



**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Consolidated Financial Statements and Supplementary Schedules

June 30, 2021 and 2020

(With Independent Auditors' Report Thereon)

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Table of Contents

	Page(s)
Independent Auditors' Report	1–2
Consolidated Balance Sheets	3
Consolidated Statements of Operations	4
Consolidated Statements of Changes in Net Assets	5
Consolidated Statements of Cash Flows	6–7
Notes to Consolidated Financial Statements	8–46
Supplementary Schedules	
Schedule 1 – Combining and Consolidating Balance Sheet Information, June 30, 2021	47
Schedule 2 – Combining and Consolidating Statement of Operations Information, Year ended June 30, 2021	48



KPMG LLP
Suite 800
500 W 5th St
Winston-Salem, NC 27101

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, 2021 and 2020, 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 Consolidated 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, 2021 and 2020, 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.



Other Matter

Our audits were conducted 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 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 28, 2021

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Consolidated Balance Sheets

June 30, 2021 and 2020

(In thousands)

Assets	2021	2020
Current assets:		
Cash and cash equivalents	\$ 98,528	157,803
Patient accounts receivable	510,291	430,091
Other receivables	47,265	41,078
Inventories of drugs and supplies	140,533	126,416
Short-term investments	770,256	815,345
Assets limited as to use	13,167	18,386
Other current assets	36,799	44,765
Total current assets	1,616,839	1,633,884
Assets limited as to use	92,307	79,788
Investments	4,691,913	3,237,433
Property and equipment, net	2,259,635	2,036,271
Right-of-use operating lease assets	356,856	328,662
Other noncurrent assets	57,633	51,512
Total assets	\$ 9,075,183	7,367,550
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ 198,460	202,280
Accrued salaries, wages, and vacation payable	259,565	230,053
Current portion of estimated third-party payor settlements, net	198,039	306,175
Current portion of postretirement and postemployment benefit obligations	8,682	8,026
Current portion of indebtedness	27,120	25,970
Current portion of finance lease liabilities	9,779	8,250
Current portion of operating lease liabilities	31,311	25,178
Other current liabilities	110,075	51,151
Total current liabilities	843,031	857,083
Estimated third-party payor settlements, net of current portion	31,064	—
Postretirement and postemployment benefit obligations, net of current portion	301,437	798,265
Indebtedness, net of current portion	1,525,381	1,556,010
Finance lease liabilities, net of current portion	166,251	164,802
Operating lease liabilities, net of current portion	340,762	313,131
Derivative instruments	73,800	100,098
Other noncurrent liabilities	114,889	94,578
Total liabilities	3,396,615	3,883,967
Net assets:		
Without donor restrictions	5,603,869	3,424,023
With donor restrictions	74,699	59,560
Total net assets	5,678,568	3,483,583
Total liabilities and net assets	\$ 9,075,183	7,367,550

See accompanying notes to consolidated financial statements.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Consolidated Statements of Operations

Years ended June 30, 2021 and 2020

(In thousands)

	2021	2020
Revenues, gains, and other support without donor restrictions:		
Patient service revenue	\$ 3,967,396	3,669,150
Other revenue	302,102	282,396
Total revenues, gains, and other support	4,269,498	3,951,546
Expenses:		
Salaries, wages, and benefits	2,029,617	1,874,479
Medical supplies	1,147,452	999,746
Interest	24,081	39,334
Depreciation and amortization	176,919	168,406
Other operating expenses	770,720	744,681
Total expenses	4,148,789	3,826,646
Operating income	120,709	124,900
Nonoperating income (loss):		
Investment income (loss)	1,642,016	(10,623)
Nonoperating components of net periodic benefit cost	1,297	16,823
Loss on extinguishment of debt	—	(10,179)
Other	(4,805)	1,302
Total nonoperating income (loss)	1,638,508	(2,677)
Excess of revenues over expenses	1,759,217	122,223
Change in funded status of defined benefit plans	563,080	(301,059)
Net assets released from restrictions for purchase of property and equipment	547	717
Transfers to the University, net	(142,998)	(117,431)
Increase (decrease) in net assets without donor restrictions	\$ 2,179,846	(295,550)

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, 2021 and 2020

(In thousands)

	2021	2020
Net assets without donor restrictions:		
Excess of revenues over expenses	\$ 1,759,217	122,223
Change in funded status of defined benefit plans	563,080	(301,059)
Net assets released from restrictions for purchase of property and equipment	547	717
Transfers to the University, net	(142,998)	(117,431)
Increase (decrease) in net assets without donor restrictions	2,179,846	(295,550)
Net assets with donor restrictions:		
Contributions for restricted purposes	12,795	6,064
Transfers to the University, net	(390)	(335)
Net assets released from restrictions used for operations	(11,261)	(4,937)
Net assets released from restrictions for purchase of property and equipment	(547)	(717)
Net realized and unrealized gains (losses)	14,542	(1,164)
Increase (decrease) in net assets with donor restrictions	15,139	(1,089)
Increase (decrease) in net assets	2,194,985	(296,639)
Net assets, beginning of year	3,483,583	3,780,222
Net assets, end of year	\$ 5,678,568	3,483,583

See accompanying notes to consolidated financial statements.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Consolidated Statements of Cash Flows

Years ended June 30, 2021 and 2020

(In thousands)

	2021	2020
Cash flows from operating activities:		
Increase (decrease) in net assets	\$ 2,194,985	(296,639)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	176,919	168,406
Amortization of debt issuance costs and premium	(3,615)	(4,222)
Investment (income) loss	(1,656,152)	11,702
Loss on the extinguishment of debt	—	10,179
Net loss (gain) on other investments and disposals of property and equipment	5,215	(1,207)
Nonperiodic changes in defined benefit plans	(563,080)	301,059
Transfers to the University, net	143,388	117,766
Donor-restricted contributions for long-term investment and capital projects and associated investment income	(539)	(625)
Changes in operating assets and liabilities:		
Patient accounts receivable	(80,200)	30,452
Other receivables	(6,352)	(2,966)
Inventories of drugs and supplies	(14,117)	(24,477)
Right-of-use operating lease assets, net of operating lease liabilities	5,570	9,647
Other assets	(2,743)	(6,411)
Accounts payable	(10,244)	2,048
Accrued salaries, wages, and vacation payable	29,512	26,174
Estimated third-party payor settlements payable	(77,072)	301,151
Postretirement and postemployment benefit obligation	66,908	27,664
Other liabilities	76,786	12,228
Net cash provided by operating activities	285,169	681,929
Cash flows from investing activities:		
Capital expenditures	(386,834)	(419,861)
(Increase) decrease in assets limited as to use	(698)	1,326
Sales of investments	2,188,894	1,961,183
Purchases of investments	(1,972,522)	(2,192,096)
(Increase) decrease in other assets	(3,097)	855
Net cash used in investing activities	(174,257)	(648,593)

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Consolidated Statements of Cash Flows

Years ended June 30, 2021 and 2020

(In thousands)

	2021	2020
Cash flows from financing activities:		
Payments on indebtedness and bank borrowings	\$ (25,970)	(321,861)
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	539	625
Payments on finance lease liabilities	(9,063)	(5,046)
Transfers to the University, net	(135,693)	(110,913)
Net cash used in financing activities	(170,187)	(126,480)
Net decrease in cash and cash equivalents	(59,275)	(93,144)
Cash and cash equivalents, beginning of year	157,803	250,947
Cash and cash equivalents, end of year	\$ 98,528	157,803
Supplemental disclosures of cash flow information:		
Cash paid for interest, net of amount capitalized	\$ 27,739	44,945
Medicare accelerated advance payments from CARES Act funding included in cash flows from operating activities	(35,737)	282,129
Supplemental disclosures of noncash investing/financing activities:		
Change in fixed asset payables as of June 30	\$ 6,636	12,123
Net transfers to the University of property and equipment	4,961	8,031
Net transfers payable between the Health System and the University	3,449	781

See accompanying notes to consolidated financial statements.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

(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 1,048 acute and specialty care 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 388 acute and specialty 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 and Duke Specialty Care. Duke Primary Care consists of 33 primary care physician practices located in Alamance, Chatham, Durham, Franklin, Granville, Orange, Vance, and Wake Counties, North Carolina; 10 urgent care centers located in Durham, Orange, and Wake Counties; and 6 pediatric practices in Durham and Wake Counties. Additionally, 7 diabetes education sites and 3 behavioral health practices are colocated with primary care sites. Duke Specialty Care was established in fiscal year 2021 and will add specialty care physician practices to DUAP beginning in fiscal year 2022.
- **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.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

(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 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 \$43,747 and \$41,876 in fiscal years 2021 and 2020, 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, 2021 and 2020, net unrestricted transfers to the University are as follows:

	2021	2020
Transfers to the School of Medicine, net	\$ 123,104	100,527
Transfers to the University, net	14,933	8,873
Total funded transfers, net	138,037	109,400
Fixed assets and other unfunded transfers, net	4,961	8,031
Unrestricted transfers to the University, net	\$ 142,998	117,431

The Health System plans to transfer \$130,976 in cash (and some noncash) equity transfers to the University in fiscal year 2022.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

(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.

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:

	<u>2021</u>	<u>2020</u>
Billing and collection services	\$ 43,741	42,095
Revenue under service agreements	64,743	61,319
DCC malpractice insurance premiums	10,292	10,580
Rental income	<u>14,168</u>	<u>11,428</u>
Total	<u>\$ 132,944</u>	<u>125,422</u>

For the years ended June 30, 2021 and 2020, other operating expenses in the Health System's consolidated statements of operations include PDC-related expenses under service agreements of \$189,665 and \$182,080, respectively. The Health System has net payables to the PDC of \$10,571 and \$7,071 as of June 30, 2021 and 2020, respectively, related to various transactions.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

(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.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

(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. U.S. generally accepted accounting principles does not allow for depreciation of land and construction in progress. The estimated useful lives by asset type are as follows:

<u>Asset type</u>	<u>Useful life</u>
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 2020 and 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 \$25,303 and \$17,741 was capitalized in fiscal years 2021 and 2020, respectively, and is included in property and equipment, net in the accompanying consolidated balance sheets.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

(f) Lease Right-Of-Use Assets

The Health System has operating and finance leases for real estate and equipment. Operating leases as a lessee are included in operating lease right-of-use assets and operating lease liabilities in the accompanying consolidated balance sheets. The assets and liabilities associated with finance leases as a lessee are included in property and equipment, net and finance lease liabilities, respectively, in the accompanying consolidated balance sheets.

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 12 months or less are not recorded on the consolidated balance sheets. The Health System has agreements that require payments for lease and nonlease components. For these contracts, the Health System separates lease from nonlease 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 lease. Right-of-use assets and lease liabilities are recognized at the commencement date, based on the 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 nonlease 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 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 present value of fixed lease payments.

(g) 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.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

(h) 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.

(i) 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.

(j) Patient Service Revenue

Patient service revenue relates to contracts with patients in which the performance obligations are to provide healthcare 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

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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, 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 applies the following practical expedients provided in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 606, *Revenue from Contracts with Customers*, to its contracts with patients:

- i. The Health System applies the portfolio approach as a practical expedient allowed under ASC Subtopic 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 for 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 Subtopic 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 Subtopic 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.

(k) 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.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

(l) 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 income (loss) in the consolidated statements of operations.

(m) 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 30, 2021 or 2020.

(n) 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 nonemergent or noncritical surgeries, procedures, and appointments beginning in mid-March through early May in 2020 due to COVID-19. The following table summarizes the impact of the various provisions in the CARES Act to the Health System's consolidated financial statements as of and for the years ended June 30, 2021 and 2020:

	2021	2020
Recognized in the consolidated statements of operations:		
Relief funds included in other operating revenue	\$ 89,900	83,470
Employee retention credit included in salaries, wages, and benefits expenses	1,810	4,930
CARES Act benefits in operating income	\$ 91,710	88,400
Liabilities recognized in the consolidated balance sheets:		
Deferred payroll taxes in other current liabilities	\$ 30,118	19,711
Deferred payroll taxes in other noncurrent liabilities	30,118	—
MAAP in current portion of estimated third-party payor settlements, net	215,328	282,129
MAAP in estimated third-party payor settlements, net of current portion	31,064	—
Deferrals and advance payments in total liabilities	\$ 306,628	301,840

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

The Health System considered frequently asked questions and other guidance issued by the U.S. Department of Health and Human Services (HHS) when assessing whether the terms and conditions of the Provider Relief Funding were met. The amounts recognized as revenue could change in the future based on continuing analysis of lost revenues and COVID-19-related expenses as well as the evolving guidance provided by HHS.

The Employee Retention Credit (ERC) is a fully refundable tax credit for eligible employers that kept employees on their payroll during the pandemic. The Health System claimed the ERC for the three consecutive quarters ending December 31, 2020. The deferred payroll taxes in the above table represent the employer portion of the Social Security payroll taxes normally due between March 27, 2020 and December 31, 2020. The CARES Act allowed employers to defer payment of these payroll taxes, with 50% being due on December 31, 2021 and the remaining 50% due on December 31, 2022. The Health System received \$282,129 in Medicare accelerated and advance payments (MAAP in above table) from the Centers for Medicare & Medicaid Services (CMS) in April 2020, and CMS began recouping these advance payments against Medicare claims beginning in April 2021. The Health System is reducing the liability as Medicare recoups the advance payments against claims for services provided during the recoupment period.

(o) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated 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.

(p) Recently Adopted Accounting Standards

The FASB issued Accounting Standards Update (ASU) No. 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 consolidated financial statements. The Health System adopted ASU No. 2018-13 in fiscal year 2021 with limited modifications to its fair value measurement disclosures.

(q) Recently Issued Accounting Standards

The FASB issued ASU No. 2018-14, *Compensation – Retirement Benefits – Defined Benefit Plans – General (Subtopic 715-20): 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 consolidated 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.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

The FASB issued ASU No. 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 No. 2018-15 is effective for the Health System in fiscal year 2022, and the Health System does not expect it to have a material effect on its consolidated financial statements.

The FASB has issued several ASUs in response to various transitions due to reference rate reform initiatives. ASU No. 2018-16, *Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes*, was issued in October 2018 and permits the OIS rate based on SOFR as a U.S. benchmark interest rate. ASU No. 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*, was issued in March 2020 and allows for optional expedients for modifications of contracts, hedging relationships, and other transactions that reference LIBOR or another reference rate expected to be discontinued. The amendments are effective for contract modifications by Topic or Industry Subtopic through December 31, 2022. The FASB also issued ASU No. 2021-01, *Reference Rate Reform (Topic 848): Scope*, in January 2021 to further clarify certain optional expedients and exceptions related to derivatives. The Health System is currently evaluating application of the optional expedients when it modifies its debt derivative contracts to transition from LIBOR to SOFR or another reference rate prior to June 2023, the date by which the USD one-month LIBOR rates used in the Health System's swap agreements will be completely phased out. The Health System expects the impact to its investment-related derivative contracts to be immaterial.

(r) Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation. These reclassifications have not changed the results of operations, cash flows, or financial position of the prior period.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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

Patient service revenue, net of price concessions, recognized in fiscal years 2021 and 2020 from major payor sources is as follows:

	<u>2021</u>		<u>2020</u>	
	<u>Amount</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>
Commercial payors	\$ 2,142,411	54.0 %	\$ 2,049,999	55.9 %
Medicare	765,323	19.3	729,261	19.9
Medicare managed care	455,372	11.5	358,996	9.8
Medicaid	461,249	11.6	418,584	11.4
Self-pay patients	23,720	0.6	6,332	0.2
Other third-party payors	119,321	3.0	105,978	2.8
Total	<u>\$ 3,967,396</u>	<u>100.0 %</u>	<u>\$ 3,669,150</u>	<u>100.0 %</u>

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 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.

North Carolina Medicaid will transition from the state administered fee for services to private managed care on July 1, 2021. The Health System expects a large number of patients insured under the current North Carolina Medicaid program to transition to the new program. The Health System has agreements with the managed care organizations selected for the new Medicaid managed care program.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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 price are recorded as adjustments to patient service revenue in the period of the change. For fiscal years 2021 and 2020, adjustments arising from changes in implicit price concessions related to prior period performance obligations were not material.

Patient service revenue includes variable consideration for estimated retroactive adjustments under reimbursement agreements with government 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 government 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 North Carolina 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 government program rules. The effects of retroactive adjustments from government programs' settlement adjustments and compliance reviews to patient service revenue were not material in fiscal years 2021 and 2020.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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 are as follows:

	2021	2020
Supplemental Medicaid amounts included in patient service revenue	\$ 223,264	209,932
Medicaid assessments included in other operating expenses	(72,540)	(77,114)
Net supplemental Medicaid revenue in operating income	\$ 150,724	132,818
Net receivable (payable) from supplemental Medicaid included in current portion of estimated third-party payor settlements, net	\$ 113	(32,121)

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 as North Carolina Medicaid transitions to private managed care.

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:

	2021	2020
Commercial payors	40.7 %	39.5 %
Medicare	20.1	20.7
Medicare managed care	15.7	13.9
Medicaid	13.0	13.7
Self-pay patients	3.7	3.8
Other third-party payors	6.8	8.4
	100.0 %	100.0 %

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

(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 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.

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:

	<u>2021</u>	<u>2020</u>
Charity care at cost	\$ 140,912	133,015
Unreimbursed Medicaid	<u>144,223</u>	<u>124,340</u>
Total charity care and means-tested programs	<u>285,135</u>	<u>257,355</u>
Health professionals education	82,583	74,686
Cash and in-kind contributions and community health improvement services	<u>13,406</u>	<u>12,299</u>
Total other benefits	<u>95,989</u>	<u>86,985</u>
Total charity care and other community benefits at cost	<u>\$ 381,124</u>	<u>344,340</u>

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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 \$412,603 and \$390,004 for the years ended June 30, 2021 and 2020, respectively. The Health System provides additional uncompensated care in the form of implicit price concessions. Estimated uncompensated costs associated with these uncollectible patient accounts were \$29,205 and \$18,773 for June 30, 2021 and 2020, respectively.

(5) Cash and Investments

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

	<u>2021</u>	<u>2020</u>
Cash and cash equivalents	\$ 98,528	157,803
Short-term investments	770,256	815,345
Investments	<u>4,691,913</u>	<u>3,237,433</u>
Cash and investments available for operations	5,560,697	4,210,581
Assets limited as to use, current	13,167	18,386
Assets limited as to use, noncurrent	92,307	79,788
Less: receivables and other assets included in assets limited as to use	<u>(4,149)</u>	<u>(3,380)</u>
Total cash and investments	<u>\$ 5,662,022</u>	<u>4,305,375</u>

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(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:

	2021	2020	Unfunded commitments ²	Redemption frequency (in days)	Redemption notice period (in days)
Cash and cash equivalents	\$ 98,528	157,803	—	daily	1
Deposits with bond trustees	300	332	—	N/A	N/A
Short-term investments	784,259	829,222	—	daily	1
Fixed income	582,332	547,936	—	1 to 30	1 to 30
Equities	863,768	594,537	—	1 to 90	1 to 90
Hedged strategies	1,224,911	908,357	554	30 to > 365	2 to 100
Private capital	1,555,117	813,927	264,095	N/A	N/A
Real assets	440,782	335,649	127,906	N/A	N/A
Other	112,025	117,612	—	N/A	N/A
	<u>5,662,022</u>	<u>4,305,375</u>	<u>\$ 392,555</u>		
Total cash and investments ¹					
Less: cash and investments included in assets limited as to use	<u>(101,325)</u>	<u>(94,794)</u>			
Cash and investments available for operations	<u>\$ 5,560,697</u>	<u>4,210,581</u>			

¹ Includes the Health System's participation in pooled assets of \$345,442 and \$239,092 at June 30, 2021 and 2020, respectively, which are managed by DUMAC.

² Future commitments likely to be called at various dates through 2025. 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 \$18,242 and (\$49,012) at June 30, 2021 and 2020, respectively, were posted (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.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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: 31% domestic, 28% developed international, 26% emerging international, and 15% global and real estate.

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 90% of the hedged strategies portfolio is invested through equity oriented strategies, 7% through credit strategies, and 3% through multistrategy 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.

Other primarily includes other derivative instruments and the Health System's participation in the University LTP.

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.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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

	<u>2021</u>	<u>2020</u>
Net realized gains from sales of investments	\$ 572,994	43,676
Net unrealized gains (losses)	<u>1,057,290</u>	<u>(52,373)</u>
Total net gains (losses)	1,630,284	(8,697)
Investment income	<u>22,051</u>	<u>38,644</u>
Investment gains	1,652,335	29,947
Net realized losses on debt derivatives	(12,958)	(10,324)
Net unrealized gains (losses) on debt derivatives	<u>26,298</u>	<u>(23,650)</u>
Total investment income (loss)	<u>\$ 1,665,675</u>	<u>(4,027)</u>

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

	<u>2021</u>	<u>2020</u>
Other operating revenue	\$ 9,117	7,760
Nonoperating income (loss)	1,642,016	(10,623)
Increase (decrease) in net assets with donor restrictions	<u>14,542</u>	<u>(1,164)</u>
Total investment income (loss)	<u>\$ 1,665,675</u>	<u>(4,027)</u>

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

	<u>2021</u>	<u>2020</u>
Assets limited as to use:		
Deposits with bond trustees	\$ 300	332
Receivables and investments designated to settle estimated professional liability costs	30,475	38,282
Externally restricted assets	<u>74,699</u>	<u>59,560</u>
Total assets limited as to use	105,474	98,174
Less: current portion of assets limited as to use	<u>(13,167)</u>	<u>(18,386)</u>
Assets limited as to use, excluding current portion	<u>\$ 92,307</u>	<u>79,788</u>

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

(6) Liquidity and Availability

Financial assets available for general expenditure within one year of June 30 are as follows:

	<u>2021</u>	<u>2020</u>
Cash and cash equivalents	\$ 98,528	157,803
Patient accounts receivable	510,291	430,091
Other receivables	47,265	41,078
Due from the University, net and accrued income	2,071	5,308
Short-term investments	770,256	815,345
Noncurrent investments	<u>2,667,454</u>	<u>2,082,760</u>
Total	<u>\$ 4,095,865</u>	<u>3,532,385</u>

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:

	<u>2021</u>	<u>2020</u>
Buildings and utilities	\$ 2,168,497	1,920,676
Furnishings and equipment	995,909	968,141
Buildings and equipment under finance lease liabilities	184,937	170,521
Computer software	<u>367,396</u>	<u>370,118</u>
Depreciable property and equipment	3,716,739	3,429,456
Less accumulated depreciation and amortization	<u>(2,248,006)</u>	<u>(2,127,666)</u>
Depreciable property and equipment, net	1,468,733	1,301,790
Land and land improvements	159,219	143,246
Construction in progress	<u>631,683</u>	<u>591,235</u>
Property and equipment, net	<u>\$ 2,259,635</u>	<u>2,036,271</u>

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

The following table summarizes other property and equipment information for fiscal years 2021 and 2020:

	2021	2020
Depreciation expense	\$ 166,758	159,767
Finance leases' accumulated amortization	53,585	41,045

(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	
					2021	2020
Tax-exempt revenue bonds:						
2005A	Direct placement	6/1/2028	2028	1.1 % \$	66,335	73,020
2005B	Direct placement	5/29/2023	2028	0.8	21,470	23,635
2006A/B/C	Direct placement	3/19/2025	2039	0.8	121,620	121,620
2012B	Direct placement	6/1/2023	2023	1.3	12,345	18,060
2016B	Direct placement	5/26/2026	2042	1.0	90,000	90,000
2016C	Direct placement	5/26/2026	2042	0.9	90,000	90,000
Total variable rate					401,770	416,335
2012A	Fixed rate	N/A	2022	1.8	1,010	2,035
2016A	Fixed rate	N/A	2028	2.0	113,765	124,145
2016D	Fixed rate	N/A	2042	3.5	125,100	125,100
Taxable bonds:						
2017	Fixed rate	N/A	2047	3.9	600,000	600,000
2020	Fixed rate	N/A	2042	2.9	299,432	299,432
Total fixed rate					1,139,307	1,150,712
Total indebtedness					1,541,077	1,567,047
Plus unamortized premium – net					27,235	31,689
Less unamortized debt issuance costs – net					(15,811)	(16,756)
Indebtedness, net					1,552,501	1,581,980
Less current portion					(27,120)	(25,970)
Indebtedness, net of current portion					\$ 1,525,381	1,556,010

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

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(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, 2021 and thereafter are as follows:

2022	\$	27,120
2023		30,963
2024		32,987
2025		34,339
2026		35,754
Thereafter		<u>1,379,914</u>
Total	\$	<u><u>1,541,077</u></u>

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.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(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 basis swap terminated effective July 6, 2021.

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

<u>Effective date</u>	<u>Associated debt series</u>	<u>Original term</u>	<u>Current notional amount</u>	<u>Health System pays</u>	<u>Health System receives</u>
Interest rate:					
August 12, 1993	2012B	30 years	\$ 12,345	5.090 %	SIFMA
May 19, 2005	N/A	23 years	198,995	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 commensurate with the principal for Series 2006 bonds. The residual portion is \$5,885.

Interest rate swap agreements are recorded at 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 which approximates fair value. The fair value is included in 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 income (loss) 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.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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

	Financial information related to debt derivative instruments					
	2021			2020		
	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 sw ap	\$ (845)	882	(879)	(1,727)	464	(865)
May 2005:						
Interest rate sw ap	(23,283)	9,630	(7,031)	(32,913)	(5,401)	(5,529)
April 2009:						
Interest rate sw ap	(49,672)	15,509	(5,123)	(65,181)	(17,856)	(3,882)
July 2001:						
Basis sw ap	—	277	75	(277)	(857)	(48)
Total derivatives not designated as hedging instruments	\$ <u>(73,800)</u>	<u>26,298</u>	<u>(12,958)</u>	<u>(100,098)</u>	<u>(23,650)</u>	<u>(10,324)</u>

¹ Balance sheet classification is derivative instruments.

² The unrealized and realized gain (loss) on derivative instruments recognized in income is included in nonoperating investment income (loss).

The Health System's 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. 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, 2021 and 2020, 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, 2021 and 2020 is \$73,800 and 100,098, 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, 2021 and 2020, the Health System would be required to post collateral of \$73,800 and \$100,098, respectively, to its counterparties.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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 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, 2021 and 2020. It also provides the net gain (loss) amounts included in investment income (loss) during fiscal years 2021 and 2020:

	<u>2021</u>	<u>2020</u>	<u>Location in financial statements</u>
Net notional amounts	\$ 3,699,427	2,753,002	N/A
Derivative assets	49,618	98,872	Investments
Derivative liabilities	(26,161)	(9,805)	Investments
Net gain (loss)	161,475	(26,728)	Investment income (loss)
Posted (held) collateral	18,242	(49,012)	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 assigns a higher priority to observable inputs that reflect verifiable information obtained from independent sources and a lower priority to unobservable inputs that would reflect the Health System's assumptions about how market participants would value an asset or liability based on the best information available. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. The classification of an investment within the hierarchy is based upon the pricing transparency or ability to redeem the investment and does not necessarily correspond to the perceived risk of that investment. Inputs are used in applying various valuation techniques that are assumptions, which market participants use to make

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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.

The three levels of the hierarchy of inputs used to measure fair value are as follows:

- Level 1* – Unadjusted quoted prices in active markets for identical assets or liabilities that are available at the measurement date.
- Level 2* – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly at the measurement date.
- Level 3* – Unobservable inputs for the asset or liability, used in situations in which little or no market activity exists for the asset or liability at the measurement date.

The categorization of fair value measurements by level of the hierarchy is based upon the lowest level input that is significant to the overall fair value measurement for a given asset or liability. In the event that changes in the inputs used in the fair value measurement of an asset or liability result in a transfer of the fair value measurement to a different categorization (i.e., from Level 3 to Level 2), such transfers between fair value categories are recognized at the end of the reporting period.

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, 2021	Level 1	Level 2	Level 3	Investments at NAV¹
Assets:					
Cash and cash equivalents	\$ 98,528	98,528	—	—	—
Deposits with bond trustees	300	300	—	—	—
Short-term investments	784,259	612,982	171,277	—	—
Fixed income	582,332	7	494,202	16,731	71,392
Equities	863,768	553,896	133,339	—	176,533
Hedged strategies	1,224,911	27,571	—	—	1,197,340
Private capital	1,555,117	27,283	—	76,932	1,450,902
Real assets	440,782	17,496	11,513	10,799	400,974
Other	112,025	2,641	51,348	—	58,036
Total assets	<u>\$ 5,662,022</u>	<u>1,340,704</u>	<u>861,679</u>	<u>104,462</u>	<u>3,355,177</u>
Liabilities:					
Basis swap derivative	\$ —	—	—	—	—
Interest rate derivatives	73,800	—	73,800	—	—
Total liabilities	<u>\$ 73,800</u>	<u>—</u>	<u>73,800</u>	<u>—</u>	<u>—</u>

¹ Fund investments reported at NAV as a practical expedient estimate of fair value at June 30, 2021.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

	June 30, 2020	Level 1	Level 2	Level 3	Investments at NAV¹
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	<u>\$ 4,305,375</u>	<u>1,379,323</u>	<u>673,370</u>	<u>104,532</u>	<u>2,148,150</u>
Liabilities:					
Basis swap derivative	\$ 277	—	277	—	—
Interest rate derivatives	99,821	—	99,821	—	—
Total	<u>\$ 100,098</u>	<u>—</u>	<u>100,098</u>	<u>—</u>	<u>—</u>

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

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.

Debt-related 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.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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 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.

	<u>Balance as of June 30, 2020</u>	<u>Net realized and unrealized gains (losses)</u>	<u>Purchases</u>	<u>Sales</u>	<u>Net transfers out</u>	<u>Balance as of June 30, 2021</u>
Asset category:						
Fixed income	\$ 11,569	822	14,405	(9,740)	(325)	16,731
Private capital	83,218	7,204	3,574	(17,064)	—	76,932
Real assets	9,745	144	984	(74)	—	10,799
Total	<u>\$ 104,532</u>	<u>8,170</u>	<u>18,963</u>	<u>(26,878)</u>	<u>(325)</u>	<u>104,462</u>

	<u>Balance as of June 30, 2019</u>	<u>Net realized and unrealized gains (losses)</u>	<u>Purchases</u>	<u>Sales</u>	<u>Net transfers in</u>	<u>Balance as of June 30, 2020</u>
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	<u>\$ 100,150</u>	<u>4,683</u>	<u>22,078</u>	<u>(22,395)</u>	<u>16</u>	<u>104,532</u>

Net unrealized gains related to Level 3 assets still held at June 30, 2021 and 2020 totaled \$25,646 and \$17,726, respectively.

(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. DCC limits its exposure to loss through reinsurance and excess loss agreements.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

Estimated professional liability costs include the estimated cost of professional liability in fiscal years 2021 and 2020 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, 2021 and 2020 was 3.5%. Accrued professional liability costs excluding estimated incurred but not reported claims as of June 30, 2021 and 2020 amounted to \$30,475 and \$38,282, 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 \$6,312 and \$6,082 as of June 30, 2021 and 2020, respectively. Estimated professional liability costs are included in other current and other noncurrent liabilities in the consolidated balance sheets.

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 and are eligible to receive employer-provided contributions in this plan. As approved by the University's Board of Trustees, the University suspended the employer-provided contributions for the first six months of fiscal year 2021. As of June 30, 2021, the Health System accrued \$34,383 of retroactive contributions that were remitted in July 2021 to participant accounts and is reflected within other current liabilities on the 2021 consolidated balance sheet and salaries, wages, and benefits expense in the 2021 consolidated statement of operations. For fiscal year 2020, the Health System contributed approximately \$58,500 to this plan, which is reported in salaries, wages, and benefits expense in the 2020 consolidated statement of operations. The Health System expects to contribute \$65,700 to this plan in fiscal year 2022.

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 10 years of employment. The Health System expects to contribute \$18,901 to this plan in fiscal year 2022. 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 80% and 77% of the total University's defined benefit pension plan for fiscal years 2021 and 2020, respectively.

(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

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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.

(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	
	2021	2020	2021	2020
Reconciliation of projected benefit obligation:				
Obligation at beginning of year	\$ 1,818,603	1,491,058	65,212	88,668
Service cost	93,944	65,932	620	999
Interest cost	49,592	52,964	1,589	3,014
Actuarial (gain) loss	(77,793)	251,825	10,866	(23,332)
Benefits paid	(42,927)	(39,176)	(4,350)	(4,137)
Administrative expenses (estimated)	(11,700)	(4,000)	—	—
Projected benefit obligation at end of year	\$ 1,829,719	1,818,603	73,937	65,212
Reconciliation of fair value of plan assets:				
Fair value of plan assets at beginning of year	\$ 1,091,302	1,115,180	—	—
Actual return on plan assets	548,798	206	—	—
Employer contributions	20,107	18,863	—	—
Benefits paid	(42,927)	(39,176)	—	—
Administrative expenses	(11,867)	(3,771)	—	—
Fair value of plan assets at end of year	\$ 1,605,413	1,091,302	—	—
Funded status:				
Net accrued benefit liability	\$ (224,306)	(727,301)	(73,937)	(65,212)

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

The pension and postretirement benefits expected to be paid for the 10 years subsequent to June 30, 2021 are as follows:

	Pension benefits	Postretirement benefits
2022	\$ 47,792	4,363
2023	50,888	4,613
2024	54,571	4,911
2025	58,475	5,176
2026	62,744	5,303
2027–2031	384,978	28,148

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	
	2021	2020	2021	2020
Service cost	\$ 93,944	65,932	620	999
Interest cost	49,592	52,964	1,589	3,014
Expected return on plan assets	(84,535)	(82,385)	—	—
Amortization of prior-service cost and losses (gains)	907	907	(923)	129
Recognized actuarial loss	32,073	8,548	—	—
Net periodic benefit cost	<u>\$ 91,981</u>	<u>45,966</u>	<u>1,286</u>	<u>4,142</u>

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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 nonoperating 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 2022 is \$907 and \$0 for the pension benefits and postretirement benefits, respectively. The expected amortization of actuarial losses for fiscal year 2022 is \$11,542 for the pension benefits, and the expected amortization of actuarial gains for fiscal year 2022 is \$437 for postretirement benefits. Included in net assets without donor restrictions are the following amounts that have not been recognized in net periodic benefit cost at June 30, 2021 and 2020, respectively:

	Pension benefits		Postretirement benefits	
	2021	2020	2021	2020
Unrecognized prior service cost	\$ 4,792	5,699	—	—
Unrecognized actuarial (gains) losses	(2,870)	571,092	(7,587)	(19,376)

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			
	2021		2020		2021		2020	
	Obligation	Cost	Obligation	Cost	Obligation	Cost	Obligation	Cost
Discount rate	2.99 %	2.76 %	2.76 %	3.60 %	2.83 %	2.52 %	2.52 %	3.48 %
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, 2021, the per capita costs of covered healthcare benefits was assumed to increase 7.8% for non-Medicare eligible employees and 7.1% 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 2021 was driven by the rates of increase used to determine the benefit obligation as of June 30, 2020, which were 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.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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 healthcare benefit cost	\$ 47	(93)
Effect on the healthcare component of the accumulated postretirement benefit obligation	4,484	(4,616)

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.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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:

	<u>June 30, 2021</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Investments reported at NAV¹</u>
Asset category:					
Short-term investments	\$ 195,777	116,353	79,424	—	—
Fixed income	90,243	10,303	42,835	—	37,105
Equities	241,162	178,710	1,841	—	60,611
Hedged strategies	319,815	13,688	(170)	—	306,297
Private capital	590,114	7,281	—	26,388	556,445
Real assets	161,259	8,743	(2,672)	—	155,188
Other investments	7,043	(7,748)	14,791	—	—
	<u>\$ 1,605,413</u>	<u>327,330</u>	<u>136,049</u>	<u>26,388</u>	<u>1,115,646</u>

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

	<u>June 30, 2020</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Investments reported at NAV¹</u>
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	—	—
	<u>\$ 1,091,302</u>	<u>249,546</u>	<u>103,879</u>	<u>31,934</u>	<u>705,943</u>

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

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

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:

	<u>Balance as of June 30, 2020</u>	<u>Net realized and unrealized gains</u>	<u>Purchases</u>	<u>Sales</u>	<u>Net transfers out</u>	<u>Balance as of June 30, 2021</u>
Private capital	\$ 31,934	763	1,419	(7,728)	—	26,388

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

The change in net unrealized gains related to Level 3 assets still held at June 30, 2021 and 2020 was \$8,375 and \$7,572, 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, 2021 and 2020, the accumulated benefit obligation for pension benefits was \$1,665,732 and \$1,659,710, respectively, as compared to the fair value of the plan assets of \$1,605,413 and \$1,091,302, respectively. At June 30, 2021 and 2020, the plan was underfunded in relation to accumulated benefits by \$(60,319) and \$(568,408), respectively.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(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:

	<u>Healthcare services</u>	<u>General and administrative</u>	<u>Total</u>
For the year ended June 30, 2021:			
Salaries, wages, and benefits	\$ 1,497,308	532,309	2,029,617
Medical supplies	1,147,452	—	1,147,452
Interest	24,081	—	24,081
Depreciation and amortization	151,235	25,684	176,919
Other operating expenses	<u>525,107</u>	<u>245,613</u>	<u>770,720</u>
Total	<u>\$ 3,345,183</u>	<u>803,606</u>	<u>4,148,789</u>
	<u>Healthcare services</u>	<u>General and administrative</u>	<u>Total</u>
For the year ended June 30, 2020:			
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	<u>497,164</u>	<u>247,517</u>	<u>744,681</u>
Total	<u>\$ 2,964,933</u>	<u>861,713</u>	<u>3,826,646</u>

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.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

(14) Leases

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

<u>Lease type</u>	<u>Classification in statement of operations</u>	<u>2021</u>	<u>2020</u>
Finance lease expense:			
Amortization of right-of-use assets	Depreciation and amortization	\$ 10,161	8,639
Interest on lease liabilities	Interest	5,415	5,516
Operating lease expense	Other operating expenses	45,665	41,759
Short-term lease expense	Other operating expenses	18,625	15,271
Total lease expense		<u>\$ 79,866</u>	<u>71,185</u>

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

	<u>2021</u>	<u>2020</u>
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows for finance leases	\$ 5,411	7,666
Operating cash flows for operating leases	40,090	36,430
Right-of-use assets obtained in exchange for new lease liabilities:		
Finance leases	\$ 12,037	20,918
Operating leases	66,183	71,450
Weighted average remaining lease term:		
Finance leases	34.1	33.9 years
Operating leases	12.5	13.0 years
Weighted average discount rate:		
Finance leases	3.15	3.32 %
Operating leases	2.00	2.28

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

The aggregate future lease payments under finance and operating leases as of June 30, 2021 are as follows:

	<u>Finance leases</u>	<u>Operating leases</u>
Year ending June 30:		
2022	\$ 14,971	38,466
2023	14,647	39,165
2024	13,412	37,414
2025	10,334	35,013
2026	8,393	32,167
Thereafter	<u>224,505</u>	<u>242,837</u>
Total minimum lease payments	286,262	425,062
Less: amount of lease payments representing interest	<u>(110,232)</u>	<u>(52,989)</u>
Present value of future minimum lease payments	176,030	372,073
Less: current portion	<u>(9,779)</u>	<u>(31,311)</u>
Lease liabilities, net of current portion	<u>\$ 166,251</u>	<u>340,762</u>

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 86% and 85% of the total finance lease liability as of June 30, 2021 and 2020, respectively. The Health System made principal and interest payments for this lease of \$7,233 and \$7,127 in fiscal years 2021 and 2020, respectively.

(15) Commitments and Contingencies

(a) Construction and Purchase Commitments

At June 30, 2021, open contracts for the construction of physical properties and other capital expenditures amounted to approximately \$157,900 and outstanding purchase orders for normal operating supplies and equipment amounted to approximately \$12,900.

(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.

**DUKE UNIVERSITY HEALTH SYSTEM, INC.
AND AFFILIATES**

Notes to Consolidated Financial Statements

June 30, 2021 and 2020

(In thousands)

(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 government 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 28, 2021, the date on which the consolidated financial statements were issued, and determined that there are no other items to disclose.

**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, 2021

(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	2021 total DUHS consolidated
Current assets:									
Cash and cash equivalents	\$ (5)	—	—	83,546	83,541	(10)	14,768	229	98,528
Patient accounts receivable	375,798	43,325	60,944	13,732	493,799	12,497	—	3,995	510,291
Other receivables	23,325	2,561	4,239	15,360	45,485	647	—	1,133	47,265
Inventories of drugs and supplies	101,475	10,635	18,442	6,227	136,779	1,463	—	2,291	140,533
Short-term investments	—	—	—	770,256	770,256	—	—	—	770,256
Assets limited as to use	—	—	—	—	—	—	13,167	—	13,167
Other current assets	(134,014)	(16,855)	(18,802)	201,997	32,326	8,102	(2,446)	(1,183)	36,799
Total current assets	366,579	39,666	64,823	1,091,118	1,562,186	22,699	25,489	6,465	1,616,839
Assets limited as to use	—	—	—	74,999	74,999	—	17,308	—	92,307
Investments	—	—	—	4,421,111	4,421,111	—	270,802	—	4,691,913
Property and equipment, net	1,220,931	300,209	347,170	296,462	2,164,772	61,306	—	33,557	2,259,635
Right-of-use operating lease assets	14,124	1,258	3,022	335,174	353,578	1,091	—	2,187	356,856
Other noncurrent assets	—	—	21,965	32,874	54,839	—	—	2,794	57,633
Total assets	\$ 1,601,634	341,133	436,980	6,251,738	8,631,485	85,096	313,599	45,003	9,075,183
Liabilities and Net Assets									
Current liabilities:									
Accounts payable	\$ 93,981	20,959	35,809	35,294	186,043	2,663	141	9,613	198,460
Accrued salaries, wages, and vacation payable	106,005	25,230	22,912	62,971	217,118	25,898	—	16,549	259,565
Current portion of estimated third-party payor settlements, net	129,308	27,909	42,060	—	199,277	(1,341)	—	103	198,039
Current portion of postretirement and postemployment benefit obligations	—	—	—	8,682	8,682	—	—	—	8,682
Current portion of indebtedness	—	—	—	27,120	27,120	—	—	—	27,120
Current portion of finance lease liabilities	3,807	4,420	277	1,275	9,779	—	—	—	9,779
Current portion of operating lease liabilities	5,058	484	1,702	23,417	30,661	466	—	184	31,311
Other current liabilities	19,963	4,645	3,810	58,926	87,344	6,019	13,167	3,545	110,075
Total current liabilities	358,122	83,647	106,570	217,685	766,024	33,705	13,308	29,994	843,031
Estimated third-party payor settlements, net of current portion	31,064	—	—	—	31,064	—	—	—	31,064
Postretirement and postemployment benefit obligations, net of current portion	—	—	—	301,437	301,437	—	—	—	301,437
Indebtedness, net of current portion	—	—	—	1,525,381	1,525,381	—	—	—	1,525,381
Finance lease liabilities, net of current portion	7,764	153,431	529	4,236	165,960	—	—	291	166,251
Operating lease liabilities, net of current portion	9,147	775	1,335	326,836	338,093	625	—	2,044	340,762
Derivative instruments	—	—	—	73,800	73,800	—	—	—	73,800
Other noncurrent liabilities	12,124	6,865	6,430	55,931	81,350	14,097	17,308	2,134	114,889
Total liabilities	418,221	244,718	114,864	2,505,306	3,283,109	48,427	30,616	34,463	3,396,615
Net assets:									
Without donor restrictions	1,183,413	96,415	322,116	3,671,733	5,273,677	36,669	282,983	10,540	5,603,869
With donor restrictions	—	—	—	74,699	74,699	—	—	—	74,699
Total net assets	1,183,413	96,415	322,116	3,746,432	5,348,376	36,669	282,983	10,540	5,678,568
Total liabilities and net assets	\$ 1,601,634	341,133	436,980	6,251,738	8,631,485	85,096	313,599	45,003	9,075,183

See accompanying independent auditors' report.

**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, 2021

(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	2021 total DUHS consolidated
Revenues, gains, and other support without donor restrictions:											
Patient service revenue	\$ 2,729,253	392,345	578,336	79,403	—	3,779,337	157,494	—	30,565	—	3,967,396
Other revenue	119,965	12,385	31,117	220,619	(166,276)	217,810	13,627	27,248	184,852	(141,435)	302,102
Revenues, gains, and other support	<u>2,849,218</u>	<u>404,730</u>	<u>609,453</u>	<u>300,022</u>	<u>(166,276)</u>	<u>3,997,147</u>	<u>171,121</u>	<u>27,248</u>	<u>215,417</u>	<u>(141,435)</u>	<u>4,269,498</u>
Expenses:											
Salaries, wages, and benefits	997,011	213,754	187,932	334,248	—	1,732,945	159,989	—	136,683	—	2,029,617
Medical supplies	756,689	75,984	183,753	101,384	—	1,117,810	16,974	—	12,668	—	1,147,452
Interest	17,477	3,108	3,412	57	—	24,054	—	—	27	—	24,081
Depreciation and amortization	80,184	19,247	21,254	46,246	—	166,931	5,741	—	4,247	—	176,919
Other operating expenses	874,903	116,097	154,061	(191,873)	(166,276)	786,912	46,664	11,313	67,266	(141,435)	770,720
Total expenses	<u>2,726,264</u>	<u>428,190</u>	<u>550,412</u>	<u>290,062</u>	<u>(166,276)</u>	<u>3,828,652</u>	<u>229,368</u>	<u>11,313</u>	<u>220,891</u>	<u>(141,435)</u>	<u>4,148,789</u>
Operating income (loss)	<u>122,954</u>	<u>(23,460)</u>	<u>59,041</u>	<u>9,960</u>	<u>—</u>	<u>168,495</u>	<u>(58,247)</u>	<u>15,935</u>	<u>(5,474)</u>	<u>—</u>	<u>120,709</u>
Nonoperating income (loss):											
Investment income (loss)	4	—	—	1,584,297	—	1,584,301	—	57,715	—	—	1,642,016
Nonoperating components of net periodic benefit cost	—	—	—	1,297	—	1,297	—	—	—	—	1,297
Other	91	44	—	(4,948)	—	(4,813)	—	—	8	—	(4,805)
Total nonoperating income (loss)	<u>95</u>	<u>44</u>	<u>—</u>	<u>1,580,646</u>	<u>—</u>	<u>1,580,785</u>	<u>—</u>	<u>57,715</u>	<u>8</u>	<u>—</u>	<u>1,638,508</u>
Excess (deficit) of revenues over expenses	123,049	(23,416)	59,041	1,590,606	—	1,749,280	(58,247)	73,650	(5,466)	—	1,759,217
Change in funded status of defined benefit plans	—	—	—	563,080	—	563,080	—	—	—	—	563,080
Net assets released from restrictions for purchase of property and equipment	502	—	—	45	—	547	—	—	—	—	547
Intracompany transfers, net	235,765	72,076	25,703	(409,719)	—	(76,175)	54,016	—	22,159	—	—
Transfers (to) from the University, net	(144,819)	—	234	(118)	—	(144,703)	555	—	1,150	—	(142,998)
Increase (decrease) in net assets without donor restrictions	<u>\$ 214,497</u>	<u>48,660</u>	<u>84,978</u>	<u>1,743,894</u>	<u>—</u>	<u>2,092,029</u>	<u>(3,676)</u>	<u>73,650</u>	<u>17,843</u>	<u>—</u>	<u>2,179,846</u>

See accompanying independent auditors' report.