considered significant to the contract.

iii. The Health System has elected to apply the practical expedient under ASC 606-10-50-14 to not disclose the transaction price allocated to unsatisfied or partially unsatisfied performance obligations as of the end of the reporting period because these performance obligations relate to contracts with an expected duration of less than one year. These unsatisfied or partially unsatisfied performance obligations are primarily related to inpatient acute care services at the end of the fiscal year and are generally completed when patients are discharged, typically within days or weeks after year end.

(j) Charity Care

The Health System provides care to patients who meet certain criteria under its financial assistance policy without charge or at amounts less than its established rates. Because the Health System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue or included in patient accounts receivable.

(k) Derivative Financial Instruments

The Health System has elected not to use hedge accounting with respect to any of its debt derivative financial instruments. Derivative financial instruments are recognized as assets or liabilities in the consolidated balance sheets at fair value. Realized and unrealized gains and losses on derivatives are included in investment (loss) income in the consolidated statements of operations.

(l) Income Taxes

The Health System and substantially all of its affiliates are organizations described under Section 501(c)(3) of the Internal Revenue Code. Such organizations are not subject to federal and state income tax on income related to their exempt purpose. There were no material uncertain tax positions as of June 20, 2020 or 2019.

(m) Coronavirus Disease (COVID-19)

In response to the economic impact of COVID-19, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was enacted by Congress and was subsequently signed into law on March 27, 2020. The CARES Act included a variety of economic assistance provisions for businesses and individuals. The Health System suspended non-emergent or non-critical surgeries, procedures and appointments beginning in mid-March through early-May in 2020 due to COVID-19. Under certain provisions in the CARES Act, the Health System recognized benefits totaling $88,400 in its consolidated statement of operations for the year ended June 30, 2020. The $88,400 benefit is comprised of $83,470 in relief funds received and reported in other operating revenue and $4,930 for the employee retention tax credit recorded as a reduction of salaries, wages and benefits expenses. The Health System also deferred payment of $19,711 for the employer portion of the Social Security payroll tax as allowed by the CARES Act. The employee retention tax credit is claimed against the employer portion of the Social Security tax. The impact of the payroll tax deferral and employee retention tax credit is a net liability of $14,781 as of June 30, 2020 and is included in other noncurrent liabilities on the accompanying consolidated balance sheet as of that date. Fifty percent of the deferred tax credit must be paid by December 31, 2021 with the remainder by December 31, 2022.

Under the CARES Act, the Health System also received $282,129 in advance payments from the Centers for Medicare & Medicaid Services (CMS) in April 2020 which is included in estimated third-party payor settlements, net on the accompanying consolidated balance sheet as of June 30, 2020. CMS has indicated that it will begin recouping these advance payments against future Medicare claims beginning in fiscal year 2021, and the Health System will reduce the liability over time as Medicare claims for services are provided during the recoupment period.

(n) 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 as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include implicit and explicit price concessions, third-party reimbursement settlements, self-insurance liabilities, retirement obligations, and the carrying amounts of property, equipment, right-of-use operating lease assets and related lease liabilities, investments, and derivative instruments. Actual results could differ from those estimates.

(o) Recently Adopted Accounting Standards

The Financial Accounting Standards Board (FASB) issued ASU 2016-02, *Leases (Topic 842)*, in February 2016. This ASU requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP which have terms of greater than 12 months. This ASU defines a lease as a contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. This ASU retains a distinction between finance leases and operating leases. The result of retaining a distinction between finance leases and operating leases in the statement of operations and the statement of cash flows is largely unchanged from existing GAAP. The Health System adopted ASU 2016-02 on July 1, 2019 using a modified retrospective approach. The Health System elected the "package of practical expedients" upon adoption that allows entities to not reassess previous conclusions on (1) classification of existing leases, (2) whether expired or existing contracts contain leases, and (3) initial direct costs. The impact of adoption on the consolidated financial statements resulted in an increase on July 1, 2019 in noncurrent assets to record right-of-use operating lease assets of $298,599 and current and noncurrent liabilities to record lease liabilities for operating leases of the same amount, which represented the present value of remaining lease payments for operating leases. The financial statements as of and for the year ended June 30, 2019 were not modified for application of this ASU.

The FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230) – Restricted Cash*, in November 2016. This ASU requires entities to include in total cash and cash equivalents on the statement of cash flows the cash and cash equivalents that have restrictions on withdrawal or use. It also requires additional disclosure of the nature of restrictions on its cash and cash equivalents. The Health System adopted ASU 2016-18 as of July 1, 2019 with no impact to the total cash and cash equivalents presented in the consolidated statements of cash flows.

The FASB issued ASU 2017-07, *Compensation – Retirement Benefits (Topic 715) – Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, in March 2017. This ASU requires entities that sponsor employee defined benefit pension and other postretirement benefit plans to report the service cost component in the same line item on the statement of operations as other salaries, wages, and benefits costs. The other components of net benefit cost will be presented separately outside of operating income. The Health System adopted ASU 2017-07 as of July 1, 2019. This ASU required retrospective presentation of the service cost and other components of net periodic pension and postretirement benefit cost in the statement of operations and prospective application for the capitalization of the service cost component of net periodic pension and postretirement benefit in assets. To present the comparative prior year statement of operations, the Health System applied the practical expedient allowed in the ASU and used the components of net periodic pension and postretirement benefit cost information disclosed in the notes to the consolidated June 30, 2019 financial statements to determine the comparative fiscal year 2019 amounts. This resulted in an increase of $21,785 in salaries, wages and benefits expenses with a corresponding increase in non-operating (loss) income for the year ended June 30, 2019. Excess of revenues over expenses was not changed.

The FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, in May 2014 which outlines a single comprehensive model for recognizing revenue and supersedes most existing revenue recognition guidance, including guidance specific to the healthcare industry. This ASU establishes principles for reporting useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts with customers. Particularly, that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Health System adopted the new standard effective July 1, 2018 using the full retrospective method.

The FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958)*, in August 2016. This ASU reduces the classes of net assets from three to two (net assets without donor restrictions and net assets with donor restrictions), introduces new quantitative and qualitative disclosures regarding liquidity, and requires reporting expenses by both their natural and functional classification. The Health System adopted ASU 2016-14 as of June 30, 2019 and applied its provisions retrospectively to the prior year presentation in the consolidated financial statements and notes.

(p) Recently Issued Accounting Standards

The FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement* in August 2018. This ASU modifies disclosure requirements on fair value measurements in the notes to the financial statements. ASU 2018-13 is effective for fiscal year 2021, and the Health System is currently evaluating the impact on its disclosure requirements.

The FASB issued ASU 2018-14, *Compensation – Retirement Benefits – Defined Benefit Plans – General Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans* in August 2018. This ASU intends to improve the effectiveness of disclosures in the notes to financial statements for employers that sponsor defined benefit pension or other retirement plans. This ASU is effective for the Health System in fiscal year 2023, and the Health System is currently evaluating the impact on its disclosure requirements.

The FASB issued ASU 2018-15, *Intangibles – Goodwill and Other – Internal-Use-Software (Subtopic 350-40)*, in August 2018. This ASU aligns requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to obtain or develop internal-use software. ASU 2018-05 is effective for fiscal year 2022, and early adoption is permitted. The Health System is currently evaluating the impact this ASU will have on its consolidated financial statements.

(Continued)

(In thousands)

(3) Net Patient Service Revenue and Estimated Third-Party Payor Settlements

Net patient service revenue, net of price concessions, recognized in fiscal years 2020 and 2019 from major payor sources is as follows:

	2020		2019	
	Amount	Percentage	Amount	Percentage
Commercial payors	$ 2,049,999	55.9 %	$ 2,049,551	56.4 %
Medicare	729,261	19.9	744,207	20.5
Medicare managed care	358,996	9.8	325,320	9.0
Medicaid	418,584	11.4	396,306	10.9
Self-pay patients	6,332	0.2	6,599	0.2
Other third-party payors	105,978	2.8	109,408	3.0
Total	$ 3,669,150	100.0 %	$ 3,631,391	100.0 %

The Health System has determined that the nature, amount, timing, and uncertainty of revenue and cash flows are affected by the following factors: payors, geography, service lines, and reimbursement method. The Health System's operations are primarily located in Durham and Wake counties in North Carolina, and its net patient service revenues are generated predominately from inpatient and outpatient acute care services to patients from the seven North Carolina counties surrounding its three hospitals. The Health System has entered into payment agreements with third-party payors, and payment arrangements by primary payor include the following:

a) Medicare – charges for healthcare services are generally paid at prospectively determined rates based on clinical, diagnostic and other factors.

b) Medicaid – charges for healthcare services are generally paid at prospectively determined rates per discharge, per occasion of service, or per covered member.

c) Commercial – agreements with commercial insurance carriers and managed care organizations provide for payments based on predetermined rates per discharge, discounts from established charges, and prospectively determined daily rates.

The Health System recognizes patient service revenue associated with services provided to patients who have third-party coverage on the basis of contractual rates for the services rendered. For uninsured patients who do not qualify for charity care, the Health System recognizes revenue on the basis of its discounted rates. Uninsured patients automatically receive a discount from billed charges (only medically necessary services are eligible). On the basis of historical experience, a significant portion of the Health System's uninsured patients who do not qualify for charity care will fail to pay for the services provided. Thus, the Health System records significant implicit price concessions related to uninsured patients in the period the services are provided. The Health System analyzes historical collections and write-offs and identifies trends for each of its major payor sources of revenue to estimate the transaction price for patients. After the initial estimated transaction price is recorded, subsequent changes to the transaction

(Continued)

(In thousands)

price are recorded as adjustments to net patient service revenue in the period of the change. For fiscal years 2020 and 2019, adjustments arising for changes in implicit price concessions related to prior period performance obligations were not material.

Net patient service revenue includes variable consideration for estimated retroactive adjustments under reimbursement agreements with governmental programs. Adjustments are accrued on an estimated basis in the period the related services are rendered and retroactively adjusted in future periods as changes to estimates become known and tentative and final settlement adjustments are identified. The amounts due to and from governmental programs (Medicare and Medicaid) for final settlement of reimbursements are determined based upon cost reports filed annually with the respective programs. The reports for all years through June 30, 2007 for Medicare and June 30, 2014 for Medicaid have been substantially resolved with the Medicare Administrative Contractor and NC Department of Health and Human Services, respectively. In the opinion of management, adequate provisions have been made in the accompanying consolidated financial statements for adjustments that may result from final settlements of reimbursable amounts. The Health System, in part through its Compliance Program, seeks to ensure compliance with governmental program rules. The effects of retroactive adjustments from governmental programs' settlement adjustments and compliance reviews to net patient service revenue were not material in fiscal years 2020 and 2019.

The Health System receives supplemental Medicaid payments from the State of North Carolina through a federally approved disproportionate share hospital program (Medicaid DSH). Medicaid DSH payments are part of the Medicaid Program and are designed to offset a portion of the Medicaid losses incurred. Amounts recognized in the Health System's accompanying consolidated financial statements related to supplemental Medicaid follows:

		2020	2019
Supplemental Medicaid amounts included in net patient service revenue	$	209,932	199,697
Medicaid assessments included in other operating expenses		(77,114)	(80,888)
Net supplemental Medicaid revenue in operating income	$	132,818	118,809
Net (payable to) receivable from supplemental Medicaid included in estimated third-party payor settlements, net	$	(32,121)	102

The 2020 net Medicaid payable shown above includes a deferred revenue liability in the amount of $34,096 related to advance payment of fiscal year 2021 Medicaid DSH received in May 2020. There can be no assurance that the Health System will continue to qualify for future participation in this program or that the program will not be discontinued or materially modified.

(In thousands)

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

	2020	2019
Commercial payors	39.5 %	40.9 %
Medicare	20.7	20.7
Medicare managed care	13.9	13.8
Medicaid	13.7	13.4
Self-pay patients	3.8	2.8
Other third-party payors	8.4	8.4
	100.0 %	100.0 %

(4) Charity Care and Other Community Benefits

The Health System provides services at no charge or at substantially discounted rates to patients who are approved under the guidelines of its financial assistance policy. The Health System does not pursue collection of amounts determined to qualify as charity care. Services qualifying for charity care consideration include emergent and medically necessary services as determined by a Health System physician. Patient household income in relation to the federal poverty guidelines is included in the determination for charity care qualification.

While charity care is excluded from net patient service revenue and receivables, the Health System maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone and estimated costs incurred for services and supplies furnished under its financial assistance policy and other equivalent service statistics. Costs incurred are estimated based on the ratio of total operating expenses to gross charges applied to charity care charges.

In addition to charity care, the Health System provides services under the Medicare and Medicaid programs, medical education (for which payments received from Medicare and Medicaid are less than the full cost of providing these activities), and research activities. The Health System also provides both in-kind service contributions and direct support payments to Lincoln Community Health Center (LCHC) and the Durham Emergency Medical Services (EMS). LCHC is an outpatient clinic serving the Durham County, North Carolina community, supported in part by a U.S. Public Service Grant. EMS serves as the primary provider of emergency ambulance service in Durham County and is a unit of the Durham County government.

(In thousands)

The Health System estimates charity care and other community benefits in accordance with Internal Revenue Code Section 501(r). Estimates of the cost of charity care and other community benefits provided during the years ended June 30 are as follows:

	2020	2019
Charity care at cost	$ 133,015	118,461
Unreimbursed Medicaid	124,340	94,945
Total charity care and means-tested programs	257,355	213,406
Health professionals education	74,686	70,779
Cash and in-kind contributions to community groups	12,299	12,237
Total other benefits	86,985	83,016
Total charity care and other community benefits at cost	$ 344,340	296,422

In addition to the above total charity care and other community benefits reported on Internal Revenue Service (IRS) Form 990, Schedule H, the Health System also provided services under the Medicare program for which payments received were less than the full cost of providing the services. The estimated unreimbursed costs attributable to providing services under Medicare are $390,004 and $277,157 for the years ended June 30, 2020 and 2019, respectively. The Health System provides additional uncompensated care in the form of implicit price concessions (formerly considered bad debts prior to the adoption of ASU 2014-09). Estimated uncompensated costs associated with these uncollectible patient accounts were $18,773 and $23,801 for June 30, 2020 and 2019, respectively.

(5) Cash and Investments

The following is a summary of cash and investments included in accompanying consolidated balance sheets at June 30:

	2020	2019
Cash and cash equivalents	$ 157,803	250,947
Short-term investments	815,345	562,095
Investments	3,237,433	3,244,196
Cash and investments available for operations	4,210,581	4,057,238
Assets limited as to use, current	18,386	17,334
Assets limited as to use, noncurrent	79,788	86,438
Less receivables and other assets included in assets limited as to use	(3,380)	(4,660)
Total cash and investments	$ 4,305,375	4,156,350

(Continued)

(In thousands)

The Health System invests through separate accounts and commingled vehicles (including limited partnerships). The fair value of cash and investments consists of the following at June 30:

	2020	2019	Unfunded commitments[2]	Redemption frequency (in days)	Redemption notice period (in days)
Cash and cash equivalents	$ 157,803	264,956	—	daily	1
Deposits with bond trustees	332	886	—	N/A	N/A
Short-term investments	829,222	562,095	—	daily	1
Fixed income	547,936	498,361	—	1 to 30	1 to 30
Equities	594,537	633,972	—	1 to 90	1 to 90
Hedged strategies	908,357	997,234	554	30 to > 365	2 to 100
Private capital	813,927	723,198	257,950	N/A	N/A
Real assets	335,649	386,809	139,293	N/A	N/A
Other	117,612	88,839	—	N/A	N/A
Total cash and investments[1]	4,305,375	4,156,350	$ 397,797		
Less cash and investments included in assets limited as to use	(94,794)	(99,112)			
Cash and investments available for operations	$ 4,210,581	4,057,238			

1 Includes the Health System's participation in pooled assets of $239,092 and $304,278 at June 30, 2020 and 2019, respectively, which are managed by DUMAC.

2 Future commitments likely to be called at various dates through 2024. The Health System expects to finance these commitments with available cash and expected proceeds from the sales of securities.

The Health System's investment classes are described in further detail below. Classes include direct holdings, which are generally marketable securities, or interest in funds, which are stated at NAV as a practical expedient for estimated fair value for which the related investment strategies are described.

Short-term investments include short-term U.S. Treasury, agency, corporate, and other highly liquid debt securities with an aggregate duration of less than a year. Short-term investments of $49,012 and $3,174 at June 30, 2020 and 2019, respectively, were held as collateral under investment derivative agreements and thus are not readily available for use.

Fixed income includes U.S. Treasury debt securities with maturities of more than one year and funds that invest in these types of investments and nongovernment U.S. and non-U.S. debt securities.

(Continued)

Equities includes U.S. and non-U.S. stocks and interests in funds that invest predominantly long but also short stocks and in certain cases are nonredeemable. The allocation by market is approximately: 30% domestic, 30% developed international, 25% emerging international, and 15% global.

Hedged strategies include interests in funds that invest both long and short in U.S. and non-U.S. stocks, credit-oriented securities and arbitrage strategies. Approximately 85% of the hedged strategies portfolio is invested through equity oriented strategies, 5% through credit strategies, and 10% through multi-strategy funds. Virtually all of the Health System's investments in these funds are redeemable, and the underlying assets of the funds are predominately marketable securities and derivatives.

Private capital primarily includes interest in funds or partnerships that hold illiquid investments in venture capital, buyouts, and credit. Certain private placement securities may also be held. These funds typically have periods of 10 or more years during which committed capital may be drawn. Distributions are received through liquidation of the underlying assets of the funds, which are anticipated to occur over the next 4 to 10 years.

Real assets include interests in funds or partnerships that hold illiquid investments in residential and commercial real estate, oil and gas production, energy, other commodities, and related services businesses. Additionally, certain liquid commodity- and real-estate related equities, private placement securities and related derivatives are included. These funds typically have periods of 10 or more years during which committed capital may be drawn. Distributions are received through liquidations of the underlying assets of the funds, which are anticipated to occur over the next 5 to 12 years.

The Health System's investments are exposed to several risks, including liquidity, currency, interest rate, credit, and market risks. The Health System attempts to manage these risks through diversification, ongoing due diligence of fund managers, and monitoring of economic conditions. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the Health System's consolidated financial statements.

The Health System may participate in programs to lend securities to brokers. To limit risk, collateral is posted and maintained daily at 100% to 105% of the market value of the lent securities depending on the type of security. Collateral generally is limited to cash, government securities, and irrevocable letters of credit. Both the Health System and security borrowers have the right to terminate a specific loan of securities at any time. The Health System receives lending fees and continues to earn interest and dividends on the loaned securities.

(Continued)

(In thousands)

The Health System's total investment (loss) return for the years ended June 30 is detailed below:

		2020	2019
Net realized gains from sales of investments	$	43,676	92,777
Net unrealized (losses) gains		(52,373)	58,892
Total net (losses) gains		(8,697)	151,669
Investment income		38,644	38,183
Investment gains		29,947	189,852
Net realized losses on debt derivatives		(10,324)	(8,006)
Net unrealized losses on debt derivatives		(23,650)	(20,387)
Total investment (loss) return	$	(4,027)	161,459

Investment (loss) return is classified in the consolidated statements of operations and changes in net assets as follows:

		2020	2019
Other operating revenue	$	7,760	7,394
Non-operating (loss) income		(10,623)	153,383
(Decrease) increase in net assets with donor restrictions		(1,164)	682
Total investment (loss) return	$	(4,027)	161,459

A summary of assets limited as to use and externally restricted funds at June 30 is as follows:

		2020	2019
Assets limited as to use:			
Deposits with bond trustees	$	332	885
Receivables and investments designated to settle estimated professional liability costs		38,282	42,238
Externally restricted assets		59,560	60,649
Total assets limited as to use		98,174	103,772
Less current portion of assets limited as to use		(18,386)	(17,334)
Assets limited as to use, excluding current portion	$	79,788	86,438

(Continued)

(In thousands)

(6) Liquidity and Availability

Financial assets available for general expenditure within one year of June 30 include the following:

	2020	2019
Cash and cash equivalents	$ 157,803	250,947
Patient accounts receivable, net	430,091	460,543
Other receivables	41,078	37,473
Due from the University, net	5,308	2,477
Short-term investments	815,345	562,095
Noncurrent investments	2,082,760	2,127,191
Total	$ 3,532,385	3,440,726

The Health System manages its financial assets to be available as its operating expenditures, liabilities, and other obligations become due. The Health System invests cash in excess of daily requirements in short-term, highly liquid investments. Although the noncurrent investments disclosed in the table above are intended to be held long-term, management could utilize those investments within the next year if deemed necessary.

(7) Property and Equipment

A summary of property and equipment at June 30 is as follows:

	2020	2019
Buildings and utilities	$ 1,920,676	1,844,219
Furnishings and equipment	968,141	935,827
Buildings and equipment under finance lease liabilities	170,521	131,401
Computer software	370,118	364,739
Depreciable property and equipment	3,429,456	3,276,186
Less accumulated depreciation and amortization	(2,127,666)	(1,980,987)
Depreciable property and equipment, net	1,301,790	1,295,199
Land and land improvements	143,246	141,306
Construction in progress	591,235	314,690
Property and equipment, net	$ 2,036,271	1,751,195

(Continued)

(In thousands)

The following table summarizes other property and equipment information for fiscal years 2020 and 2019:

	2020	2019
Depreciation expense	$ 159,767	157,446
Amortization of finance leases	8,639	5,512
Finance leases' accumulated amortization	41,045	34,452

(8) Indebtedness

A summary of indebtedness at June 30 is as follows:

Series	Underlying structure	Mandatory tender date[1]	Fiscal year of maturity	Effective interest rate	Outstanding principal 2020	Outstanding principal 2019
Tax-exempt revenue bonds:						
2005A	Direct placement	6/1/2028	2028	2.22 %	$ 73,020	79,470
2005B	Direct placement	5/29/2023	2028	1.89	23,635	25,725
2006A/B/C	Direct placement	3/19/2025	2039	1.77	121,620	121,620
2012B	Direct placement	6/1/2023	2023	2.45	18,060	23,490
2016B	Direct placement	5/26/2026	2042	2.11	90,000	90,000
2016C	Direct placement	5/26/2026	2042	1.99	90,000	90,000
	Total variable rate				416,335	430,305
2012A	Fixed rate	N/A	2042	4.69	2,035	276,275
2016A	Fixed rate	N/A	2028	1.98	124,145	134,145
2016D	Fixed rate	N/A	2042	3.48	125,100	125,100
Taxable bonds:						
2017	Fixed rate	N/A	2047	3.92	600,000	600,000
2020	Fixed rate	N/A	2042	2.92	299,432	—
	Total fixed rate				1,150,712	1,135,520
	Total indebtedness				1,567,047	1,565,825
	Plus unamortized premium – net				31,689	50,634
	Less unamortized debt issuance costs – net				(16,756)	(17,142)
	Indebtedness, net				1,581,980	1,599,317
	Less current portion				(25,970)	(24,925)
	Indebtedness, net of current portion				$ 1,556,010	1,574,392

[1] Represents the date upon which the bonds are currently subject to mandatory tender by the bank.

(Continued)

(In thousands)

On January 14, 2020, the Health System issued its Series 2020 taxable bonds in the par amount of $299,432 to fund an escrow account that was irrevocably placed with a trustee to meet the principal and interest payments of its 2012A tax-exempt bonds maturing on or after June 1, 2023 and pay certain expenses of issuing the bonds. The amount of the 2012A tax-exempt bonds refunded was $273,285, and the refunding meets the requirements for derecognition of the bond liability in fiscal year 2020. The refunding transaction resulted in a loss on extinguishment of debt of $10,179 representing the write-off of the unamortized premium and bond issue costs related to the refunded bonds and the escrow funding requirements for principal and interest in excess of the face value of the 2012A refunded bonds.

All Duke University Health System, Inc. Tax Exempt Revenue Bonds were issued by the North Carolina Medical Care Commission (NCMCC). The Health System is obligated to make payments of principal and interest that correspond to the obligations of the NCMCC under the bond agreements. The aggregate annual maturities of indebtedness for each of the five fiscal years subsequent to June 30, 2020 and thereafter are as follows:

2021	$	25,970
2022		27,120
2023		30,963
2024		32,987
2025		34,339
Thereafter		1,415,668
Total	$	1,567,047

The Health System must remain compliant with certain covenants and restrictions required by the trust indentures underlying its revenue bonds. These covenants include maintaining a required debt service coverage ratio and a specific liquidity target, as well as other nonfinancial restrictions.

(Continued)

(In thousands)

(9) Derivatives and Other Financial Instruments

(a) Debt Derivatives

The Health System has executed derivative financial instruments in the normal course of managing its debt portfolio. The Health System has three interest rate swap agreements that are designed to synthetically decrease the variable rate exposure associated with its portfolio of indebtedness. In addition, the Health System has one basis swap designed to reduce the interest rate risk on variable rate indebtedness by utilizing the spread between the yield curves for taxable debt securities and tax-exempt municipal debt securities.

The following summarizes the general terms for each of the Health System's swap agreements:

Effective date	Associated debt series	Original term	Current notional amount	Health System pays	Health System receives
Interest rate:					
August 12, 1993	2012B	30 years	$ 18,060	5.090 %	SIFMA
May 19, 2005	N/A	23 years	219,050	3.601	61.52% of one-month LIBOR plus 0.28%
April 1, 2009	Portfolio[1]	30 years	127,505	4.107	67.00% of one-month LIBOR
Basis:					
July 6, 2001	N/A	20 years	$ 400,000	SIFMA	72.125% of one-month LIBOR

[1] The notional amount of the April 2009 Interest Rate Swap declines coincidentally with the principal for Series 2006 bonds. The residual portion is $5,885.

Interest rate swap agreements are recorded as the estimated amount the Health System would receive or pay to terminate the swap agreement at the reporting date, taking into account current interest rates, and approximates fair value. The fair value is included in other noncurrent assets and derivative instruments on the consolidated balance sheets, while the change in fair value and the net settlement amount incurred on the swaps are included as a gain or loss in investment (loss) income on the consolidated statements of operations. The debt derivative instruments contain cross-collateralization provisions that require each counterparty to post collateral if the fair value meets certain thresholds.

(Continued)

(In thousands)

The related financial information on each of these instruments at June 30 is as follows:

	Financial information related to debt derivative instruments					
	2020			2019		
	Fair value [1]	Unrealized gain or (loss) recognized in income [2]	Realized gain or (loss) recognized in income [2]	Fair value [1]	Unrealized gain or (loss) recognized in income [2]	Realized gain or (loss) recognized in income [2]
Derivatives not designated as hedging instruments under ASC Topic 815:						
August 1993:						
Interest rate swap	$ (1,727)	464	(865)	(2,191)	355	(995)
May 2005:						
Interest rate swap	(32,913)	(5,401)	(5,529)	(27,512)	(5,090)	(4,743)
April 2009:						
Interest rate swap	(65,181)	(17,856)	(3,882)	(47,325)	(15,547)	(2,911)
July 2001:						
Basis swap	(277)	(857)	(48)	580	(105)	643
Total derivatives not designated as hedging instruments	$ (100,098)	(23,650)	(10,324)	(76,448)	(20,387)	(8,006)

[1] Balance sheet classification is noncurrent derivative instruments and other noncurrent assets.

[2] The unrealized and realized gain (loss) on derivative instruments recognized in income is included in non-operating investment (loss) income.

Health System debt derivative instruments contain provisions requiring long term, unsecured debt to be maintained at specified credit ratings from Moody's Investor Service and Standard and Poor's Rating Service, major rating agencies. If the ratings of the Health System's debt were to fall below certain benchmarks, the counterparty could request immediate payment on derivatives in net liability positions. At June 30, 2020 and 2019, the Health System's long term debt ratings exceeded these requirements. The aggregate fair value of all derivative instruments with credit risk related contingent features that are in a liability position on June 30, 2020 and 2019 is $100,098 and $77,028, respectively, for which the Health System was not required to post any collateral in the normal course of business. If the credit risk related features underlying these agreements were triggered on June 30, 2020 and 2019, the Health System would be required to post collateral of $100,098 and $77,028, respectively, to its counterparties.

The Health System is exposed to financial loss in the event of nonperformance by a counterparty to any of the financial instruments described above. General market conditions could impact the credit standing of the counterparties and, therefore, potentially impact the value of the instruments on the Health System's consolidated balance sheets. The Health System controls this counterparty risk by considering the credit rating, business risk, and reputation of any counterparty before entering into a transaction, monitoring for any change in credit standing of its counterparty during the life of the transaction, and requiring collateral be posted when predetermined thresholds are crossed. The Health

(In thousands)

System is also exposed to interest rate risk driven by factors influencing the spread between the taxable and tax-exempt market interest rates on its basis swap.

(b) Investment Derivatives

Investment strategies employed by DUMAC and investment managers retained by DUMAC incorporate the use of various derivative financial instruments with off balance sheet risk. DUMAC uses these instruments for a number of investment purposes, including hedging or altering exposure to certain asset classes and cost-effectively adding exposures to portions of the portfolio. Positions are expected to create gains or losses that, when combined with the applicable portion of the total investment portfolio, provide an expected result.

The following table provides the net notional amounts and fair value of the Health System's investment derivative activities at June 30, 2020 and 2019. It also provides the net loss amounts included in investment (loss) income during fiscal years 2020 and 2019.

	2020	2019	Location in financial statements
Net notional amounts	$ 2,753,002	3,364,054	N/A
Derivative assets	98,872	67,614	Investments
Derivative liabilities	(9,805)	(37,712)	Investments
Net loss	(26,728)	(18,974)	Investment (loss) gain
Posted collateral	(49,012)	(3,174)	Short-term investments

(10) Fair Value Measurements

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

(In thousands)

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

Level 1 – Valuations based on quoted market prices in active markets.

Level 2 – Investments that trade in markets that are considered to be active, but are based on dealer quotations or alternative pricing sources supported by observable inputs, or investments that trade in markets that are not considered to be active, but are valued based on quoted market prices, dealer quotations or alternative pricing sources supported by observable inputs.

Level 3 – Investments classified within Level 3 have significant unobservable inputs, as they trade infrequently or not at all.

The following is a summary of the levels within the fair value hierarchy for the Health System's financial assets and liabilities measured at fair value:

	June 30, 2020	Level 1	Level 2	Level 3	Investments Reported at NAV[1]
Assets:					
Cash and cash equivalents	$ 157,803	157,803	—	—	—
Deposits with bond trustees	332	332	—	—	—
Short-term investments	829,222	766,378	62,844	—	—
Fixed income	547,936	75,044	396,729	11,569	64,594
Equities	594,537	352,054	107,187	—	135,296
Hedged strategies	908,357	20,719	13,288	—	874,350
Private capital	813,927	543	—	83,218	730,166
Real assets	335,649	6,798	16,538	9,745	302,568
Other	117,612	(348)	76,784	—	41,176
Total	$ 4,305,375	1,379,323	673,370	104,532	2,148,150
Liabilities:					
Basis swap derivative	$ 277	—	277	—	—
Interest rate derivatives	99,821	—	99,821	—	—
Total	$ 100,098	—	100,098	—	—

[1] Fund investments reported at NAV as a practical expedient estimate of fair value at June 30, 2020.

(Continued)

(In thousands)

	June 30, 2019	Level 1	Level 2	Level 3	Investments Reported at NAV[1]
Assets:					
Cash and cash equivalents	$ 264,956	264,956	—	—	—
Deposits with bond trustees	886	886	—	—	—
Short-term investments	562,095	455,420	106,675	—	—
Fixed income	498,361	35,576	359,488	14,095	89,202
Equities	633,972	399,322	6,264	—	228,386
Hedged strategies	997,234	8,290	11,891	—	977,053
Private capital	723,198	1,105	—	77,956	644,137
Real assets	386,809	8,222	5,535	8,099	364,953
Other	88,839	(190)	47,539	—	41,490
Total investment assets	4,156,350	1,173,587	537,392	100,150	2,345,221
Basis swap derivative	580	—	580	—	—
Total	$ 4,156,930	1,173,587	537,972	100,150	2,345,221
Liabilities:					
Interest rate derivatives	$ 77,028	—	77,028	—	—

[1] Fund investments reported at NAV as a practical expedient estimate of fair value at June 30, 2019.

The following methods and assumptions are used by the Health System in estimating the fair value of each class of financial instruments:

Cash and cash equivalents, patient accounts receivable, other receivables, accounts payable, accrued salaries, wages, and vacation payable and related accruals, estimated third-party payor settlements, and other liabilities: The carrying amounts approximate fair value because of the short maturity of these instruments.

Investments and deposits with bond trustees: Reported at fair value as of the date of the consolidated financial statements.

Finance and operating lease liabilities: Estimated as the present value of future minimum lease payments over the lease term.

Derivative instruments: Based on a mid-market position obtained from the swap counterparties. The Health System engages a management advisor to validate the reasonableness of the swaps' recorded fair value. Collateral posting requirements are determined each month using the mid-market positions.

The following tables present additional information about Level 3 financial instruments measured at fair value. Both observable and unobservable inputs may be used to determine the fair value of positions that the Health System has classified within the Level 3 category. As a result, the unrealized gains and losses

(Continued)

(In thousands)

for assets within the Level 3 category in the tables below may include changes in fair value that were attributable to both observable and unobservable inputs.

	Balance as of June 30, 2019	Net realized and unrealized gains (losses)	Purchases	Sales	Net transfers in	Balance as of June 30, 2020
Asset category:						
Fixed Income	$ 14,095	(637)	13,400	(15,289)	—	11,569
Equities	—	(16)	17	(17)	16	—
Private capital	77,956	7,108	4,274	(6,120)	—	83,218
Real assets	8,099	(1,772)	4,387	(969)	—	9,745
Total	$ 100,150	4,683	22,078	(22,395)	16	104,532

	Balance as of June 30, 2018	Net realized and unrealized gains (losses)	Purchases	Sales	Net transfers in	Balance as of June 30, 2019
Asset category:						
Fixed Income	$ —	(239)	19,169	(4,835)	—	14,095
Private capital	61,193	19,505	9,844	(9,611)	(2,975)	77,956
Real assets	8,240	(141)	—	—	—	8,099
Total	$ 69,433	19,125	29,013	(14,446)	(2,975)	100,150

Net unrealized gains related to Level 3 assets still held at June 30, 2020 and 2019 totaled $17,726 and $23,190, respectively. There were no transfers between Level 1 and Level 2 investments during fiscal years 2020 and 2019.

(11) Professional Liability Risk Program

The accompanying consolidated financial statements include the assets and liabilities of DCC, a wholly owned subsidiary of the Health System that insures a portion of the medical malpractice risks and patient general liability, privacy/cyber liability, and international liability risks of Health System clinical providers and the PDC. Policy limits were $110,000 per incident for fiscal years ended June 30, 2020 and 2019 and $145,000 in the aggregate for fiscal years ended June 30, 2020 and 2019 for medical malpractice risks. DCC limits its exposure to loss through reinsurance and excess loss agreements.

Estimated professional liability costs include the estimated cost of professional liability in fiscal years 2020 and 2019 for reported claims incurred in the DCC program. DCC evaluates its estimated professional liability on a discounted actuarial basis. The discount rate at June 30, 2020 and 2019 was 3.5%. Accrued professional liability costs excluding estimated incurred but not reported claims as of June 30, 2020 and

2019 amounted to $38,282 and $42,238, respectively. Other receivables and investments in this amount have been designated by the Health System to settle these claims. Also included in estimated professional liability costs are estimated claims incurred but not reported related to the Health System in the amounts of $6,082 and $6,276 as of June 30, 2020 and 2019, respectively.

The estimated liability for professional and patient general liability claims will be significantly affected if current and future claims differ from historical trends. While management monitors reported claims closely and considers potential outcomes as estimated by its actuaries when determining its professional and general liability accruals, the complexity of the claims, the extended period of time to settle the claims and the wide range of potential outcomes complicate the estimation. In the opinion of management, adequate provision has been made for this related risk.

(12) Benefit Plans

(a) Pension and Retirement Plans

Staff members of the Health System are eligible to participate in the University's defined contribution retirement plan. For the years ended June 30, 2020 and 2019, the Health System contributed approximately $58,500 and $53,800, respectively, to this plan, which is reported in salaries, wages, and benefits expense in the consolidated statements of operations. The Health System does not expect to contribute to this plan in fiscal year 2021.

In addition, other full time Health System employees participate in the University's noncontributory defined benefit pension plan (ERP). The benefits for the defined benefit plan are based on years of service and the employee's compensation during the last ten years of employment. The Health System expects to contribute $17,902 to this plan in fiscal year 2021. The allocation of the prepaid pension asset or pension liability between the University and the Health System is based primarily on compensation expense of covered employees. Health System staff represent approximately 77% of the total University's defined benefit pension plan for fiscal years 2020 and 2019.

(b) Postretirement Medical Plan

In addition to the Health System's pension plans, the Health System sponsors an unfunded, defined benefit postretirement medical plan that covers all of its full time employees who elect coverage and satisfy the plan's eligibility requirements when they retire. The plan is contributory with retiree contributions established as a percentage of the total cost for retiree healthcare and for the healthcare of their dependents. The Health System pays all benefits on a current basis. Employees hired after June 30, 2002 are not eligible for Health System contribution to the cost of this benefit and must bear the full cost themselves if elected at retirement. As a healthcare provider, the Health System utilizes an incremental cost approach to determine its liability for the postretirement medical plan. The total liability reflects estimated additional costs to provide healthcare benefits to retirees within the Health System plus the full cost to provide healthcare benefits to retirees at facilities other than Health System facilities.

(In thousands)

(c) Pension and Postretirement Medical Plans

The measurement date for both the defined benefit pension plan and the postretirement health benefit plan is June 30. Pension and postretirement expense, pension contributions, and the associated liabilities are included in the following tables, which provide a reconciliation of the changes in the Health System's portion of the plans' benefit obligations and fair value of assets for the years ended June 30:

	Pension benefits		Postretirement benefits	
	2020	**2019**	**2020**	**2019**
Reconciliation of projected benefit obligation:				
Obligation at beginning of year	$ 1,491,058	1,268,427	88,668	78,523
Service cost	65,932	53,880	999	890
Interest cost	52,964	53,122	3,014	3,245
Actuarial loss (gain)	251,825	155,840	(23,332)	10,358
Benefits payments	(39,176)	(36,710)	(4,137)	(4,348)
Administrative expenses (estimated)	(4,000)	(3,501)	—	—
Projected benefit obligation at end of year	$ 1,818,603	1,491,058	65,212	88,668
Reconciliation of fair value of plan assets:				
Fair value of plan assets at beginning of year	$ 1,115,180	1,075,610	—	—
Actual return on plan assets	206	62,044	—	—
Employer contributions	18,863	17,918	—	—
Benefits payments	(39,176)	(36,710)	—	—
Administrative expenses	(3,771)	(3,682)	—	—
Fair value of plan assets at end of year	$ 1,091,302	1,115,180	—	—
Funded status:				
Net accrued benefit liability	$ (727,301)	(375,878)	(65,212)	(88,668)

(Continued)

(In thousands)

The pension and postretirement benefits expected to be paid for the ten years subsequent to June 30, 2020 are as follows:

	Pension benefits	Postretirement benefits
2021	$ 43,923	4,350
2022	46,954	4,473
2023	50,349	4,650
2024	54,297	4,913
2025	58,373	5,130
2026–2030	361,286	27,060

The expected benefits to be paid are based on the same assumptions used to measure the Health System's benefit obligation at June 30 and include estimated future employee service.

The following table provides the components of net periodic benefit cost for the plans for the years ended June 30:

	Pension benefits		Postretirement benefits	
	2020	2019	2020	2019
Service cost	$ 65,932	53,880	999	890
Interest cost	52,964	53,122	3,014	3,245
Expected return on plan assets	(82,385)	(79,360)	—	—
Amortization of prior-service cost	907	1,208	129	—
Recognized actuarial loss	8,548	—	—	—
Net periodic benefit cost	$ 45,966	28,850	4,142	4,135

The service cost component of net periodic benefit cost is included in salaries, wages, and benefits in operating expenses with the other components of net periodic benefit cost included in non-operating components of net periodic benefit cost in the consolidated statements of operations. The prior-service costs are amortized on a straight-line basis over the average remaining service period of active participants. The expected amortization of prior-service cost for fiscal year 2021 is $907 and $0 for the pension benefits and postretirement benefits, respectively. The expected amortization of actuarial loss for fiscal year 2021 is $32,073 for the pension benefits, and the expected amortization of actuarial gain for fiscal year 2021 is $923 for postretirement benefits. Included in net assets without donor restrictions

(Continued)

(In thousands)

are the following amounts that have not been recognized in net periodic benefit cost at June 30, 2020 and 2019, respectively:

	Pension benefits		Postretirement benefits	
	2020	2019	2020	2019
Unrecognized prior service cost	$ 5,699	6,606	—	—
Unrecognized actuarial losses (gains)	571,092	245,866	(19,376)	4,085

The assumptions used in the measurement of the Health System's benefit obligation and benefit cost are shown in the following table:

Weighted average assumptions as of measurement date	Pension benefits				Postretirement benefits			
	2020		2019		2020		2019	
	Obligation	Cost	Obligation	Cost	Obligation	Cost	Obligation	Cost
Discount rate	2.76 %	3.60 %	3.60 %	4.25 %	2.52 %	3.48 %	3.48 %	4.25 %
Expected return on plan assets	N/A	7.5 %	N/A	7.5 %	N/A	N/A	N/A	N/A
Rate of compensation increase	3.0%/2.0%[1]	3.0%/2.0%[1]	3.0%/2.0%[1]	3.0%/2.0%[1]	N/A	N/A	N/A	N/A

[1] Compensation increase for first 20 years of service/thereafter

In order to determine the benefit obligation as of June 30, 2020, the per capita costs of covered healthcare benefits was assumed to increase 8.0% for non-Medicare eligible employees and 7.5% for Medicare eligible employees, declining to an ultimate annual rate of increase of 4.5% by 2035 for non-Medicare and 2030 for Medicare eligible employees. The benefit expense for fiscal year 2020 was driven by the rates of increase used to determine the benefit obligation as of June 30, 2019, which were 8.0% for non-Medicare eligible employees and 7.9% for Medicare eligible employees, declining to an ultimate annual rate of increase of 4.5% by 2035 for non-Medicare and 2030 for Medicare eligible employees.

Assumed healthcare cost trend rates have a significant effect on the amounts reported for healthcare plans. A 1.0% change in assumed healthcare cost trend rates would have the following effects:

	One percentage increase	One percentage decrease
Effect on total of service and interest cost components of net periodic postretirement health care benefit cost	$ 635	(503)
Effect on the healthcare component of the accumulated postretirement benefit obligation	1,654	(2,591)

(Continued)

(In thousands)

The defined benefit pension plan's investment strategy focuses on maximizing total return and places limited emphasis on liability matching and no emphasis on generating income. Over the long term, the plan's average exposure target is 48% equity (public and private investments in companies), 9% commodity (direct commodity exposure, commodity related equities, and private investments in energy, power, infrastructure and timber), 9% real estate (private real estate and REITs), 15% credit (investment-grade bonds, corporate bonds, bank debt, asset backed securities, etc.), 13% absolute return oriented strategies, 4% rates (public obligations including treasuries and agencies) and 2% inflation-linked strategies.

The expected return on plan assets is established at an amount that reflects the targeted asset allocation and expected returns for each component of the plan assets. The expected return on pension plan assets was developed using a stochastic forecast model of long term expected returns for each asset class. The rate is reviewed periodically and adjusted as appropriate to reflect changes in the expected market performance or in targeted asset allocation ranges.

The same levels of the fair value hierarchy as described in note 10 are used to categorize the pension plan assets. The Health System's portion of the assets was initially based on the Health System's employee liability as of June 30, 2008 and rolled forward each fiscal year using the Health System's associated employee benefit payments since fiscal year 2008. The fair value of the Health System's portion of assets available for pension benefits as of the June 30 measurement date is as follows:

	June 30, 2020	Level 1	Level 2	Level 3	Investments Reported at NAV[1]
Asset category:					
Short-term investments	$ 103,877	95,775	8,102	—	—
Fixed income	118,240	19,381	65,883	—	32,976
Equities	168,982	116,095	5,227	—	47,660
Hedged strategies	231,125	15,890	(184)	—	215,419
Private capital	317,591	303	—	31,934	285,354
Real assets	129,749	2,849	2,366	—	124,534
Other investments	21,738	(747)	22,485	—	—
	$ 1,091,302	249,546	103,879	31,934	705,943

[1] Fund investments reported at NAV as a practical expedient estimate of fair value.

(Continued)

(In thousands)

	June 30, 2019	Level 1	Level 2	Level 3	Investments Reported at NAV[1]
Asset category:					
Short-term investments	$ 62,898	26,224	36,674	—	—
Fixed income	159,662	20,627	115,435	—	23,600
Equities	176,435	126,827	2,146	—	47,462
Hedged strategies	259,848	1,576	—	—	258,272
Private capital	291,843	627	—	30,401	260,815
Real assets	157,579	2,801	1,695	—	153,083
Other investments	6,915	(4,620)	11,535	—	—
	$ 1,115,180	174,062	167,485	30,401	743,232

[1] Fund investments reported at NAV as a practical expedient estimate of fair value.

The following tables present additional information about the Level 3 financial instruments available for pension benefits measured at fair value. Both observable and unobservable inputs may be used to determine the fair value of positions that the Health System has classified within the Level 3 category. As a result, the unrealized gains and losses for assets within the Level 3 category in the tables below may include changes in fair value that were attributable to both observable and unobservable inputs:

	Balance as of June 30, 2019	Net realized and unrealized gains	Purchases	Sales	Net transfers out	Balance as of June 30, 2020
Private capital	$ 30,401	2,521	1,359	(2,347)	—	31,934

	Balance as of June 30, 2018	Net realized and unrealized gains	Purchases	Sales	Net transfers out	Balance as of June 30, 2019
Private capital	$ 24,281	7,662	2,394	(3,015)	(921)	30,401

The change in net unrealized gains related to Level 3 assets still held at June 30, 2020 and 2019 was $7,572 and $9,546, respectively, and was recorded within change in funded status of defined benefit plans on the consolidated statements of changes in net assets.

At June 30, 2020 and 2019, the accumulated benefit obligation for pension benefits was $1,659,710 and $1,363,452, respectively, as compared to the fair value of the plan assets of $1,091,302 and $1,115,180, respectively. At June 30, 2020 and 2019, the plan was underfunded in relation to accumulated benefits by $(568,408) and $(248,272), respectively.

(Continued)

(In thousands)

(13) Functional Expenses

The Health System provides general healthcare services to residents within its geographic location. The following table presents expenses related to providing these services by both their nature and function as follows:

Year ended June 30, 2020	Healthcare services	General and administrative	Total
Salaries, wages, and benefits	$ 1,285,344	589,135	1,874,479
Medical supplies	999,746	—	999,746
Interest	39,334	—	39,334
Depreciation and amortization	143,345	25,061	168,406
Other operating expenses	497,164	247,517	744,681
Total	$ 2,964,933	861,713	3,826,646

Year ended June 30, 2019	Healthcare services	General and administrative	Total
Salaries, wages, and benefits	$ 1,180,446	530,947	1,711,393
Medical supplies	934,185	—	934,185
Interest	55,445	—	55,445
Depreciation and amortization	139,606	23,352	162,958
Other operating expenses	488,362	222,715	711,077
Total	$ 2,798,044	777,014	3,575,058

The accompanying consolidated financial statements report certain natural expense classifications that are attributed to both healthcare services and general and administrative functions. Natural expenses attributed to more than one functional expense category are allocated using a variety of cost allocation techniques such as occupancy, services utilized, and time and effort.

(14) Leases

Information as of and for the year ended June 30, 2020:

The Health System has operating and finance leases for real estate and equipment. The determination of whether or not a contract contains a lease is made at the inception of a contract. Leases with an initial term of twelve months or less are not recorded on the consolidated balance sheets. The Health System has agreements which require payments for lease and non-lease components. For these contracts, the Health System separates lease from non-lease components using information within the contract or by obtaining additional information from the respective parties in the contract.

Right-of-use assets represent the Health System's right to use an underlying asset during the lease term, and lease liabilities represent the Health System's obligation to make lease payments arising from the

(Continued)

(In thousands)

lease. Right-of-use assets and lease liabilities are recognized at the commencement date, based on the net present value of fixed lease payments over the lease term. Variable lease payments that depend on an index or a rate are included in the lease payments. Payments for taxes, common area maintenance, and utilities are typically separated from the lease payments and accounted for separately as non-lease components. The commencement date is when the Health System takes possession of the asset, and in the case of real estate is the date the landlord makes the building available for the Health System to use. The Health System's lease term includes options to extend or terminate the lease when it is reasonably certain that the options will be exercised. Since most of the Health System's operating and finance leases do not provide an implicit rate in the lease, the Health System primarily uses its incremental borrowing rate for the discount rate based on the most recent quarterly AA taxable municipal bond yields available at the commencement date to determine the net present value of lease payments. For equipment finance leases that include an interest rate in the agreement, the Health System uses the rate per the agreement instead of its incremental borrowing rate to determine the net present value of fixed lease payments.

The following table shows operating expenses related to the Health System's leasing activity for the year ended June 30, 2020:

Lease type	Classification in statement of operations		Amount
Finance lease expense:			
Amortization of right-of-use assets	Depreciation and amortization	$	8,639
Interest on lease liabilities	Interest		5,516
Operating lease expense	Other operating expenses		41,759
Short-term lease expense	Other operating expenses		15,271
Total lease expense		$	71,185

Other information related to the Health System's operating and finance right-of-use assets and lease liabilities for the year ended June 30, 2020 is reported in the below table:

Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows for finance leases	$	7,666
Operating cash flows for operating leases		36,430
Right-of-use assets obtained in exchange for new lease liabilities:		
Operating leases	$	71,450
Finance leases		20,918

(Continued)

(In thousands)

Weighted average remaining lease term:	
Operating leases	13.0 years
Finance leases	33.9 years
Weighted average discount rate:	
Operating leases	2.28 %
Finance leases	3.32

The aggregate future lease payments under finance and operating leases as of June 30, 2020 are as follows:

	Finance leases	Operating leases
Year ending June 30:		
2021	$ 13,655	32,641
2022	13,937	33,396
2023	13,469	31,168
2024	12,175	31,057
2025	9,098	30,949
Thereafter	223,373	237,250
Total minimum lease payments	285,707	396,461
Less amount of lease payments representing interest	(112,655)	(58,152)
Present value of future minimum lease payments	173,052	338,309
Less current portion	(8,250)	(25,178)
Lease liabilities, net of current portion	$ 164,802	313,131

The DRH facility lease, which is a forty-year-minimum automatically renewing “evergreen” lease, is the Health System’s largest finance lease, accounting for approximately 91% of the total finance lease payments in the above table. The Health System made principal and interest payments for this lease of $7,127 and $8,337 in fiscal years 2020 and 2019, respectively.

Total rental expense in fiscal year 2019 for all operating leases was $42,647, consisting of $11,729 for equipment leases and $30,918 for real estate leases.

(Continued)

(15) Commitments and Contingencies

(a) Construction and Purchase Commitments

At June 30, 2020, open contracts for the construction of physical properties and other capital expenditures amounted to approximately $294,855 and outstanding purchase orders for normal operating supplies and equipment amounted to approximately $4,445.

(b) Self Insurance

The Health System provides employee healthcare benefits, long term disability benefits, unemployment benefits, and workers' compensation benefits primarily through employer contributions, participant contributions, and excess loss insurance and manages those programs through third party administrators. In the opinion of management, adequate provision has been made for the related risks.

(c) Legal Considerations

Laws and regulations governing Medicare and Medicaid programs are complex and subject to interpretation. The Health System, in part through its Compliance Program, seeks to ensure compliance with such laws and regulations, and to rectify instances of noncompliance with governmental program (Medicare, Medicaid, and Tricare) rules. The Health System believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that would have a material effect on the Health System's consolidated financial statements. Compliance with such laws and regulations is subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs.

In addition to the above, the Health System is involved in various legal actions occurring in the normal course of business. While the final outcomes cannot be determined at this time, management is of the opinion that the resolution of these matters will not have a material adverse effect on the Health System's financial position.

(16) Subsequent Events

The Health System has evaluated subsequent events from the balance sheet date through September 29, 2020, the date on which the consolidated financial statements were issued, and determined that there are no other items to disclose.

Schedule 1

DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES

Combined Group under April 13, 1999 Master Trust Indenture (MTI) and Consolidated

Combining and Consolidating Balance Sheet Information

June 30, 2020

(In thousands)

Assets	Duke University Hospital	Duke Regional Hospital	Duke Raleigh Hospital	Other MTI	MTI Combined Group	Duke Univ. Affiliated Physicians	Durham Casualty Company	Other Non-MTI	2020 total DUHS consolidated
Current assets:									
Cash and cash equivalents	$ —	—	—	137,106	137,106	—	20,422	275	157,803
Patient accounts receivable, net	324,074	36,002	50,490	7,335	417,901	9,572	—	2,618	430,091
Other receivables	18,670	1,664	5,979	12,077	38,390	1,487	—	1,201	41,078
Inventories of drugs and supplies	88,020	10,846	19,028	5,735	123,629	1,404	—	1,383	126,416
Short-term investments	—	—	—	815,345	815,345	—	—	—	815,345
Assets limited as to use	—	—	—	—	—	—	18,386	—	18,386
Other assets	(152,019)	(23,042)	(23,856)	247,257	48,340	1,685	(669)	(4,591)	44,765
Total current assets	278,745	25,470	51,641	1,224,855	1,580,711	14,148	38,139	886	1,633,884
Assets limited as to use	—	—	—	59,892	59,892	—	19,896	—	79,788
Investments	—	—	—	3,047,763	3,047,763	—	189,670	—	3,237,433
Property and equipment, net	1,147,559	265,884	270,072	276,960	1,960,475	55,427	—	20,369	2,036,271
Right-of-use operating lease assets	4,116	1,006	3,178	318,440	326,740	—	—	1,922	328,662
Other noncurrent assets	—	—	21,465	27,252	48,717	—	—	2,795	51,512
Total assets	$ 1,430,420	292,360	346,356	4,955,162	7,024,298	69,575	247,705	25,972	7,367,550
Liabilities and Net Assets									
Current liabilities:									
Accounts payable	$ 106,697	20,757	28,891	33,279	189,624	2,762	90	9,804	202,280
Accrued salaries, wages and vacation payable	92,203	20,683	20,680	60,349	193,915	21,662	—	14,476	230,053
Estimated third-party payor settlements, net	222,015	37,573	47,944	—	307,532	(1,486)	—	129	306,175
Current portion of postretirement and postemployment benefit obligations	—	—	—	8,026	8,026	—	—	—	8,026
Current portion of indebtedness	—	—	—	25,970	25,970	—	—	—	25,970
Current portion of finance lease liabilities	2,900	4,239	271	840	8,250	—	—	—	8,250
Current portion of operating lease liabilities	2,124	387	1,594	21,046	25,151	—	—	27	25,178
Current portion of estimated professional liability costs	—	—	—	—	—	—	18,386	—	18,386
Other current liabilities	14,066	2,289	1,996	10,670	29,021	1,809	—	1,935	32,765
Total current liabilities	440,005	85,928	101,376	160,180	787,489	24,747	18,476	26,371	857,083
Postretirement and postemployment benefit obligations, net of current portion	—	—	—	798,265	798,265	—	—	—	798,265
Indebtedness, net of current portion	—	—	—	1,556,010	1,556,010	—	—	—	1,556,010
Finance lease liabilities, net of current portion	7,763	151,907	806	3,918	164,394	—	—	408	164,802
Operating lease liabilities, net of current portion	2,052	623	1,623	306,874	311,172	—	—	1,959	313,131
Estimated professional liability costs, net of current portion	—	—	—	6,082	6,082	—	19,896	—	25,978
Derivative Instruments	—	—	—	100,098	100,098	—	—	—	100,098
Other noncurrent liabilities	11,684	6,147	5,413	36,336	59,580	4,483	—	4,537	68,600
Total liabilities	461,504	244,605	109,218	2,967,763	3,783,090	29,230	38,372	33,275	3,883,967
Net assets:									
Without donor restrictions	968,916	47,755	237,138	1,927,839	3,181,648	40,345	209,333	(7,303)	3,424,023
With donor restrictions	—	—	—	59,560	59,560	—	—	—	59,560
Total net assets	968,916	47,755	237,138	1,987,399	3,241,208	40,345	209,333	(7,303)	3,483,583
Total liabilities and net assets	$ 1,430,420	292,360	346,356	4,955,162	7,024,298	69,575	247,705	25,972	7,367,550

See accompanying independent auditors' report.

Schedule 2

DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES

Combined Group under April 13, 1999 Master Trust Indenture (MTI) and Consolidated

Combining and Consolidating Statement of Operations Information

Year ended June 30, 2020

(In thousands)

	Duke University Hospital	Duke Regional Hospital	Duke Raleigh Hospital	Other MTI	MTI Group eliminations	MTI Combined Group	Duke Univ. Affiliated Physicians	Durham Casualty Company	Other Non-MTI	Other eliminations	2020 total DUHS consolidated
Revenues, gains, and other support without donor restrictions:											
Net patient service revenue	$ 2,578,964	352,279	512,961	62,483	(15)	3,506,672	137,056	—	25,422	—	3,669,150
Other revenue	110,760	30,069	27,536	199,201	(152,239)	215,327	3,830	26,268	168,496	(131,525)	282,396
Revenues, gains, and other support	2,689,724	382,348	540,497	261,684	(152,254)	3,721,999	140,886	26,268	193,918	(131,525)	3,951,546
Expenses:											
Salaries, wages, and benefits	920,393	195,766	175,340	322,174	—	1,613,673	135,683	—	125,123	—	1,874,479
Medical supplies	668,079	63,292	165,652	79,716	—	976,739	13,197	—	9,810	—	999,746
Interest	29,134	4,742	5,326	113	—	39,315	—	—	19	—	39,334
Depreciation and amortization	79,050	16,587	20,262	45,558	—	161,457	4,825	—	2,124	—	168,406
Other operating expenses	853,901	110,957	145,911	(185,321)	(152,254)	773,194	31,721	8,771	62,520	(131,525)	744,681
Total expenses	2,550,557	391,344	512,491	262,240	(152,254)	3,564,378	185,426	8,771	199,596	(131,525)	3,826,646
Operating income (loss)	139,167	(8,996)	28,006	(556)	—	157,621	(44,540)	17,497	(5,678)	—	124,900
Non-operating (loss) income:											
Investment (loss) income	4	—	—	(7,076)	—	(7,072)	—	(3,551)	—	—	(10,623)
Non-operating components of net periodic benefit cost	12,051	2,664	2,428	(806)	—	16,337	921	—	(435)	—	16,823
Loss on the extinguishment of debt	—	—	—	(10,179)	—	(10,179)	—	—	—	—	(10,179)
Other	70	33	5	(4,801)	—	(4,693)	—	—	5,995	—	1,302
Total nonoperating (loss) income	12,125	2,697	2,433	(22,862)	—	(5,607)	921	(3,551)	5,560	—	(2,677)
Excess (deficit) of revenues over expenses	151,292	(6,299)	30,439	(23,418)	—	152,014	(43,619)	13,946	(118)	—	122,223
Change in funded status of defined benefit plans	(35,191)	(7,651)	(6,628)	(248,929)	—	(298,399)	(2,660)	—	—	—	(301,059)
Net assets released from restrictions for purchase of property and equipment	600	—	—	117	—	717	—	—	—	—	717
Intracompany transfers, net	(83,763)	(110,530)	(16,332)	162,959	—	(47,666)	48,324	—	(658)	—	—
Transfers (to) from the University, net	(122,270)	—	147	3,690	—	(118,433)	414	—	588	—	(117,431)
Increase (decrease) in net assets without donor restrictions	$ (89,332)	(124,480)	7,626	(105,581)	—	(311,767)	2,459	13,946	(188)	—	(295,550)

See accompanying independent auditors' report.