

# Advocate Aurora Health, Inc.

Condensed Consolidated Financial Statements and Other Information

As of and for the Three and Six Months Ended June 30, 2021



**ADVOCATE AURORA HEALTH, INC.**  
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**ADVOCATE AURORA HEALTH, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in thousands)

	Unaudited	Note 1
	June 30, 2021	December 31, 2020
Assets		
Current assets		
Cash and cash equivalents	\$ 781,326	\$ 959,878
Assets limited as to use	127,763	125,053
Patient accounts receivable	1,610,185	1,570,738
Other current assets	690,440	686,686
Third-party payors receivables	19,496	16,933
Collateral proceeds under securities lending program	18,618	19,789
Total current assets	<u>3,247,828</u>	<u>3,379,077</u>
Assets limited as to use	11,700,641	11,107,210
Property and equipment, net	5,828,105	5,851,977
Other assets		
Goodwill and intangible assets, net	256,920	82,752
Investments in unconsolidated entities	239,651	210,303
Reinsurance receivable	48,889	50,514
Operating lease right-of-use assets	283,313	309,678
Other noncurrent assets	519,667	458,132
Total other assets	<u>1,348,440</u>	<u>1,111,379</u>
<b>Total assets</b>	<b><u>\$ 22,125,014</u></b>	<b><u>\$ 21,449,643</u></b>

(Continued)

**ADVOCATE AURORA HEALTH, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in thousands)

	Unaudited	Note 1
	June 30, 2021	December 31, 2020
Current liabilities		
Long-term debt and commercial paper, current portion	\$ 97,277	\$ 101,996
Long-term debt subject to short-term financing arrangements	116,350	119,660
Operating lease liabilities, current portion	77,147	79,934
Accrued salaries and employee benefits	1,032,291	1,207,672
Accounts payable and other accrued liabilities	1,036,853	1,341,619
Third-party payors payables	377,615	318,801
Accrued insurance and claim costs, current portion	135,873	130,391
Collateral under securities lending program	18,618	19,789
Total current liabilities	<u>2,892,024</u>	<u>3,319,862</u>
Noncurrent liabilities		
Long-term debt, less current portion	3,301,835	3,310,401
Operating lease liabilities, less current portion	242,738	268,575
Accrued insurance and claims cost, less current portion	620,187	593,739
Accrued losses subject to insurance recovery	48,889	50,514
Obligations under swap agreements	98,496	118,620
Other noncurrent liabilities	1,401,466	1,387,888
Total noncurrent liabilities	<u>5,713,611</u>	<u>5,729,737</u>
<b>Total liabilities</b>	<b>8,605,635</b>	<b>9,049,599</b>
Net assets		
Without donor restrictions		
Controlling interest	13,115,564	12,012,719
Noncontrolling interest in subsidiaries	160,569	154,645
Total net assets without donor restrictions	<u>13,276,133</u>	<u>12,167,364</u>
With donor restrictions	243,246	232,680
<b>Total net assets</b>	<b><u>13,519,379</u></b>	<b><u>12,400,044</u></b>
<b>Total liabilities and net assets</b>	<b><u>\$ 22,125,014</u></b>	<b><u>\$ 21,449,643</u></b>

*Note 1: December 31, 2020 financial statement information was derived from and should be read in conjunction with the Advocate Aurora Health, Inc. consolidated audited financial statements as of and for the year ended December 31, 2020, available on the Electronic Municipal Market Access website ([www.emma.msrb.org](http://www.emma.msrb.org))*

See accompanying notes to condensed consolidated financial statements.

**ADVOCATE AURORA HEALTH, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS**

(in thousands)

	Unaudited		Unaudited		Note 1
	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
<b>Revenue</b>					
Patient service revenue	\$ 2,915,166	\$ 2,055,322	\$ 5,632,018	\$ 4,663,820	\$ 10,216,386
Capitation revenue	302,221	273,373	607,189	558,919	1,121,428
Other revenue	263,101	570,368	509,702	792,937	1,794,375
Total revenue	3,480,488	2,899,063	6,748,909	6,015,676	13,132,189
<b>Expenses</b>					
Salaries, wages and benefits	1,868,218	1,861,908	3,705,581	3,692,633	7,427,903
Supplies, purchased services and other	1,105,908	936,375	2,169,273	1,967,226	4,200,203
Contracted medical services	110,886	127,914	246,607	266,247	502,420
Depreciation and amortization	142,167	141,804	282,052	281,210	560,215
Interest	26,611	27,780	54,467	54,419	112,126
Total expenses	3,253,790	3,095,781	6,457,980	6,261,735	12,802,867
<b>Operating income (loss) before nonrecurring expenses</b>	<b>226,698</b>	<b>(196,718)</b>	<b>290,929</b>	<b>(246,059)</b>	<b>329,322</b>
Nonrecurring expenses	13,047	20,315	26,331	56,629	116,355
<b>Operating income (loss)</b>	<b>213,651</b>	<b>(217,033)</b>	<b>264,598</b>	<b>(302,688)</b>	<b>212,967</b>
<b>Nonoperating income (loss)</b>					
Investment income (loss), net	571,649	644,769	867,374	(526,632)	593,283
Loss on debt refinancing	(14,468)	(12,231)	(14,468)	(12,244)	(12,244)
Change in fair value of interest rate swaps	(7,214)	2,223	20,124	(36,635)	(27,280)
Pension settlement loss	—	—	—	—	(119,658)
Other nonoperating loss, net	(4,389)	(7,225)	(8,905)	(24,436)	(38,943)
Total nonoperating income (loss), net	545,578	627,536	864,125	(599,947)	395,158
Revenue in excess of (less than) expenses	759,229	410,503	1,128,723	(902,635)	608,125
Less noncontrolling interest	(20,399)	(2,561)	(38,141)	(11,805)	(50,093)
<b>Revenue in excess of (less than) expenses - attributable to controlling interest</b>	<b>\$ 738,830</b>	<b>\$ 407,942</b>	<b>\$ 1,090,582</b>	<b>\$ (914,440)</b>	<b>\$ 558,032</b>

(Continued)

**ADVOCATE AURORA HEALTH, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS**  
(in thousands)

	Unaudited		Unaudited		Note 1
	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
<b>Net assets without donor restrictions, controlling interest</b>					
Revenue in excess of (less than) expenses - attributable to controlling interest	\$ 738,830	\$ 407,942	\$ 1,090,582	\$ (914,440)	\$ 558,032
Pension-related changes other than net periodic pension costs	3,326	2,731	6,627	5,286	138,208
Net assets released from restrictions for purchase of property and equipment	1,118	1,300	5,206	3,141	6,206
Other, net	110	(248)	430	165	454
Increase (decrease) in net assets without donor restrictions, controlling interest	743,384	411,725	1,102,845	(905,848)	702,900
<b>Net assets without donor restrictions, noncontrolling interest</b>					
Revenues in excess of expenses	20,399	2,561	38,141	11,805	50,093
Distributions to noncontrolling interest	(9,133)	(2,725)	(32,217)	(22,644)	(41,948)
Other, net	—	—	—	—	(240)
Increase (decrease) in net assets without donor restrictions, noncontrolling interest	11,266	(164)	5,924	(10,839)	7,905
<b>Net assets with donor restrictions</b>					
Contributions	2,383	7,921	5,737	11,386	22,971
Investment income (loss), net	9,610	7,784	14,652	(7,055)	9,948
Net assets released from restrictions for operations	(2,509)	(4,240)	(4,840)	(7,020)	(17,074)
Net assets released from restrictions for purchase of property and equipment	(1,118)	(1,300)	(5,206)	(3,141)	(6,206)
Central IL net assets with donor restrictions sold	—	—	—	(18,949)	(18,949)
Other, net	82	67	223	(3,357)	(115)
Increase (decrease) in net assets with donor restrictions	8,448	10,232	10,566	(28,136)	(9,425)
<b>Increase (decrease) in net assets</b>	<b>763,098</b>	<b>421,793</b>	<b>1,119,335</b>	<b>(944,823)</b>	<b>701,380</b>
Net assets at beginning of period	12,756,281	10,332,048	12,400,044	11,698,664	11,698,664
<b>Net assets at end of period</b>	<b>\$ 13,519,379</b>	<b>\$ 10,753,841</b>	<b>\$ 13,519,379</b>	<b>\$ 10,753,841</b>	<b>\$ 12,400,044</b>

Note 1: December 31, 2020 financial statement information was derived from and should be read in conjunction with the Advocate Aurora Health, Inc. consolidated audited financial statements as of and for the year ended December 31, 2020, available on the Electronic Municipal Market Access website ([www.emma.msrb.org](http://www.emma.msrb.org))

See accompanying notes to condensed consolidated financial statements.

**ADVOCATE AURORA HEALTH, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	Unaudited		Unaudited		Note 1
	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
<b>Cash flows from operating activities</b>					
Increase (decrease) in net assets	\$ 763,098	\$ 421,793	\$ 1,119,335	\$ (944,823)	\$ 701,380
Adjustments to reconcile change in net assets to net cash provided by operating activities:					
Depreciation, amortization and accretion	140,448	140,799	278,310	279,123	555,515
Amortization of operating lease right-of-use assets	16,540	15,597	33,553	32,957	63,840
Loss on debt refinancing	14,468	12,231	14,468	12,244	12,244
Loss on sale of property and equipment	699	1,787	804	11,964	12,571
Change in fair value of swap agreements	7,214	(2,223)	(20,124)	36,635	27,280
Pension-related changes other than net periodic pension cost	(3,326)	(2,731)	(6,627)	(5,286)	(138,208)
Net assets released from restrictions for operations	(2,509)	(4,240)	(4,840)	(7,020)	(17,074)
Distribution to noncontrolling interest	9,260	18,277	32,217	28,225	50,205
Distributions from unconsolidated entities	839	1,367	3,563	4,497	14,951
Loss on sale of Central IL disposal group	—	—	—	—	21,346
Central IL net assets with donor restrictions sold	—	—	—	18,949	18,949
Changes in operating assets and liabilities					
Trading securities, net	(641,377)	(664,577)	(611,287)	645,000	(2,025,066)
Accounts receivable, net	(57,870)	79,917	(39,446)	238,585	31,871
Accounts payable and accrued liabilities	(313,323)	(73,854)	(472,012)	(192,833)	1,006,265
Third-party payors receivable and payable, net	22,245	670,541	56,250	686,055	16,896
Other assets and liabilities, net	(16,409)	1,597	(65,589)	81,297	240,620
Net cash (used in) provided by operating activities	(60,003)	616,281	318,575	925,569	593,585
<b>Cash flows from investing activities</b>					
Capital expenditures	(133,206)	(167,650)	(260,276)	(355,779)	(703,611)
Proceeds from sale of property and equipment	307	767	387	1,646	1,998
Purchases of investments designated as non-trading, net	(254)	321	(475)	235	241
Investments in unconsolidated entities, net	(84)	(516)	(14,059)	(516)	(8,016)
Cash received from sale of Central IL disposal group	—	—	—	—	190,000
Acquisition of Senior Helpers, net of cash acquired	(183,672)	—	(183,672)	—	—
Other	(1,590)	(146)	(1,754)	(1,686)	(15,879)
Net cash used in investing activities	(318,499)	(167,224)	(459,849)	(356,100)	(535,267)
<b>Cash flows from financing activities</b>					
Proceeds from issuance of debt	182,157	695,915	182,157	695,915	695,915
Repayments of long-term debt	(203,008)	(197,612)	(207,607)	(202,607)	(226,781)
Distribution to noncontrolling interest	(9,260)	(18,277)	(32,217)	(28,225)	(50,205)
Proceeds from restricted contributions and income on investments	11,993	15,705	20,389	4,331	32,919
Net cash (used in) provided by financing activities	(18,118)	495,731	(37,278)	469,414	451,848
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>(396,620)</b>	<b>944,788</b>	<b>(178,552)</b>	<b>1,038,883</b>	<b>510,166</b>
Cash and cash equivalents at beginning of period	1,177,946	543,807	959,878	449,712	449,712
<b>Cash and cash equivalents at end of period</b>	<b>\$ 781,326</b>	<b>\$ 1,488,595</b>	<b>\$ 781,326</b>	<b>\$ 1,488,595</b>	<b>\$ 959,878</b>

Supplemental disclosures of noncash information

Operating lease right-of-use assets in exchange for new operating lease liabilities	\$	5,313	\$	4,163	\$	5,947	\$	13,681	\$	24,272
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*Note 1: December 31, 2020 financial statement information was derived from and should be read in conjunction with the Advocate Aurora Health, Inc. consolidated audited financial statements as of and for the year ended December 31, 2020, available on the Electronic Municipal Market Access website ([www.emma.msrb.org](http://www.emma.msrb.org)).*

See accompanying notes to condensed consolidated financial statements.



**ADVOCATE AURORA HEALTH, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2021**  
**(in thousands)**

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**1. ORGANIZATION AND BASIS OF PRESENTATION**

**Description of Business**

Advocate Aurora Health, Inc. is a Delaware nonprofit corporation (the "Parent Corporation"). The Parent Corporation is the sole corporate member of Advocate Health Care Network, an Illinois not-for-profit corporation ("Advocate") and Aurora Health Care, Inc., a Wisconsin nonstock not-for-profit corporation ("Aurora"). The Parent Corporation, Advocate, Aurora and their controlled subsidiaries are collectively referred to herein as the "System." The System was formed in furtherance of the parties' common and unifying charitable health care mission to promote and improve the quality and expand the scope and accessibility of affordable health care and health care-related services for the communities they serve.

The System is comprised of various not-for-profit and for-profit entities, the primary activities are the delivery of health care services or the provision of goods and services ancillary thereto.

The System provides a continuum of care through its 24 acute care hospitals, an integrated children's hospital and a psychiatric hospital, primary and specialty physician services, outpatient centers, physician office buildings, pharmacies, rehabilitation and home health and hospice care in northern Illinois and eastern Wisconsin.

**Basis of Presentation**

The accompanying condensed consolidated financial statements as of and for the three and six months ended June 30, 2021, have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim reporting. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included in these financial statements. Included in the System's accompanying condensed consolidated financial statements are all its controlled subsidiaries. All significant intercompany transactions have been eliminated in consolidation. The accompanying condensed consolidated financial statements do not include all the information and footnotes required by GAAP for complete financial statements. As such the accompanying condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements as of and for the year ended December 31, 2020. The audited consolidated financial statements are available from the Municipal Securities Rulemaking Board ("MSRB") on its Electronic Municipal Market Access ("EMMA") system, found at <http://emma.msrb.org>. Additional information can be found in the investor relations section of the System's website at <https://www.advocateaurorahealth.org/investor-relations>.

Operating results for the three and six months ended June 30, 2021 are not necessarily indicative of the results that may be experienced during the year ending December 31, 2021.

**2. SIGNIFICANT EVENTS**

Due to the COVID-19 pandemic, the behavior of businesses and people globally was altered in a manner that had a negative impact on global and local economies including significant investment market volatility, various temporary business closures resulting in increased unemployment and other

effects which have and could continue to result in supply disruptions, lower collections on patient accounts receivable and/or decisions to defer medical treatments at the System's facilities.

At various times in 2020 and at various locations the System postponed or canceled elective procedures to comply with public health protocols. This, along with the growth in the volume of COVID-19 patients, had a negative impact on operations and revenues and also caused the System to estimate the timing, source and rate of reimbursement for COVID-19 related patient care.

The continuing and total impact of the COVID-19 pandemic on the System is difficult to predict and could adversely impact the business, investment portfolio, financial condition or results of operations and, accordingly, may have a material adverse impact on the financial condition of the System. The System continues to monitor liquidity and cash flow and has taken, and continues to take, steps to protect its fiscal health, including a focus on maintaining liquidity to meet its obligations. In addition, the System applied for certain COVID-19 related resources, including supplies, financial support, payroll tax deferrals and relief and other assistance made available through local, state and federal governments.

The System received \$0 for the three and six months ended June 30, 2021, \$364,991 for the three and six months ended June 30, 2020 and \$786,655 for the year ended December 31, 2020, in grant payments from the U.S. Department of Health and Human Services ("HHS") from the Provider Relief Fund established under the Coronavirus Aid, Relief and Economic Security Act ("CARES Act"), which has been recognized as revenue and included in other operating revenue within the condensed consolidated statement of operations and changes in net assets. Payments from the Provider Relief Fund are intended to cover unreimbursed healthcare related expenses and lost revenue from patient care attributed to COVID-19 and are not required to be repaid provided the recipient attests to and complies with the terms and conditions of the grant funds. Management of the System believes that the System is in compliance with the terms and conditions of the Provider Relief Fund distributions and will continue to monitor compliance. The CARES Act also entitled eligible employers to an employee retention tax credit designed to encourage employers to keep employees on their payroll. The refundable tax credit is limited to 50% of up to \$10 in qualified wages paid to each employee by an eligible employer whose business had been financially impacted by COVID-19. The System recognized \$0 for the three and six months ended June 30, 2021 and June 30, 2020 and \$37,060 for the year ended December 31, 2020 for the employee retention tax credit, which is included in other operating revenue within the condensed consolidated statement of operations and changes in net assets and a corresponding receivable that is included in other current assets in the condensed consolidated balance sheets. The recognition of the COVID-19 support falls under the grant accounting guidance of accounting principles generally accepted in the United States. This guidance requires all significant terms and conditions to have been met for recognition to occur. Management of the System will continue to monitor compliance with the terms and conditions of the CARES Act grant funds and the impact of the pandemic on the System's revenues and expenses.

In addition, the System received \$0 for the three and six months ended June 30, 2021, \$730,000 for the three and six months ended June 30, 2020 and approximately \$773,000 for the year ended December 31, 2020 from the Centers for Medicare and Medicaid Services ("CMS") as an advance payment for Medicare services. The funds were provided through the expansion of the Medicare Accelerated and Advance Payment Program to ensure providers and suppliers had the resources needed to combat the COVID-19 pandemic. The advances will be recouped by withholding future Medicare fee-for-service payments for claims until the full accelerated payment has been recouped, unless the System elects to repay the advances prior to full recoupment. Subsequent to the twenty-nine month recoupment period any unpaid remaining balance is subject to an interest charge of 4 percent per annum. For the three and six months ended June 30, 2021, CMS payments of

approximately \$70,000 have been recouped. Medicare accelerated and advance payments of approximately \$215,000 and \$285,000 are included in accounts payable and other accrued liabilities within the condensed consolidated balance sheets at June 30, 2021 and December 31, 2020, respectively. Medicare accelerated and advance payments of approximately \$488,000 are included in other noncurrent liabilities within the condensed consolidated balance sheets at June 30, 2021 and December 31, 2020. The CARES Act also permitted employers to defer the employer portion of social security taxes through December 31, 2020. Employers are required to remit one-half of the amount deferred by December 31, 2021 and the remaining half by December 31, 2022. Through December 31, 2020, the System deferred approximately \$215,000 of these taxes. At June 30, 2021 and December 31, 2020, approximately \$107,500 is included in accrued salaries and employee benefits and other noncurrent liabilities, respectively, within the condensed consolidated balance sheets.

On April 1, 2021, the System purchased the stock of SH Corporate Company, Inc. and SHF Acquisition Company, Inc. (collectively "Senior Helpers") for \$187,000 to further the System's strategy. The System acquired the following significant assets: \$86,984 of goodwill and \$96,800 of intangible assets. Included in the condensed consolidated statements of operations and changes in net assets from the date of acquisition is \$8,597 of revenue and \$2,862 of operating loss for the three and six months ended June 30, 2021. The related changes in net assets without donor restrictions of \$2,840 from the date of acquisition is included in the condensed consolidated balance sheets.

On July 1, 2020, the System sold a majority of the assets and certain liabilities (the "disposal group") related to operations of the System in central Illinois. The disposal group had assets sold in excess of liabilities transferred of \$205,273, consisting primarily of property and equipment and certain investment interests in unconsolidated entities. The purchase price for the disposal group was \$190,000. The System recorded a loss, inclusive of selling costs, of \$21,346 that is included in nonrecurring expenses for the year ended December 31, 2020 in the condensed consolidated financial statements.

### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **Use of Estimates**

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities and amounts disclosed in the notes to the condensed consolidated financial statements at the date of the condensed consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Although estimates are considered to be fairly stated at the time made, actual results could differ materially from those estimates.

#### **Cash Equivalents**

The System considers all highly liquid investments with a maturity of three months or less when purchased, other than those included in the investment portfolio, to be cash equivalents.

#### **Investments**

The System has designated substantially all of its investments as trading. Investments in debt and equity securities with readily determinable fair values are measured at fair value using quoted market prices or otherwise observable inputs. Investments in private equity limited partnerships and derivative products (hedge funds) are reported at fair value using net asset value as a practical expedient.

Commingled funds are carried at fair value based on other observable inputs. Investment income or loss (including realized gains and losses, interest, dividends and unrealized gains and losses) is included in the nonoperating section of the condensed consolidated statements of operations and changes in net assets, unless the income or loss is restricted by donor or law or is related to assets designated for self-insurance programs. Investment income (loss) on self-insurance trust funds is reported in other revenue in the accompanying condensed consolidated statements of operations and changes in net assets. Investment income (loss) that is restricted by donor or law is reported as a change in net assets with donor restrictions.

### **Assets Limited as to Use**

Assets limited as to use consist of investments set aside by the System for future capital improvements and certain medical education and other health care programs. The System retains control of these investments and may, at its discretion, subsequently use them for other purposes. Additionally, assets limited as to use include investments held by trustees or in trust under debt agreements, self-insurance trusts, assets held in reinsurance trust accounts and donor-restricted funds.

### **Patient Service Revenue and Accounts Receivable**

Patient service revenue is reported at the amount that reflects the consideration to which the System expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including managed care payors and government programs and excludes revenues for services provided to patients under capitated arrangements) and others and include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations. Generally, patients and third-party payors are billed within days after the services are performed or after discharge. Revenue is recognized as performance obligations are satisfied. Provisions for third-party payor settlements and adjustments are estimated in the period the related services are provided and adjusted in future periods as additional information becomes available and final settlements are determined.

As the System's performance obligations relate to contracts with a duration of less than one year, the System has applied the optional exemption provided in the guidance and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

The System does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component, due to the expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less.

The System has entered into payment arrangements with patients that allow for payments over a term in excess of one year. The System has evaluated historical collections in excess of one year and current market interest rates to determine whether a significant financing component exists that would require an adjustment to the promised amount of consideration from patients and third-party payors. The System has determined that the impact of implicit financing arrangements for payment agreements in excess of one year is insignificant to the condensed consolidated statements of operations and changes in net assets.

The System does not incur significant incremental costs in obtaining contracts with patients. Any costs incurred are expensed in the period of occurrence, as the amortization period of any asset that the System would have recognized is one year or less in duration.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is a possibility that recorded estimates will change by a material amount.

### **Inventories**

Inventories, consisting primarily of medical supplies, pharmaceuticals and durable medical equipment, are stated at the lower of cost (first-in, first-out) or market. Retail pharmaceutical inventories are stated at replacement cost.

### **Reinsurance Receivables**

Reinsurance receivables are recognized in a manner consistent with the liabilities relating to the underlying reinsured contracts.

### **Goodwill and Intangible Assets, Net**

Goodwill of \$144,997 and \$63,740 is included in goodwill and intangible assets, net in the accompanying condensed consolidated balance sheets at June 30, 2021 and December 31, 2020, respectively. As described in Note 2. SIGNIFICANT EVENTS, the System recognized \$86,984 of goodwill related to the stock purchase of SH Corporate Company, Inc. and SHF Acquisition Company, Inc. The System has elected to amortize goodwill prospectively using the straight-line method over a 10-year period in accordance with Accounting Standards Update ("ASU") 2019-06. Goodwill amortization is included in depreciation and amortization in the accompanying condensed consolidated statements of operations and changes in net assets. Goodwill amortization expense is as follows:

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Goodwill amortization	\$ 4,154	\$ 1,793	\$ 7,079	\$ 3,575	\$ 7,255

Intangible assets with expected useful lives are amortized over that period.

### **Asset Impairment**

The System considers whether indicators of impairment are present and, if indicators are present, performs the necessary tests to determine if the carrying value of an asset is recoverable. Impairment write-downs are recognized in the accompanying condensed consolidated statements of operations and changes in net assets as a component of operating expense at the time the impairment is identified. There were no material impairment charges recorded for the six months ended June 30, 2021 and the year ended December 31, 2020.

### **Property and Equipment, Net**

Property and equipment are reported at cost or, if donated, at fair value at the date of the gift. Costs of computer software developed or obtained for internal use, including external and internal direct costs of materials and labor directly associated with internal-use software development projects, are capitalized during the application development stage and included in property and equipment. Internal

labor and interest expense incurred during the period of construction of significant capital projects are capitalized as a component of costs of the asset.

Property and equipment capitalized under direct financing leases are recorded at the present value of future lease payments, adding initial direct costs and prepaid lease payments, reduced by any lease incentives. Property and equipment capitalized under direct financing leases are amortized using the straight-line method over the related lease term. Amortization of property and equipment under financing leases is included in the accompanying condensed consolidated statements of operations and changes in net assets in depreciation and amortization expense.

Property and equipment are depreciated on the straight-line method over a period ranging from 3 years to 80 years.

### **Operating Lease Right-of-use Assets**

The System records an operating lease right-of-use asset (an asset that represents the System's right to use the leased asset for the lease term) for leases that do not meet the criteria as a sales-type lease or a direct financing lease.

The System records operating lease right-of-use assets at the present value of future lease payments, adding initial direct costs and prepaid lease payments, reduced by any lease incentives. Operating lease right-of-use assets are amortized using the straight-line method over the related lease term. Amortization of operating lease right-of-use assets is included in the accompanying condensed consolidated statements of operations and changes in net assets in supplies, purchased services and other expense.

Included within operating lease right-of-use assets are assets that the System previously sold and then leased back. Those sale/leaseback transactions, which related to various administrative and medical support buildings, did not meet the accounting criteria as a sales-type lease or a direct financing lease. The buyer-lessors for such transactions are generally unrelated special-purpose entities.

### **Investments in Unconsolidated Entities**

Investments in unconsolidated entities are accounted for using the cost or equity method. The System applies the equity method of accounting for investments in unconsolidated entities when its ownership or membership interest is 50% or less and the System has the ability to exercise significant influence over the operating and financial policies of the investee. All other unconsolidated entities are accounted for using the cost method. The income (loss) on health care-related unconsolidated entities is included in other revenue in the accompanying condensed consolidated statements of operations and changes in net assets. The income or loss on non-health-related unconsolidated entities is included within other nonoperating loss, net.

### **Derivative Financial Instruments**

The System enters into transactions to manage its interest rate, credit and market risks. Derivative financial instruments, including exchange-traded and over-the-counter derivative contracts and interest rate swaps, are recorded as either assets or liabilities at fair value. Subsequent changes in a derivative's fair value are recognized in nonoperating income (loss).

### **Bond Issuance Costs, Discounts and Premiums**

Bond issuance costs, discounts and premiums are amortized over the term of the bonds using the effective interest method and are included in long-term debt, less current portion in the accompanying condensed consolidated balance sheets.

### **General and Professional Liability Risks**

The provision for self-insured general and professional liability claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. The System measures the cost of its unfunded obligations under such programs based upon actuarial calculations and records a liability on a discounted basis.

### **Net Assets With Donor Restrictions**

Net assets with donor restrictions are those assets whose use by the System has been limited by donors to a specific time period or purpose or consist of gifts with corpus values that have been restricted by donors to be maintained in perpetuity. Net assets with donor restrictions are used in accordance with the donor's wishes primarily to purchase property and equipment, to fund medical education or to fund health programs.

Assets released from restrictions to fund purchases of property and equipment are reported in the accompanying condensed consolidated statements of operations and changes in net assets as increases to net assets without donor restrictions. Those assets released from restriction for operating purposes are reported in the accompanying condensed consolidated statements of operations and changes in net assets as other revenue. When restricted, earnings are recorded as net assets with donor restrictions until amounts are expended in accordance with the donor's specifications.

### **Nonrecurring Expenses**

The System has incurred salaries, purchased services and other expenses in connection the implementation of an electronic medical records and billing system and the implementation of an enterprise resource planning system. Also recorded in nonrecurring expenses is the loss incurred on the divestiture of the central Illinois disposal group (see Note 2. SIGNIFICANT EVENTS). Due to the nature of these expenses, the costs were reported as nonrecurring in the accompanying condensed consolidated statements of operations and changes in net assets.

### **Other Nonoperating Loss, Net**

Revenues and expenses from delivering health care services and the provision of goods and services ancillary thereto are reported in operations. Income and losses that arise from transactions that are peripheral or incidental to the System's main purpose are included in other nonoperating loss, net. Other nonoperating loss, net primarily consists of fund-raising expenses, contributions to charitable organizations, income taxes and the net non-service components of the periodic benefit expense of the System's pension plans.

### **Revenue in Excess of (Less Than) Expenses and Changes in Net Assets**

The accompanying condensed consolidated statements of operations and changes in net assets includes the revenue in excess of (less than) expenses as the performance indicator. Changes in net assets without donor restrictions, which are excluded from revenue in excess of (less than) expenses, primarily include contributions of long-lived assets (including assets acquired using contributions, which

by donor restriction were to be used for the purposes of acquiring such assets), pension-related changes other than net periodic pension costs and distributions to noncontrolling interests.

#### **Accounting Pronouncements Not Yet Adopted**

In August 2018, the Financial Accounting Standards Board (“FASB”) issued ASU 2018-14, Compensation-Retirement Benefits-Defined Benefit Plans-General (Subtopic 715-20) to improve the effectiveness of disclosures for defined benefit plans under ASC 715-20. The ASU applies to employers that sponsor defined benefit pension or other postretirement plans. This ASU is effective for non-public business entities for fiscal years ending after December 15, 2021 with early adoption permitted. The amendments in this update remove disclosures that no longer are considered cost beneficial, clarify the specific requirements of disclosures and add disclosure requirements identified as relevant. Management is currently analyzing the impact of this ASU on its financial statement disclosures.

In March 2020, the FASB issued ASU 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. This guidance provides optional expedients and exceptions for applying current GAAP to contracts, hedging relationships and other transactions affected by the transition from the use of London Interbank Offered Rate (“LIBOR”) to an alternative reference rate. In response to concerns about structural risks of interbank offered rates (“IBORs”), and, particularly, the risk of cessation of LIBOR, regulators in several jurisdictions around the world have undertaken reference rate reform initiatives to identify alternative reference rates that are more observable or transaction based and less susceptible to manipulation. This guidance provides companies the option to ease the potential accounting burden associated with transitioning away from reference rates that are expected to be discontinued. In January 2021, the FASB issued ASU 2021-01, *Reference Rate Reform (Topic 848): Scope*, which adds implementation guidance to ASU 2020-04 to clarify certain optional expedients in Topic 848. The guidance has to be adopted no later than December 1, 2022 with early adoption permitted. Management is currently evaluating the impact of this guidance.

#### **4. REVENUE AND RECEIVABLES**

##### **Patient Service Revenue**

Patient service revenue is reported at the amount that reflects the consideration to which the System expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including managed care payors and government programs and excludes revenues for services provided to patients under capitated arrangements) and others and include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations. Generally, patients and third-party payors are billed shortly after discharge. Revenue is recognized as performance obligations are satisfied.

Performance obligations are identified based on the nature of the services provided. Revenue associated with performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. Performance obligations satisfied over time relate to patients receiving inpatient acute care services. The System measures the performance obligation from admission into the hospital to the point when there are no further services required for the patient, which is generally the time of discharge. For outpatient services, the performance obligation is satisfied as the patient simultaneously receives and consumes the benefits provided as the services are performed. In the case of these outpatient services, recognition of the obligation over time yields the same result as recognizing the obligation at a point in time. Management believes this



method provides a faithful depiction of the transfer of services over the term of performance obligations based on the inputs needed to satisfy the obligations.

The System uses a portfolio approach to account for categories of patient contracts as a collective group rather than recognizing revenue on an individual contract basis. The portfolios consist of major payor classes for inpatient revenue and major payor classes and types of services provided for outpatient revenue. Based on the historical collection trends and other analyses, the System believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach were used.

The System determines the transaction price, which involves significant estimates and judgment, based on standard charges for goods and services provided, reduced by explicit and implicit price concessions, including contractual adjustments provided to third-party payors, discounts provided to uninsured and underinsured patients in accordance with policy and/or implicit price concessions based on the historical collection experience of patient accounts. The System determines the transaction price associated with services provided to patients who have third-party payor coverage based on reimbursement terms per contractual agreements, discount policies and historical experience. For uninsured patients who do not qualify for charity care, the System determines the transaction price associated with services based on charges reduced by implicit price concessions. Implicit price concessions included in the estimate of the transaction price are based on historical collection experience for applicable patient portfolios. Patients who meet the System's criteria for charity care are provided care without charge; such amounts are not reported as revenue. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Settlements with third-party payors for retroactive adjustments due to audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care using the most likely outcome method. These settlements are estimated based on the terms of the payment agreements with the payor, correspondence from the payor and historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as new information becomes available or as years are settled or are no longer subject to such audits, reviews and investigations.

For the six months ended June 30, 2021 and 2020 and the year ended December 31, 2020, changes in the System's estimates of implicit price concessions, discounts and contractual adjustments or other reductions to expected payments for performance obligations related to prior years were not significant.

In the normal course of business, the System does receive payments in advance for certain services provided and would consider these amounts to represent contract liabilities. The amounts received in the normal course of business at June 30, 2021 and December 31, 2020 were not material. In 2020 the CMS accelerated and advance payments received in relation to the COVID-19 pandemic for Medicare services are deemed contract liabilities at June 30, 2021 and December 31, 2020. See Note 2. SIGNIFICANT EVENTS.

Currently, the State of Illinois utilizes supplemental reimbursement programs to increase reimbursement to providers to offset a portion of the cost of providing care to Medicaid and indigent patients. These programs are designed with input from the CMS and are funded with a combination of state and federal resources, including assessments levied on the providers. Under these supplemental programs, the System recognizes revenue and related expenses in the period in which amounts are

estimable and collection is reasonably assured. Reimbursement and the assessment under these programs are reflected in the accompanying condensed consolidated statements of operations and changes in net assets are as follows:

	<b>Classification</b>	<b>Three Months Ended June 30, 2021</b>	<b>Three Months Ended June 30, 2020</b>	<b>Six Months Ended June 30, 2021</b>	<b>Six Months Ended June 30, 2020</b>	<b>Year Ended December 31, 2020</b>
Reimbursement	Patient service revenue	\$ 78,263	\$ 68,173	\$ 152,082	\$ 136,227	\$ 286,105
Assessment	Supplies, purchased services and other expense	45,545	41,306	90,693	82,611	171,312

The State of Wisconsin assesses a fee or tax on gross patient service revenue. The revenues from this assessment are used to increase payments made to hospitals for services provided to Medicaid and other medically indigent patients. The System's patient service revenue reflects this increase in payment for services to Medicaid and other medically indigent patients and hospital tax assessment expense reflects the fees assessed by the State. Reimbursement and the assessment under these programs is reflected in the accompanying condensed consolidated statements of operations and changes in net assets are as follows:

	<b>Classification</b>	<b>Three Months Ended June 30, 2021</b>	<b>Three Months Ended June 30, 2020</b>	<b>Six Months Ended June 30, 2021</b>	<b>Six Months Ended June 30, 2020</b>	<b>Year Ended December 31, 2020</b>
Reimbursement	Patient service revenue	\$ 32,876	\$ 30,794	\$ 69,771	\$ 68,255	\$ 137,317
Assessment	Supplies, purchased services and other expense	25,320	25,418	50,640	50,839	101,477

Management has determined that the nature, amount, timing and uncertainty of revenue and cash flows are affected by the payor's geographical location, the line of business that renders services to patients and the timing of when revenue is recognized and billed.

The composition of patient service revenue by payor is as follows:

<b>Three Months Ended June 30</b>	<b>2021</b>		<b>2020</b>	
Managed care	\$ 1,609,648	55 %	\$ 1,102,762	55 %
Medicare	853,342	29	639,244	30
Medicaid - Illinois	212,229	7	156,019	8
Medicaid - Wisconsin	133,601	5	106,281	5
Self-pay and other	106,346	4	51,016	2
	<u>\$ 2,915,166</u>	<u>100 %</u>	<u>\$ 2,055,322</u>	<u>100 %</u>

<b>Six Months Ended June 30</b>	<b>2021</b>		<b>2020</b>	
Managed care	\$ 3,149,245	56 %	\$ 2,527,300	54 %
Medicare	1,657,643	29	1,470,733	32
Medicaid - Illinois	390,554	7	226,709	5
Medicaid - Wisconsin	269,000	5	339,099	7
Self-pay and other	165,576	3	99,979	2
	<u>\$ 5,632,018</u>	<u>100 %</u>	<u>\$ 4,663,820</u>	<u>100 %</u>

Year Ended December 31	2020	
Managed care	\$ 5,521,363	54 %
Medicare	3,124,812	30
Medicaid - Illinois	773,851	8
Medicaid - Wisconsin	481,215	5
Self-pay and other	315,145	3
	<u>\$ 10,216,386</u>	<u>100 %</u>

Deductibles, copayments and coinsurance under third-party payment programs, which are the patient's responsibility, are included within the primary payor category in the tables above.

### Capitation Revenue

The System has agreements with various managed care organizations under which the System provides or arranges for medical care to members of the organizations in return for a monthly payment per member. Revenue is earned each month as a result of the System agreeing to provide or arrange for the members' medical care.

### Other Revenue

Other revenue is recognized at an amount that reflects the consideration to which the System expects to be entitled in exchange for providing goods and services. The amounts recognized reflect consideration due from customers, third-party payors and others. Primary categories of other revenue include grant revenues from the CARES Act, income from joint ventures, retail pharmacy revenue, grant revenue, cafeteria revenue, rent revenue and other miscellaneous revenue.

Revenue disaggregation by state and business line are as follows:

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Illinois	\$ 1,615,616	\$ 1,241,512	\$ 3,097,129	\$ 2,736,101	\$ 5,713,977
Wisconsin	1,601,771	1,087,183	3,142,078	2,486,638	5,623,837
Total patient service revenue and capitation	3,217,387	2,328,695	6,239,207	5,222,739	11,337,814
Other revenue	263,101	570,368	509,702	792,937	1,794,375
Total revenue	<u>\$ 3,480,488</u>	<u>\$ 2,899,063</u>	<u>\$ 6,748,909</u>	<u>\$ 6,015,676</u>	<u>\$ 13,132,189</u>
Hospital	\$ 2,165,503	\$ 1,602,101	\$ 4,169,237	\$ 3,552,792	\$ 7,611,197
Clinic	668,361	371,268	1,294,913	950,287	2,231,783
Home Care	66,441	55,698	127,471	115,417	240,043
Other	14,861	26,255	40,397	45,324	133,363
Total patient service revenue	2,915,166	2,055,322	5,632,018	4,663,820	10,216,386
Capitation revenue	302,221	273,373	607,189	558,919	1,121,428
Other revenue	263,101	570,368	509,702	792,937	1,794,375
Total revenue	<u>\$ 3,480,488</u>	<u>\$ 2,899,063</u>	<u>\$ 6,748,909</u>	<u>\$ 6,015,676</u>	<u>\$ 13,132,189</u>

### Patient Accounts Receivable

The System's patient accounts receivable is reported at the amount that reflects the consideration to which it expects to be entitled, in exchange for providing patient care. Patient accounts receivable are reported at net realizable value based on certain assumptions. For third-party payors including Medicare, Medicaid and Managed Care, the net realizable value is based on the estimated contractual

reimbursement percentage, which is based on current contract prices or historical paid claims data by payor. For self-pay, the net realizable value is determined using estimates of historical collection experience including an analysis by aging category. These estimates are adjusted for expected recoveries and any anticipated changes in trends including significant changes in payor mix and economic conditions or trends in federal and state governmental health care coverage.

The composition of patient accounts receivable is summarized as follows:

	<u>June 30, 2021</u>		<u>December 31, 2020</u>	
Managed care	\$ 755,190	47 %	\$ 681,078	43 %
Medicare	369,070	23	350,948	22
Medicaid - Wisconsin	62,397	4	41,694	3
Medicaid - Illinois	145,548	9	188,280	12
Self-pay and other	277,980	17	308,738	20
	<u>\$ 1,610,185</u>	<u>100 %</u>	<u>\$ 1,570,738</u>	<u>100 %</u>

The self-pay patient accounts receivable above includes amounts due from patients for co-insurance, deductibles, installment payment plans and amounts due from patients without insurance.

## 5. INVESTMENTS

The System invests in a diversified portfolio of investments, including alternative investments, such as real asset funds, hedge funds and private equity limited partnerships, whose fair value was \$5,092,900 and \$4,504,346 at June 30, 2021 and December 31, 2020, respectively. Collectively, these funds have liquidity terms ranging from daily to annual with notice periods typically ranging from 1 to 90 days. Certain of these investments have redemption restrictions that may restrict redemption for up to 11 years. However, the potential for the System to sell its interest in these funds in a secondary market prior to the end of the fund term does exist for prices at or other than the carrying value.

At June 30, 2021, the System had additional commitments to fund alternative investments, including callable distributions of \$1,628,054 over the next seven years.

In the normal course of operations and within established investment policy guidelines, the System may enter into various exchange-traded and over-the-counter derivative contracts for trading purposes, including futures, options and forward contracts. These instruments are used primarily to maintain the System's strategic asset allocation. These instruments require the System to deposit cash or securities collateral with the broker or custodian. Collateral provided was \$8,887 and \$13,031 at June 30, 2021 and December 31, 2020, respectively. The notional value of the derivatives in long positions was \$463,801 and \$241,232 at June 30, 2021 and December 31, 2020, respectively. The notional value of the derivatives in a short position was \$(36,202) and \$(91,862) at June 30, 2021 and December 31, 2020, respectively.

By using derivative financial instruments, the System exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of a derivative contract is positive, the counterparty owes the System, which creates credit risk for the System. When the fair value of a derivative contract is negative, the System owes the counterparty and, therefore, it does not possess credit risk. The System minimizes the credit risk in derivative instruments by entering into transactions that may require the counterparty to post collateral for the benefit of the System based on the credit rating of the counterparty and the fair value of the derivative contract. Market risk is the adverse effect on the value of a financial instrument that

results from a change in the underlying reference security. The market risk associated with market changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

Receivables and payables for investment trades not settled are presented with other current assets and accounts payable and other accrued liabilities in the accompanying condensed consolidated balance sheets. Unsettled sales resulted in receivables to brokers of \$15,143 and \$49,512 at June 30, 2021 and December 31, 2020, respectively. Unsettled purchases resulted in payables due to brokers of \$96,208 and \$88,890 at June 30, 2021 and December 31, 2020, respectively.

Investment returns for assets limited as to use and cash and cash equivalents are composed of the following:

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Interest income and dividends	\$ 32,340	\$ 28,149	\$ 52,168	\$ 29,859	\$ 83,232
Income (loss) from alternative investments	328,151	165,925	518,905	(247,095)	51,675
Net realized gains (losses)	74,808	11,076	126,748	(35,388)	41,293
Net unrealized gains (losses)	159,661	459,260	211,226	(255,907)	476,794
Total	<u>\$ 594,960</u>	<u>\$ 664,410</u>	<u>\$ 909,047</u>	<u>\$ (508,531)</u>	<u>\$ 652,994</u>

Investment returns are included in the accompanying condensed consolidated statements of operations and changes in net assets as follows:

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Other revenue	\$ 13,701	\$ 11,857	\$ 27,021	\$ 25,156	\$ 49,763
Investment income (loss), net	571,649	644,769	867,374	(526,632)	593,283
Net assets with donor restrictions	9,610	7,784	14,652	(7,055)	9,948
Total	<u>\$ 594,960</u>	<u>\$ 664,410</u>	<u>\$ 909,047</u>	<u>\$ (508,531)</u>	<u>\$ 652,994</u>

The cash and cash equivalents and assets limited as to use presented within the accompanying condensed consolidated balance sheets are comprised of the following:

	June 30, 2021	December 31, 2020
Internally designated for capital and other	\$ 10,850,027	\$ 10,291,819
Held for self-insurance	683,595	658,466
Donor restricted	149,049	137,980
Investments under securities lending program	17,970	18,945
Total noncurrent assets limited as to use	11,700,641	11,107,210
Cash and cash equivalents	781,326	959,878
Current assets limited as to use	127,763	125,053
Total cash and cash equivalents and assets limited as to use	<u>\$ 12,609,730</u>	<u>\$ 12,192,141</u>

## 6. FAIR VALUE

The System accounts for certain assets and liabilities at fair value and categorizes assets and liabilities measured at fair value in the accompanying condensed consolidated financial statements based upon whether the inputs used to determine their fair values are observable or unobservable. Observable inputs are inputs that are based on market data obtained from sources independent of the reporting

entity. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about pricing the asset or liability, based on the best information available under the circumstances.

The fair value of all assets and liabilities recognized or disclosed at fair value is classified based on the lowest level of significant inputs. Assets and liabilities that are measured at fair value are disclosed and classified in one of three categories. Category inputs are defined as follows:

Level 1 — Quoted prices (unadjusted) in active markets for identical assets or liabilities on the reporting date.

Level 2 — Inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 — Inputs that are unobservable for the asset or liability for which there is little or no market data.

The following section describes the valuation methodologies used by the System to measure financial assets and liabilities at fair value. In general, where applicable, the System uses quoted prices in active markets for identical assets and liabilities to determine fair value. This pricing methodology applies to Level 1 investments, such as domestic and international equities, exchange-traded funds and agency securities.

If quoted prices in active markets for identical assets and liabilities are not available to determine the fair value, then quoted prices for similar assets and liabilities or inputs other than quoted prices that are observable either directly or indirectly are used. These investments are included in Level 2 and consist primarily of corporate notes and bonds, foreign government bonds, mortgage-backed securities, fixed-income securities, including fixed-income government obligations, commercial paper and certain agency, United States and international equities, which are not traded on an active exchange. The fair value for the obligations under swap agreements included in Level 2 is estimated using industry-standard valuation models. These models project future cash flows and discount the future amounts to a present value using market-based observable inputs, including interest rate curves. The fair values of the obligation under swap agreements include adjustments related to the System's credit risk.

Investments owned by the System are exposed to various kinds and levels of risk. Equity securities and equity funds expose the System to market risk, performance risk and liquidity risk for both domestic and international investments. Market risk is the risk associated with major movements of the equity markets. Performance risk is the risk associated with a company's operating performance. Fixed-income securities and fixed-income mutual funds expose the System to interest rate risk, credit risk and liquidity risk. As interest rates change, the value of many fixed-income securities is affected, including those with fixed interest rates. Credit risk is the risk that the obligor of the security will not fulfill its obligations. Liquidity risk is affected by the willingness of market participants to buy and sell particular securities. Liquidity risk tends to be higher for equities related to small capitalization companies and certain alternative investments. Due to the volatility in the capital markets, there is a reasonable possibility of subsequent changes in fair value, resulting in additional gains and losses in the near term.

The carrying values of cash and cash equivalents, accounts receivable and payable, other current assets and accrued liabilities are reasonable estimates of their fair values, due to the short-term nature of these financial instruments.

The fair values of financial assets and liabilities that are measured at fair value on a recurring basis are as follows:

	June 30, 2021	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets</b>				
<b>Investments</b>				
Cash and short-term investments	\$ 1,522,997	\$ 1,020,950	\$ 502,047	\$ —
Corporate bonds and other debt securities	806,783	—	806,783	—
United States government bonds	543,068	—	543,068	—
Bond and other debt security funds	1,057,462	113,171	944,291	—
Non-government fixed-income obligations	36,649	—	36,649	—
Equity securities	900,104	900,104	—	—
Equity funds	2,622,433	161,614	2,460,819	—
	<u>7,489,496</u>	<u>\$ 2,195,839</u>	<u>\$ 5,293,657</u>	<u>\$ —</u>
<b>Investments at net asset value</b>				
Alternative investments	<u>5,120,234</u>			
<b>Total investments</b>	<u>\$ 12,609,730</u>			
<b>Collateral proceeds received under securities lending program</b>				
	<u>\$ 18,618</u>		<u>\$ 18,618</u>	
<b>Liabilities</b>				
Obligations under swap agreements	<u>\$ (98,496)</u>		<u>\$ (98,496)</u>	
Obligations to return capital under securities lending program	<u>\$ (18,618)</u>		<u>\$ (18,618)</u>	

	December 31, 2020	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets</b>				
<b>Investments</b>				
Cash and short-term investments	\$ 1,861,490	\$ 1,296,986	\$ 564,504	\$ —
Corporate bonds and other debt securities	705,552	—	705,552	—
United States government bonds	615,723	—	615,723	—
Bond and other debt security funds	1,325,705	73,668	1,252,037	—
Non-government fixed-income obligations	18,944	—	18,944	—
Equity securities	826,194	826,194	—	—
Equity funds	2,307,912	143,521	2,164,391	—
	<u>7,661,520</u>	<u>\$ 2,340,369</u>	<u>\$ 5,321,151</u>	<u>—</u>
<b>Investments at net asset value</b>				
Alternative investments	4,530,621			
<b>Total investments</b>	<u>\$ 12,192,141</u>			
<b>Collateral proceeds received under securities lending program</b>	<u>\$ 19,789</u>		<u>\$ 19,789</u>	
<b>Liabilities</b>				
<b>Obligations under swap agreements</b>	<u>\$ (118,620)</u>		<u>\$ (118,620)</u>	
<b>Obligations to return capital under securities lending program</b>	<u>\$ (19,789)</u>		<u>\$ (19,789)</u>	

## 7. PROPERTY AND EQUIPMENT, NET

The components of property and equipment, net are summarized as follows:

	June 30, 2021	December 31, 2020
Land and improvements	\$ 463,340	\$ 461,831
Buildings and fixed equipment	7,636,790	7,536,013
Movable equipment and computer software	2,601,234	2,520,502
Construction-in-progress	538,718	478,335
	<u>11,240,082</u>	<u>10,996,681</u>
Accumulated depreciation and amortization	(5,411,977)	(5,144,704)
Property and equipment, net	<u>\$ 5,828,105</u>	<u>\$ 5,851,977</u>

Property and equipment, net include assets recorded as finance leases and under other financing arrangements. See additional disclosure in Note 8. LEASES.

Depreciation expense is as follows:

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Depreciation expense	<u>\$ 134,773</u>	<u>\$ 139,400</u>	<u>\$ 271,078</u>	<u>\$ 276,425</u>	<u>\$ 553,634</u>



## 8. LEASES

The System leases office and clinical space, land and equipment. Leases with an initial term of 12 months or less are not recorded on the consolidated balance sheets. For lease agreements entered into after the adoption of ASU 2016-02 on January 1, 2019, the System combines lease and non-lease components except for medical equipment leases.

The depreciable lives of assets are limited by the expected lease terms. Most leases include options to renew. The majority of leases do not provide an implicit rate; therefore, the System has elected to use its incremental borrowing rate, which is the interest rate the System would borrow on a collateralized basis over a similar term, as the discount rate. The System used its incremental borrowing rate on January 1, 2019 for operating leases that commenced prior to that date.

Operating and finance leases are classified as follows within the accompanying condensed consolidated balance sheets:

Leases	Classification	June 30, 2021	December 31, 2020
<b>Assets</b>			
Operating	Operating lease right-of-use assets	\$ 283,313	\$ 309,678
Finance	Property and equipment, net	144,000	149,961
Total lease assets		<u>\$ 427,313</u>	<u>\$ 459,639</u>
<b>Liabilities</b>			
<b>Current</b>			
Operating	Operating lease liabilities, current portion	\$ 77,147	\$ 79,934
Finance	Long-term debt and commercial paper, current portion	9,591	9,182
<b>Noncurrent</b>			
Operating	Operating lease liabilities, less current portion	242,738	268,575
Finance	Long-term debt, less current portion	160,850	165,507
Total lease liabilities		<u>\$ 490,326</u>	<u>\$ 523,198</u>

Finance lease assets are recorded net of accumulated amortization of \$63,867 and \$57,873 as of June 30, 2021 and December 31, 2020, respectively.

Lease costs are classified as follows within the accompanying condensed consolidated statements of operations and changes in net assets:

Lease cost	Classification	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Operating lease cost	Supplies, purchased services and other	\$ 20,878	\$ 21,262	\$ 43,149	\$ 43,029	\$ 85,253
Short term lease cost	Supplies, purchased services and other	3,561	5,241	6,275	7,327	13,407
Variable lease cost	Supplies, purchased services and other	9,832	7,762	17,872	16,393	36,740
<b>Finance lease cost</b>						
Amortization of lease assets	Depreciation and amortization	2,997	2,917	5,994	5,681	11,629
Interest on lease liabilities	Interest	2,885	3,111	5,799	6,178	12,093
Sublease income	Other revenue	(562)	(608)	(1,175)	(1,215)	(2,434)
Net lease cost		<u>\$ 39,591</u>	<u>\$ 39,685</u>	<u>\$ 77,914</u>	<u>\$ 77,393</u>	<u>\$ 156,688</u>

Lease terms, discount rates and other supplemental information are as follows:

	As of June 30, 2021	As of June 30, 2020	As of December 31, 2020
Weighted average remaining lease term (in years)			
Operating	4.8	6.0	5.5
Finance	11.2	12.5	11.6
Weighted average discount rate			
Operating	2.21 %	2.33 %	2.24 %
Finance	7.56 %	7.74 %	7.54 %

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Cash paid for amounts included in the measurement of lease liabilities					
Operating cash flows from operating leases	\$ 22,269	\$ 22,278	\$ 44,251	\$ 44,434	\$ 88,387
Operating cash flows from finance leases	2,885	3,282	5,799	6,659	11,500
Financing cash flows from finance leases	1,889	2,101	4,248	3,982	8,184

Future maturities of lease liabilities at June 30, 2021 are as follows:

	Operating Leases	Finance Leases	Total
2021	\$ 43,832	\$ 9,451	\$ 53,283
2022	77,850	21,094	98,944
2023	67,054	21,030	88,084
2024	49,966	21,532	71,498
2025	35,449	21,025	56,474
Thereafter	65,687	169,777	235,464
Future minimum lease payments	339,838	263,909	603,747
Less remaining imputed interest	19,953	93,468	113,421
Total	\$ 319,885	\$ 170,441	\$ 490,326

## 9. INVESTMENTS IN UNCONSOLIDATED ENTITIES

The System contributed \$25,000 to an independent foundation, which is designated to support the operations and capital needs of Bay Area Medical Center and/or Aurora Bay Area Medical Group. The interest in that foundation is reflected in investments in unconsolidated entities in the accompanying condensed consolidated balance sheets, which amounted to \$16,859 and \$18,668 at June 30, 2021 and December 31, 2020, respectively. Cash distributions from this Foundation under terms of the definitive agreement were received as follows:

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Cash distributions	\$ 200	\$ 630	\$ 1,884	\$ 1,413	\$ 2,518

The System has an interest in the net assets of the Masonic Family Health Foundation ("MFHF"), an independent organization, under the terms of an asset purchase agreement (the "Agreement"). Substantially all of MFHF's net assets are designated to support the operations and/or capital needs of one of the System's medical facilities. Additionally, 90% of MFHF's investment yield, net of expenses, on substantially all of MFHF's investments is designated for the support of one of the System's medical

facilities. MFHF must pay the System, annually, 90% of the investment yield or an agreed-upon percentage of the beginning of the year net assets.

The interest in the net assets of MFHF amounted to \$117,302 and \$109,017 at June 30, 2021 and December 31, 2020, respectively, and is presented within investments in unconsolidated entities in the accompanying condensed consolidated balance sheets. The System's interest in the investment income is reflected in the accompanying condensed consolidated statements of operations and changes in net assets and amounted to the following:

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Interest in the investment income	\$ 8,016	\$ 14,348	\$ 10,085	\$ 1,071	\$ 17,287

Cash distributions were received by the System from MFHF under terms of the Agreement as follows:

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Cash distributions	\$ —	\$ —	\$ 3,584	\$ 3,978	\$ 3,978

In addition, MFHF made the following contributions to the System for program support:

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Contributions	\$ —	\$ —	\$ —	\$ —	\$ 537

At June 30, 2021, the System had a 49.5% ownership interest in RML Health Providers, L.P. ("RML") that is accounted for on an equity basis. RML is an Illinois not-for-profit limited partnership that operates a 115-bed licensed long-term acute care hospital in Hinsdale, Illinois, and an 86-bed licensed long-term acute care hospital in Chicago, Illinois. The System's investment in RML was \$39,763 and \$35,235 at June 30, 2021 and December 31, 2020, respectively, and is presented within investments in unconsolidated entities in the accompanying condensed consolidated balance sheets.

RML leases its Chicago, Illinois facility from the System. The lease has a fixed term through June 30, 2025. The System recorded rental income as follows:

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Rental income	\$ 294	\$ 293	\$ 596	\$ 587	\$ 1,192

The summarized financial position and results of operations for significant entities accounted for under the equity method as of and for the periods ended is outlined below:

	<u>RML</u>	<u>MFHF</u>
<b>As of June 30, 2021</b>		
Total assets	\$ 144,827	\$ 119,580
Total liabilities	74,688	2,319
Partners' equity/net assets	70,139	117,261
<b>Three Months Ended June 30, 2021</b>		
Total revenue	33,142	8,007
Revenue in excess of expenses	4,233	6,768
<b>Three Months Ended June 30, 2020</b>		
Total revenue	33,235	14,141
Revenue in excess of expenses	6,428	13,134
<b>Six Months Ended June 30, 2021</b>		
Total revenue	64,898	10,312
Revenue in excess of expenses	8,031	7,876
<b>Six Months Ended June 30, 2020</b>		
Total revenue	59,757	1,091
Revenue in excess of (less than) expenses	5,801	(993)
<b>As of December 31, 2020</b>		
Total assets	131,256	112,993
Total liabilities	58,482	3,661
Partners' equity/net assets	72,774	109,332

## 10. LONG-TERM DEBT

The System's outstanding bonds are secured by obligations issued under the Second Amended and Restated Master Trust Indenture dated as of August 1, 2018, as the same may be amended from time to time, between Advocate Aurora Health, Inc., the other affiliates identified therein as the Members of the Obligated Group and U.S. Bank National Association, as master trustee ("the System Master Indenture"). Under the terms of the bond indentures and other arrangements, various amounts are to be on deposit with trustees, and certain specified payments are required for bond redemption and interest payments. The System Master Indenture and other debt agreements, including bank agreements, also place restrictions on the System and require the System to maintain certain financial ratios.

The System's unsecured variable rate revenue bonds, Series 2011B of \$69,660 and Series 2018B-1 of \$46,690, while subject to a long-term amortization period, may be put to the System at the option of the bondholders in connection with certain remarketing dates. To the extent that bondholders may, under the terms of the debt, put their bonds within 12 months after June 30, 2021, the principal amount of such bonds has been classified as a current obligation as long-term debt subject to short-term financing arrangements in the accompanying condensed consolidated balance sheets. Management believes the likelihood of a material amount of bonds being put to the System is remote. However, to address this possibility, the System has taken steps to provide various sources of liquidity, including alternate sources of financing, lines of credit and/or net assets without donor restrictions as a source of self-liquidity.

The System has standby bond purchase agreements with banks to provide liquidity support for the Series 2008C Bonds. In the event of a failed remarketing of a Series 2008C Bond upon its tender by an existing holder and subject to compliance with the terms of the standby bond purchase agreement, the standby bank would provide the funds for the purchase of such tendered bonds, and the System would

be obligated to repay the bank for the funds it provided for such bond purchase (if such bond is not subsequently remarketed), with the first installment of such repayment commencing on the date one year and one day after the bank purchases the bond. As of June 30, 2021, there were no bank-purchased bonds outstanding. To the extent that the standby bond purchase agreement expiration date is within 12 months after June 30, 2021, the principal amount of such bonds would be classified as a current obligation in the accompanying condensed consolidated balance sheets. The standby bond purchase agreements expire as follows: \$129,456 in January 2024, \$87,694 in September 2024 and \$58,225 in September 2025.

In May 2020, the System issued its Series 2020A Taxable Bonds in the aggregate principal amount of \$700,000. The proceeds of the Series 2020A Taxable Bonds were used for general corporate purposes, to refinance a portion of the Series 2011B, Series 2011C, Series 2011D, Series 2012, Series 2013A, Series 2015 and Series 2015B Bonds, to repay \$82,000 of commercial paper and to pay certain financing costs. In connection with this transaction, the System recognized a loss on refinancing in the amount of \$12,231.

On April 8, 2021, the System issued additional Series 2018 Taxable Bonds in the principal amount of \$85,000 and additional Series 2019 Taxable Bonds in the principal amount of \$85,210 ("Additional Taxable Bonds"). The proceeds of the Additional Taxable Bonds were used to refinance a portion of the Series 2012, Series 2013A, Series 2014, Series 2015 Bonds and to pay certain financing costs. In connection with this transaction, the System recognized a loss on refinancing in the amount of \$14,421.

As of June 30, 2021, the System is authorized to issue up to \$1,000,000 in commercial paper aggregate principal outstanding. As of June 30, 2021, \$50,000 of commercial paper notes were outstanding, with maturities of 120 days. As of December 31, 2020, \$50,000 of commercial paper was outstanding, with maturities ranging from 119 to 122 days.

At June 30, 2021, the System had lines of credit with banks aggregating to \$1,425,000 in available commitments. These lines of credit provide for various interest rates and payment terms and as of June 30, 2021 expire as follows: \$100,000 in August 2021, \$100,000 in December 2022, \$425,000 in March 2023, \$400,000 in March 2024 and \$400,000 in March 2025. These lines of credit may be used to redeem bonded indebtedness, to pay costs related to such redemptions, for capital expenditures, for general working capital purposes or to provide for certain letters of credit. As of June 30, 2021, letters of credit totaling \$71,684 have been issued under one of these lines. At June 30, 2021, no amounts were outstanding on these lines or drawn on the letters of credit.

The System maintains an interest rate swap program on certain of its variable rate debt, as described in Note 11. INTEREST RATE SWAP PROGRAM.

The System's interest paid amount includes all debt agreements including revenue bonds and revenue refunding bonds, taxable bonds, finance lease obligations, commercial paper, financing arrangements and interest rate swaps.

The System's interest paid, net of capitalized interest and capitalized interest are as follows:

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Interest paid, net of capitalized interest	\$ 27,846	\$ 19,477	\$ 57,516	\$ 50,165	\$ 116,953
Capitalized interest	3,115	541	5,921	927	8,198

## 11. INTEREST RATE SWAP PROGRAM

The System has interest rate-related derivative instruments to manage the exposure of its variable rate debt instruments. By using derivative financial instruments to manage the risk of changes in interest rates, the System exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of a derivative contract is positive, the counterparty owes the System, which creates credit risk for the System. When the fair value of a derivative contract is negative, the System owes the counterparty and, therefore, it does not possess credit risk. The System minimizes the credit risk in derivative instruments by entering into transactions that may require the counterparty to post collateral for the benefit of the System based on the credit rating of the counterparty and the fair value of the derivative contract. Market risk is the adverse effect on the value of a derivative financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. The System also mitigates risk through periodic reviews of its derivative positions in the context of its total blended cost of capital.

At June 30, 2021, the System maintains an interest rate swap program on its Series 2008C variable rate demand revenue bonds. These bonds expose the System to variability in interest payments due to changes in interest rates. The System believes that it is prudent to limit the variability of its interest payments. To meet this objective and to take advantage of low interest rates, the System entered into various interest rate swap agreements to manage fluctuations in cash flows resulting from interest rate risk. These swaps convert the variable rate cash flow exposure on the variable rate demand revenue bonds to synthetically fixed cash flows. The notional amount under each interest rate swap agreement is reduced over the term of the respective agreement to correspond with reductions in the principal outstanding under various bond series.

The System has two swaps that are being held as a swap portfolio as the related debt is no longer outstanding.

The following is a summary of the outstanding positions under these interest rate swap agreements at June 30, 2021:

<b>Bond Series</b>	<b>Notional Amount</b>	<b>Maturity Date</b>	<b>Rate Received</b>	<b>Rate Paid</b>
2008C-1	\$ 129,900	November 1, 2038	61.7% of LIBOR + 26bps	3.605 %
2008C-2B	58,425	November 1, 2038	61.7% of LIBOR + 26bps	3.605 %
2008C-3A	88,000	November 1, 2038	61.7% of LIBOR + 26bps	3.605 %
Swap portfolio	50,000	November 1, 2038	61.7% of LIBOR + 26bps	3.605 %
Swap portfolio	25,280	February 1, 2038	70.0% of LIBOR	3.314 %

The swaps are not designated as hedging instruments and, therefore, hedge accounting has not been applied. As such, unrealized changes in fair value of the swaps are classified as changes in fair value of swaps in the accompanying condensed consolidated statements of operations and changes in net assets. The net cash settlement payments, representing the realized changes in fair value of the swaps, are included as interest expense in the accompanying condensed consolidated statements of operations and changes in net assets.

The fair value of the interest rate swap agreements was a liability of \$98,496 and \$118,620 as of June 30, 2021 and December 31, 2020, respectively. No collateral was posted under these swap agreements as of June 30, 2021 and December 31, 2020.

Amounts recorded in the condensed consolidated statements of operations and changes in net assets are as follows:

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Net cash payments on interest rate swap agreements (interest expense)	\$ 2,844	\$ 2,555	\$ 5,745	\$ 4,564	\$ 10,241
Change in fair value of interest rate swaps	\$ (7,214)	\$ 2,223	\$ 20,124	\$ (36,635)	\$ (27,280)

The interest rate swap instruments contain provisions that require the System to maintain an investment grade credit rating on its bonds from certain major credit rating agencies. If the System's bonds were to fall below investment grade, it would be in violation of these provisions and the counterparties to the swap instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on interest rate swap instruments in net liability positions.

## 12. RETIREMENT PLANS

The System maintains various employee retirement benefit plans available to qualifying employees and retirees.

The Condell Health Network Retirement Plan ("Condell Plan") was frozen effective January 1, 2008, to new participants and participants ceased to accrue additional pension benefits. During the year ended December 31, 2020, \$3,000 in cash contributions were made to the Condell Plan.

The Aurora Health Care, Inc. Pension Plan ("Aurora Plan") was frozen effective December 31, 2012 and participants ceased to accrue additional pension benefits. During the year ended December 31, 2020, no contributions were made to the Aurora Plan.

On December 31, 2020, the Condell Plan liabilities and assets were merged into the Aurora Plan. With the merger of the liabilities and assets, the Aurora Plan was renamed the Advocate Aurora Health Pension Plan ("AAH Plan") on January 1, 2021. The accompanying condensed consolidated balance sheets contain an other noncurrent liability related to the AAH Plan of \$65,576 and \$66,494 at June 30, 2021 and December 31, 2020, respectively. The noncurrent liability of the AAH Plan at both dates, reflects the merged liabilities of the Condell Plan and the Aurora Plan. During the three and six months ended June 30, 2021, no contributions were made to the AAH Plan.

The Advocate Health Care Network Pension Plan ("Advocate Plan") was frozen effective December 31, 2019, to new participants and participants ceased accruing additional pension benefits. The accompanying condensed consolidated balance sheets contain an other noncurrent liability related to the Advocate Plan totaling \$96,922 and \$134,325 at June 30, 2021 and December 31, 2020, respectively. During the three and six months ended June 30, 2021 and the year ended December 31, 2020, \$0, \$30,000 and \$40,000, respectively, in cash contributions were made to the Advocate Plan.

In September 2020, the System transferred benefit obligations for certain participants of the Advocate Plan, Condell Plan and Aurora Plan through the purchase of annuity contracts. As a result of this transaction, all three Plans were remeasured as of September 30, 2020 and a combined settlement loss of \$119,658 was recorded in the nonoperating income (loss) section in the accompanying condensed consolidated statements of operations and changes in net assets as of December 31, 2020.

Pension plan (income) expense included in the accompanying condensed consolidated statements of operations and changes in net assets is as follows:

**Three Months Ended June 30, 2021**

	<u>Advocate</u>	<u>AAH</u>	<u>Total</u>
Interest cost	\$ 6,579	\$ 10,412	\$ 16,991
Expected return on plan assets	(10,280)	(10,872)	(21,152)
Amortization of:			
Actuarial loss	1,148	2,603	3,751
Prior service cost	—	1	1
Net pension (income) expense	<u>\$ (2,553)</u>	<u>\$ 2,144</u>	<u>\$ (409)</u>

**Three Months Ended June 30, 2020**

	<u>Advocate</u>	<u>AAH **</u>	<u>Total</u>
Interest cost	\$ 9,286	\$ 14,359	\$ 23,645
Expected return on plan assets	(10,998)	(16,920)	(27,918)
Amortization of:			
Actuarial loss	1,288	3,087	4,375
Net pension (income) expense	<u>\$ (424)</u>	<u>\$ 526</u>	<u>\$ 102</u>

**Six Months Ended June 30, 2021**

	<u>Advocate</u>	<u>Aurora</u>	<u>Total</u>
Interest cost	\$ 13,158	\$ 20,824	\$ 33,982
Expected return on plan assets	(20,560)	(21,744)	(42,304)
Amortization of:			
Actuarial loss	2,296	5,206	7,502
Prior service cost	—	2	2
Net pension (income) expense	<u>\$ (5,106)</u>	<u>\$ 4,288</u>	<u>\$ (818)</u>

**Six Months Ended June 30, 2020**

	<u>Advocate</u>	<u>Aurora</u>	<u>Total</u>
Interest cost	\$ 18,572	\$ 28,718	\$ 47,290
Expected return on plan assets	(21,997)	(33,839)	(55,836)
Amortization of:			
Actuarial loss	2,575	6,173	8,748
Prior service cost	—	1	1
Net pension expense (income)	<u>\$ (850)</u>	<u>\$ 1,053</u>	<u>\$ 203</u>

**Year Ended December 31, 2020**

	<u>Advocate</u>	<u>AAH **</u>	<u>Total</u>
Interest cost	\$ 34,835	\$ 53,855	\$ 88,690
Expected return on plan assets	(43,456)	(62,558)	(106,014)
Amortization of:			
Actuarial loss	4,897	11,798	16,695
Prior service cost	—	3	3
Settlement/curtailment	33,561	92,107	125,668
Net pension expense	<u>\$ 29,837</u>	<u>\$ 95,205</u>	<u>\$ 125,042</u>

\*\*AAH includes the legacy Condell and Aurora Plans. On December 31, 2020, the Condell Plan liabilities and assets were merged into the Aurora Plan and renamed the AAH Plan on January 1, 2021.

The components of net periodic benefit costs other than the service cost component are included in other nonoperating loss, net in the accompanying condensed consolidated statements of operations and changes in net assets.



The expected employee benefit payments to be paid from the pension plans are as follows:

	<u>Advocate</u>	<u>AAH</u>	<u>Total</u>
2021	\$ 60,586	\$ 46,832	\$ 107,418
2022	61,578	52,219	113,797
2023	62,241	55,154	117,395
2024	61,506	58,191	119,697
2025	61,336	61,722	123,058
2026-2030	294,108	345,472	639,580
Total	<u>\$ 601,355</u>	<u>\$ 619,590</u>	<u>\$ 1,220,945</u>

The System's asset allocation and investment strategies are designed to earn returns on plan assets consistent with a reasonable and prudent level of risk. Investments are diversified across classes, economic sectors and manager style to minimize the risk of loss. The System utilizes investment managers specializing in each asset category and, where appropriate, provides the investment manager with specific guidelines that include allowable and/or prohibited investment types. The System regularly monitors manager performance and compliance with investment guidelines.

The System's target and actual pension asset allocations for the plans are as follows:

Asset Category - Advocate Plan	<u>June 30, 2021</u>		<u>December 31, 2020</u>	
	<u>Target</u>	<u>Actual</u>	<u>Target</u>	<u>Actual</u>
De-risking portfolio	68 %	68 %	75 %	67 %
Domestic and international equity securities	22	22	21	22
Alternative investments	7	7	2	7
Fixed-income securities	3	3	2	4
	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

Asset Category - AAH/Aurora Plan **	<u>June 30, 2021</u>		<u>December 31, 2020</u>	
	<u>Target</u>	<u>Actual</u>	<u>Target</u>	<u>Actual</u>
De-risking portfolio	85 %	83 %	85 %	82 %
Domestic and international equity securities	12	14	12	15
Alternative investments	1	1	1	1
Fixed-income securities	2	2	2	2
	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

*\*\*On December 31, 2020, the Condell Plan liabilities and assets were merged into the Aurora Plan and the Plan was renamed the AAH Plan on January 1, 2021.*

Assumptions used to determine benefit obligations are as follows:

	<u>December 31, 2021</u>
Discount rate - Advocate Plan	2.49 %
Discount rate - AAH Plan	2.79 %
Assumed rate of return on assets - Advocate Plan	4.40 %
Assumed rate of return on assets - AAH Plan	3.40 %

The assumed rate of return on each of the Plan's assets is based on historical and projected rates of return for asset classes in which the portfolio is invested. The de-risking portfolio is comprised of cash and fixed-income instruments designed to hedge Plan liabilities.

In addition to these plans, the System sponsors a defined contribution plan for its employees. Expense related to the plan, is included in salaries, wages and benefits expense in the condensed consolidated statements of operations and changes in net assets as follows:

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Defined contribution plan expense	\$ 80,050	\$ 75,133	\$ 159,015	\$ 152,799	\$ 300,971

### 13. FUNCTIONAL EXPENSES

For the six months ended June 30, 2021 and June 30, 2020, the majority of the System's expenses were directly attributable to the provision of health care services. The remaining expenses, primarily legal, finance, purchasing and human resources were attributable to general and administrative functions. Health care services require the benefit of and the expense of general and administrative services; therefore, these costs would be further allocated to health care services. Fundraising expense are primarily reported within other nonoperating loss, net in the accompanying condensed consolidated statements of operations and changes in net assets.

### 14. LIQUIDITY

The System's financial assets available within one year of the consolidated balance sheets date for general expenditures are as follows:

	June 30, 2021	December 31, 2020
Current assets		
Cash and cash equivalents	\$ 781,326	\$ 959,878
Assets limited as to use	127,763	125,053
Patient accounts receivable	1,610,185	1,570,738
Third-party payors receivables	19,496	16,933
Collateral proceeds under securities lending program	18,618	19,789
Total current assets	2,557,388	2,692,391
Assets limited as to use		
Internally designated for capital and other	10,850,027	10,291,819
Held for self-insurance	683,595	658,466
Donor restricted	149,049	137,980
Investments under securities lending program	17,970	18,945
Total assets limited as to use	11,700,641	11,107,210
Total financial assets	14,258,029	13,799,601
Less		
Amounts unavailable for general expenditures		
Alternative investments	(2,381,971)	(2,110,330)
Total amounts unavailable for general expenditure	(2,381,971)	(2,110,330)
Amounts unavailable to management without approval		
Held for self-insurance	(811,358)	(783,519)
Donor restricted	(149,049)	(137,980)
Investments under securities lending program	(17,970)	(18,945)
Total amounts unavailable to management without approval	(978,377)	(940,444)
Total financial assets available to management for general expenditure within one year	\$ 10,897,681	\$ 10,748,827

## **15. GENERAL AND PROFESSIONAL LIABILITY RISKS**

The System is self-insured for substantially all general and professional liability risks. The self-insurance programs combine various levels of self-insured retention with excess commercial insurance coverage. In addition, various umbrella insurance policies have been purchased to provide coverage in excess of the self-insured limits. Revocable trust funds, administered by a trustee and captive insurance companies, have been established for the self-insurance programs. Actuarial consultants have been retained to determine the estimated cost of claims, as well as to determine the amount to fund into the irrevocable trust and captive insurance companies.

The System's hospitals, clinics, surgery centers, physicians and certified registered nurse anesthetist providers that provide health care in Wisconsin are qualified health care providers that are fully covered for losses in excess of statutory limits through mandatory participation in the State of Wisconsin Injured Patients and Families Compensation Fund.

The estimated cost of claims is actuarially determined based on past experience, as well as other considerations, including the nature of each claim or incident and relevant trend factors. Accrued insurance liabilities and contributions to the trust were determined using a discount rate of 3.00% as of June 30, 2021 and December 31, 2020.

The System entities are defendants in certain litigation related to professional and general liability risks, and other matters. Although the outcome of the litigation cannot be determined with certainty, management believes, after consultation with legal counsel, that the ultimate resolution of the litigations will not have a material adverse effect on the System's operations or financial condition.

In May 2021 the state of Illinois passed a law that is effective July 1, 2021, which will impose pre-judgment interest to defendants of personal injury and wrongful death cases. Management does not expect the change in law to have a material impact on the financial condition of the System.

## **16. LEGAL, REGULATORY AND OTHER CONTINGENCIES**

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. During the last few years, due to nationwide investigations by governmental agencies, various health care organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, exclusion from the Medicare and Medicaid programs and revocation of federal or state tax-exempt status. Moreover, the System expects that the level of review and audit to which it and other health care providers are subject will increase.

Various federal and state agencies have initiated investigations, which are in various stages of discovery, relating to reimbursement, billing practices and other matters of the System. There can be no assurance that regulatory authorities will not challenge the System's compliance with these laws and regulations, and it is not possible to determine the impact, if any, such claims or penalties would have on the System. To foster compliance with applicable laws and regulations, the System maintains a compliance program designed to detect and correct potential violations of laws and regulations related to its programs.

## **17 SUBSEQUENT EVENTS**

The System evaluated events and transactions subsequent to June 30, 2021 through August 20, 2021, the date of consolidated financial statement issuance.

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL POSITION

This quarterly report includes the condensed consolidated financial statements and analysis for Advocate Aurora Health, Inc., a Delaware nonprofit corporation (the "Parent Corporation"), and its subsidiaries. References to "the System", "we", "our", or "us" in this document are to the Parent Corporation and all of the subsidiaries consolidated with it pursuant to accounting principles generally accepted in the United States of America ("GAAP"). References to the Parent Corporation are references only to the Parent Corporation and should not be read to include any of the Parent Corporation's and subsidiaries.

The financial information should be read together with our condensed consolidated financial statements and related notes included elsewhere in this quarterly report, as well as the audited consolidated financial statements of the System as of and for the year ended December 31, 2020, which is available from the Municipal Securities Rulemaking Board (the MSRB) on its Electronic Municipal Market Access ("EMMA") system, found at <http://emma.msrb.org>. Additional information can be found on the investor relations section of the System's website at <https://www.advocateaurorahealth.org/investor-relations>.

Certain statements included in this quarterly report constitute forward-looking statements that involve risks and uncertainties. Actual results may differ significantly from the results discussed in the forward-looking statements as a result of known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. We do not plan to issue any updates or revisions to those forward-looking statements if or when the expectations, or events, conditions or circumstances on which such statements are based occur.

The information included herein is being provided solely to comply with contractual commitments. This filing does not purport to contain all information that may be material to an investor's decision to buy, sell or hold bonds issued by or for the benefit of the System ("Related Bonds"), and does not constitute or imply any representation that no other information exists that may have a bearing on the financial condition of the System, the security for any Related Bonds or an investor's decision to buy, sell or hold any Related Bonds. This report includes information only as of and for the three and six months ended June 30, 2021 and June 30, 2020, and such information should not be relied upon as indicative of future financial performance. The COVID-19 pandemic described herein has and may adversely affect the System's future financial performance to an extent that could be material.

**ADVOCATE AURORA HEALTH, INC.**  
**KEY FINANCIAL RATIOS**

	Three Months Ended,	
	June 30, 2021	June 30, 2020
<b>Profitability</b>		
Operating margin <sup>(1)</sup>	6.5%	(6.8)%
Operating cash flow margin <sup>(2)</sup>	11.4%	(0.9)%
Excess margin <sup>(3)</sup>	18.9%	11.6%
EBIDA margin <sup>(4)</sup>	26.7%	20.0%
	Six Months Ended,	
	June 30, 2021	June 30, 2020
<b>Profitability</b>		
Operating margin <sup>(1)</sup>	4.3%	(4.1)%
Operating cash flow margin <sup>(2)</sup>	9.3%	1.5%
Excess margin <sup>(3)</sup>	14.8%	(16.7)%
EBIDA margin <sup>(4)</sup>	21.7%	(9.4)%
	As of June 30,	As of
	2021	December 31,
<b>Leverage and Liquidity</b>		
Debt to capitalization <sup>(5)</sup>	20.9%	22.5%
Cash to debt <sup>(6)</sup>	331%	319%
Days cash on hand <sup>(7)</sup>	340	334
Historical debt service coverage ratio	9.5x	5.6x

**Profitability**

<sup>(1)</sup> Operating income before nonrecurring expenses/Total revenue

<sup>(2)</sup> (Operating income before nonrecurring expenses + Interest + Depreciation and amortization)/Total revenue

<sup>(3)</sup> Revenue in excess of expenses/(Total revenue + Total nonoperating (loss) income, net)

<sup>(4)</sup> (Revenue in excess of expenses + Interest + Depreciation and amortization)/Total revenue

**Liquidity**

<sup>(5)</sup> (Current portion of long-term debt and commercial paper + Long-term debt subject to short-term financing arrangements + Long-term debt, less current portion) / (Current portion of long-term debt and commercial paper + Long-term debt subject to short-term financing arrangements + Long-term debt, less current portion + Total net assets without donor restrictions)

<sup>(6)</sup> Unrestricted cash and investments / (Current portion of long-term debt and commercial paper + Long-term debt subject to short-term financing arrangements + Long-term debt, less current portion)

<sup>(7)</sup> Unrestricted cash and investments / (Total expenses before nonrecurring expenses - Depreciation and amortization + Nonrecurring expenses (less estimated loss on sale of property)/days in period). The days cash on hand ratio is calculated from expenses for the six months ended June 30, 2021 and the year ended December 31, 2020.

**ADVOCATE AURORA HEALTH, INC.**  
**KEY FINANCIAL RATIOS**  
(in thousands)

<b>Trailing twelve month debt service coverage</b>	<u><b>As of June 30, 2021</b></u>
Revenue in excess of expenses- attributable to controlling interest	\$ 2,563,054
Adjustments:	
Depreciation and amortization expense	561,057
Interest expense	112,174
Unrealized gain on investments	(1,756,327)
Unrealized gain on interest rate swap obligation	(29,479)
Pension settlement loss	119,658
Loss on early extinguishment of debt	14,468
Asset impairment charges	4,006
Nonrecurring expenses	<u>86,057</u>
Total income available for debt service	1,674,668
Debt service requirement	176,768
Historical debt service coverage ratio	9.5

This ratio is being presented for information purposes only and is not indicative of future results. This ratio is calculated in the same manner as that presented in the Management, Discussion and Analysis of the condensed consolidated financial statements as of and for the year ended December 31, 2020.

**ADVOCATE AURORA HEALTH, INC.**  
**HISTORICAL UTILIZATION**

	<b>Three Months Ended June 30, 2021</b>	<b>Three Months Ended June 30, 2020</b>	<b>Change</b>	<b>% Change</b>	<b>Modified Change<sup>(2)</sup></b>	<b>Modified % Change<sup>(2)</sup></b>
Discharges	63,348	66,709	(3,361)	(5.0)%	(1,543)	(2.4)%
Observation Cases	27,936	24,458	3,478	14.2 %	3,953	16.5 %
Hospital Outpatient Visits	1,074,964	1,027,074	47,890	4.7 %	73,930	7.4 %
Physician Visits	2,412,904	2,407,479	5,425	0.2 %	50,692	2.1 %
Home Care Visits	205,111	184,756	20,355	11.0 %		
Capitated Member Lives <sup>(1)</sup>	248,274	252,919	(4,645)	(1.8)%		

	<b>Six Months Ended June 30, 2021</b>	<b>Six Months Ended June 30, 2020</b>	<b>Change</b>	<b>% Change</b>	<b>Modified Change<sup>(3)</sup></b>	<b>Modified % Change<sup>(3)</sup></b>
Discharges	122,669	122,408	261	0.2 %	4,267	3.6 %
Observation Cases	51,647	41,147	10,500	25.5 %	11,611	29.0 %
Outpatient Visits	2,050,157	1,672,090	378,067	22.6 %	444,735	27.7 %
Physician Visits	4,734,307	4,079,362	654,945	16.1 %	748,563	18.8 %
Home Care Visits	406,282	350,503	55,779	15.9 %		

<sup>(1)</sup> As of the date set forth in the column header

<sup>(2)</sup> For comparison purposes the impact of the central Illinois disposal group for the three month period ended June 30, 2020 are excluded it was disposed of in 2020 and therefore there are no comparable amounts for the three months ended June 30, 2021. See discussion of this transaction within Note 2. SIGNIFICANT EVENTS of the Condensed Consolidated Financial Statements.

<sup>(3)</sup> For comparison purposes the impact of the central Illinois disposal group for the period of January through June 2020 is excluded as it was disposed of July 1, 2020 and therefore there are no comparable amounts in the June 30, 2020 year to date results. See discussion of this transaction within Note 2. SIGNIFICANT EVENTS of the Condensed Consolidated Financial Statements.



**MANAGEMENT DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS**  
**(in thousands)**

The management discussion and analysis section refers to the condensed consolidated statements of operations.

Results of Operations – Six Months Ended June 30, 2021 Compared to Six Months Ended June 30, 2020

The change in operations between the six months ended June 30, 2021 and the six months ended June 30, 2020 was impacted by the COVID-19 pandemic, which began having a significant negative impact on operations in March 2020. As the vaccination rates have increased and other mitigation strategies to contain the virus along with remediation efforts that have taken effect in 2021, operations have improved in the six months ended June 30, 2021.

Operating income before nonrecurring expenses was \$290,929 for the six months ended June 30, 2021, resulting in an operating margin of 4.3%, compared to operating loss before nonrecurring expenses of \$(246,059) for the six months ended June 30, 2020, for an operating margin of (4.1)%. This represented a period-over-period increase of \$536,988. If the impact of the disposition of the central Illinois disposal group was excluded, the period-over-period increase would decrease by \$25,284 to \$511,704.

Total revenue for the six months ended June 30, 2021 was \$6,748,909, which was \$733,233 (12.2%) higher than the comparative period of 2020. If the impact of the disposition of the central Illinois disposal group was excluded, the period-over-period increase in total revenue would be \$844,433 (14.3%).

Patient service revenue increased \$968,198 (20.8%), in the six months ended June 30, 2021 compared to the same period in the prior year. If the impact of the disposition of the central Illinois disposal group was excluded, the period-over-period increase would increase to \$1,054,129 (23.0%). Patient service revenue for the six months ended June 30, 2020 was negatively impacted by the COVID-19 pandemic which led to cancellations and postponements of certain health care services.

Capitation revenue increased \$48,270 (8.6%) in the six months ended June 30, 2021, compared to the same period in the prior year due to a shift in the overall membership mix. The ratio of capitation revenue between Medicare Advantage versus commercial products was higher in the six months ended June 30, 2021 compared to the same period in the prior year. The increase in capitation revenue was slightly offset by a decrease in capitated lives of 1.8%.

Other operating revenue of \$509,702 decreased \$(283,235) (35.7)%. The decrease is due to \$362,293 received during the six months ended June 30, 2020 of HHS Provider Relief grants offset by the higher shared savings revenue for the six months ended June 30, 2021.

Total expenses (excluding nonrecurring expenses) for the six months ended June 30, 2021 were \$6,457,980, which was \$196,245 (3.1%) higher than the comparative period of 2020. If the impact of the disposition of the central Illinois disposal group was excluded, the period-over-period increase would have been \$332,729 (5.4%).

Salaries, wages and benefits expenses increased \$12,948 (0.4%). If the impact of the disposition of the central Illinois disposal group was excluded, the period-over-period increase would be \$83,866 (2.3%). The increase is primarily due to an increase in temporary help offset by a decrease in full-time equivalent employees of 0.5%. Also, additional pay programs related to the COVID-19 pandemic response such as family care reimbursement and cell phone and remote worker allowances were implemented subsequent to March 31, 2020 which have carried into 2021.

Supplies, purchased services and other expenses increased \$202,047 (10.3%). If the impact of the disposition of the central Illinois disposal group was excluded, the period-over-period increase would be \$258,455 (13.5%). The increase is primarily due an increase in patient volumes period-over-period due to the COVID-19 pandemic leading to cancellations and postponements of certain health care services for the six months ended June 30, 2020.

Nonrecurring expenses were \$26,331 and \$56,629 for the six months ended June 30, 2021 and June 30, 2020, respectively. Nonrecurring expenses consist of costs incurred in connection with the implementation of an electronic medical records and billing system and an enterprise resource planning system. As the implementation of the electronic medical records and billing system was completed in late 2020 there were no significant costs incurred related to that implementation in 2021.

Nonoperating income of \$864,125 for the six months ended June 30, 2021 compares favorably to the nonoperating loss of \$(599,947) for the six months ended June 30, 2020 primarily due to investment income, net which increased \$1,394,006 over the comparative period. See disclosure of the composition of investment income (loss), net within Note 5. INVESTMENTS of the condensed consolidated financial statements. The increase is due to an improvement in the financial markets over the comparative period, which reflected investment losses that occurred in that period, primarily as a result of market volatility relating to concerns over the COVID-19 pandemic. The change in fair value of interest rate swaps is attributable to the change (an increase) in interest rates.

Overall, the System reported revenue in excess of (less than) expenses - attributable to controlling interest of \$1,090,582 for the six months ended June 30, 2021 compared to \$(914,440) for the six months ended June 30, 2020 due primarily to decreased investment yields and operating loss resulting from the COVID-19 pandemic in 2020.

## **Liquidity**

The System holds substantially all its investments in a single investment portfolio. The investments in this portfolio are managed by external investment professionals under the guidelines set out in the investment policy statement adopted by the System's Board.

This policy includes the target allocations for the System's investment program. The System's investment program's target asset allocation, excluding cash and cash equivalents maintained for operating purposes, provides for a commitment to equity securities (30%), fixed income investments (20%) and select alternative investment classes (50%). Limitations are placed on investment managers as to the overall amount that can be invested in one issuer (except for U.S. government obligations and its agencies) or economic sector. See disclosure of the composition of the System's investment assets within Note 6. FAIR VALUE.

Investment income (including both realized and unrealized gains on investments) significantly impacts the System's financial results. Market fluctuations have affected and will likely continue to materially affect the value of those investments and those fluctuations may be and historically have been material. Reduction in investment income, or realized and unrealized losses, and the market value of its investments may have a negative impact on the System's financial condition, including its ability to provide its own liquidity for variable rate debt or to fund capital expenditures from cash and investments.

The System's financing strategy is to ensure liquidity and access to capital markets, to maintain a balanced spectrum of debt maturities and to manage our net exposure to floating interest rate volatility. Within these parameters, we seek to minimize our borrowing costs. The ability to access the long-term debt and commercial paper markets helps provide the System with sources of liquidity. Management is authorized to

issue commercial paper and/or have lines of credit in place up to a combined maximum of \$2,500,000 (with a sublimit of \$1,000,000 on commercial paper) at any given time.

### Days Cash on Hand

Days cash on hand was 340 as of June 30, 2021 compared to 334 as of December 31, 2020. Excluding the Medicare accelerated and advance payments and the deferred employer portion of the Social Security tax portion of FICA taxes, days cash on hand was 318 as of June 30, 2021 and 305 as of December 31, 2020.

### Indebtedness

Master Indenture Obligations: Substantially all of the System's outstanding Related Bonds and certain other obligations to lenders, banks and swap counterparties are all secured by Obligations issued under the Second Amended and Restated Master Trust Indenture dated as of August 1, 2018, with the Members of the Obligated Group and U.S. Bank National Association, as master trustee (the "System Master Indenture").

On May 5, 2020, the System issued \$700,000 of Taxable Bonds for general corporate purposes, to refinance certain tax-exempt bonds in the aggregate principal amount of \$78,750, to refinance commercial paper in the amount of \$82,000 and to pay certain expenses incurred in connection with their issuance.

On April 8, 2021, the System issued \$170,210 of Additional Taxable Bonds to refinance certain tax-exempt bonds in the aggregate principal amount of \$159,725 and to pay certain expenses incurred in connection with their issuance.

Under the terms of the bond indentures and other arrangements, various amounts are to be on deposit with trustees and certain specified payments are required for bond redemption and interest payments. The System Master Indenture and other debt agreements, including bank credit agreements, also place restrictions on the System to maintain certain financial ratios. Each of the bank agreements requires various reporting, operating and financial covenants to be maintained. These covenants may be waived, modified or amended by the related bank in its sole discretion and without notice to or consent by any bond trustee, the Master Trustee or the holders of any outstanding Related Bonds. Violation of any such covenants may result in an Event of Default under the System Master Indenture, which could result in acceleration of all Obligations issued under the System Master Indenture.

The System's total long-term debt and commercial paper was as follows:

	<u>June 30, 2021</u>	<u>December 31, 2020</u>
Tax-exempt bonds	\$ 1,237,616	\$ 1,409,326
Taxable bonds	1,941,955	1,760,500
Financing arrangements	205,686	214,360
Taxable term loan	80,205	97,871
Commercial paper	50,000	50,000
Total long-term debt	<u>\$ 3,515,462</u>	<u>\$ 3,532,057</u>

Standby Bond Purchase Agreements ("SBPA"): The System is a party to three SBPAs with two banks to provide liquidity support for the three subseries of the Series 2008C Bonds in the event of a failed remarketing of any such Series 2008C Bonds. The termination dates of the SBPAs are as follows:

<b>Subseries</b>	<b>Par</b>	<b>Expiration</b>
2008C-1	\$ 129,500	1/15/2024
2008C-2B	58,200	9/30/2025
2008C-3A	87,700	9/27/2024
Total	<u>\$ 275,400</u>	

In the event any bonds are not remarketed within one year from the date they are purchased by a bank pursuant to an SBPA ("Bank Bonds"), the System has agreed to cause such Bank Bonds to be redeemed pursuant to the related bond indenture such that the unpaid principal balance of all outstanding Bank Bonds shall amortize in approximately equal quarterly installments, with the first installment commencing on the date that is one year and one day after the date on which such Series 2008C Bond became a Bank Bond, the final installment payable on the date that is five years from the date on which such Series 2008C Bond became a Bank Bond (or, with respect to any Series 2008C-1 Bond or Series 2008C-2B that is a Bank Bond, if earlier, the date that is one year and one day following the then current Stated Expiration Date). At June 30, 2021, there were no Bank Bonds outstanding.

Covenant Agreements ("CAs"): The System is party to CAs with a bank, related to the Series 2011C Bonds and Series 2011D Bonds issued in September 2011 and purchased by the bank. The Series 2011C Bonds and Series 2011D Bonds currently bear interest at an indexed rate until September 3, 2024. At the end of their initial periods, the Series 2011C Bonds and the Series 2011D Bonds will be subject to mandatory tender, unless waived by the holders thereof, and the System presently anticipates that the Series 2011C Bonds and Series 2011D Bonds will be remarketed to new holders in one of the interest rate modes available under the related bond indenture. In the event the Series 2011C Bonds or the Series 2011D Bonds are not remarketed on their respective mandatory tender dates, then, as long as no default or event of default (as defined in the CAs) has occurred and is continuing, the Series 2011C Bonds or Series 2011D Bonds, as applicable, may either be repaid over a three-year period or remarketed during that time.

Windows Variable Rate Bonds: The System's Series 2011B Bonds bear interest at Windows Interest Rates (the "Windows Variable Rate Bonds") and are subject to optional and mandatory tender for purchase. The Windows Variable Rate Bonds are not supported by any external dedicated liquidity facility. Holders of Windows Variable Rate Bonds have a right to optionally tender their Bonds for purchase. If the tendered Windows Variable Rate Bonds are not successfully remarketed within the 30-day period that follows the date that notice of such optional tender is received by the Remarketing Agent (the "Remarketing Window"), then all Windows Variable Rate Bonds are required to be purchased on the day that is 210 days after notice of such optional tender is received by the Remarketing Agent (the "Windows Mandatory Tender Date"). The period from the end of the Remarketing Window until the Windows Mandatory Tender Date (initially, 180 days) is referred to as the Funding Window. During the Funding Window, the System expects that it would analyze the then current market conditions, availability and relative cost of any refinancing or restructuring alternatives for those Windows Variable Rate Bonds that are required to be purchased on the Windows Mandatory Tender Date (including, without limitation, conversion of those bonds to another interest mode or the refinancing or repayment of those bonds). The Windows Variable Rate Bonds are classified as current liabilities at June 30, 2021 and December 31, 2020 in the condensed consolidated balance sheets because these bonds may be subject to tender on a date that was within one year of the balance sheet date.

Long-term Rate Bonds: The Series 2018B-1, 2018B-2, Series 2018B-3, Series 2018B-4 Bonds, and Series 2018C-1 Bonds ("the Long-Term Rate Bonds") bear interest at long-term rates for a particular interest rate period and are subject to mandatory tender at the end of each particular interest rate period.

The following table summarizes the next scheduled mandatory tender dates for the Long-Term Rate Bonds as of June 30, 2021. In the event these Long-Term Rate Bonds are not remarketed upon mandatory tender

at the end of their current interest rate period, management anticipates utilizing marketable unrestricted investments, commercial paper issuance and/or available lines of credit to meet the purchase obligations.

<b>Subseries</b>	<b>Par</b>	<b>Expiration</b>
Series 2018B-1	46,690	1/26/2022
Series 2018B-2	46,310	1/25/2023
Series 2018B-3	48,560	1/31/2024
Series 2018B-4	49,420	1/29/2025
Series 2018C-1	40,885	7/29/2026
Total	<u>\$ 231,865</u>	

On January 15, 2020, \$42,045 of the Series 2008A-1 Bonds were remarketed for a new long-term rate period and will next be subject to mandatory tender on November 1, 2030, which is also the maturity date for the Series 2008A-1 Bonds. In connection with the remarketing, \$5,590 of the Series 2008A-1 Bonds were redeemed.

On February 12, 2020, \$30,820 of the Series 2008A-2 Bonds were remarketed for a new long-term rate period and will next be subject to mandatory tender on November 1, 2030, which is also the maturity date for the Series 2008A-2 Bonds. In connection with the remarketing, \$4,670 of the Series 2008A-2 Bonds were redeemed.

On April 8, 2021, \$40,885 of the Series 2018C-1 Bonds were remarketed for a new long-term rate period and will next be subject to mandatory tender on July 29, 2026. In connection with the remarketing, \$9,115 of the Series 2018C-1 Bonds were redeemed.

Indexed Floating Rate Bonds: The Series 2018C-2 Bonds, Series 2018C-3 Bonds and Series 2018C-4 Bonds (collectively the "Indexed Rate Bonds") bear interest at an indexed rate. At the end of their respective initial index rate periods, the Indexed Rate Bonds will be subject to mandatory tender. The following table summarizes the next scheduled mandatory tender dates for the Indexed Rate Bonds as of June 30, 2021.

<b>Subseries</b>	<b>Principal Amount</b>	<b>Next Mandatory Tender date</b>
Series 2018C-2	50,000	7/27/2022
Series 2018C-3	49,065	7/26/2023
Series 2018C-4	50,350	7/31/2024
Total	<u>\$ 149,415</u>	

Taxable Term Note: The System is party to a taxable term loan agreement with a bank, relating to a \$80,205 term loan, the proceeds of which were used to defease a portion of the Series 2010 Bonds. Absent an agreement between the System and the bank to extend the final maturity, the taxable term loan matures on September 27, 2024.

Commercial Paper: In order to enhance the System's liquidity, Management has the authority to issue up to \$1,000,000 from time to time under the System's commercial paper program. As of June 30, 2021, \$50,000 of commercial paper notes were outstanding and the System has the authority to issue \$950,000 of additional commercial paper.

Lines of Credit: At June 30, 2021, the System had lines of credit agreements with banks totaling \$1,425,000. These agreements expire as follows: \$100,000 in August 2021, \$100,000 in December 2022, \$425,000 in March 2023, \$400,000 in March 2024 and \$400,000 in March 2025. At June 30, 2021, the System had a \$100,000 line of credit, under which letters of credit can also be issued. At June 30, 2021, letters issued under the line of credit totaling \$71,684 were outstanding. At June 30, 2021, there were no outstanding

draws on the line of credit or letters of credit. Each line of credit is secured by a separate Obligation issued under the System Master Indenture.

Under regulatory rules of the State of Illinois, Advocate is required to post a letter of credit or surety bond with a State Agency, Advocate held a surety bond in the amount of \$17,475. No amounts were drawn on this surety bond at June 30, 2021.

Other Indebtedness: At June 30, 2021, the System had various finance lease arrangements totaling \$205,686 classified as long-term debt. These arrangements, which relate to various administrative and medical support buildings, had initial lease terms of 15 to 25 years.

Interest Rate Swaps: The System has multiple floating-to-fixed interest rate swap arrangements with respect to the Series 2008C Bonds (collectively, the Series 2008C Swaps) pursuant to ISDA Master Agreements. Pursuant to the Series 2008C Swaps, Wells Fargo Bank, National Association ("Wells Fargo") and PNC Bank, National Association ("PNC") pay the System the sum of a percentage of the one-month London Interbank Offered Rate ("LIBOR") plus a spread, and the System pays Wells Fargo and PNC amounts based on a fixed rate (approximately 3.605%). All Wells Fargo, PNC and the System payments are made on a same day net payment basis with reference to a notional amount that declines over the term of the Series 2008C Swaps. Unless terminated earlier in accordance with their terms, the Series 2008C Swaps' scheduled termination date is November 1, 2038. Under certain circumstances, however, the Series 2008C Swaps are subject to termination prior to the scheduled termination date.

In connection with an acquisition, the System acquired a floating-to-fixed interest rate swap agreement ("Portfolio Swap"). Piper Jaffray Financial Products Inc. ("Piper Jaffray") pays the System a percentage of the one-month LIBOR and the System pays Piper Jaffray amounts based on a fixed rate (approximately 3.314%) based on the notional amount which declines over the term of the Portfolio Swap. Unless terminated earlier in accordance with their terms, the Portfolio Swap's scheduled termination date is February 1, 2038. Under certain circumstances, the Portfolio Swap is subject to termination prior to the scheduled termination date.

See Note 6. FAIR VALUE and Note 11. INTEREST RATE SWAP PROGRAM for discussion of the fair value and a description of the accounting treatment of the System's interest rate swap arrangements.

Risks Associated with Discontinuance of LIBOR: Certain of the System's outstanding interest rate swaps and other indebtedness are payable based on LIBOR, which is an interbank offered rate. The entities that regulate and supervise the publication of LIBOR have announced their intent to cease publication of one week and two-month U.S. Dollar LIBOR tenors after December 31, 2021 and all other U.S. Dollar LIBOR tenors after June 30, 2023.

If future uncertainty surrounding the calculation of LIBOR results in sudden increases in LIBOR rates, the amounts payable by IHS on its LIBOR-based instruments may be materially affected. Further, the phase out of LIBOR and the uncertainty as to the benchmark rate that may succeed LIBOR may increase the costs and availability of financing or otherwise materially adversely affect IHS, in part depending on the market levels of any such replacement rate, and the potential vulnerability to manipulation (if any) of any such replacement rate. The replacement of LIBOR with a successor rate could cause the amounts payable by the System on its LIBOR-based obligations to be different or higher than expected.

Securities Lending: As part of the management of the investment portfolio, the System has entered into an arrangement whereby securities owned by the System are loaned, primarily to brokers and investment banks. The loans are arranged through a bank. Borrowers are required to post collateral in the form of cash or highly rated securities for securities borrowed equal to no less than 102% of the value of the security loaned on a daily basis. The bank is responsible for reviewing the credit-worthiness of the borrowers. The System has also entered into an arrangement whereby the bank is responsible for the risk of borrower bankruptcy and default. At June 30, 2021 and December 31, 2020, the System loaned approximately \$17,970

and \$18,945, respectively in securities and accepted collateral for these loans in the amount of \$18,618 and \$19,789, respectively which represented cash and government securities. The collateral received under the securities lending program has been reflected as a current asset and a current obligation payable in the condensed consolidated balance sheets presented. The balance of securities on loan and accepted collateral fluctuates daily.

### **Capital Expenditures**

For the six months ended June 30, 2021, capital expenditures of the System were \$260,276; at June 30, 2021 the System had \$538,718 of construction-in-progress. The amounts of construction-in-progress at June 30, 2021 relate to various projects to improve existing facilities and expand access to health care in the markets served.

The System has three significant capital projects that are ongoing in 2021. The System is currently expanding the Center for Advanced Care (ambulatory base) at Advocate Illinois Masonic Medical Center in Chicago, Illinois. This expansion is expected to cost approximately \$121,300 and is estimated to be completed in June 2024. The System is also building a hospital and medical office building on a site along the I-94 corridor in Mount Pleasant, Wisconsin. Management expects that the hospital, medical office building and ancillary buildings will cost approximately \$230,000, with construction estimated to be completed in 2021 and opened for patients in February 2022. The System is building a medical campus, replacing an existing campus, in Sheboygan, Wisconsin. Management currently anticipates a cost of approximately \$325,000 for that campus, with an expected completion date of June 2022. Currently, management expects to fund capital commitments and expenditures with cash generated from operations and investment income, as well as from existing cash and investment balances.

Management continues to evaluate planned capital projects and routine capital expenditures with a focus on liquidity needs, operating margin considerations and alignment with the strategic plan.

### **LEGAL AND REGULATORY COMPLIANCE**

The System operates in a highly litigious industry. As a result, various lawsuits, claims and proceedings have been instituted or asserted against it from time to time. The System has knowledge of certain pending suits against certain of its entities that have arisen in the ordinary course of business. In the opinion of management, the System maintains adequate insurance and/or other financial reserves to cover the estimated potential liability for damages in these cases, or, to the extent such liability is uninsured, adverse decisions will not have a material adverse effect on the financial position or operations of the System.

As a health care provider, the System entities are subject to extensive and frequently changing federal, state and local laws and regulations governing various aspects of our business. In particular, the System entities provide a broad range of services, many of which are regulated by different government agencies, subject to differing regulatory schemes and subject to contractual reviews and program audits in the normal course of business. Many operations that the System entities undertake are subject to significant governmental certification and licensing regulations, as well as federal and state laws.

The System, like all major health care systems, periodically may be subject to investigations or audits by federal, state and local agencies involving compliance with a variety of laws and regulations. These investigations seek to determine compliance with, among other things, laws and regulations relating to Medicare and Medicaid reimbursement, including billing practices for certain services. Violation of such laws could result in substantial monetary fines, civil and/or criminal penalties and exclusion from participation in Medicare, Medicaid or similar programs.

## **Compliance and Internal Audit Programs**

The System's Compliance and Integrity Program ("Program") is overseen by the System Chief Compliance Officer. The System Chief Compliance Officer reports to the Chief Executive Officer, with reporting accountability to the Audit and Compliance Committee of the System Board of Directors. The Program is modeled after the seven essential elements of an effective compliance program, as set forth in the U.S. Health and Human Services, Office of Inspector General Compliance Program Guidance and further interpreted by the Federal Sentencing Guidelines and the U.S. Department of Justice Guidelines for the Federal Prosecution of Corporations. The Program includes mandatory annual education of all employees regarding specific legal and regulatory requirements applicable to health care organizations, including requirements related to patient confidentiality, information privacy, information systems security, conflicts of interest, licensure and certification, federal fraud and abuse laws, billing, coding and documentation, civil rights and non-retaliation. The Program is based on a Code of Conduct and includes an anonymous hotline available to report violations or seek guidance on compliance issues.

The System also has an internal audit department responsible for providing independent and objective assurance and consulting services designed to add value and help the System accomplish its objectives by bringing a systematic, disciplined approach to evaluate the effectiveness of risk management, control and governance processes. The System Audit Officer reports functionally to the Audit and Compliance Committee of the Board of Directors and administratively to the Chief Financial Officer. The internal audit department carries out an annual audit program that assesses the System's design and operation of internal controls to achieve efficient and effective operations, accurate and reliable financial reporting, compliance with policies, laws and regulations and the proper safeguarding of assets.

## **BOND RATINGS**

In August 2021, Fitch affirmed a rating of AA (stable outlook) and Moody's affirmed a rating of Aa3 (positive outlook) on the Related Bonds. As of the date of this report, S&P maintains a rating of AA (stable outlook).

The ratings above reflect only the view of the rating organization providing the same, and an explanation of the significance of such ratings may be obtained only from the rating agency furnishing the same. There is no assurance that such ratings will continue for any given period of time or that they will not be revised downward or withdrawn entirely by such rating agency if, in its judgment, circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of System's outstanding bonds. A securities rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time.

Additional information on the System's bond ratings can be obtained from the Investor Relations section on <https://www.advocateaurorahealth.org/investor-relations>.

## **MANAGEMENT**

Key members of the management of the System are described within the "GOVERNANCE AND MANAGEMENT" section in Appendix A to the Offering Memorandum dated April 28, 2020, relating to the Series 2020A Bonds. The Offering Memorandum can be accessed at <http://munios.com>. Since April 28, 2020, the following changes occurred:

In December 2020, Mike Lappin, the System's Chief Integration Officer, left the System. There are currently no plans to fill this position.

In March 2021, Shoeb Sitafalwalla, MD was announced as the System's new Chief Strategy Officer, effective April 1, 2021. Scott Powder, the System's previous Chief Strategy Officer, transitioned to focus exclusively



on the whole person health portion of the System's strategic plan and thus, was appointed President of Advocate Aurora Enterprises.

In March 2021, Meghan Woltman was appointed as the System's Chief Government Relations Officer, replacing Joyce Rogers, who resigned from the System in January 2021.

## **SYSTEM STRATEGY**

The System maintains a strategic plan and is well positioned to carry out its purpose: to help people live well. The plan calls for transformation of the System's core business of health care delivery while simultaneously building the System's future as a consumer health company. The plan has three major focus areas: transform the core, consumer-first and whole person health. Transform the core includes strategies to achieve breakthrough performance in safety, health outcomes, growth and affordability. Consumer-first includes strategies to provide a seamless and connected consumer experience. Whole person health includes strategies to develop new care models and new consumer-facing businesses targeted to individualized health and wellness needs.

The System will continue to evaluate potential affiliations, divestitures, joint ventures and other strategic relationships that it believes will be advantageous.

## **ENVIRONMENTAL, SOCIAL AND GOVERNANCE PRACTICES ("ESG")**

The System's focus on environmental sustainability, team member development, wellness, diversity, equity and inclusion and safety are rooted in the System's purpose to help people live well. This commitment extends beyond the boundaries of our System and into the communities the System is privileged to serve.




### ***Environmental Sustainability***

The System is steadfast in efforts to eliminate harm to human and environmental health, and to improve environmental quality by enhancing policies, programs and practices for all its business activities. Towards this end, the System adopted environmentally preferable purchasing guidelines and strategies that inform all sourcing and contracting decisions. The System seeks to purchase environmentally preferable products from environmentally responsible suppliers whenever financially feasible. Additionally, the scale of the System is utilized to drive the market toward transparency and accelerated development of healthier, safer products and building materials which protect human and environmental health across their entire life cycle.

The System's sustainability efforts also focus on reducing waste (e.g. recycling, single use device reprocessing, paper utilization and food waste) and energy conservation. The System aims for Leadership in Energy and Environmental Design ("LEED") for Healthcare certification on select new major buildings. A roadmap also guides all current and future renovations and construction projects across the System on a path of sustainability. The roadmap meets or exceeds the U.S. Green Building Council requirements for LEED Certification. In addition, the System has announced a commitment to power its health care operations with 100% renewable electricity by 2030. Over the next decade, all major construction and renovation projects will be evaluated for the addition of on-site renewables and implemented when financially feasible.

Environmental sustainability goals are governed by the System's sustainability team. The sustainability team sets the areas of focus and most implementation strategies for environmental stewardship work at the System. The sustainability team lead meets regularly with senior leadership to discuss proposed goals, progress, barriers and initiatives. Progress towards the System's established sustainable operations goals is conveyed through the Environmental Sustainability Dashboard.

Below are metrics from the System’s 2020 Environmental Sustainability Dashboard:

Category			2020 System Target	2020 System Results*
 <b>Sustainable Purchases</b>	<b>Chemical Free Furniture Purchases</b>	Percent of freestanding furniture and medical furnishing purchases without the use formaldehyde, perfluorinated compounds, polyvinyl chloride, antimicrobials, and flame retardants (where code permits).	90%	95%
	<b>Certified Green Cleaners Purchases</b>	Percent of general-purpose, window/glass, bathroom, carpet/rug, and floor cleaner purchases that are certified by a third-party for having reduced environmental and public health impacts compared to similar products.	70%	62%
	<b>Antibiotic Free Meat Purchases</b>	Percent of meat purchased from animals raised without the routine use of antibiotics. Low doses of antibiotics are often given to farm animals to boost growth and prevent disease in otherwise healthy animals; this practice contributes to antibiotic resistance.	25%	26%
 <b>Waste Reduction</b>	<b>Waste Reduction</b>	Percent reduction of the volume of solid and medical waste produced per adjusted patient day from baseline. Waste reduction activities include waste prevention, reprocessing, donation, and recycling.	-1% from 2019 baseline	-1.5%
	<b>Paper Reduction</b>	Percent reduction in paper utilization from the previous year.	-2% from 2019 baseline	-16.8%
 <b>Energy and Climate</b>	<b>Energy Use Intensity</b>	Percent reduction of the building's weather-normalized energy use intensity (12-month rolling). Energy Use Intensity calculates the amount of energy used per square foot in the building (total energy usage/gross floor area).	<0% from 2019 baseline	0.64%
	<b>Greenhouse Gas ("GHG") Emission Intensity</b>	Percent reduction of the buildings GHG intensity. GHG intensity is calculated by dividing the total GHG emissions of the building in one year by the total gross floor area of the building.	-2% from 2019 baseline	0.64%

\* Results from Green Cleaners, Waste Reduction, Energy and GHG Emissions include hospital data only.

To foster environmental sustainability in the community, the System provides national leadership and mentoring in sustainable health care through the membership and participation in several sustainability leadership councils and groups. A summary of the significant initiatives the System has taken to spur movement toward healthier and more sustainable practices throughout the health care sector and wider marketplace include:

- Member of the [Healthcare Anchor Network](#) (“HAN”) and a signatory of the HAN Impact Purchasing Pledge.
- Joined the Health Care Climate Council to lead the transformation to climate-smart health care.
- Member of the Healthcare Facility Advisory Board of Healthcare Plastics Recycling Coalition.
- Continued leadership in Health Care Without Harm and Practice Greenhealth.
- Signatory of the Chemical Footprint Project.

External recognition of the System’s sustainability efforts include:

- Recipient of the 2021 System for Change Award from Practice Greenhealth. This is the thirteenth consecutive year the System has received this award, the longest run in the country.
- Recipient of the 2021 Environmental Excellence Award for all the System’s acute care hospitals.

### ***Socially Responsible Investment***

The System has numerous social responsibility guidelines in place within its Investment program. The security selection process involves screening the sources of revenue of potential investments. The System does not invest directly in companies that derive 20% or greater of their revenue from certain prohibited activities. Additionally, the System believes that investment performance and diversity can co-exist. The System proactively seeks out diverse investment managers to manage its investment assets.

### ***Human Capital***

The System is committed to creating and maintaining a diverse, inclusive and engaged environment where team members can pursue their passion and feel supported, valued and recognized. The System believes attraction, development, engagement and retention of team members is critical to fulfilling its purpose and thus, dedicates resources to support these efforts including training and talent development programs.

The System is also committed to supporting personal well-being and preserving a healthy environment for its approximate 75,000 team members. The System's team member well-being program is designed to educate and encourage all team members. Those who take action to manage and improve their health are incentivized and recognized for their efforts and achievements. The System offers discounts at its fitness centers, indoor and outdoor guided walking paths at each hospital location and a variety of physical, mental and social programs, resources and interventions to support team members in their well-being journey. In 2021 in the midst of a pandemic, the System achieved top quartile team member engagement.

The System believes that a diverse workforce, in a thriving inclusive environment, delivers a higher level of equitable care, serving patients across all communities. By recruiting and retaining a diverse workforce and empowering diverse perspectives, the System aims to inspire creativity that leads to innovative solutions. To assist in reaching these goals and reflective of the Systems commitment to and prioritization of diversity, equity and inclusion, the Board of Directors established a Diversity, Equity & Inclusion ("DE&I") Committee of the Board of Directors. The Board of Directors is responsible to ensure the DE&I strategy is embedded throughout the System and to maintain organizational accountability around that strategy. The Advocate Aurora Health Inclusion Council was also created along with core teams tasked with locally implementing DE&I efforts to strengthen the broader culture of inclusion.

External recognition of the System's DE&I efforts include:

- Listed for the third time on Diversity MBA Magazine's as one of the best places to work for women and diverse managers.
- The System's Chief External Affairs Officer named one of 50 business leaders of color for 2021 by Chicago United.
- LGBTQ healthcare equality leader designation for all 24 of the System's hospitals, with a perfect Healthcare Equality Index score of 100.

Additional information regarding the System's diversity, equity and inclusion efforts is available in the [2020 DE&I Impact Report](#).

### ***Safety and High Reliability***

In furtherance of the System's efforts to do no harm, the System has developed a high reliability plan which incorporates proactive strategies to anticipate risks and to establish system wide safety process to address these risks. This plan applies across the care continuum and in both clinical and non-clinical areas. The System's high reliability plan includes several programs, such as:

- *Establishment and maintenance of safety as the cultural foundation of care.* This is inclusive of both patient safety and team member safety.
- *Teach leaders to lead to safety.* Educating and hard wiring the use of explicit high reliability leadership skills. Leaders are taught to define and demonstrate *Safety First* as part of the overall patient experience, to find problems and fix causes in systems and processes and reinforce and build accountability for high reliability behaviors.
- *Empower and support the frontline to address safety issues.* Through deliberate influence, frontline team members are encouraged to change culture by using high reliability tools and tactics, exercising autonomy in fixing latent safety threats and being the voice of patient safety at the local level.
- *Engagement of patients and families in patient safety.* A commitment to transparency with patients and their families enables strong partnerships and collaboration to learn from and prevent safety events.

### ***Addressing Health Inequities***

The System is committed to addressing health inequity while focusing on quality of care, safety and reducing the cost of care. The System provides charitable care and services to its communities including: charity and other uncompensated care that is provided free, subsidized or without full reimbursement from Medicare, Medicaid or other government-sponsored programs; subsidized health services that respond to unique community needs; education to train health care professionals; volunteer services provided by team members who donate time to supporting their communities; language assistance and interpreter services; and contributions of equipment, supplies and other assistance to community groups.

A summary of the significant initiatives taken to address health inequities and promote DE&I in the System's communities include:

- Joined Chicago Mayor Lori Lightfoot's Racial Equity Rapid Response Initiative with other health systems and community partners to incite real change to achieve racial justice and end health disparities.
- Co-led Chicago's South Side Healthcare Transformation and renewed its commitment to revitalize Milwaukee's near west side.
- Spearheaded the creation of the Racial and Health Equity Advisory Council within the Milwaukee Health Care Partnership to build an interorganizational anti-racism and health equity collaboration.
- Established a formal Business Diversity Program within the System with the focus to increase purchases that are made from diverse businesses. The System will seek to purchase goods and services from diverse suppliers whenever financially feasible with the belief that utilizing diverse suppliers can help provide economic strength to underserved communities in the regions the System serves.
- Founding member of the HAN, a national consortium of health systems dedicated to driving inclusive anchor strategies to positively impact the social and economic determinants of health. The System signed the HAN Racism is a Public Health Crisis statement.
- Contracted with NowPow to provide important social determinants of health to its patients. NowPow is used to screen patients for social determinants of health and provide referrals to community benefit organizations that provide services that address patient needs.
- Provided free, community based, flu vaccines for our most vulnerable populations.
- Established a Health Equity Council to develop key innovation strategies to address inequities in our patient population.
- Established a community investment program that grants low interest loans to community organizations.

## **CYBERSECURITY**

Healthcare providers and insurers are highly dependent upon integrated electronic medical record and other information technology systems to deliver high quality, coordinated and cost-effective healthcare. These systems necessarily hold large quantities of highly sensitive protected health information that is highly valued on the black market for such information. As a result, the electronic systems and networks of healthcare providers and insurers are considered likely targets for cyberattacks and other potential breaches of their systems. In addition to regulatory fines and penalties, the healthcare entities subject to the breaches may be liable for the costs of remediating the breaches, damages to individuals (or classes) whose information has been breached, reputational damage and business loss and damage to the information technology infrastructure. The System has taken, and continues to take, measures to protect its information technology system against such cyberattacks, but there can be no assurance that the System will not experience a significant breach. If such a breach occurs, the financial consequences of such a breach could have a materially adverse impact on the System.

As the System's investment in information technology continues to increase, cybersecurity continues to be a top priority. The System has developed a cyber security program and continues to implement tools, processes and policies to secure its technology infrastructure and protect its data assets. The cyber security program is dynamic in nature with all tenets under constant review and modification to protect against continually emerging threats and to ensure regulatory compliance.

## **INDUSTRY RISKS**

For a description of industry risks, see the "BONDHOLDERS' RISKS" section in the Offering Memorandum dated April 28, 2020, relating to the Series 2020A Bonds. The Offering Memorandum can be accessed at <http://munios.com>.

As described in the BONDHOLDERS' RISKS section in the Offering Memorandum, the System is aware of certain additional risks regarding the spread of COVID-19, a strain of coronavirus. On March 11, 2020, the World Health Organization declared COVID-19 a pandemic, and on March 13, 2020, President Trump declared a national emergency. The federal government and a large number of state governments, including Illinois and Wisconsin, imposed strict measures to curtail certain aspects of public life in an effort to contain the spread of COVID-19.

An outbreak of an infectious disease, including any growth in the magnitude or severity of COVID-19 cases in the System's service areas, could result in an abnormally high demand for health care services, potentially inundating hospitals with patients in need of intensive care services and the treatment of a highly contagious disease at one of the System's facilities could also result in a temporary shutdown of facilities or diversion of patients or staffing shortages. Additionally, elective procedures may be deferred, resulting in reduced patient volumes and operating revenues at the System's facilities. Further, the changing global economic conditions or potential global health concerns such as the COVID-19 virus may also affect the System's partners, suppliers, distributors and payors, potentially disrupting or delaying the System's supply chain and delaying reimbursement by governmental or private payors.

The spread of COVID-19 has altered the behavior of businesses and people in a manner that is having negative effects, including significant growth in unemployment and underemployment related to business curtailment and closures, on global and local economies. In response to COVID-19 concerns, which resulted in the deferral or cancellation of most elective procedures occurring within the System's facilities from mid-March 2020 to mid-May 2020 when reactivation began, the System's patient service revenue from March to December of 2020 was approximately \$600,000 or 10% lower than the comparable period of 2019. The System also incurred cost of approximately \$35,000 and \$80,000 for the three and six months ended June

30, 2021, respectively, and \$384,000 for the year ended December 31, 2020 associated with the COVID-19 pandemic primarily in the form of increased salaries and wages related to pay programs implemented to compensate team members assigned to COVID-19 hotspots and other continuity related pay and other preparation related costs. The System continues to evaluate its pay programs and other costs and will adjust as the System's needs continue to evolve. It is not possible to predict the costs associated with the potential treatment of an infectious disease outbreak by the System's health care operations or preparation for such treatment.

In addition to the direct impact to the health care industry, investment markets in the United States and globally saw a significant decline in value in March 2020 attributed to COVID-19 concerns. The investment markets started to recover in April 2020, but continued spread of COVID-19 or any other similar outbreaks could result in another significant decline in value.

The continued spread of COVID-19 or any other similar outbreaks in the future may materially adversely impact the System's financial condition and results of operations, as well as national and local economies. See Note 2. SIGNIFICANT EVENTS for further details on the financial effects on the System.

The System benefited \$16,900, \$38,300 and \$56,500 for the three and six months ended June 30, 2021 and year ended December 31, 2020, respectively, from the suspension of Medicare sequestration and the 20% add-on to the DRG payment of inpatients admitted with COVID-19 during the emergency period imposed under the CARES Act. Further, the System received \$0 for the six months ended June 30, 2021 and approximately \$9,000 for the year ended December 31, 2020 in additional Illinois Medicaid Hospital Assessment Program and Wisconsin disproportionate share hospital payments.

The System does anticipate as a result of the significant increase in unemployment and underemployment caused by business curtailment and closures, collectability on the patient responsibility portions of its non-COVID-19 related accounts receivable will be negatively impacted. As a result, the System increased its estimate for uncollectible accounts by approximately \$40,000 in March 2020.

The System has reactivated all aspects of its health care operations. The success of such reactivation is subject to many factors external to the System including potential new government mandated prohibitions of non-essential healthcare procedures, the willingness of patients to resume preventive and elective care, availability of personal protection equipment and other supplies and drugs, changes in clinical care and patient and caregiver safety protocols and processes required by the Centers for Disease Control and Prevention, the Occupational Health and Safety Administration, states' departments of public health and other government bodies.

Although the System has activated plans to address the COVID-19 pandemic and operates pursuant to infectious disease protocols, the potential impact of a pandemic, epidemic or outbreak of an infectious disease with respect to the System's service areas or facilities is difficult to predict and could adversely impact the business, financial condition or results of operations, and, accordingly, may materially adversely impact the financial condition of the System.

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