KPMG

KALEIDA HEALTH

Consolidated Financial Statements

December 31, 2018 and 2017

(With Independent Auditors' Report Thereon)

KALEIDA HEALTH

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KPMG LLP
500 Seneca Street
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Buffalo, New York 14204

Independent Auditors' Report

To the Board of Directors
Kaleida Health:

We have audited the accompanying consolidated financial statements of Kaleida Health (Kaleida), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations and changes in net assets, and cash flows for each of the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Upper Allegheny Health System, which consists of Bradford Regional Medical Center and Olean General Hospital, both wholly owned subsidiaries, whose statements reflect total assets constituting 11% of consolidated total assets as of December 31, 2017, and total operating revenue constituting 6% of consolidated total operating revenue for the year ending December 31, 2017. Those statements were audited by other auditors, whose report have been furnished to us, and our opinion, insofar as it relates to the amounts included for Upper Allegheny Health System, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kaleida Health as of December 31, 2018 and 2017, and results of its operations and changes in net assets, and its cash flows for each of the years then ended, in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in Note 2(t) to the consolidated financial statements, during the year ended December 31, 2018, Kaleida adopted Financial Accounting Standards Board Accounting Standards Update (ASU) No. 2016-14, Not-for-Profit Entities (Topic 958): Presentation of Financial Statements for Not-for-Profit Entities. Our opinion is not modified with respect to this matter.

KPMG LLP

April 30, 2019

KALEIDA HEALTH

Consolidated Balance Sheets

December 31, 2018 and 2017

(Dollars in thousands)

Assets		2018	2017
Current assets:			
Cash and cash equivalents	$	61,731	37,385
Investments (notes 6 and 7)		168,709	213,383
Accounts receivable:			
Patient, less estimated allowance for doubtful accounts of $35,852 in 2018 and $31,004 in 2017		298,229	251,977
Other (note 10)		44,635	34,213
Grants receivable		13,287	16,243
Estimated third-party payor receivables (note 4)		19,934	14,120
Inventories		46,219	42,379
Prepaid expenses and other current assets		17,989	28,284
Total current assets		670,733	637,984
Assets limited as to use (notes 5, 6, 7, and 10):			
Designated under debt agreements		39,830	40,892
Designated under self-insurance programs		89,862	101,174
Board designated and donor restricted		123,322	142,864
Other		2,568	2,006
		255,582	286,936
Property and equipment, less accumulated depreciation and amortization (note 9)		767,635	755,078
Other (note 10)		54,472	69,796
Total assets	$	1,748,422	1,749,794

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KALEIDA HEALTH

Consolidated Balance Sheets

December 31, 2018 and 2017

(Dollars in thousands)

Liabilities and Net Assets		2018	2017
Current liabilities:			
Accounts payable and other accrued expenses	$	175,665	149,355
Accrued payroll and related expenses		70,292	68,144
Construction costs payable		—	11,269
Estimated third-party payor settlements (note 4)		22,203	22,598
Current portion of long-term debt (note 11)		41,210	36,546
Line of credit (note 11)		42,054	10,000
Other current liabilities		9,744	9,786
Total current liabilities		361,168	307,698
Long-term debt, less current portion (note 11)		399,827	407,291
Estimated self-insurance reserves (note 5)		158,293	155,410
Asset retirement obligations (note 14)		8,066	11,185
Pension and postretirement obligations (note 13)		319,436	359,876
Other long-term liabilities (note 4)		3,585	3,241
		889,207	937,003
Total liabilities		1,250,375	1,244,701
Commitments (notes 9 and 12)			
Net assets:			
Without donor restrictions:			
Available for operations		726,265	740,425
Provision for future benefit costs (note 13)		(355,337)	(381,845)
Total without donor restrictions		370,928	358,580
Total with donor restrictions		127,119	146,513
Total net assets		498,047	505,093
Total liabilities and net assets	$	1,748,422	1,749,794

See accompanying notes to consolidated financial statements.

KALEIDA HEALTH

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2018 and 2017

(Dollars in thousands)

		2018	2017
Operating revenue:			
Patient service revenue, net of contractual allowances and discounts (notes 3 and 4)	$	1,802,654	1,621,831
Less provision for bad debts		23,316	19,937
Net patient service revenue		1,779,338	1,601,894
Other operating revenue (notes 6 and 15)		61,405	55,875
Net assets released from donor restrictions for operations		12,811	8,693
Total operating revenue		1,853,554	1,666,462
Operating expenses:			
Salaries and benefits		1,015,900	922,538
Purchased services and other		381,196	325,327
Medical and nonmedical supplies		350,612	311,052
Depreciation and amortization		77,088	66,433
Interest		18,681	13,797
Total operating expenses		1,843,477	1,639,147
Income from operations		10,077	27,315
Other income:			
Investment (loss) income (note 6)		(18,057)	22,779
Net realized (losses) gains on sales of investments (note 6)		(5,650)	2,863
Net change in unrealized (losses) gains on investments (note 6)		(6,824)	8,520
Loss on impairment and disposal of assets (note 9)		—	(12,198)
Total other (losses) income, net		(30,531)	21,964
(Deficiency) excess of revenue over expenses, before effect of affiliation, net		(20,454)	49,279

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Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2018 and 2017

(Dollars in thousands)

		2018	2017
Changes in net assets without donor restrictions:			
(Deficiency) excess of revenue over expenses, before effect of affiliation	$	(20,454)	49,279
Effect of affiliation (note 18)		—	41,584
(Deficiency) excess of revenues over expenses, after effect of affiliation		(20,454)	90,863
Pension and postretirement related changes other than net periodic cost (note 13)		26,508	(50,212)
Contributions for capital acquisitions		—	12,588
Net assets released from restrictions for capital expenditures		6,397	16,721
Other, net		(103)	3,746
Increase in net assets without donor restrictions		12,348	73,706
Changes in net assets with donor restrictions:			
Contributions, bequests, and grants		8,892	5,823
Restricted investment income		6,284	9,342
Effect of affiliation (note 17)		—	20,218
Net change in unrealized (losses) gains on investments		(15,362)	6,259
Net assets released from restrictions for operations		(12,811)	(8,693)
Net assets released from restrictions for capital expenditures		(6,397)	(16,721)
Effect of affiliation (note 17)		—	24,214
(Decrease) increase in net assets with donor restrictions		(19,394)	40,442
Change in net assets		(7,046)	114,148
Net assets, beginning of year		505,093	390,945
Net assets, end of year	$	498,047	505,093

See accompanying notes to consolidated financial statements.

KALEIDA HEALTH

Consolidated Statements of Cash Flows

Years ended December 31, 2018 and 2017

(Dollars in thousands)

		2018	2017
Operating activities:			
Change in net assets	$	(7,046)	114,148
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		77,088	66,433
Effect of affiliation		—	(86,016)
Loss on impairment and disposal of assets		—	12,198
Accretion expense		540	785
Restricted contributions and bequests		(1,639)	(23,334)
Restricted grants		(8,236)	(2,415)
Change in interests in other investments		19,772	(20,850)
Net change in unrealized gains on investments		19,598	(14,779)
Net realized gains and losses on investments		(634)	(12,205)
Provision for bad debts		23,316	19,937
Pension and postretirement related changes other than net periodic cost		(26,508)	50,212
Change in operating assets and liabilities:			
Patient accounts receivable		(69,568)	(76,455)
Estimated third-party payor receivables		(5,814)	332
Other receivables, inventories, and prepaid expenses		(3,966)	(21,858)
Accounts payable, accrued expenses, accrued payroll, and construction costs payable		25,805	41,907
Estimated third-party payor settlements		(395)	2,921
Other assets		5,377	(6,615)
Other liabilities		(14,405)	19,661
Net cash provided by operating activities		33,285	64,007
Investing activities:			
Additions to property and equipment, net of change in capital acquisitions included in accounts payable		(64,832)	(159,805)
Purchases of investments		(349,100)	(168,066)
Proceeds from sales of investments		398,826	188,005
Change in cash restricted for use		2,136	(439)
Capital contributions to joint venture		(4,626)	—
Net cash provided by (used in) investing activities		(17,596)	(140,305)
Financing activities:			
Principal payments on debt and capital lease obligations		(36,131)	3,620
Proceeds from restricted contributions and bequests		1,639	23,334
Proceeds from line of credit		32,054	10,000
Proceeds from restricted grants		11,192	5,000
Proceeds from long-term debt		—	26,581
Payments for deferred financing fees		(97)	(635)
Net cash provided by financing activities		8,657	67,900
Net increase (decrease) in cash and cash equivalents		24,346	(8,398)
Cash and cash equivalents, beginning of year		37,385	45,783
Cash and cash equivalents, end of year	$	61,731	37,385
Supplemental disclosures on cash flow activities:			
Capital lease obligations	$	33,333	49,872
Interest paid		19,909	17,377
Capital acquisitions included in accounts payable		4,350	12,967

See accompanying notes to consolidated financial statements.

(1) Organization

Kaleida Health (Kaleida) is an integrated healthcare delivery system that provides acute, skilled nursing, rehabilitative, outpatient, and home healthcare services primarily to the residents of Western New York. The entities consolidated within Kaleida are the Hospital Corporation (consisting of Buffalo General Medical Center, John R. Oishei Children's Hospital, the Millard Fillmore Suburban Hospital, DeGraff Memorial Hospital, and two hospital based nursing facilities), Visiting Nursing Association of WNY, Inc., VNA Home Care Services, Inc., General Physician, P.C. and its subsidiaries (General Physicians), Great Lakes Physicians, P.C. (Great Lakes), several other subsidiaries, and two charitable foundations that raise funds for Kaleida.

Effective July 3, 2017, Kaleida entered into an affiliation agreement with Upper Allegheny Health System (UAHS), in which Kaleida became the active parent and sole corporate member of UAHS. UAHS is a not-for-profit management holding corporation and the sole corporate member of Olean General Hospital (Olean), which provides inpatient, outpatient and emergency care services for residents of the southern tier of western New York, and Bradford Regional Medical Center (BRMC) and its controlled subsidiaries, which provide acute inpatient, outpatient, long-term nursing care, and home care services primarily to residents of Northwest Pennsylvania. The affiliation was consummated to enhance their common mission of promoting the health of the communities they serve. For the period from July 3, 2017 through December 31, 2017, and for the year ended December 31, 2018, the effect of this affiliation is included within the accompanying consolidated financial statements.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The accompanying consolidated financial statements of Kaleida are presented consistent with the Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 954, *Health Care Entities*, (ASC 954), which addresses the presentation of financial statements for health care entities. In accordance with the provisions of ASC 954, net assets and revenue, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. This is accomplished by classification of fund balances into two net classes of net assets: without donor restrictions and with donor restrictions. Descriptions of the two net asset categories and the types of transactions affective each category follow:

- Without donor restriction – Net assets that are not subject to donor stipulations restricting their use but may be designated for specific purposes by the Kaleida or may be limited by contractual agreements with outside parties.
- With donor restrictions – Net assets subject to donor stipulations that expire with the passage of time, can be fulfilled by actions pursuant to the stipulations, or which may be perpetual. Laws may also extend donor imposed restrictions, including the New York Prudent Management of Institutional Funds Act (NYPMIFA). Donors include contributors, including the maker of certain grants.

The consolidated financial statements include the accounts of Kaleida and its wholly owned subsidiaries and those financial statements where Kaleida controls professional corporations in accordance with Financial Accounting Standards Board (FASB) *Accounting Standards Codification*

(ASC) 810, *Consolidation*. All significant intercompany transactions between Kaleida and its subsidiaries have been eliminated in consolidation.

Kaleida considers events or transactions that occur after the consolidated balance sheet date, but before the consolidated financial statements are issued, to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. These consolidated financial statements were available to be issued on April 30, 2019 and subsequent events have been evaluated through that date.

(b) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The most significant areas which are affected by the use of estimates include assets acquired through business combinations, asset impairment losses, the allowance for doubtful accounts, estimated third-party payor settlements, self-insurance reserves, and pension and postretirement obligations. Actual results could differ from those estimates, and the differences in estimates from actual results could be significant.

(c) Cash and Cash Equivalents

Cash equivalents include amounts deposited in short-term interest-bearing accounts. For purposes of the consolidated statements of cash flows, cash equivalents exclude amounts maintained within investment portfolios and amounts classified as assets limited as to use.

Kaleida invests cash in money market securities and maintains cash balances in financial institutions in excess of federal deposit insurance limits. As discussed in note 2(m), cash equivalents available for operating purposes are stated at fair value and are considered a Level 1 financial asset.

(d) Charity Care and Provision for Bad Debts

Kaleida provides care to patients who meet certain criteria under its charity care policies without charge or at amounts less than their established rates. Because Kaleida does not anticipate collection of amounts determined to qualify as charity care, they are not reported as revenue.

Kaleida grants credit without collateral to patients, most of whom are local residents and are insured by commercial and government insurance plans. Patient accounts receivable is reported net of the estimated allowance for doubtful accounts. Additions to the estimated allowance for doubtful accounts are made by means of the provision for bad debts. The provision for bad debts primarily relates to patients without insurance and to those that are either underinsured or without the necessary resources to pay coinsurance and deductible balances. Accounts written off as uncollectible are deducted from the allowance and subsequent recoveries are added. The amount of the provision for bad debts is based upon management’s assessment of historical and expected net collections, business and economic conditions, trends in Federal and State governmental healthcare coverage, and other collection indicators.

(e) Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Revenue under certain third-party payor agreements is subject to audit and retroactive adjustment. Provision for estimated third-party payor settlements and adjustments are estimated in the period the related services are rendered and adjusted in future periods as final settlements are determined. Net patient service revenue from Medicare and New York State Medicaid, and commercial insurance plans accounted for approximately 40%, 21% and 39%, of total net patient service revenue for the year ended December 31, 2018 and 39%, 21% and 40% for the year ended December 31, 2017. Significant concentrations of patient accounts receivable at December 31, 2018 include 15% Medicare, 8% Medicaid, and 38% commercial insurance plans. Significant concentrations of patient accounts receivable at December 31, 2017 include 17% Medicare, 10% Medicaid, and 40% commercial insurance plans. Kaleida is dependent on these payors to carry out its operating activities.

(f) Investments and Investment Income

Investments are reported at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing participants at the measurement date. See notes 2(m) and 7 for a discussion of fair value measurements.

Participation units in pooled investment funds held within net assets without donor restrictions and net assets with donor restrictions are determined monthly based on the fair value of the underlying investments at the calculation date. Income earned on pooled investments is allocated to participating funds based on their respective unit shares of the pool.

Investment income or loss (including interest, dividends, realized gains and losses on investments, change in interest in other investments, and change in unrealized gains and losses) is included in excess of revenue over expenses, unless the income is restricted by the donor or law. Further, investment income from funds designated for self-insurance programs and debt and lease agreements, and funds generated by and used to support operations are recorded as a component of operating revenue.

(g) Inventories

Inventories consist principally of pharmaceutical and other medical supplies and are stated at the lower of cost or net realizable value. Cost is determined using the first-in, first-out method.

(h) Assets Limited as to Use

Assets limited as to use include investments maintained by a trustee under irrevocable self-insurance agreements and cash and investments held by trustees pursuant to debt agreements. Assets limited as to use also include investments set aside by the board of directors for specific purposes, as well as investments restricted by donors and grantors for a specific time period or purpose.

(i) Property and Equipment

Property and equipment are recorded at cost, except for donated items, which are recorded at fair market value at the date of donation. Cost includes interest incurred on related indebtedness during

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periods of construction. The costs of routine maintenance and repairs are charged to expense as incurred.

Kaleida monitors its long-lived assets for impairment indicators on an ongoing basis. If impairment indicators exist, Kaleida performs the required analysis and records impairment charges. In conducting its analysis, Kaleida compares the undiscounted cash flows expected to be generated from the long-lived assets to the related net book values. If the undiscounted cash flows exceed the net book value, the long-lived assets are considered not to be impaired. If the net book value exceeds the undiscounted cash flows, an impairment loss is measured and recognized based on the fair value of the asset, less costs to sell, or discounted cash flows compared to book value.

Depreciation is generally computed under the straight line method using date of service for buildings, fixtures and improvements, and the half-year convention for moveable equipment over the estimated useful lives of the assets. The estimated useful lives of assets generally follow American Hospital Association guidelines: land improvements, 10 years; buildings, fixtures, and improvements, 10 to 50 years; and movable equipment, 3 to 15 years. Assets recorded as capital leases are amortized over the lease term of the asset or its useful life, if shorter. Lease amortization is included within depreciation and amortization expense.

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

(j) Self-Insured Programs

Certain divisions of Kaleida are partially self-insured for medical malpractice, general liability, and workers' compensation costs, with excess liability policies for exposures in excess of self-insurance retentions. Trusts have been established for the purpose of setting aside assets. Under the trust agreements, the trust assets can be used only for payment of losses, related expenses, and the costs of administering the trust.

Kaleida is also self-insured for employee health and pharmaceutical coverage. Kaleida has recorded a provision for estimated claims which is based on Kaleida's own experience and includes the estimated ultimate cost of reported claims and claims incurred but not yet reported.

(k) Donor Contributions

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as a net asset with donor restrictions support if they are received with donor stipulations limiting the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, a net asset with donor restrictions is reclassified to net assets without donor restrictions and reported as net assets released from donor restrictions and included as a component of total operating revenue, if for operations, or as an addition to net assets without donor restriction, if for capital purposes. Contributions whose restrictions lapse, expire, or are otherwise met in the same reporting period as the contribution was received are recorded as unrestricted support and included as additions to net assets without donor restrictions.

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(l) Endowment Funds

Kaleida's net assets with donor restrictions consist of individual endowment funds established by donors to support a variety of purposes.

The New York Prudent Management of Institutional Funds Act (NYPMIFA or Act) provides standards of fund management for those charged with governance of institutional or endowment funds. Among its various provisions, it requires that those responsible for managing institutional funds adopt a written investment policy; requires diversification of investments; and provides institutions with a process by which donor restrictions can be lifted. The Act allows an institution to determine the appropriate level of endowment expenditure, subject to donor-imposed restrictions expressed in the gift instrument. However, it establishes a rebuttable presumption of imprudence if such expenditure in any year is greater than 7% of the five year average fair market value of an endowment fund.

Kaleida classifies as net assets with donor restrictions (a) the original value of gifts donated to an endowment fund, (b) the original value of subsequent gifts to that fund, and (c) accumulations to the fund made in accordance with the direction, if any, of the applicable donor gift instrument at the time the accumulation is added to the fund. Expendable portions of endowment gifts restricted by donors to specific purposes and any retained income and appreciation thereon is included as a component of net assets with donor restrictions. When the restrictions on these assets have been met, the assets are reclassified to net assets without donor restrictions pursuant to Kaleida's spending policy.

(m) Fair Value Measurement of Financial Instruments

Kaleida estimates fair value based on a valuation framework that uses a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of fair value hierarchy as defined by ASC 820, *Fair Value Measurements and Disclosures*, are described below:

Level 1: Quoted prices in active markets that are accessible at the measurement date for identical assets and liabilities.

Level 2: Inputs, other than quoted prices in active markets, that are observable either directly or indirectly and fair value is determined through the use of models or other valuation methodologies.

Level 3: Unobservable inputs that are supported by little or no market activity and require significant management judgment or estimation in the determination of fair value.

Kaleida applies the accounting provisions of Accounting Standards Update (ASU) 2009-12, *Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalents) (ASU 2009-12)* and ASU 2015-07, *Disclosures for Investments in Certain Entities that Calculate NAV per Share (or its Equivalent) (ASU 2015-07)*. ASU 2009-12 allows for the estimation of the fair value of investments in certain investment companies for which the investment does not have a readily determinable value by using net asset value (NAV) per share or its equivalent as a practical expedient. ASU 2015-07 removes the requirement to classify within the fair value hierarchy table in Levels 2 or 3 investments in certain funds measured at NAV or its equivalent as a practical expedient to estimate fair value.

(n) Goodwill

Goodwill is an asset representing the future economic benefit arising from assets acquired in a business combination that are not separately identified and recognized. Goodwill is reviewed for impairment at least annually in accordance with the provisions of ASC Topic 350, *Intangibles – Goodwill and Other*. In September 2011, the FASB issued ASU 2011-08, *Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment.* This ASU permits an entity to make a qualitative assessment (step zero analysis) of whether it is more likely than not that a reporting unit's fair value is less than its carrying amount before applying a two-step quantitative goodwill impairment test. If an entity concludes it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, it need not perform the two-step quantitative impairment test.

If considered necessary, under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit is less than its carrying value, an indication of impairment exists for the reporting unit and the enterprise must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed.

Accordingly, Kaleida performed a step zero analysis in the current and the prior year. This qualitative assessment considers various factors. Under this analysis Kaleida determined that it is more likely than not that the fair value of the reporting unit exceeds its carrying value. Based on this analysis, a further goodwill impairment assessment was not required to be performed. No impairment losses have been recorded in 2018 or 2017.

(o) Debt Issuance Costs

Kaleida has capitalized various costs associated with obtaining long-term financing. Debt issuance costs and original issue discounts are recorded as a component of debt outstanding and are amortized over the period the related obligation is outstanding, generally using the interest method.

(p) Income Taxes

Kaleida and substantially all of its affiliates have been determined by the Internal Revenue Service to be organizations described in Internal Revenue Code (the Code) Section 501(c)(3) and, therefore, are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. Kaleida recognizes income tax positions when it is more-likely than-not that the position will be sustainable based on the merits of the position. Management has concluded that there are no material uncertain tax positions that need to be recorded.

On December 22, 2017, the President signed into law H.R. 1, originally known as the Tax Cuts and Jobs Act. The new law includes several provisions that result in changes to the tax treatment of tax-exempt organizations and their donors. Kaleida has reviewed these provisions and concluded the enactment of H.R. 1 does not have a material effect on the operations of the organization.

(q) (Deficiency) Excess of Revenue over Expenses, after Effect of Affiliation

Kaleida's primary mission is meeting the healthcare needs of the people in the regions in which it operates. Kaleida is committed to providing a broad range of general and specialized healthcare services, including inpatient acute care, long-term care, home care, outpatient services, and other healthcare related services.

The consolidated statements of operations and changes in net assets include a performance indicator, the (deficiency) excess of revenue over expenses, after the effect of affiliation. Changes in net assets without donor restrictions which are excluded from the (deficiency) excess of revenue over expenses consistent with generally accepted accounting principles include contributions of long-lived assets and pension and postretirement related changes other than net periodic cost.

For purposes of display, transactions deemed by management to be recurring, major or central to the provision of healthcare services, including contributions without donor restrictions and interest and dividends from various funds, are reported as operating revenue and expenses in the determination of Kaleida's operating results. Investment trading activities and peripheral transactions (i.e., nonrecurring restructuring charges and gains and losses related to the disposal or impairment of fixed assets) are reported as other income or losses.

(r) Concentration of Credit Risk

Financial instruments that potentially subject Kaleida to concentrations of credit risk consist primarily of accounts receivable and certain investments. Investments, which include government obligations, equity securities, other alternative investments funds, and fixed income mutual funds, are not concentrated in any corporation or industry.

Kaleida receives a significant portion of its payments for services rendered from a limited number of government and commercial third-party payors, including Medicare, Medicaid, and various commercial insurance plans. Kaleida has not historically incurred any significant concentrated credit losses in the normal course of business.

(s) Reclassifications

Certain amounts in the 2017 consolidated financial statements have been reclassified to conform to 2018 presentation.

(t) Recently Adopted Accounting Pronouncements

Kaleida adopted Accounting Standard Update (ASU) No. 2016-14 – *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities* (ASU 2016-14) during 2018. This guidance is intended to improve the net asset classification requirements and the information presented in the financial statements and notes about a not-for-profit entity's liquidity, financial performance, and cash flows. Main provisions of this guidance include: presentation of two classes of net assets versus the previously required three; recognition of capital gifts for construction as a net asset without donor restrictions when the associated long-lived asset is placed in service; and

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recognition of underwater endowment funds as a reduction in net assets with donor restrictions, among other changes. The guidance also enhances disclosure for board designated amounts, composition of net assets without donor restrictions, liquidity, and expenses by both their natural and functional classification.

A summary of the net assets reclassifications that were recorded in connection with the adoption of ASU 2016-14 as of December 31, 2018 and 2017 are as follows:

	ASU 2016-14 Classifications		
Net asset classifications	**Without donor restrictions**	**With donor restrictions**	**Total net assets**
2017 net assets, as previously presented:			
Unrestricted	$ 358,580	—	358,580
Temporarily restricted	—	101,550	101,550
Permanently restricted	—	44,963	44,963
2017 net assets, as restated	$ 358,580	146,513	505,093

(3) Uncompensated Care

(a) Charity Care

Kaleida accepts all patients regardless of their ability to pay. A patient’s care may be classified as charity care in accordance with certain established policies of Kaleida. Essentially, these policies define charity services as those services for which no payment is anticipated.

To enhance and accelerate the charity care qualification process, Kaleida utilizes a presumptive charity scoring system in order to determine charity care eligibility. The system uses demographic and public financial information to qualify patient accounts for charity care. In addition, Kaleida makes and receives payments to and from a statewide pool to support the delivery of charity care to patients throughout New York. These net payments are reported as a component of patient service revenue in the consolidated financial statements.

Kaleida’s net cost of charity care, including payments to and receipts from the statewide pool was approximately $12.8 million in 2018 and $11.3 million in 2017 as follows:

	Year ended December 31	
	2018	**2017**
	(Dollars in thousands)	
Charity care at cost	$ 8,383	6,303
Payments to statewide pool	8,191	8,588
Receipts from statewide pool	(3,769)	(3,566)
Cost of charity care, net	$ 12,805	11,325

The cost of charity care provided was determined based on the application of the ratio of Kaleida's overall cost to patient charges.

(b) Community Benefit

Kaleida Health offers numerous programs and services in various community-based settings as well as its main campuses and facilities in response to the needs of the communities it serves, including a special emphasis on the medically underserved populations. Programs and services include community health fairs, health screenings, health education programs for community groups and the general public, school health education programs, consumer health information, facilitated (insurance plan) enrollment services, patient financial assistance, clinical services including school-based health centers, outpatient clinics, adult and pediatric long-term care services, neonatal intensive care services, pediatric behavioral health services, and care coordination services including a Medicaid health home for children.

Staff members of Kaleida Health also participate in volunteer activities and community leadership efforts by donating significant hours of service to other not-for-profit organizations. Kaleida Health supports graduate medical education and offers health professions education support for community members through continuing education programs and scholarships.

In addition, Kaleida Health serves a very large Medicaid and indigent patient population in Western New York whose healthcare services are only partially reimbursed by Federal or State government payment programs. Kaleida Health provides service to Medicaid patients at reimbursement levels that are below the cost of care provided.

(4) Third-Party Reimbursement Agreements

Kaleida has agreements with third-party payors that provide for payments at amounts different from their established rates as follows:

(a) Inpatient Acute Care Services

Inpatient acute care services rendered are paid at prospectively determined rates per discharge in accordance with the Federal Prospective Payment System (PPS) for Medicare and generally at negotiated or otherwise pre-determined amounts under the provisions of the New York State All Patient Defined Diagnosis Related Groups (APR-DRGs) for Medicaid and other NonMedicare payors. Inpatient nonacute services are paid at various rates under different arrangements with third-party payors, commercial insurance carriers, and health maintenance organizations. The basis for payment under these agreements includes prospectively determined per diem and per visit rates and fees, discounts from established charges, fee schedules, and reasonable cost subject to limitations. Medicare outpatient services are paid under a prospective payment system whereby services are reimbursed on a predetermined amount for each outpatient procedure, subject to various mandated modifications.

In addition, under New York State Public Health Law, all NonMedicare payors are required to make surcharge payments for the subsidization of indigent care and other health care initiatives. The percentage amounts of the surcharge varies by payor and applies to a broader array of health care services. Also, certain payors are required to fund a pool for graduate medical education expenses through surcharges on payments to hospitals for inpatient services or through voluntary election to pay a covered lives assessment directly to the New York State Department of Health (DOH).

Kaleida has entered into an agreement with the Center for Medicare and Medicaid Services under the Bundled Payments for Care Improvement initiative. This initiative is comprised of four broadly defined models of care, which link payments for multiple services beneficiaries receive during an episode of care. Under the initiative, organizations enter into payment arrangements that include financial and performance accountability for episodes of care. Kaleida participates in Model 2, which involves a retrospective bundled payment arrangement where actual expenditures are reconciled against a target price for an episode of care. Under this payment model, Medicare continues to make fee-for-service (FFS) payments to providers and suppliers furnishing services to beneficiaries in Model 2 episodes. Bundled payments for Care Improvement Model 2 ended with discharges through June 30, 2018, and Kaleida began participation in Bundle Payments for Care Improvement Advance (BPCIA), effective for discharges October 1, 2018 and after. The total expenditures for a beneficiary's episode is later reconciled against a bundled payment amount (the target price) determined by CMS. A payment or recoupment amount is then made by Medicare reflecting the aggregate performance compared to the target price. In Model 2, the episode of care includes a Medicare beneficiary's inpatient stay in the acute care hospital, post-acute care and all related services during the episode of care, which for Kaleida ends 90 days after hospital discharge. Of the available 48 different clinical episodes to participate in under model 2, Kaleida Health has selected 6 episodes. Under BPCIA, Kaleida has remained in 5 episodes.

(b) Skilled Nursing and Home Health Care Services

Net patient service revenue for skilled nursing services under the Medicaid program is based on a statewide pricing system using the Resource Utilization Group (RUGs) patient classification system. DOH calculates direct and indirect portions of Kaleida's rate by blending equally a statewide and a peer group component determined by DOH using 2007 filed cost report data as the base year for allowable costs. Capital and noncomparable costs are based on facility specific costs. Also, the direct portion of Kaleida's rate is adjusted twice annually for changes in the intensity of services provided to the nursing home residents. With respect to long-term care, New York State began transitioning Medicaid patients into managed care programs in 2011, after the state's Medicaid Redesign Team recommended care management for all as a means of reducing costs while maintaining quality. Medicaid recipients of long-term care moved into managed care in 2012. This required providers to negotiate long-term care agreements with managed-care plans to provide services to people who need long-term care services and support. Also, in 2014, New York State began enrolling individuals in the Managed long-term care program. This program focused on the chronically ill or disabled and began with Medicare/Medicaid dual-eligible beneficiaries. This program was expanded to a voluntary program for certain qualifying individuals.

Home health care services for Medicare are reimbursed under a prospective payment system (PPS) basis, which is based on a 60 day episode, case mix adjusted into one of the home health resource groups (HHRG). Adjustments exist for low and high utilization of services during a 60-day episode. Medicare will generally make an initial payment of 60% based on the submitted HHRG with the balance of the payment due at the end of the 60 day episode or at discharge, whichever occurs sooner. Local Medicare Advantage plans utilize a modified version of the PPS reimbursement methodology. Effective May 1, 2012, Medicaid began reimbursing for certified home health care visits on a per episode basis similar to Medicare. For all other payors, the basis of payment includes prospectively determined per visit rates and fees, discount on charges, and fee schedules.

Kaleida is required to prepare and file various reports of actual and allowable costs annually. Provisions have been made in the consolidated financial statements for prior and current years' estimated final settlements. The difference between the amount provided and the actual final settlement is recorded as an adjustment to net patient service revenue as adjustments become known or as years are no longer subject to audits, reviews, and investigations. During 2018 and 2017, Kaleida recorded adjustments for estimated settlements with third-party payors, which resulted in increases to net patient service revenue of approximately $3.4 million and $5.3 million, respectively.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Kaleida receives regulatory inquiries and reviews in the normal course of business. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs. Kaleida believes it is in substantial compliance with all applicable laws and regulations.

(5) Self-Insurance Trusts and Estimated Self-Insurance Reserves

Kaleida is partially self-insured for medical malpractice, general liability, and workers' compensation costs, and excess liability policies are generally maintained for exposures in excess of self-insurance retentions. Trusts are established for the purpose of setting aside assets based on actuarial funding recommendations. Under the trust agreements, the trust assets can be used only for payment of losses, related expenses, and the costs of administering the trust. The estimated liability for self-insured workers' compensation is discounted at 3.26% at December 31, 2018 and 3.13% at December 31, 2017. Estimated self-insurance reserves are approximately $158.3 million and $155.4 million at December 31, 2018 and 2017, respectively. As of December 31, 2018 and 2017, there are no material amounts recoverable from Kaleida's excess liability policies.

At December 31, 2018 and 2017, Kaleida has irrevocable secured letters of credit supporting the medical malpractice and workers compensation self-insurance programs totaling approximately $4.4 million at December 31, 2018 and 2017, respectively. The annual fee for the letters of credit ranges between 75 and 85 basis points and they renew automatically unless the issuer notifies both parties in writing sixty days in advance. In addition, Kaleida has established additional security through collateral trust agreements on self-insured investments in the amount of $37.4 million and $38.5 million at December 31, 2018 and 2017, respectively.

At December 31, 2018 and 2017, there were various actions filed against Kaleida by former patients and others seeking compensatory and punitive damages.

Management believes current estimates for known and unknown claims reflected in the self-insurance accrual are adequate. If the ultimate costs differ from the estimates, such additional amounts will be accrued when known.

(Continued)

(6) Investments and Assets Limited as to Use

The components of investments and assets limited as to use, stated at fair value, at December 31 are summarized as follows:

	2018	2017
	(Dollars in thousands)	
Current investments:		
Cash and cash equivalents	$ 15,446	2,389
Equity and fixed income mutual funds	18,007	42,442
Equity securities	51,450	92,453
Other investments	83,806	76,099
	168,709	213,383
Assets limited as to use:		
Designated under debt agreements:		
Cash and cash equivalents	2,593	2,645
U.S. government obligations	37,237	38,247
	39,830	40,892
Designated under self-insurance programs:		
Cash and cash equivalents	5,569	4,844
Equity and fixed income mutual funds	48,536	50,974
Equity securities	13,014	24,428
Other investments	22,743	20,928
	89,862	101,174
Board designated and donor restricted:		
Cash and cash equivalents	12,809	8,374
U.S. government obligations	259	1,285
Equity and fixed income mutual funds	5,270	16,593
Equity securities	63,074	82,835
Other investments	41,910	33,777
	123,322	142,864
Other:		
Cash and cash equivalents	2,568	2,006
	255,582	286,936
Total investments and assets limited as to use	$ 424,291	500,319

The components of investment return without donor restrictions include the following for the years ended December 31:

		2018	2017
		(Dollars in thousands)	
Other operating revenue:			
Interest and dividends	$	7,201	8,181
Other income:			
Investment income:			
Interest and dividends	$	1,715	1,929
Change in interests in other investments		(19,772)	20,850
	$	(18,057)	22,779
Net realized gains on sales of investments	$	(5,650)	2,863
Net change in unrealized gains and losses on investments		(6,824)	8,520

(7) Fair Value Measurements

The following is a description of the valuation methodologies used by Kaleida for its assets measured at fair value on a recurring basis:

Cash equivalents: Cash equivalents are valued at the NAV reported by the financial institution.

Equity and fixed income securities: Kaleida's equity and fixed income portfolios consist of direct investment in individual equity and fixed income securities that are valued based on quoted market prices (Level 1 measurements). If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments or, if necessary, matrix pricing from a third party pricing vendor to determine fair value (Level 2 measurements). Matrix prices are based on quoted prices for fixed income securities with similar coupons, ratings and maturities, rather than on specific bids and offers for a designated security.

In addition, Kaleida's equity and fixed income portfolios include investments in actively traded mutual funds valued at the closing price on the active market in which the individual funds are traded (Level 1 measurements) and pooled/commingled investment funds where Kaleida owns shares, units, or interests of pooled funds rather than the underlying securities in the fund. The pooled/commingled funds are measured at fair value based on the nature of the underlying investments, timing of the pricing of the fund's NAV and liquidity restrictions for the funds (Level 1 or 2 measurements).

Other investments: Other investments consist of private, domestic and global equities, real assets, fixed income, and hedge funds. Other investments are typically redeemable with the fund at NAV under the original terms of the partnership agreement and/or subscription agreements. The estimation of fair value of other investments for which the underlying securities do not have a readily determinable value is made using the NAV per share or its equivalent as a practical expedient and reported separately from investments categorized in Level 1, 2, or 3 in the hierarchy table. The inputs or methodology used for valuing or classifying investments for financial reporting purposes are not necessarily an indication of the risk associated with investing in those investments.

The following tables set forth Kaleida's consolidated financial assets that were accounted for at fair value on a recurring basis and those in which NAV issued as a practical expedient as of December 31, 2018 and December 31, 2017. Investments are classified in their entirety based on the lowest level of input that is significant to the fair value measurement and include related strategy, liquidity, and funding commitments (dollars in thousands):

	2018					
	NAV or equivalent	Level 1	Level 2	Total	Redemption period frequency	Days notice
Investments:						
Cash and cash equivalents	$ —	38,985	—	38,985	Daily	Same day
U.S. government obligations	—	—	37,496	37,496	Daily	Same day
Equity securities:						
Large-cap securities	—	121,817	—	121,817	Daily	Same day
International securities	—	5,721	—	5,721	Daily	5 days
Equity and fixed income mutual funds	—	71,813	—	71,813	Daily	Same day
Other investments:						
Hedge funds	43,334	—	—	43,334	Monthly – see (a) below	10 days – See (a) below
Private equity	41,926	—	—	41,926	Quarterly – see (a) below	45 days – See (a) below
Global equity	24,485	—	—	24,485	Monthly – quarterly	1 – 90 days
Domestic equity	10,345	—	—	10,345	Annually	60 days
Fixed income	28,369	—	—	28,369	See (a) below	See (a) below
	$ 148,459	238,336	37,496	424,291		

	2017					
	NAV or equivalent	Level 1	Level 2	Total	Redemption period frequency	Days notice
Investments:						
Cash and cash equivalents	$ —	20,257	—	20,257	Daily	Same day
U.S. government obligations	—	—	39,533	39,533	Daily	Same day
Equity securities:						
Large-cap securities	—	166,019	—	166,019	Daily – monthly	Same day – 9 days
International securities	13,775	19,922	—	33,697	Daily – monthly	2 – 30 days
Equity and fixed income mutual funds	—	110,009	—	110,009	Daily	Same day
Other investments:						
Hedge funds	30,899	—	—	30,899	Monthly – see (a) below	10 days – See (a) below
Private equity	46,553	—	—	46,553	Quarterly – see (a) below	45 days – See (a) below
Global equity	38,920	—	—	38,920	Monthly	3 – 15 days
Domestic equity	10,516	—	—	10,516	Annually	60 days
Fixed income	3,917	—	—	3,917	See (a) below	See (a) below
	$ 144,580	316,207	39,533	500,319		

(a) Certain investments include noncontrolling shares or interests in funds where the controlling general partner serves as the investment manager. Such shares are typically not eligible for redemption from the fund or general partner, but are typically sold to third party buyers in private transactions that typically can be completed in approximately 90 days. It is the intent of Kaleida to hold these investments until the fund has fully distributed all proceeds to the limited partners and the term of the partnership agreements expire.

Under the terms of certain agreements, Kaleida has committed to contribute a specified level of capital over a defined period of time. Through December 31, 2018, Kaleida has committed to contribute approximately $53.3 million to such investments, of which Kaleida has contributed approximately $33.8 million and has outstanding commitments of $19.5 million.

There were no significant transfers into or out of Level 1 and Level 2 fair value measurements during the years ended December 31, 2018 and 2017.

(8) Financial Assets and Liquidity Resources

As of December 31, 2018, financial assets and liquidity resources available within one year for general expenditures, including operating expenses, scheduled principal payments on debt, capital construction that is not financed by debt and other operating obligations, on an aggregated basis are as follows:

Financial assets, at year-end	$	852,173
Less those financial assets not available for general expenditure within one year due to:		
Contractual or donor restrictions		(146,385)
Donor restricted endowment		(122,139)
Pledges receivable		(3,265)
Board designated funds		(13,018)
Financial assets available to meet cash needs for general expenditures within one year	$	567,366

Kaleida's working capital and cash flows are typically not exposed to significant seasonal variations during a year. In addition, the board designated funds above can be made available for general expenditure with the approval of the Kaleida board or, if applicable, a respective affiliate board's approval. Kaleida and its affiliates also have access to lines of credit during 2019 totaling $10.0 million that may be used for general expenditures.

(9) Property and Equipment

A summary of property and equipment at December 31 follows:

		2018	2017
		(Dollars in thousands)	
Land and land improvements	$	33,911	34,835
Buildings, fixtures, and improvements		1,087,423	1,071,810
Movable equipment		977,666	962,975
		2,099,000	2,069,620
Less accumulated depreciation and amortization		1,367,260	1,352,597
		731,740	717,023
Construction in progress		35,895	38,055
	$	767,635	755,078

During 2018, Kaleida completed the Flint Road Laboratory consolidation project and the DeGraff Memorial Hospital Emergency Room renovation. Total estimated costs for these projects were $22.3 million.

During 2017, Kaleida completed the construction of the John R. Oishei Children's Hospital adjacent to the Buffalo General Medical Center. The hospital was financed through mortgage proceeds (note 11), philanthropy, equipment financing, grant awards and hospital equity.

Further, Kaleida sold the former Women and Children's Hospital site and surrounding property in November 2017. Additionally, effective October 1, 2017, Kaleida reduced the level of services being offered at DeGraff Memorial Hospital.

Accordingly, Kaleida recorded charges of approximately $12.2 million related to the sale of the former Women and Children's Hospital site, which was reflected as a component of other income within the consolidated statements of operations and changes in net assets in 2017.

Commitments outstanding at December 31, 2018, for routine capital projects totaled approximately $41.2 million. Net property and equipment includes approximately $12.1 million and $13.4 million applicable to capital leases at December 31, 2018 and 2017. During 2018 and 2017 Kaleida capitalized net interest expense of approximately $925,000 and $8.2 million, respectively.

(10) Other Assets

	2018	2017
	(Dollars in thousands)	
Long term pledges receivable, net (a)	$ 5,427	6,020
Note receivable	—	3,125
Equity investments in joint ventures (b)	12,772	23,474
Goodwill (c)	28,034	27,492
Other	8,239	9,685
	$ 54,472	69,796

(a) Long term pledges receivable include donor contributions that are not expected to be collected within one year. These amounts are reported at their present value and consisted of the following at December 31:

	2018	2017
	(Dollars in thousands)	
Gross pledges receivable	$ 5,762	6,409
Less discount and reserve	(335)	(389)
	$ 5,427	6,020

Total pledges receivable, which includes $4.4 million and $6.0 million of current pledges receivable included within other receivables on the consolidated balance sheets at December 31, 2018 and 2017, respectively, are expected to be realized in the following periods:

		2018	**2017**
		(Dollars in thousands)	
Less than one year	$	4,350	5,982
One year to five years		4,136	4,422
More than five years		200	789
	$	8,686	11,193

(b) Investments in partnerships and joint ventures in which Kaleida owns more than 20% but less than 80% or has significant influence on operations are accounted for using the equity method of accounting. Kaleida recognizes its proportionate share of income or loss from their partnership and joint venture investments in the current period and records this income or loss as an increase or decrease in the related investment.

In November 2018, Collaborative Care Ventures, LLC, a joint venture that Kaleida Health owns 60% of, sold its' purchased assets of MedFirst Urgent Care, PLLC, and acquired an interest in WNY UC Support, LLC (the purchaser).

(c) In recent years, General Physicians and Great Lakes Physicians have purchased the assets of several primary care and specialty physician practices. There were no acquisitions during 2018 and 2017.

(11) Long-Term Debt

Long-term debt consists of the following at December 31:

		2018	2017
		(Dollars in thousands)	
Mortgage notes payable for GVI in monthly installments of $539,000, including interest at 4.24%, through February 1, 2037. (a)	$	81,799	84,727
Mortgage notes payable for HighPointe SNF in monthly installments of $325,000, including interest at 5.73%, through February 1, 2037. (a)		44,053	45,395
Mortgage notes payable for BGMC in monthly installments of $545,000, including interest at 2.44% through August 1, 2023. (a)		28,834	34,597
Mortgage notes payable for MFH in monthly installments of $514,000, including interest at 3.29% through November 1, 2017 and $314,000, including interest at 3.29% through April 1, 2020. (a)		4,914	8,461

	2018	2017
	(Dollars in thousands)	
Mortgage notes payable for MFS in monthly installments of $338,000, including interest at 4.00%, through October 1, 2033. (a)	$ 42,013	44,039
Mortgage notes payable for BGMC Cath Lab in monthly installments of $107,000, including interest at 3.95%, through February 1, 2032. (a)	12,247	12,943
Mortgage notes payable for John R. Oishei Children's Hospital with interest only payments at 4.18% through October 2017. Thereafter, monthly installments of $645,000, including interest at 4.18% through October 1, 2042. (a)	124,565	127,555
Industrial Development bond payable in monthly fixed principal installments of $25,000 plus interest at 2.21% through January 2013. Thereafter, varying monthly principal and interest installments through June 2018.	—	141
Term note payable, varying amounts of principal and interest due monthly at 4.62% through 2025. (b)	10,377	—
McKean County Hospital Authority Revenue Refunding Bonds, Series 2005. (b)	—	12,140
Bank held revenue bonds, varying annual payments of principal plus interest at 2.5% through October 2030, secured by related property and equipment and Hospital gross receipts. (b)	9,125	10,315
Capital lease obligations, less imputed interest of $5,157,171 and $4,234,897 at December 31, 2018 and 2017, respectively.(c)	43,349	36,260
Equipment notes payable (d)	44,506	32,300
Other	4,922	5,590
	450,704	454,463
Debt issuance costs	9,667	10,626
	441,037	443,837
Less current maturities	41,210	36,546
	$ 399,827	407,291

(a) Mortgages Payable

The mortgages payable, which are insured by the U.S. Department of Housing and Urban Development (HUD), are secured by essentially all assets of the respective borrowing entities.

On December 9, 2014, Kaleida secured a loan commitment of approximately $120.0 million by entering into a new mortgage note and building loan agreement. In October 2017, HUD increased the amount of the approved mortgage note by approximately $7.5 million. The proceeds from the loan commitment were used to finance the cost of the construction of the John R. Oishei Children's Hospital adjacent to the Buffalo General Medical Center. The mortgage note has a 25 year term, fixed monthly payments and an annual interest rate of 4.18%.

On December 7, 2010, Kaleida secured a loan commitment of approximately $51.9 million by entering into a new mortgage note and building loan agreement. The proceeds from the loan commitment were used to finance the cost of constructing and equipping Highpointe SNF. The mortgage note has a 25 year term, fixed monthly payments and an annual interest rate of 5.73%.

On September 19, 2012, Kaleida refinanced the existing mortgage of $62.2 million maturing in August 2023 related to improvements made to the Buffalo General Medical Center. Although the principal amount refinanced and mortgage term remained the same, the interest rate and monthly payment were modified. This refinancing was not determined to be a significant modification for financial reporting purposes.

On July 22, 2015, Kaleida refinanced the existing mortgage of $48.2 million maturing in October 2033 related to improvements made to the Millard Fillmore Suburban Hospital and the existing mortgage of $14.5 million maturing in February 2032 related to cardiac catheterization laboratory equipment. Although the principal amount refinanced and mortgage term remained the same, the interest rate and monthly payment were modified. This refinancing was not determined to be a significant modification for financial reporting purposes.

On October 28, 2016, Kaleida refinanced the existing mortgage of $87.8 million maturing in February 2037 related to the construction and equipping of the Gates Vascular Institute (GVI). Although the principal amount refinanced and mortgage term remained the same, the interest rate and monthly payment were modified. This refinancing was not determined to be a significant modification for financial reporting purposes.

Kaleida has entered into Regulatory Agreements with HUD, which set forth certain provisions and requirements. Among these requirements are certain performance indicators, financial ratios, and reporting requirements. Also among these requirements is the funding of a Mortgage Reserve Fund (Mortgage Reserve) as established by the Mortgage Reserve Fund Agreement, dated May 20, 2004, as amended September 21, 2006, December 4, 2009, December 7, 2010, September 19, 2012, December 9, 2014, July 22, 2015, October 28, 2016, and September 19, 2017. As required under the Mortgage Reserve Fund Agreement, Kaleida is required to maintain a certain balance either through deposits or investment earnings. Failure to comply with these requirements may result in oversight activities by HUD.

Under the terms of the borrowing agreements, Kaleida established certain bank trustee accounts which include the Mortgage Reserve Fund. Included in the accompanying consolidated balance sheets, classified as assets limited as to use, is Kaleida's balance in this fund at December 31 as follows:

	2018	2017
	(Dollars in thousands)	
Mortgage reserve fund	$ 39,830	40,892

(b) Upper Allegheny Health Services

The McKean County Hospital Authority Revenue Refunding Bonds, Series 2005 (the 2005 Bonds) in the original amount of $23.3 million bear interest at 3.50% to 5.25%, are due in graduated installments through October 1, 2030, and are secured by a pledge of and security in the gross revenues of BRMC. The 2005 Bonds are insured by ACA Financial Guaranty Corporation (ACA), and the bond agreements contain various financial ratios and covenants with which BRMC is required to comply. These financial ratios include the maintenance of a debt service coverage ratio and days' cash on hand.

Effective January 2018, BRMC defeased and replaced the 2005 Bonds in part with a $10.5 million bank term note payable in varying monthly amounts of principal plus interest at 4.62% through January 2025, balloon payment of $8.2 million is then due. The loan agreement (along with other UAHS loans) contains various covenants, certain of which pertain to the maintenance of financial ratios, and potential limitations on indebtedness.

The bank held revenue bonds and bank term loan agreements contain various covenants, certain of which pertain to the maintenance of financial ratios, and potential limitations on indebtedness.

As of December 31, 2018, UAHS was not in compliance with certain financial covenants contained in its bank term note payable and bank held revenue bonds and is working with its lender to cure the instance of noncompliance.

(c) Capital Leases

The capital lease obligations represent arrangements entered into with a bank to finance acquisitions of various pieces of equipment. These arrangements are administered by the Dormitory Authority of the State of New York (DASNY) as part of their Tax-Exempt Leasing Program (TELP) as well as by private financing institutions.

(d) Equipment Notes Payable

In March 2016, Kaleida Health entered into an equipment financing agreement with EB-5 Childrens, LLC and PPNP Investors, LLC. The maximum aggregate principal amount of credit that can be extended under the agreement is $50.0 million. There was approximately $44.5 million of borrowings on the financing agreement at December 31, 2018 which represents a 7 year note which bears interest at approximately 2.0% payable monthly through August 2023.

Future annual principal payments of long-term debt and capital leases for the next five years as of December 31, 2018 are as follows (dollars in thousands):

2019	$	41,210
2020		40,235
2021		37,493
2022		36,736
2023		30,129

(Continued)

(e) Lines of Credit

In February 2018, Kaleida entered into a Revolving Credit Loan Agreement (Loan Agreement) with a financial institution. The Loan Agreement requires Kaleida to pay off the outstanding balance annually for a period of twenty calendar days. The maximum aggregate principal amount of credit that can be extended under the Loan Agreement is $50.0 million. Interest is payable monthly and is calculated using the lender's prime rate. Kaleida also pays monthly an unused facility fee equal to 10 basis points per year on the average unused daily balance. HUD agreed to subordinate its security interest in the first $60.0 million worth of patient accounts receivable to the bank as collateral for borrowings on the Loan Agreement. Total borrowings outstanding were $40.0 million and $10.0 at December 31, 2018 and 2017.

UAHS also has available a $2.0 million bank demand line of credit for working capital with interest payable at LIBOR plus 2.15%, secured by bank deposits. Total borrowings outstanding were $2.0 million and $0 at December 31, 2018 and 2017.

(12) Lease Commitments

Kaleida leases various equipment and facilities under noncancelable operating leases expiring at various dates in the future. Rental expense for all operating leases was approximately $51.0 million and $46.5 million in 2018 and 2017, respectively. Future minimum payments under noncancelable operating leases as of December 31, 2018 having lease terms in excess of one year are as follows (dollars in thousands):

2019	$	34,094
2020		31,444
2021		30,658
2022		30,097
2023		29,758

(13) Pension and Other Postretirement Benefits

(a) Kaleida Pension Plans

Kaleida sponsors a defined benefit plan (the Plan) covering substantially all of its eligible employees. The Plan provides benefits based upon years of service and the employee's compensation. Kaleida's funding policy is to contribute amounts required by the Employee Retirement Income Security Act (ERISA). The amount to be funded is subject to annual review by management and Kaleida's consulting actuary.

The following table sets forth the defined benefit pension plan's projected benefit obligation and fair value of plan assets at December 31:

		2018	2017
		(Dollars in thousands)	
Change in projected benefit obligation:			
Benefit obligation at beginning of year	$	953,007	824,934
Service cost		28,422	25,116
Interest cost		32,361	30,995
Actuarial (gains) losses		(86,999)	98,308
Benefits paid		(31,213)	(26,346)
Benefit obligation at end of year	$	895,578	953,007
Change in plan assets:			
Fair value of plan assets at beginning of year	$	635,550	544,875
Actual return on plan assets		(35,752)	83,586
Employer contributions		42,500	33,435
Benefits paid		(31,213)	(26,346)
Fair value of assets at end of year	$	611,085	635,550

The funded status of the plan and amounts recognized in the consolidated balance sheets at December 31, are as follows:

		2018	2017
		(Dollars in thousands)	
Funded status at end of year:			
Fair value of plan assets	$	611,085	635,550
Projected benefit obligation		895,579	953,007
Pension obligation recognized in the consolidated balance sheets at end of year	$	(284,494)	(317,457)
Amount recorded in net assets without donor restrictions at end of year for future pension cost:			
Net actuarial loss	$	(320,646)	(343,367)
Prior service costs		94	105
	$	(320,552)	(343,262)

The estimated prior service credit and net actuarial loss that will be amortized from net assets without donor restrictions in 2018 as a component of net periodic pension cost are approximately $11,000 and $23.2 million, respectively.

The accumulated benefit obligations at the Plan's measurement date for 2018 and 2017 was approximately $835.0 million and $880.0 million, respectively.

The components of net periodic pension cost for the years ended December 31 is as follows:

		2018	2017
		(Dollars in thousands)	
Service cost	$	28,423	25,116
Interest cost		32,361	30,995
Expected return on plan assets		(51,699)	(47,954)
Amortization of net prior service (credit) cost		(11)	(11)
Amortization of actuarial loss		23,173	14,944
Net periodic pension cost	$	32,247	23,090

The weighted average assumptions used to determine pension cost and benefit obligations at the Plan's measurement date (December 31):

	2018	2017
Discount rate for benefit obligations	4.44 %	3.76 %
Discount rate for net pension cost	3.76	4.45
Rate of compensation increase for benefit obligations	3.00	3.00
Rate of compensation increase for net pension cost	3.00	3.00
Expected long-term rate of return on plan assets	8.00	8.00

The investment policy specifies the type of investment vehicles appropriate for the plan, asset allocation guidelines, criteria for selection of investment managers, procedures to maintain overall investment performance, as well as investment manager performance. The expected long-term rate of return on plan assets reflects long-term earnings expectations on existing plan assets and those contributions expected to be received during the current plan year. In estimating that rate, appropriate consideration was given to historical returns earned by plan assets in the fund and the rates of returns expected to be available for reinvestment. Rates of return were evaluated based on current capital market assumptions and investment allocations.

The range of target investment allocation percentages at December 31, 2018 are listed below:

Asset class	Min	Target	Max
Public equities	—	39 %	—
Hedge funds long bias	—	6	—
Private equity	—	15	—
Total growth assets	42 %	60 %	78 %
Liquid fixed income	—	10 %	—
Hedge funds – absolute return	—	5	—
Growth fixed income	—	10	—
Total risk reduction assets	18 %	25 %	33 %
Liquid real assets	—	3 %	—
Private real assets	—	12	—
Total inflation protection assets	11 %	15 %	20 %

The following tables present Kaleida's defined benefit pension plan's assets at December 31, 2018 and 2017 that are measured at fair value on a recurring basis. The hierarchy and inputs to valuation techniques to measure fair value of the plan's assets are the same as outlined above in note 7 of the consolidated financial statements (dollars in thousands):

	2018					
	NAV or equivalent	Level 1	Level 2	Total	Redemption period frequency	Days notice
Investments:						
Cash and cash equivalents	$ —	12,785	—	12,785	Daily	Same day
Insurance contract	—	—	1,706	1,706	Daily	Same day
Equity securities:						
Large-cap securities	—	58,865	—	58,865	Daily – monthly	Same day – 9 days
International securities	—	43,106	—	43,106	Daily – monthly	2 – 30 days
Equity and fixed income mutual funds	—	185,484	—	185,484	Daily	Same day
Other investments:						
Hedge funds	104,176	—	—	104,176	Monthly – See note 7(a)	20 days – See note 7(a)
Private equity	139,559	—	—	139,559	Quarterly – See note 7(a)	60 days – See note 7(a)
Global equity	34,644	—	—	34,644	Monthly	3 – 15 days
Domestic equity	11,580	—	—	11,580	Monthly – annually	30 – 60 days
Real assets	2,104	—	—	2,104	See note 7(a)	See note 7(a)
Fixed income	17,076	—	—	17,076	Annually	180 days
	$ 309,139	300,240	1,706	611,085		

	2017					
	NAV or equivalent	Level 1	Level 2	Total	Redemption period frequency	Days notice
Investments:						
Cash and cash equivalents	$ —	16,815	—	16,815	Daily	Same day
Insurance contract	—	—	1,891	1,891	Daily	Same day
Equity securities:						
Large-cap securities	—	46,138	—	46,138	Daily – monthly	Same day – 9 days
International securities	32,336	22,924	—	55,260	Daily – monthly	2 – 30 days
Equity and fixed income mutual funds	—	178,310	—	178,310	Daily	Same day
Other investments:						
Hedge funds	61,674	—	—	61,674	Monthly – See note 7(a)	20 days – See note 7(a)
Private equity	125,524	—	—	125,524	Quarterly – See note 7(a)	60 days – See note 7(a)
Global equity	127,270	—	—	127,270	Monthly	3 – 15 days
Domestic equity	11,760	—	—	11,760	Monthly – annually	30 – 60 days
Real assets	2,307	—	—	2,307	See note 7(a)	See note 7(a)
Fixed income	8,598	—	—	8,598	Annually	180 days
	$ 369,469	264,187	1,891	635,550		

The insurance contract held within Kaleida's defined benefit plan is recorded at contract value which approximates fair value.

Under the terms of certain agreements, Kaleida has committed to contribute a specified level of capital over a defined period of time. Through December 31, 2018, Kaleida has committed to contribute approximately $268.6 million to such investments, of which Kaleida has contributed approximately $196.7 million and has outstanding commitments of $71.9 million.

Contributions – For the calendar year ended December 31, 2018, Kaleida has contributed $42.5 million. Expected contributions for the plan year ending December 31, 2019 will be made at a level recommended by Kaleida's consulting actuary and in accordance with ERISA funding requirements.

Estimated Future Benefit Payments – The following benefit payments, which reflect expected future service, are as follows for the Plan (dollars in thousands):

2019	$ 34,457
2020	37,404
2021	40,574
2022	43,634
2023	46,810
2024–2028	274,041

The expected benefits are based on the same assumptions used to measure Kaleida's benefit obligations at December 31, 2018 and include future employee service.

Other Pension Benefit Plans – In addition, Kaleida contributes to a multi-employer defined benefit pension plan as required by union contracts from which benefits are paid to certain union employees. Additionally, Kaleida provides an employer-matched Tax Sheltered Annuity program (403(b) Plan) for nonunion employees. Total expense under these plans was approximately $4.7 million and $4.2 million for 2018 and 2017, respectively.

(b) Upper Allegheny Health System

Olean sponsors a noncontributory defined benefit pension plan covering substantially all employees. The Hospital's policy is to contribute on an annual basis an amount equal to the minimum funding standards of the Employee Retirement Income Security Act of 1974. In addition, BRMC sponsors a noncontributory defined benefit pension plan covering substantially all employees active through March 31, 2011. BRMC's policy is to contribute on an annual basis an amount equal to the minimum funding standards of the Employee Retirement Income Security Act of 1974.

Olean partially froze the defined benefit pension plan effective April 1, 2011 by freezing all nonunion participant benefits as of that date. An enhanced defined contribution Section 403(b) savings incentive plan replaced the pension benefits for nonunion employees. BRMC froze the defined benefit pension plan effective April 1, 2011 by freezing all participant benefits as of that date. An enhanced defined contribution Section 403(b) savings incentive plan replaced the pension benefits.

The following table provides the changes in the projected benefit obligation and plan assets for the year ending December 31, 2018:

		Olean	BRMC	Total
			(Dollars in thousands)	
Change in projected benefit obligation:				
Benefit obligation at beginning of year	$	37,764	35,167	72,931
Service cost		908	162	1,070
Interest cost		1,217	1,211	2,428
Actuarial (gains)		(2,695)	(3,687)	(6,382)
Benefits paid		(2,462)	(1,123)	(3,585)
Benefit obligation at end of year	$	34,732	31,730	66,462
Change in plan assets:				
Fair value of plan assets at beginning of the year	$	20,221	19,829	40,050
Actual return on plan assets		(959)	(1,227)	(2,186)
Employer contributions		1,961	1,225	3,186
Benefits paid		(2,649)	(1,123)	(3,772)
Fair value of assets at end of year	$	18,574	18,704	37,278

(Continued)

The following table provides the changes in the projected benefit obligation and plan assets for the period from July 3, 2017 through December 31, 2017:

		Olean	BRMC	Total
			(Dollars in thousands)	
Change in projected benefit obligation:				
Benefit obligation at beginning of year	$	35,304	34,040	69,344
Service cost		365	—	365
Interest cost		626	649	1,275
Actuarial losses		2,100	996	3,096
Benefits paid		(631)	(518)	(1,149)
Benefit obligation at end of year	$	37,764	35,167	72,931
Change in plan assets:				
Fair value of plan assets at beginning of the year	$	19,103	18,714	37,817
Actual return on plan assets		941	1,084	2,025
Employer contributions		808	549	1,357
Benefits paid		(631)	(518)	(1,149)
Fair value of assets at end of year	$	20,221	19,829	40,050

The funded status of the plan and amounts recognized in the consolidated balance sheets at December 31, 2018 are as follows:

		Olean	BRMC	Total
			(Dollars in thousands)	
Funded status at end of year:				
Fair value of plan assets	$	18,574	18,704	37,278
Projected benefit obligation		(34,732)	(31,730)	(66,462)
Pension obligation recognized in the consolidated balance sheets at end of year	$	(16,158)	(13,026)	(29,184)
Amount recorded in net assets without donor restrictions at end of year for future pension cost:				
Net actuarial loss	$	(17,195)	(17,590)	(34,785)
	$	(17,195)	(17,590)	(34,785)

The funded status of the plan and amounts recognized in the consolidated balance sheets at December 31, 2017 are as follows:

		Olean	BRMC	Total
			(Dollars in thousands)	
Funded status at end of year:				
Fair value of plan assets	$	20,221	19,829	40,050
Projected benefit obligation		(37,764)	(35,167)	(72,931)
Pension obligation recognized in the consolidated balance sheets at end of year	$	(17,543)	(15,338)	(32,881)
Amount recorded in net assets without donor restrictions at end of year for future pension cost:				
Net actuarial loss	$	(19,306)	(19,277)	(38,583)
	$	(19,306)	(19,277)	(38,583)

The net periodic pension expense recognized for Olean and BRMC was approximately $1,179,000 and $367,000, respectively, for the year ended December 31, 2018. The net periodic pension expense recognized for Olean and BRMC was approximately $555,000 and $209,000, respectively for the period from July 3, 2017 to December 31, 2017.

The weighted average assumptions used to determine pension cost for both Olean and Bradford included (a) discount rate of 3.35%-3.50%; and (b) expected return on plan assets of 7.5%. The weighted average assumptions used to determine the projected plan obligation for both Olean and Bradford included: (a) discount rate of 4.05% – 4.20%; and (b) compensation increase between 0%–3.52%.

The Hospital’s pension plan target allocation, by asset category, are as follows:

	Olean target allocation	BRMC target allocation
Asset category:		
Equity securities	25%–80%	40 %
Debt securities	15%–40%	25
Cash and equivalents	0%–10%	—
Other (partnership and common collective trust)	0%–30%	Not applicable
Inflation hedging	Not applicable	15
Flexible capital	Not applicable	20

The following tables present Olean and BRMC's defined benefit pension plan assets at December 31, 2018 and December 31, 2017, respectively, that are measured at fair value on a recurring basis. The hierarchy and inputs to valuation techniques to measure fair value of the plan's assets are the same as outlined above in note 7 of the consolidated financial statements (dollars in thousands):

	Olean		BRMC		
	NAV or equivalent	**Level 1**	**NAV or equivalent**	**Level 1**	**Total**
Cash equivalents	$ —	2,773	—	683	3,456
Equity securities	—	6,737	—	7,987	14,724
Debt securities	—	3,810	—	4,140	7,950
Flexible capital	2,072	—	2,249	—	4,321
Inflation hedging	3,182	—	3,645	—	6,827
	$ 5,254	13,320	5,894	12,810	37,278

	Olean		BRMC		
	NAV or equivalent	**Level 1**	**NAV or equivalent**	**Level 1**	**Total**
Cash equivalents	$ —	2,854	—	466	3,320
Equity securities	—	8,127	—	9,024	17,151
Debt securities	—	3,783	—	4,165	7,948
Flexible capital	2,189	—	2,429	—	4,618
Inflation hedging	3,269	—	3,744	—	7,013
	$ 5,458	14,764	6,173	13,655	40,050

Level 1 investments may be redeemed daily with a day's notice. Investments valued at NAV represent limited partnerships interests (may only be redeemed annually with notice of 65–90 days) and a common collective trust that may be redeemed daily.

Olean expects to contribute $2,818,086 to its pension plan during the annual period ending December 31, 2019. The following benefit payments, which reflect expected future service costs, are expected to be paid:

2019	$ 2,737
2020	2,407
2021	2,754
2022	2,406
2023	2,509
Thereafter through 2028	10,542
	$ 23,355

BRMC expects to contribute $793,125 to its pension plan during the annual period ending December 31, 2019. The following benefit payments are expected to be paid:

2019	$	1,227
2020		1,318
2021		1,418
2022		1,498
2023		1,602
Thereafter through 2028		9,045
	$	16,108

(c) Retiree Health and Life Insurance Plan

Kaleida also maintains a contributory retiree health and life insurance plan covering only certain eligible employees of DeGraff Memorial Hospital (DeGraff). The following table sets forth the funded status and amounts recognized in the consolidated balance sheets at December 31:

		2018	2017
		(Dollars in thousands)	
Accumulated postretirement obligation at end of year	$	(5,758)	(7,654)
Fair value of plan assets at end of year		—	—
Postretirement obligation recognized at of year included as a component of pension and postretirement obligations	$	(5,758)	(7,654)

Net postretirement benefit cost was approximately $612,000 and $522,000 for the years ended December 31, 2018 and 2017, respectively. The weighted average assumptions used to determine postretirement benefit cost and obligations at the Plan's measurement date (December 31):

	2018	2017
Discount rate for benefit obligations	4.23 %	3.53 %
Discount rate for net postretirement cost	3.53	3.95

For measurement purposes, 2018 increases in the per capita cost of covered health care benefits were assumed for medical and prescription drugs at 6.3%. The rate is assumed to decrease gradually on an annual basis. A one-percentage point change in assumed healthcare cost trend rates would not have a material impact on the future cost or benefit obligation.

(d) Collective Bargaining Agreements

A significant portion of Kaleida employees work under collective bargaining agreements which were renegotiated in 2016. The agreements have a duration of three years and will expire in May 2019.

(14) Asset Retirement Obligations

Kaleida has asset retirement obligations (AROs) to perform certain asset retirement activities in the event they renovate or demolish buildings in the future. The liability was initially measured at fair value and subsequently is adjusted for accretion expense and changes in the amount or timing of the estimated cash flows. The following table presents the activity for the AROs for the years ended December 31:

		2018	2017
		(Dollars in thousands)	
Balance at beginning of year	$	11,185	13,601
Net obligations settled in current period		(3,659)	(3,201)
Accretion expense		540	785
Balance at end of year	$	8,066	11,185

(15) Other Operating Revenue

Components of other operating revenue for the years ended December 31 are as follows:

		2018	2017
		(Dollars in thousands)	
Grant revenue	$	13,243	16,103
Unrestricted contributions		2,477	3,173
Rental revenue		2,447	3,764
Rebate and other miscellaneous revenue		37,344	25,688
Pharmaceutical discount program revenue		5,894	7,147
	$	61,405	55,875

(16) Functional Expenses

Kaleida provides general healthcare services to residents within its geographic location. Expenses related to these services are as follows for the years ended December 31, 2018 and 2017:

	Health care services					Support services		
	Acute	Ambulatory	Physician	Post acute	Other	MG&A	Fundraising	Total
Salaries and benefits	$ 671,078	38,348	102,509	118,307	5,463	78,985	1,210	1,015,900
Purchased services and other	250,923	(5,704)	48,880	14,380	4,588	63,270	4,859	381,196
Medical and nonmedical supplies	294,899	16,404	11,911	13,058	14,405	(91)	26	350,612
Depreciation and amortization	46,915	1,806	2,882	4,655	866	19,953	10	77,088
Interest	13,730	180	257	2,563	105	1,845		18,681
	$ 1,277,545	51,034	166,439	152,963	25,427	163,962	6,105	1,843,477

	Health care services					Support services		
	Acute	Ambulatory	Physician	Post acute	Other	MG&A	Fundraising	Total
2017 Total	$ 1,112,583	49,262	134,963	151,606	23,928	161,038	5,767	1,639,147

(17) Donor Restricted Net Assets

Net assets with donor restrictions, which are recorded in assets limited to use on the balance sheet, are composed of the following at December 31:

	2018	2017
	(In thousands)	
Capital expansion and improvements	$ 11,130	10,467
Advancement of medical education and research and healthcare services	115,989	132,397
Total	$ 127,119	142,864

Donor restricted endowment funds, which have been included in the chart above, represent donor restricted investments, a portion of which is the original gift (to be held in perpetuity) and the accumulated earnings thereon (which represents the unexpended income generated from the permanent endowment net assets).

Changes in donor restricted endowment net assets for the year ended December 31, 2018 and 2017 are as follows:

		2018	2017
Endowment net assets, beginning of year	$	44,963	46,056
Investment return		1,098	3,080
Contributions		533	629
Appropriation of endowment assets for expenditure		(1,314)	(1,683)
Other		216	(3,120)
Endowment net assets, end of year	$	45,496	44,962

Kaleida has interpreted the NYPMIFA as requiring the preservation of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Kaleida classifies as donor restricted net assets the original value of gifts donated to the permanent endowment. The remaining portion of the donor-restricted endowment fund that is not classified permanently endowed is classified remains as donor restricted net assets until those amounts are appropriated for expenditure by Kaleida in a manner consistent with the standard of prudence prescribed by NYPMIFA. In accordance with NYPMIFA, Kaleida considers certain factors in making a determination to appropriate or accumulate endowment funds. The factors include the duration and preservation of the fund, the purpose of the organization and the donor-restricted endowment fund, general economic conditions, the possible effect of inflation and deflation, the expected total return from income and the appreciation of investments, other resources of the organization and the investment policies of the organization. Kaleida estimates approximately $6.0 million to be spent from the donor restricted endowment funds for the year ended December 31, 2019.

(18) Affiliation

As discussed in note 1, effective July 3, 2017, Kaleida finalized an affiliation agreement with UAHS. Among its various terms and conditions, Kaleida became the sole corporate member of UAHS. No consideration was transferred in connection with the affiliation under the affiliation agreement.

The affiliation has been accounted for as an acquisition under ASC 954-810, which provides the accounting guidance for healthcare organization business combinations. ASC 954-810 establishes principles and requirements in determining whether a not-for-profit entity combination is a merger or acquisition and the associated accounting treatment. This transaction qualifies as an acquisition of a business, and therefore the net assets acquired are to be recorded at fair value. The fair value used for current assets acquired and current liabilities assumed generally represents the carrying value due to their current nature, and includes patient accounts and other receivables, investments, and assets limited as to use, and various accrued liabilities. The fair value of property and equipment was determined with the assistance of a third party valuation firm that used a combination of discounted cash flow models and comparable market transactions, considering the highest and best use of the property by market participants.

The following table summarizes the assets acquired and liabilities assumed as of July 3, 2017:

Assets acquired:		
Current	$	69,026
Long-term		125,830
Total assets		194,856
Liabilities assumed:		
Current		43,935
Long-term		64,905
Total liabilities		108,840
Net assets acquired	$	86,016

The value of the net assets acquired have been recognized in Kaleida's 2017 consolidated statement of operations and changes in net assets as a component of net assets without donor restrictions and as a component of the changes in net assets with donor restrictions based on the nature of restrictions of those net assets.

The UAHS net patient service revenue and decrease in net assets for the period from affiliation through December 31, 2017, included in the accompanying consolidated financial statement, was $89.7 million and $2.7 million, respectively.

The following table presents revenue, earnings, and net assets of the consolidated entity as if the affiliation with UAHS had occurred effective January 1, 2017.

	Total operating revenue	Excess of operating revenue over operating expenses	Unrestricted net assets	Temporarily restricted net assets	Permanently restricted net assets
Supplemental proforma information for year ending December 31, 2017	$ 1,757,341	23,819	358,580	101,550	44,963