

UPMC Audited Consolidated Financial Statements

FOR THE PERIOD ENDED DECEMBER 31, 2021



UPMC
LIFE CHANGING MEDICINE



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Report of Independent Registered Public Accounting Firm

To the Board of Directors of UPMC

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of UPMC (the Company) as of December 31, 2021 and 2020, the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2021 and 2020, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) (PCAOB) and in accordance with auditing standards generally accepted in the United States of America, the Company's internal control over financial reporting as of December 31, 2021, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 28, 2022 (not presented herein) expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are required to be independent with respect to the Company in accordance with the relevant ethical requirements relating to our audit.

We conducted our audits in accordance with the auditing standards of the PCAOB and 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 financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Supplemental Information

The accompanying supplemental consolidating balance sheet as of December 31, 2021 and supplemental consolidating statement of operations for the year ended December 31, 2021 have been subjected to audit procedures performed in conjunction with the audit of the Company's financial statements. Such information is the responsibility of the Company's management. Our audit procedures included determining whether the information reconciles to the financial statements or the underlying accounting and other records, as applicable, and performing procedures to test the completeness and accuracy of the information. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.



Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of the critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing separate opinion on the critical audit matter or on the accounts or disclosures to which they relate.

Implicit and Explicit Price Concessions for Revenue Recognition

Description of the Matter

For the year ended December 31, 2021, the Company's net patient service revenue was \$10.0 billion. As discussed in Note 1 to the consolidated financial statements, net patient service revenue is recorded based upon the estimated amounts the Company expects to be entitled to receive from patients and third-party payers in exchange for providing patient care. Estimates of the explicit price concessions under managed care, commercial, and governmental insurance plans are based upon the payment terms specified in the related contractual agreements or as mandated under government payer programs. Management continually reviews the explicit price concession estimation process to consider and incorporate updates to laws and regulations and the frequent changes in managed care and commercial contractual terms resulting from contract negotiations and renewals. Revenues related to uninsured patients and uninsured copayment and deductible amounts for patients who have health care insurance coverage may have discounts applied (uninsured discounts and contractual discounts). The Company also records estimated implicit price concessions (based primarily on historical collection experience) related to uninsured accounts to record these revenues and accounts receivable at the estimated amounts the Company expects to collect. Additional collection risks relate to uninsured patients accounts, including amounts owed from patients after insurance has paid the amounts covered by the applicable agreement. Implicit price concessions relate primarily to amounts due directly from patients and are based upon management's assessment of a patient's historical propensity to pay and write-offs, business and economic conditions, trends in federal, state and private employer health care coverage and other collection indicators.

Auditing management's estimates of explicit and implicit price concessions was complex and judgmental due to the significant data inputs and subjective assumptions utilized in determining related amounts.

How We Addressed the Matter in Our Audit

We tested internal controls that address the risks of material misstatement related to the measurement and valuation of revenues, including estimation of explicit and implicit price concessions. For example, we tested management's internal controls over the key data inputs to the explicit and implicit price concessions models, significant assumptions underlying management's models, and management's internal controls over retrospective hindsight reviews of historical reserve accuracy.



To test the estimated explicit and implicit price concessions, we performed audit procedures that included, among others, assessing methodologies and evaluating the significant assumptions discussed above and testing completeness and accuracy of the underlying data used by the Company in its estimates. We compared the significant assumptions used by management to current industry and economic trends and considered changes, if any, to the Company's business and other relevant factors. We also assessed the historical accuracy of management's estimates based on the results of the analysis comparing prior year estimates to actual results and other analytics as a source of potential corroborative or contrary evidence.

Ernst + Young LLP

We have served as the Company's auditor since 1994.
February 28, 2022

CONSOLIDATED BALANCE SHEETS

(DOLLARS IN THOUSANDS)

	As of	
	December 31, 2021	December 31, 2020
CURRENT ASSETS		
Cash and cash equivalents	\$ 930,376	\$ 1,541,036
Patient accounts receivable	1,404,695	1,210,992
Insurance and other receivables	1,634,524	1,412,735
Other current assets	591,570	510,565
Total current assets	4,561,165	4,675,328
Board-designated, restricted, trustee and other investments	9,766,549	8,332,120
Beneficial interests in foundations and trusts	783,779	678,806
Property, buildings and equipment:		
Land and land improvements	532,564	529,575
Buildings and fixed equipment	8,314,299	8,048,913
Movable equipment	3,294,921	3,146,341
Finance leases	194,118	180,988
Construction in progress	590,085	520,119
	12,925,987	12,425,936
Less allowance for depreciation	(6,715,391)	(6,315,165)
	6,210,596	6,110,771
Operating lease right-of-use assets	976,026	1,033,598
Other assets	790,300	755,022
Total assets	\$ 23,088,415	\$ 21,585,645
CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 783,477	\$ 763,798
Accrued salaries and related benefits	963,076	866,890
Current portion of insurance reserves	1,018,418	950,387
Current portion of long-term obligations	280,793	333,864
Other current liabilities	1,571,781	1,281,417
Total current liabilities	4,617,545	4,196,356
Long-term obligations	5,300,849	5,258,046
Pension liability	-	171,983
Long-term insurance reserves	429,182	389,290
Operating lease noncurrent liabilities	895,949	963,812
Other noncurrent liabilities	566,530	1,184,968
Total liabilities	11,810,055	12,164,455
Net assets without donor restrictions	9,883,697	8,166,762
Net assets with donor restrictions	1,394,663	1,254,428
Total net assets	11,278,360	9,421,190
Total liabilities and net assets	\$ 23,088,415	\$ 21,585,645

See accompanying notes

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS

(DOLLARS IN THOUSANDS)

	Years Ended December 31	
	2021	2020
NET ASSETS WITHOUT DONOR RESTRICTIONS		
Net patient service revenue	\$ 10,005,556	\$ 9,199,717
Insurance enrollment revenue	12,110,124	11,432,067
Other revenue	2,250,804	2,461,633
Total operating revenues	24,366,484	23,093,417
Salaries, professional fees and employee benefits	8,207,431	7,778,450
Insurance claims expense	8,469,749	7,915,612
Supplies, purchased services and general	6,157,002	5,835,501
Depreciation and amortization	689,389	685,585
Total operating expenses	23,523,571	22,215,148
Operating income	842,913	878,269
Academic and research support provided	(240,300)	(227,409)
Inherent contribution	-	160,565
Other non-operating activities	87,171	66,777
Income tax expense	(6,032)	(5,094)
After-tax income	\$ 683,752	\$ 873,108
Investing and financing activities:		
Investment gain	902,569	555,940
Interest expense	(161,976)	(177,244)
(Loss) gain on extinguishment of debt	(2,342)	1,274
UPMC Enterprises activity:		
Portfolio company revenue and net gains from sales	271,482	53,515
Portfolio company and research and development expense	(199,785)	(201,592)
Gain from investing and financing activities	809,948	231,893
Excess of revenues over expenses	1,493,700	1,105,001
Excess of revenues over expenses attributable to noncontrolling interest	33,674	31,605
Excess of revenues over expenses attributable to controlling interest	1,460,026	1,073,396
Net change in pension liability and other	256,909	(48,044)
Change in net assets without donor restrictions	\$ 1,716,935	\$ 1,025,352
NET ASSETS WITH DONOR RESTRICTIONS		
Net contributions and other changes	21,081	32,808
Net realized and unrealized gains on restricted investments	22,754	5,180
Restricted net assets acquired	-	12,138
Assets released from restriction for operations and capital purchases	(8,573)	(16,512)
Change in beneficial interests in foundations and trusts	104,973	54,115
Change in net assets with donor restrictions	140,235	87,729
Change in total net assets	1,857,170	1,113,081
Net assets, beginning of period	9,421,190	8,308,109
Net assets, end of period	\$ 11,278,360	\$ 9,421,190

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

(DOLLARS IN THOUSANDS)

Years Ended December 31

	2021	2020
OPERATING ACTIVITIES		
Increase in total net assets	\$ 1,857,170	\$ 1,113,081
Adjustments to reconcile change in total net assets to net cash provided by operating activities:		
Depreciation and amortization	689,389	685,585
Change in beneficial interest in foundations and trusts	(104,973)	(54,115)
Restricted contributions and investment revenue	(43,835)	(37,988)
Restricted net assets acquired	-	(12,138)
Unrealized gains on investments	(245,080)	(208,855)
Realized gains on investments	(575,402)	(271,288)
Purchases of non-alternative investments	(11,759,789)	(8,283,826)
Sales of non-alternative investments	11,128,045	6,972,277
Inherent contribution	-	(160,565)
Changes in operating assets and liabilities:		
Accounts receivable	(415,492)	(59,943)
Other current assets	(81,005)	(44,815)
Accounts payable and accrued liabilities	115,865	131,332
Insurance reserves	107,923	214,057
Other current liabilities	290,364	665,861
Other noncurrent assets and liabilities	(830,497)	612,061
Other operating changes	(153,202)	(261,154)
Net cash (used in) provided by operating activities	(20,519)	999,567
INVESTING ACTIVITIES		
Purchase of property and equipment	(756,970)	(844,180)
UPMC Enterprises investments in non-consolidated entities	(43,156)	(52,500)
Cash acquired through divestitures	83,543	255,011
Net change in investments designated as nontrading	(21,593)	(37,854)
Purchases of alternative investments	(289,523)	(226,148)
Sales of alternative investments	363,264	152,530
Net change in other assets	39,131	58,196
Net cash used in investing activities	(625,304)	(694,945)
FINANCING ACTIVITIES		
Repayments of long-term obligations	(1,372,555)	(2,212,531)
Borrowings of long-term obligations	1,363,883	3,059,741
Restricted contributions and investment income	43,835	37,988
Net cash provided by financing activities	35,163	885,198
Net change in cash and cash equivalents	(610,660)	1,189,820
Cash and cash equivalents, beginning of period	1,541,036	351,216
Cash and cash equivalents, end of period	\$ 930,376	\$ 1,541,036
SUPPLEMENTAL INFORMATION		
Finance lease obligations incurred to acquire assets	\$ 25,130	\$ 20,888
<i>See accompanying notes</i>		

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

1. ORGANIZATIONAL OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

UPMC is a Pennsylvania nonprofit corporation and is exempt from federal income tax pursuant to Section 501(a) of the Internal Revenue Code (the "Code") as an organization described in Section 501(c)(3) of the Code. Headquartered in Pittsburgh, Pennsylvania, UPMC is one of the world's leading integrated delivery and financing systems. UPMC comprises nonprofit and for-profit entities offering medical and health care-related services, including health insurance products. Closely affiliated with the University of Pittsburgh (the "University") and with shared academic and research objectives, UPMC partners with the University's Schools of the Health Sciences to deliver outstanding patient care, train tomorrow's health care specialists and biomedical scientists, and conduct groundbreaking research on the causes and course of disease.

The accompanying audited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP") and include the accounts of UPMC and its subsidiaries. Intercompany accounts and transactions are eliminated in consolidation.

New Accounting Pronouncements

Effective January 1, 2021, UPMC adopted the Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") 2018-14, *Compensation - Retirement Benefits- Defined Benefit Plans* (Topic 715). This ASU modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. UPMC applied the relevant provisions of the standard to their consolidated financial statement disclosures accordingly.

Cash and Cash Equivalents

Cash and cash equivalents consist primarily of cash and investments, which are so near to maturity that they present insignificant risk of changes in value. Fixed income instruments with original, short-term maturities of less than 90 days that are held in Master Trust Funds ("MTF") are excluded from cash equivalents as they are commingled with longer-term investments.

Net Patient Service Revenue

UPMC's net patient service revenue is recorded based upon the estimated amounts UPMC expects to be entitled to receive from patients, third-party payers (including health insurers and government programs) and others and includes an estimate of variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations. Generally, UPMC bills the patients and third-party payers several days after the services are performed and/or the patient is discharged from the facility. Estimates of the explicit price concessions under managed care, commercial and governmental insurance plans are based upon the payment terms specified in the related contractual agreements or as mandated under government payer programs. UPMC continually reviews the explicit price concession estimation process to consider and incorporate updates to laws and regulations and the frequent changes in managed care and commercial contractual terms resulting from contract negotiations and renewals. Revenue is recognized as performance obligations are satisfied. Performance obligations are determined based on the nature of the services provided by UPMC. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. UPMC believes that this method provides a reasonable representation of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to inpatient services. UPMC measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time is recognized when goods or services are provided and UPMC does not believe it is required to provide additional goods or services to the patient.

The majority of UPMC's services are rendered to patients with third-party coverage. Payment under these programs for all payers is based on a combination of prospectively determined rates, discounted charges and historical costs. Amounts received under Medicare and Medical Assistance programs are subject to review and final determination by program intermediaries or

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

their agents and the contracts UPMC has with commercial payers also provide for retroactive audit and review of claims. Agreements with third-party payers typically provide for payments at amounts less than established charges. Generally, patients who are covered by third-party payers are responsible for related deductibles and coinsurance, which vary in amount. UPMC also provides services to uninsured patients. Revenues related to uninsured patients and uninsured copayment and deductible amounts for patients who have health care coverage may have discounts applied (uninsured discounts and contractual discounts). UPMC also records estimated implicit price concessions (based primarily on historical collection experience) related to uninsured accounts to record these revenues at the estimated amounts UPMC expects to collect. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to net patient service revenue in the period of the change and are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods if final settlements differ from estimates. Adjustments arising from a change to previously estimated transaction prices were not significant in the years ended December 31, 2021 or 2020.

Consistent with UPMC's mission, care is provided to patients regardless of their ability to pay. UPMC has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances (for example, copays and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts UPMC expects to collect based on its collection history with those patients. Patients who meet UPMC's criteria for charity care are provided care without charge or at amounts less than established rates and UPMC has determined it has provided an implicit price concession. Price concessions, including charity care, are deducted from net patient service revenue.

The collection of outstanding receivables from Medicare, Medicaid, managed care payers, other third-party payers and patients is UPMC's primary source of cash and is critical to its operating performance. The primary collection risks relate to uninsured patient accounts, including patient accounts for which the primary insurance carrier has paid the amounts covered by the applicable agreement, but patient responsibility amounts (deductibles and copayments) remain outstanding. Implicit price concessions relate primarily to amounts due directly from patients. Estimated implicit price concessions are recorded for all uninsured accounts, regardless of the age of those accounts. Accounts are written off when all reasonable internal and external collection efforts have been performed. The estimates for implicit price concessions are based upon UPMC's assessment of historical write-offs and expected net collections, business and economic conditions, trends in federal, state and private employer health care coverage and other collection indicators.

The composition of net patient service revenue for the years ended December 31, 2021 and 2020 is as follows:

<u>Years Ended December 31</u>	2021	2020
Commercial	39%	37%
Medicare	37%	39%
Medical Assistance	16%	16%
Self-pay/other	8%	8%
	100%	100%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

Laws and regulations governing the Medicare and Medical Assistance programs are complex and subject to interpretation. UPMC believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. Compliance with such laws and regulations is subject to government review and interpretation as well as significant regulatory action, including fines, penalties and exclusion from Medicare and Medical Assistance programs. As a result, there is at least a reasonable possibility that the recorded estimates may change.

Insurance Enrollment Revenue

UPMC's insurance subsidiaries (collectively, the "Health Plans") provide health care services on a prepaid basis under various contracts. Insurance enrollment revenues are recognized as income in the period in which enrollees are entitled to receive health care services, which represents the performance obligation. Health care premium payments received from UPMC's members in advance of the service period are recorded as unearned revenues.

Insurance enrollment revenues include premiums that are collected from companies, individuals, and government entities. Laws and regulations governing the Medicare and Medical Assistance programs are complex and subject to interpretation. UPMC believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. Compliance with such laws and regulations can be subject to government review and interpretation as well as significant regulatory action, including fines, penalties and exclusion from the programs. As a result, there is at least a reasonable possibility that recorded estimates may change.

Other Revenue

UPMC's other revenue consists of various contracts related to its Health Services and Insurance Services divisions. These contracts vary in duration and in performance obligations. Revenues are recognized when the performance obligations identified within the individual contracts are satisfied and collectability is probable. Revenue recognized related to the CARES Act and the American Rescue Plan funding is captured in other revenue.

Receivables

Concentrations of patient accounts receivable at December 31, 2021 and 2020 include:

Years Ended December 31	2021	2020
Commercial	44%	41%
Medicare	28%	32%
Medical Assistance	12%	11%
Self-pay/other	16%	16%
	100%	100%

Insurance and other receivables are primarily comprised of payments due to Insurance Services and include the uncollected amounts from fully insured groups, individuals and government programs and are reported net of an allowance for estimated terminations and uncollectible accounts.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

Board-Designated, Restricted, Trusteed and Other Investments

Substantially all of UPMC's investments in debt and equity securities are classified as trading. This classification requires UPMC to recognize unrealized gains and losses on substantially all of its investments in debt and equity securities as investment revenue in the consolidated statements of operations and changes in net assets. This classification also includes UPMC Enterprises' cost basis investments in early stage entities, which are categorized as alternative investments. Gains and losses on the sales of securities are determined by the average cost method. Realized and unrealized gains and losses are included in investment revenue in the consolidated statements of operations and changes in net assets. Realized and unrealized gains and losses on donor-restricted assets are recorded as changes in net assets with donor restrictions in the consolidated statements of operations and changes in net assets.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value using quoted market prices or model-driven valuations. These investments predominantly include those maintained in MTF and are summarized as nonalternative investments in Note 5.

Investments in limited partnerships that invest in marketable securities (hedge funds) are reported using the equity method of accounting based on information provided by the respective partnership, generally received on a one month lag. The values provided by the respective partnerships are based on historical cost, appraisals or other estimates that require varying degrees of judgment. Generally, UPMC's holdings reflect net contributions to the partnership and an allocated share of realized and unrealized investment income and expenses. The investments may individually expose UPMC to securities lending, short sales, and trading in futures and forward contract options and other derivative products. UPMC's risk is limited to its carrying value for these lending and derivatives transactions. Amounts can be divested only at specified times. The financial statements of the limited partnerships are audited annually, generally as of December 31.

The values of UPMC's private equity investments are based upon financial statements received from the general partners, which are generally received on a quarterly lag. As a result, the market values and earnings recorded as of December 31, 2021 generally reflect the partnership activity experienced during the year ended September 30, 2021. These investments are summarized as alternative investments in Note 5.

Fair Value Elections

Pursuant to accounting guidance provided by ASC 825-10, *Financial Instruments*, UPMC makes elections, on an investment-by-investment basis, as to whether it measures certain equity method investments that are traded in active markets at fair value. Fair value elections are generally irrevocable. The initial unrealized gains recognized upon election of the fair value option are recorded as operating revenue in the consolidated statements of operations and changes in net assets consistent with accounting for other equity method investments where UPMC has the ability to exercise significant influence but not control. Any subsequent changes in the fair value of the investment are recorded as investment revenue in the consolidated statements of operations and changes in net assets consistent with UPMC's reporting of gains and losses on other marketable securities included in board-designated, restricted, trustee and other investments. Management believes this reporting increases the transparency of UPMC's financial condition.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

Financial Instruments

Cash and cash equivalents and investments recorded at fair value aggregate to \$9,583,692 and \$9,015,921 at December 31, 2021 and 2020, respectively. The fair value of these instruments is based on market prices as estimated by financial institutions. The fair value of amounts owed to counterparties under derivative contracts at December 31, 2021 and 2020, is \$3,683 and \$6,562, respectively, and due from counterparties is \$222 and \$544, respectively, based on pricing models that take into account the present value of estimated future cash flows.

UPMC participates in securities lending transactions whereby a portion of its investments are loaned, through its agent, to various parties in return for cash and securities from the parties as collateral for the securities loaned. The amount of cash collateral received under securities lending is reported as an asset with a corresponding payable in the consolidated balance sheets. The total collateral is required to have a market value between 102% and 105% of the market value of securities loaned. As of December 31, 2021 and 2020, securities loaned to various parties, of which UPMC maintains ownership, were \$203,256 and \$251,339, respectively, and total collateral (cash and noncash) received related to the securities loaned was \$213,284 and \$265,892, respectively.

Beneficial Interests in Foundations and Trusts

Several of UPMC's subsidiary hospitals have foundations that, according to their bylaws, were formed for the exclusive purpose of supporting and furthering the mission of the respective hospital. The foundations are separate corporations and are not liable for the obligations of UPMC, including any claims of creditors of any UPMC entities. The net assets of certain foundations are included in the consolidated balance sheets as beneficial interests in foundations and net assets with donor restrictions because the hospitals' use of these assets is at the discretion of the foundations' independent boards of directors.

Beneficial interests in foundations and trusts of \$783,779 and \$678,806 and the net assets with donor restrictions of consolidated foundations of \$61,262 and \$82,580 as of December 31, 2021 and 2020, respectively, are not pledged as collateral for UPMC's debt.

Property, Buildings and Equipment

Property, buildings and equipment are recorded at cost or, if donated or impaired, at fair market value at the date of receipt or impairment. Interest cost incurred on borrowed funds (net of interest earned on such funds) during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Costs associated with the development and installation of internal-use software are expensed or capitalized depending on whether they are incurred in the preliminary project stage, application development stage or post-implementation stage.

Depreciation is computed using the straight-line method at rates designed to depreciate the assets over their estimated useful lives (predominantly ranging from 3 to 40 years) and includes depreciation related to finance leases. Certain newly constructed buildings have estimated useful lives of up to 60 years. Depreciation expense on property, buildings and equipment for the years ended December 31, 2021 and 2020 was \$687,178 and \$682,711, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Leases

Leases are classified as either operating or financing, and the lease classification determines whether the expense is recognized on a straight-line basis (operating leases) or based on an effective interest method (finance leases). UPMC has made accounting policy elections not to apply lease recognition requirements to short-term leases as well as to use the risk-free discount rate for its operating leases. Operating leases are categorized as operating lease right-of-use assets on the consolidated balance sheets, while finance leases are recognized as property, buildings and equipment. UPMC has also made an accounting policy election not to bifurcate lease components from non-lease components. For leases that include variable lease payments, the payment is determined based on the executed contract terms. Some leases contain options to extend or terminate the lease, but these are not recognized in the right-of-use assets and lease liabilities as of December 31, 2021, unless it is probable that the option will be exercised.

Asset Impairment

UPMC evaluates the recoverability of the carrying value of long-lived assets by reviewing long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable and adjusts the asset cost to fair value if undiscounted cash flows are less than the carrying amount of the asset. There were no significant impairments in the years ended December 31, 2021 or 2020.

Other Assets

Investments in individual entities in which UPMC has the ability to exercise significant influence but does not control, generally 20% to 50% ownership, are reported using the equity method of accounting unless the fair value option is elected. Other assets include approximately \$384,920 and \$390,601 at December 31, 2021 and 2020, respectively, relating to investments in partnerships and joint ventures that provide health care, management, and other goods and services to UPMC, its affiliates and the community at large.

Goodwill

Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to the fair value of assets acquired and liabilities assumed. As of December 31, 2021 and 2020, goodwill of \$267,702 and \$241,075 respectively, is recorded in UPMC's consolidated balance sheets as other assets. The overall increase in goodwill compared to prior year is primarily related to the acquisition of minor international businesses within the Health Services division.

Goodwill is reviewed annually for impairment, or more frequently if events or circumstances indicate that the carrying value of an asset may not be recoverable. UPMC has the option to qualitatively assess goodwill for impairment before completing a quantitative assessment. Under the qualitative approach, if, after assessing the totality of events or circumstances, including both macroeconomic, industry and market factors, and entity-specific factors, UPMC determines it is likely (more likely than not) that the fair value is greater than its carrying amount, then the quantitative impairment analysis is not required. As of December 31, 2021 and 2020, after application of the qualitative approach, there were no indicators of impairment.

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Derivatives

UPMC uses derivative financial instruments (“derivatives”) to modify the interest rates and manage risks associated with its asset allocation and outstanding debt. UPMC records derivatives as assets or liabilities in the consolidated balance sheets at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative depends on whether it has been designated and qualifies as part of a hedging relationship and, further, on the type of hedging relationship. UPMC has entered into interest rate swap agreements that convert a portion of its variable rate debt to a fixed interest rate. None of UPMC’s swaps outstanding as of December 31, 2021 and 2020 are designated as hedging instruments and, as such, changes in fair value are recognized in investing and financing activities as investment revenue (expense) in the consolidated statements of operations and changes in net assets.

By using derivatives to manage these risks, UPMC exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivatives. When the fair value of a derivative is positive, the counterparty owes UPMC, which creates credit risk for UPMC. When the fair value of a derivative is negative, UPMC owes the counterparty, and therefore, it does not incur credit risk. UPMC minimizes the credit risk in derivatives by entering into transactions that require the counterparty to post collateral for the benefit of UPMC based on the credit rating of the counterparty and the fair value of the derivative. If UPMC has a derivative in a liability position, UPMC’s credit is a risk and fair market values could be adjusted downward. Market risk is the effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. Management also mitigates risk through periodic reviews of derivative positions in the context of UPMC’s total blended cost of capital.

Net Assets

Resources are classified for reporting purposes as net assets without donor restrictions and net assets with donor restrictions, according to the absence or existence of donor-imposed restrictions. Board-designated net assets are net assets without donor restrictions that have been set aside by the Board for specific purposes. Net assets with donor restrictions are those assets, including contributions and accumulated investment returns, whose use has been limited by donors for a specific purpose or time period or are those for which donors require the principal of the gifts to be maintained in perpetuity to provide a permanent source of income.

Net assets with donor restrictions include \$439,517 and \$384,683 of net assets held in perpetuity and \$955,146 and \$869,745 of temporary restricted net assets at December 31, 2021 and 2020, respectively. Net assets with donor restrictions include beneficial interests in foundations that support research and other health care programs. Some net assets with donor restrictions are limited by donors and the foundations to a specific time period or purpose and are reclassified to net assets without donor restrictions and included in the consolidated statements of operations and changes in net assets as other revenue or assets released from restriction for capital purchases when the restriction is met.

Inherent Contribution

UPMC applies the guidance set forth in ASC 958-805, *Not-for-Profit Entities for Business Combinations*, for affiliations and acquisitions. The guidance primarily characterizes business combinations between not-for-profit entities as nonreciprocal transfers of assets resulting in the contribution of the acquiree’s net assets to the acquirer. The guidance prescribes that the acquirer recognizes an excess of the acquisition date fair value of unrestricted net assets acquired over the fair value of the consideration transferred as a separate credit in its statement of operations as of the acquisition date or, conversely, recognizes the excess of the fair value of the consideration transferred over the fair value of the unrestricted net assets acquired as goodwill. Adjustments to these fair value assessments and other related charges are recorded in the statement of operations and changes in net assets in the period incurred or identified.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

Excess of Revenues Over Expenses

The consolidated statements of operations and changes in net assets include excess of revenues over expenses as a performance indicator. Excess of revenues over expenses includes all changes in net assets without donor restrictions except for contributions and distributions from foundations for the purchase of property and equipment, adjustments for pension liability, other than net periodic pension cost, discontinued operations, if any, and the cumulative effect of changes in accounting principles, if any.

Use of Estimates

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

Change to Prior Year Statement of Operations and Changes in Net Assets

In order to enhance transparency within UPMC's consolidated financial statements, UPMC disclosed all gains and losses related to its noncontrolling interests in a separate line item on the consolidated statements of operations and changes in net assets. To conform to this presentation for the year ended December 31, 2021, \$41,892 of operating expenses and (\$10,287) of net investing and financing activities were reclassified to excess of revenues over expenses attributable to noncontrolling interest for the year ended December 31, 2020.

2. COVID-19

In March 2020 and March 2021, the federal government enacted the CARES Act and the American Rescue Plan, respectively, that provides, among other funding sources, relief funds to hospitals and other health care providers on the front lines of the COVID-19 response. This funding has been used to support health care related expenses or lost revenue attributable to COVID-19. Beginning in April 2020, over 90 individual UPMC facilities received an aggregate of approximately \$761,000 of federal funding through December 31, 2021. Approximately \$264,000 and \$380,000 were recognized as other revenue for the years ended December 31, 2021 and 2020, respectively. The remaining amounts received will be evaluated for recognition in future periods. UPMC and its subsidiaries have and expect to continue to experience an impact on operations as a result of the COVID-19 pandemic.

In order to increase cash flow to providers of services and suppliers impacted by the COVID-19 pandemic, the Centers for Medicare & Medicaid Services ("CMS") expanded the current Accelerated and Advance Payment Program. Beginning in April 2020, CMS provided advance funding that aggregated to a total of approximately \$840,000 to 185 individually identified UPMC entities. In October 2020, a bill was signed into law which changed the original Medicare loan repayment terms for health care providers allowing recoupment to begin one year after the Medicare Accelerated and Advance Payment Program loan was issued. Recoupment began in April 2021 and the recovery period is estimated to be approximately 18 months from that date. As of December 31, 2021, \$325,000 of the advance funding has been recouped by CMS. Additionally, the CARES Act allows employers to defer the deposit and payment of the employer's share of Social Security/FICA taxes. As part of this deferral program, UPMC currently has \$104,000 of deferred FICA payments as of December 31, 2021. Remaining repayment to the federal government will occur in December 2022.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

3. SIGNIFICANT TRANSACTIONS

In February 2020, UPMC and Western Maryland Health System (“WMHS”) executed an Integration and Affiliation Agreement (the “Agreement”) providing for an affiliation between UPMC and WMHS. The transaction is intended to preserve and enhance the mission of WMHS and to advance its ability to provide high-quality health services to its communities. On the date of the affiliation, the articles of incorporation and bylaws of WMHS were amended such that UPMC became the sole corporate member.

As a result of this affiliation, UPMC acquired approximately \$532,000 of total assets, consisting of \$241,000 of property, plant and equipment, \$189,000 of cash and investments, \$60,000 of current and long-term assets and \$42,000 of accounts receivable, and assumed approximately \$360,000 of total liabilities, including \$210,000 of long-term debt obligations, and current and long-term liabilities of \$150,000, and acquired approximately \$12,000 of net assets with donor restrictions.

For this affiliation, UPMC applied the not-for-profit business combination accounting guidance. The guidance primarily characterizes business combinations between not-for-profit entities as nonreciprocal transfers of assets resulting in the contribution of the acquiree’s net assets to the acquirer. The guidance prescribes that the acquirer recognizes an excess of the acquisition date fair value of the net assets without donor restrictions acquired over the fair value of the consideration transferred as a separate credit in its consolidated statement of operations and changes in net assets as of the acquisition date. Accordingly, UPMC recognized an inherent contribution related to the net assets without donor restrictions acquired in the transaction of approximately \$160,000 in its consolidated statement of operations and changes in net assets for the year ended December 31, 2020. The inherent contribution recorded for the period is based on the fair market values of the net assets without donor restrictions acquired. WMHS, contributing \$314,000 of total operating revenues to UPMC’s consolidated results for the year ended December 31, 2020, would have contributed an additional \$32,000 of total operating revenues had it been consolidated for the entire year ended December 31, 2020.

In December 2020, UPMC executed an agreement with CarepathRx whereby a portion of UPMC Chartwell, one of the largest health system-based providers of home infusion therapy and specialty pharmacy services, was sold to CarepathRx. UPMC Chartwell transferred certain management and administrative assets, including related personnel, to a newly formed management services entity (the “MSO”). All of the equity interests in the MSO were subsequently sold to CarepathRx in exchange for \$385,000 in aggregate consideration, comprised of \$210,000 in cash and \$175,000 in equity of CarepathRx. UPMC retains its ownership of Chartwell, which will in turn retain all core pharmacy and fulfillment assets. UPMC recognized a gain on sale of approximately \$236,000 in other revenues, of which approximately \$35,000 was attributable to noncontrolling interest, in its consolidated statement of operations and changes in net assets for the year ended December 31, 2020, in accordance with ASC 810, *Consolidation*.

4. CHARITY CARE

UPMC’s patient acceptance policy is based on its mission and its community service responsibilities. Accordingly, UPMC accepts patients in immediate need of care, regardless of their ability to pay. UPMC does not pursue collection of amounts determined to qualify as charity care based on established policies of UPMC. These policies define charity care as those services for which no payment is due for all or a portion of the patient’s bill. For financial reporting purposes, charity care is excluded from net patient service revenue. The amount of charity care provided, determined on the basis of cost, was \$87,331 and \$110,378 for the years ended December 31, 2021 and 2020, respectively. UPMC estimates the cost of providing charity care using the ratio of average patient care cost to gross charges and then applying that ratio to the gross uncompensated charges associated with providing charity care.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

5. CASH AND INVESTMENTS

Following is a summary of cash and investments included in the consolidated balance sheets:

	December 31	
	2021	2020
Internally designated:		
Health insurance programs	\$ 1,694,242	\$ 1,411,146
Professional and general liability insurance program	692,969	653,827
Employee benefit and workers' compensation self-insurance programs	159,220	145,216
Other	99,182	59,374
	2,645,613	2,269,563
Externally designated:		
Trusteed assets for capital and debt service payments	3,447	3,445
Donor-restricted assets	606,064	584,473
	609,511	587,918
Other long-term investments	6,511,425	5,474,639
Board-designated, restricted, trustee and other investments	9,766,549	8,332,120
Cash and cash equivalents	930,376	1,541,036
	\$ 10,696,925	\$ 9,873,156

Investments are primarily maintained in MTF and administered using a bank as trustee. As of December 31, 2021, UPMC utilized 171 ongoing external investment managers, including 48 traditional managers, 18 hedge fund managers and 105 private capital managers. UPMC is also invested with an additional 34 legacy private capital and hedge fund managers. The largest allocation to any alternative investment fund is \$138,868 as of December 31, 2021. Certain managers use various equity and interest rate derivatives. These instruments are subject to various risks similar to nonderivative financial instruments, including market, credit, liquidity, operational and foreign exchange risk. UPMC's unfunded commitments to investments are \$376,193 and \$297,977 as of December 31, 2021 and 2020, respectively. Unfunded commitments may be called by managers pursuant to the terms of each specific fund's documents, which allow capital to be called during a fund's investment period for new investments. While terms vary, investment periods are generally within six years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

As of December 31, 2021 and 2020, respectively, UPMC had \$1,113,233 and \$857,235 of alternative investments accounted for under the equity method, which approximates fair value. Investment return from cash and investments is comprised of the following for the years ended December 31, 2021 and 2020:

	2021	2020
Interest income	\$ 73,213	\$ 78,829
Dividend income	40,928	27,068
Net realized gains on sales of securities	575,402	271,288
	689,543	377,185
Unrealized investment gains	245,080	208,855
Derivative contracts mark to market	2,557	(320)
	247,637	208,535
Total investment gain	937,180	585,720
Traditional investment manager and trustee fees	(34,611)	(29,780)
Investment gain	\$ 902,569	\$ 555,940

In managing the UPMC investment strategy, an important consideration is to ensure sufficient liquidity. While UPMC's relationships with its external investment managers vary in terms of exit provisions, a percentage of the agreements allow ready access to underlying assets which are generally liquid and marketable. Liquidity as of December 31, 2021 is shown below:

Liquidity Availability	Cash and Cash Equivalents	Nonalternative Investments	Alternative Investments	Total
Within three days	\$ 930,376	\$ 6,634,148	\$ -	\$ 7,564,524
Within 30 days	-	156,737	51,478	208,215
Within 60 days	-	-	129,529	129,529
Within 90 days	-	-	342,022	342,022
More than 90 days	-	351,788	2,100,847	2,452,635
Total	\$ 930,376	\$ 7,142,673	\$ 2,623,876	\$ 10,696,925

6. CREDIT ARRANGEMENTS

UPMC has a revolving line and letter of credit facility (the "Revolving Facility") with a capacity of \$600,000. The Revolving Facility expires on January 24, 2024. The Revolving Facility is used to manage cash flow during the year and to provide for a consolidated method of issuing various letters of credit for certain business units. A note to secure UPMC's repayment obligation with respect to the Revolving Facility was issued under the 2007 Master Trust Indenture ("2007 UPMC MTI") and is secured by a pledge of and security interest in the gross revenues of UPMC's parent corporation, UPMC Presbyterian Shadyside, UPMC Magee-Womens Hospital, UPMC Passavant and UPMC St. Margaret as members of the obligated group under the 2007 UPMC MTI. Advances may be variable rate based on the prime rate or the Federal Funds effective rates or fixed on the date of the advance based on the LIBOR Rate and the reserve requirement on Eurocurrency liabilities.

As of December 31, 2021 and 2020, UPMC had issued \$82,990 and \$83,920, respectively, of letters of credit under the Revolving Facility. These letters of credit predominantly support the capital requirements of certain insurance subsidiaries. As of December 31, 2021 and 2020, there was \$517,010 and \$516,080, respectively, available to borrow under the Revolving Facility. No amounts were outstanding under the Revolving Facility as of December 31, 2021 and 2020.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

UPMC has credit facilities of \$50,000 and \$19,000, the latter of which temporarily increases each year to \$150,000 from May 14th to August 15th, with expiration dates in April 2022. Both credit facilities support the Insurance Services Division. As of December 31, 2021, there were no draws on either credit facility. To further support the Insurance Services Division, in the second quarter of 2021 UPMC entered into additional credit facilities with a capacity totaling \$400 million. In the fourth quarter of 2021 the capacity was reduced to \$200 million as a result of a scheduled facility termination. For the remaining facility with a scheduled termination in April 2022, there were no draws outstanding as of December 31, 2021.

7. LONG-TERM OBLIGATIONS AND DERIVATIVE INSTRUMENTS

Long-term obligations consist of the following:

	December 31	
	2021	2020
Fixed rate revenue bonds	\$ 4,496,406	\$ 4,089,762
Variable rate revenue bonds	701,192	1,126,477
Finance leases and other	124,758	142,111
Par value of long-term obligations	5,322,356	5,358,350
Net premium and other	259,286	233,560
	5,581,642	5,591,910
Less current portion	(280,793)	(333,864)
Total long-term obligations	\$ 5,300,849	\$ 5,258,046

Bonds and leases outstanding represent funds borrowed by the UPMC parent corporation and various subsidiaries pursuant to loan agreements and lease and sublease financing arrangements with governmental authorities. The proceeds were used for the purchase, construction and renovation of hospital facilities, certain buildings and equipment, as well as the extinguishment of debt.

The fixed rate revenue bonds bear interest at fixed coupon rates ranging from 1.80% to 6.00% as of December 31, 2021 and from 2.00% to 6.00% as of December 31, 2020. The average interest costs for the variable rate revenue bonds were 1.30% and 1.66% during the years ended December 31, 2021 and 2020, respectively. Bonds have varying principal payments and final maturities from 2022 through 2051. Certain revenue bonds (\$43,595 and \$43,584 for 2021 and 2020, respectively) are secured by bond insurance. The bonds contain redemption provisions whereby, at the direction of UPMC, the bonds may be redeemed on various dates as presented within the bond agreements.

Bonds in the aggregate of \$5,193,915 and \$5,209,677 as of December 31, 2021 and 2020, respectively, are issued under the UPMC MTI. The bonds are secured by a pledge of and security interest in gross revenues. Certain amounts borrowed under the MTI are loaned to certain subsidiary corporations pursuant to loan and contribution agreements and require the transfer of subsidiary funds to the parent corporation in the event of failure to satisfy the UPMC parent corporation liquidity covenant.

The various indebtedness agreements contain restrictive covenants, the most significant of which are the maintenance of minimum debt service coverage and liquidity ratios, and restrictions as to the incurrence of additional indebtedness and transfers of assets. UPMC was in compliance with such covenants as of December 31, 2021 and 2020.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

Aggregate maturities of long-term obligations for the next five years, assuming no remarketing of UPMC's variable rate debt, indicating the maximum potential payment obligations in these years, are as follows:

2022	\$	280,793
2023		363,477
2024		150,410
2025		502,131
2026		564,315

Interest paid, net of amounts capitalized, on all obligations was \$191,221 and \$201,413 during the years ended December 31, 2021 and 2020, respectively.

During the year ended December 31, 2021, UPMC issued Series 2021A, 2021B, and 2021C fixed rate bonds in the par amount of \$221,860, \$47,430, and \$400,000, respectively, with an original issue premium of \$42,165, \$10,288, and \$0, respectively, in order to fund new capital projects and refund existing debt.

UPMC maintains interest rate swap programs on certain of its bonds in order to manage its interest rate risk. To meet this objective and to take advantage of low interest rates, UPMC entered into various interest rate swap agreements to manage interest rate risk. The notional amount under each interest rate swap agreement is reduced over the term of the respective agreement to correspond with reductions in various outstanding bond series.

During the term of these agreements, the floating to fixed rate swaps convert variable rate debt to a fixed rate and the basis swaps convert the interest rate on underlying LIBOR-based bonds to the Securities Industry and Financial Markets Association Municipal Swap Index ("SIFMA Index").

Under the basis swaps, UPMC pays a rate equal to the SIFMA Index, an index of seven-day, high-grade, tax-exempt variable rate demand obligations. The SIFMA Index rates ranged from 0.02% to 0.11% (weighted average rate of 0.04%) and from 0.08% to 5.20% (weighted average rate of 0.55%) as of December 31, 2021 and 2020, respectively.

The following table summarizes UPMC's interest rate swap agreements:

Swap	Maturity Date	UPMC Pays	UPMC Receives	Notional Amount at	
				Dec 31, 2021	Dec 31, 2020
Floating to fixed	2025	3.60%	68% one-month LIBOR	\$ 49,280	\$ 60,030
Basis	2021	SIFMA Index	67% three-month LIBOR plus .2077%	-	7,375
Basis	2037	SIFMA Index	67% three-month LIBOR plus .3217%	46,095	46,095
Floating to fixed	2024	1.413%	67% one-month LIBOR	7,500	8,000
				\$ 102,875	\$ 121,500

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

Pursuant to master netting arrangements, UPMC has the right to offset the fair value of amounts recognized for derivatives, including the right to reclaim or obligation to return cash collateral from/to counterparties. The fair values of UPMC's derivative financial instruments are presented below, representing the gross amounts recognized as of December 31, 2021 and 2020 which are not offset by counterparty or type of item hedged:

	Dec 31, 2021	Dec 31, 2020
Other assets	\$ 222	\$ 544
Long-term obligations	(3,683)	(6,562)
	\$ (3,461)	\$ (6,018)

8. FAIR VALUE MEASUREMENTS

As of December 31, 2021 and 2020, UPMC held certain assets that are required to be measured at fair value on a recurring basis. These include cash and cash equivalents and certain board-designated, restricted, trustee, and other investments and derivative instruments. Certain alternative investments are measured using the equity method of accounting and are therefore excluded from the fair value hierarchy tables presented herein. The valuation techniques used to measure fair value are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs are generally unsupported by market activity. The three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value, includes:

- Level 1: Quoted prices for identical assets or liabilities in active markets.
- Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-driven valuations whose inputs are observable or whose significant value drivers are observable.
- Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following tables represent UPMC's fair value hierarchy for its financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2021 and 2020. The interest rate swaps are valued using internal models, which are primarily based on market observable inputs, including interest rate curves. When quoted market prices are unobservable for fixed income securities, quotes from independent pricing vendors based on recent trading activity and other relevant information, including market interest rate curves, referenced credit spreads and estimated prepayment rates where applicable, are used for valuation purposes. These investments are included in Level 2 and include corporate fixed income, government bonds, and mortgage and asset-backed securities.

Other investments measured at fair value represent funds included on the consolidated balance sheets that are reported using net asset value ("NAV"). These amounts are not required to be categorized in the fair value hierarchy. The fair value of these investments is based on the net asset value information provided by the general partner. Fair value is based on the proportionate share of the NAV based on the most recent partners' capital statements received from the general partners, which is generally one quarter prior to the balance sheet date. Certain of UPMC's alternative investments are utilizing NAV to calculate fair value and are included in other investments in the following tables.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

FAIR VALUE MEASUREMENTS AS OF DECEMBER 31, 2021

	Level 1	Level 2	Level 3	NAV	Total Carrying Amount
ASSETS					
Fixed income	\$ 1,041,729	\$ 2,911,201	\$ -	\$ -	\$ 3,952,930
Domestic equity	1,490,595	9,760	-	-	1,500,355
International equity	873,730	-	-	-	873,730
Public real estate	137,364	-	-	-	137,364
Long/short equity	73,485	15,173	-	-	88,658
Absolute equity	54,195	-	-	-	54,195
Commodities	-	-	-	-	-
Derivative instruments	-	222	-	-	222
Securities on loan	203,256	-	-	-	203,256
Securities lending collateral	117,873	-	-	-	117,873
Alternative and other investments at NAV	-	-	-	1,842,828	1,842,828
Total assets measured at fair value on a recurring basis	\$ 3,992,227	\$ 2,936,356	\$ -	\$ 1,842,828	\$ 8,771,411
LIABILITIES					
Payable under securities lending agreement	\$ (117,873)	\$ -	\$ -	\$ -	\$ (117,873)
Derivative instruments	-	(3,683)	-	-	(3,683)
Total liabilities measured at fair value on a recurring basis	\$ (117,873)	\$ (3,683)	\$ -	\$ -	\$ (121,556)

FAIR VALUE MEASUREMENTS AS OF DECEMBER 31, 2020

	Level 1	Level 2	Level 3	NAV	Total Carrying Amount
ASSETS					
Fixed income	\$ 655,043	\$ 3,166,311	\$ -	\$ -	\$ 3,821,354
Domestic equity	1,059,489	15,061	-	-	1,074,550
International equity	708,306	719	-	-	709,025
Public real estate	70,857	-	-	-	70,857
Long/short equity	31,188	10,423	-	-	41,611
Absolute equity	16,093	-	-	-	16,093
Commodities	6,601	-	-	-	6,601
Derivative instruments	-	544	-	-	544
Securities on loan	251,339	-	-	-	251,339
Securities lending collateral	80,527	-	-	-	80,527
Alternative and other investments at NAV	-	-	-	1,483,455	1,483,455
Total assets measured at fair value on a recurring basis	\$ 2,879,443	\$ 3,193,058	\$ -	\$ 1,483,455	\$ 7,555,956
LIABILITIES					
Payable under securities lending agreement	\$ (80,527)	\$ -	\$ -	\$ -	\$ (80,527)
Derivative instruments	-	(6,562)	-	-	(6,562)
Total liabilities measured at fair value on a recurring basis	\$ (80,527)	\$ (6,562)	\$ -	\$ -	\$ (87,089)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

9. PENSION PLANS

UPMC and its subsidiaries maintain defined benefit pension plans (the "Plans"), defined contribution plans and nonqualified pension plans that cover substantially all of UPMC's employees. Under the defined contribution plans, employees may elect to contribute a percentage of their salary, which is matched in accordance with the provisions of the defined contribution plans. Contributions to the nonqualified pension plans are based on a percentage of salary or contractual arrangements. Total expense relating to the aforementioned pension plans was \$231,374 and \$228,120, respectively, for the years ended December 31, 2021 and 2020.

Benefits under the Plan vary and are generally based upon the employee's earnings and years of participation. It is UPMC's policy to meet the requirements of the Employee Retirement Income Security Act of 1974 ("ERISA") and the Pension Protection Act of 2006. UPMC's policy is to contribute amounts sufficient to, among other things, avoid Pension Benefit Guaranty Corporation variable premiums. Contributions made to the Plan were \$0 and \$31,100 for the years ended December 31, 2021 and 2020, respectively.

To develop the expected long-term rate of return on plan assets assumption, UPMC considers the current level of expected returns on risk-free investments, the historical level of risk premium associated with the other asset classes in which the pension portfolio is invested and the expectations for future returns on each asset class. The expected return for each asset class is then weighted based on the target asset allocation to develop the expected long-term rate of return on assets assumption for the pension portfolio.

The table below sets forth the accumulated benefit obligation, the change in the projected benefit obligation and the change in the assets of the Plan. The table also reflects the funded status of the Plan as well as recognized and unrecognized amounts in the consolidated balance sheets. As of December 31, 2021, the pension asset is included in other assets on the consolidated balance sheet.

	Year Ended December 31	
	2021	2020
Accumulated benefit obligation	\$ 2,895,156	\$ 2,883,938
CHANGE IN PROJECTED BENEFIT OBLIGATION		
Projected benefit obligation at beginning of year	\$ 3,018,239	\$ 2,485,106
Pension plans acquired	-	359,481
Service cost	174,019	148,740
Interest cost	76,674	80,069
Actuarial (gain) loss	(5,429)	244,363
Annuity purchases	-	(122,953)
Benefits paid	(206,074)	(176,567)
Projected benefit obligation at end of year	3,057,429	3,018,239
CHANGE IN PLAN ASSETS		
Fair value of plan assets at beginning of year	2,846,256	2,507,361
Pension plans acquired	-	282,196
Actual return on plan assets	447,012	325,119
Employer contributions	-	31,100
Annuity purchases	-	(122,953)
Benefits paid	(206,074)	(176,567)
Fair value of plan assets at end of year	3,087,194	2,846,256
Pension (asset) liability at end of year	\$ (29,765)	\$ 171,983

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Included in net assets without donor restrictions at December 31, 2021 and 2020 are the following amounts that have not yet been recognized in net periodic pension cost:

	As of December 31	
	2021	2020
Unrecognized prior service credit	\$ 34,063	\$ 39,319
Unrecognized net actuarial loss	(243,569)	(532,905)
	\$ (209,506)	\$ (493,586)

Changes in plan assets and benefit obligations recognized in net assets without donor restrictions during 2021 and 2020 include the following:

	Year Ended December 31	
	2021	2020
Current year net actuarial gain (loss)	\$ 261,056	\$ (90,896)
Amortization of actuarial loss	28,280	29,647
Amortization of prior service credit	(5,256)	(5,256)
	\$ 284,080	\$ (66,505)

The service cost component of net periodic benefit cost is included in salaries, professional fees and employee benefits and all other components of net periodic benefit cost are included in other non-operating activities in the consolidated statements of operations and changes in net assets. The components of net periodic pension cost for the Plan were as follows:

	Year Ended December 31	
	2021	2020
Service cost	\$ 174,019	\$ 148,740
Interest cost	76,674	80,069
Expected return on plan assets	(191,385)	(171,652)
Recognized net actuarial loss	28,280	29,647
Amortization of prior service credit	(5,256)	(5,256)
Net periodic pension cost	\$ 82,332	\$ 81,548

The weighted average actuarial assumptions used to determine the benefit obligations and net periodic pension cost for the Plan are as follows:

	December 31	
	2021	2020
Discount rates:		
Used for benefit obligations	2.87%	2.49%
Used for net periodic pension cost	2.49%	3.17%
Expected rate of compensation increase:		
Used for benefit obligations	Age-graded	Age-graded
Used for net periodic pension cost	Age-graded	Age-graded
Expected long-term rate of return on plan assets	7.00%	7.00%
Interest crediting rate	2.40%	2.40%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

The assumptions for long-term rate of return are developed using the expected returns of the various asset classes in which the pension invests and the allocations of each asset class with respect to the investment as a whole. The change in discount rate from 2.49% to 2.87% had the net effect of decreasing the projected benefit obligation by \$114,779 for the year ended December 31, 2021.

The following pension benefit payments are expected to be paid in the years ending December 31:

2022	\$	221,137
2023		226,269
2024		228,592
2025		229,616
2026		228,187
2027-2031		1,091,267

UPMC employs a total return investment approach whereby a mix of equities and fixed income investments are used to maximize the long-term return on plan assets subject to accepting a prudent level of risk. Risk tolerance is established through consideration of plan liabilities, plan funded status and corporate financial condition. The pension portfolio contains a diversified blend of equity, fixed income and alternative investments. Equity investments are diversified across United States and non-United States corporate stocks, as well as growth, value, and small and large capitalizations. Other assets such as real estate, private equity and hedge funds are used to enhance long-term returns while improving portfolio diversification. Investment risk is measured and monitored on an ongoing basis through quarterly investment portfolio reviews, annual liability measurements and periodic asset/liability studies.

As of December 31, 2021, UPMC employed 179 external investment managers to handle the investment of the assets in the pension portfolio. Of these, 25 managers manage equity investments, 10 manage fixed income investments and 144 managers oversee alternative investment strategies. The largest allocation to any alternative investment manager is \$60,202 as of December 31, 2021. Unfunded commitments due to investments within the Plan, funded with Plan assets, are \$349,438 and \$396,013 as of December 31, 2021 and 2020, respectively. Unfunded commitments may be called by managers pursuant to the terms of each specific fund's documents, which allow capital to be called during a fund's investment period for new investments. While terms vary, investment periods are generally within six years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

The following is a summary of the pension plan asset allocations at December 31, 2021 and 2020:

	2021	2020	2021 Target
Nonalternative investments:			
Fixed income	11.8%	12.2%	13.0%
Domestic equity	21.1%	23.2%	23.0%
International equity	18.2%	22.4%	22.0%
Total nonalternative investments	51.1%	57.8%	58.0%
Real assets:			
Real estate	3.7%	2.8%	4.0%
Income opportunities	1.7%	2.5%	2.0%
Natural resources	4.2%	3.5%	4.0%
Total real assets	9.6%	8.8%	10.0%
Alternative investments:			
Long/short equity	10.9%	10.1%	10.0%
Absolute return	6.0%	5.3%	7.0%
Private equity	22.4%	18.0%	15.0%
Total alternative investments	39.3%	33.4%	32.0%
Total	100.0%	100.0%	100.0%

All of the Plan's assets are measured at fair value, including its alternative investments. The same levels of the fair value hierarchy as described in Note 8 are used to categorize the Plan's assets. Corporate debt instruments and fixed income/bonds are valued using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. The fair value of common/collective trust funds is determined by the issuer sponsoring such funds by dividing the fund's net assets at fair value by its units outstanding at the valuation dates. Partnership interests are valued using NAV, which is based on the unit values of the interests as determined by the issuer sponsoring such interests dividing the fund's net assets at fair value by its units outstanding at the valuation dates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

The fair values of the Plan's assets at December 31, 2021, by asset category and by the level of inputs used to determine fair value, were as follows:

	Level 1	Level 2	Level 3	NAV	Total
ASSETS					
Equity securities:					
Domestic equity	\$ 576,856	\$ 6,403	\$ -	\$ -	\$ 583,259
International equity	322,344	-	-	-	322,344
U.S. REITS	51,923	1,598	-	-	53,521
Fixed income:					
Government securities	30,976	-	-	-	30,976
Bond funds	145,405	-	-	-	145,405
Corporate debt instruments	-	42,145	-	-	42,145
Asset and mortgage-backed securities	-	68,948	-	-	68,948
Long/short equity	47,895	-	-	-	47,895
Absolute return	11,482	-	-	-	11,482
Other investments	-	-	-	1,780,190	1,780,190
Net receivables	1,029	-	-	-	1,029
Plans' assets at fair value	\$ 1,187,910	\$ 119,094	\$ -	\$ 1,780,190	\$ 3,087,194

The fair values of the Plan's assets at December 31, 2020, by asset category and by the level of inputs used to determine fair value, were as follows:

	Level 1	Level 2	Level 3	NAV	Total
ASSETS					
Equity securities:					
Domestic equity	\$ 609,619	\$ 3,353	\$ -	\$ -	\$ 612,972
International equity	444,684	-	-	-	444,684
U.S. REITS	32,266	-	-	-	32,266
Fixed income:					
Government securities	-	35,194	-	-	35,194
Bond funds	156,884	-	-	-	156,884
Corporate debt instruments	-	43,171	-	-	43,171
Asset and mortgage-backed securities	3,356	64,405	-	-	67,761
Long/short equity	25,679	-	-	-	25,679
Absolute return	-	-	-	-	-
Other investments	-	-	-	1,427,290	1,427,290
Net receivables	355	-	-	-	355
Plans' assets at fair value	\$ 1,272,843	\$ 146,123	\$ -	\$ 1,427,290	\$ 2,846,256

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

10. HEALTH INSURANCE REVENUE AND COSTS

Health care costs were \$11,338,966 and \$10,328,949, of which \$2,869,217 and \$2,413,337 were eliminated in consolidation representing medical services performed by other UPMC entities for the years ended December 31, 2021 and 2020, respectively. Such costs are included in insurance claims expense. These costs include estimates of payments to be made on claims reported but not yet processed as of the balance sheet date and estimates of health care services incurred but not reported to the Health Plans. Such estimates include the cost of services that will continue to be incurred after the balance sheet date when the Health Plans are obligated to remit payment for such services in accordance with contract provisions or regulatory requirements. UPMC determines the amount of the reserve for incurred but not paid claims by following a detailed actuarial process that uses both historical claim payment patterns as well as emerging medical cost trends to project UPMC's best estimate of reserve for physical health care costs. This process involves formatting of historical paid claims data into claim triangles, which compare claim incurred dates to the dates of claim payments. This information is analyzed to create completion factors that represent the average percentage of total incurred claims that have been paid through a given date after being incurred. Completion factors are applied to claims paid through the period-end date to estimate the ultimate claim expense incurred for the period. Actuarial estimates of incurred but not paid claim liabilities are then determined by subtracting the actual paid claims from the estimate of the ultimate incurred claims.

For the most recent incurred months, the percentage of claims paid for claims incurred in those months is generally low. This makes the completion factors methodology less reliable for such months. Therefore, incurred claims for most recent months are not projected from historical completion and payment patterns; rather, they are projected by estimating the claims expense for those months based on recent claims expense levels and health care trend levels, or trend factors.

While there are many factors that are used as part of the estimation of UPMC's reserve for physical health care costs, the two key assumptions having the most significant impact on UPMC's incurred but not paid claims liability as of December 31, 2021 were the completion and trend factors.

	2021	2020
Reserve for physical health care costs (beginning balance)	\$ 705,361	\$ 493,731
Add: Provisions for medical costs occurring in:		
Current year	10,149,739	9,319,976
Prior year	(26,263)	(17,285)
Net incurred medical costs	10,123,476	9,302,691
Deduct: Payments for claims occurring in:		
Current year	9,507,661	8,623,868
Prior year	679,098	467,193
Net paid medical costs	10,186,759	9,091,061
Reserve for physical health care costs (ending balance)	\$ 642,078	\$ 705,361

The foregoing rollforward shows favorable development of \$26,263 and \$17,285 for the years ended December 31, 2021 and 2020, respectively. UPMC regularly reviews and sets assumptions regarding cost trends and utilization when initially establishing a reserve for physical health care costs. UPMC continually monitors and adjusts the reserve and claim expense based on subsequent paid claims activity. If it is determined that UPMC's assumptions regarding cost trends and utilization are materially different from actual results, UPMC's consolidated statement of operations and changes in net assets and consolidated balance sheet could be impacted in future periods. Adjustments of prior year estimates may result in additional claim expense or a reduction of claim expense in the period an adjustment is made.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

Incurred claims development for the years ended December 31, 2021, 2020 and 2019 are as follows:

	(Unaudited) December 31, 2019	(Unaudited) December 31, 2020	December 31, 2021
December 31, 2019	\$ 8,232,994	\$ 8,215,709	\$ 8,208,948
December 31, 2020		9,319,976	9,300,474
December 31, 2021			10,149,739
			\$ 27,659,161

Paid claims development for the years ended December 31, 2021, 2020 and 2019 are as follows:

	(Unaudited) December 31, 2019	(Unaudited) December 31, 2020	December 31, 2021
December 31, 2019	\$ 7,741,510	\$ 8,206,456	\$ 8,208,948
December 31, 2020		8,623,868	9,300,474
December 31, 2021			9,507,661
			\$ 27,017,083

At December 31, 2021, the total of incurred but not reported ("IBNR") liabilities plus expected development on reported claims and the cumulative number of reported claims for the years ended December 31, 2021, 2020 and 2019 are as follows:

	Total IBNR and Expected Development on Reported Claims	(Unaudited) Cumulative Number of Reported Claims*
December 31, 2019	\$ -	24,459
December 31, 2020	-	23,307
December 31, 2021	642,078	25,671
Total	\$ 642,078	73,437

* In thousands

The cumulative number of reported claims for each claim year has been developed using historical data captured by UPMC's claims payment system and data warehouse.

Net assets without donor restrictions required to meet statutory requirements of the Health Plans were \$1,587,303 and \$1,207,408 at December 31, 2021 and 2020, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

11. PROFESSIONAL AND GENERAL LIABILITY INSURANCE

UPMC is insured for professional and general liability losses through wholly owned, multiprovider insurance companies (the "Captives"). The Captives provide primary and excess professional liability coverage to UPMC subsidiaries, employed physicians of UPMC and other entities not included in the consolidated financial statements. For those self-insured risks, UPMC has established irrevocable trust funds to pay claims and related costs.

Certain insurance agreements have retrospective clauses that permit additional premiums or refunds to be made based on actual experience. The reserve for professional and general liability indemnity losses and loss adjustment expenses is determined using individual case-based evaluations and actuarial analyses and represents an estimate of reported claims and claims incurred but not reported. Those estimates are subject to the effects of trends in average loss severity and average frequency. Although considerable variability is inherent in such estimates, management believes that the reserves for professional and general liability losses and loss adjustment expenses are reasonable. The estimates are reviewed and adjusted as necessary as experience develops or new information becomes known. Such adjustments are included in current operations. Reserves for professional and general liability losses and loss adjustment expenses of \$533,315 and \$479,421, discounted at 1.00% and 0.25% (which approximates the risk-free rates), were recorded as of December 31, 2021 and 2020, respectively. At December 31, 2021 and 2020, respectively, \$104,133 and \$90,939 of the loss reserves are included in current portion of insurance reserves and \$429,182 and \$388,482 are included in long-term insurance reserves.

The following table provides a rollforward of the reserve balances for professional and general liability costs for the years ended December 31, 2021 and 2020.

	2021	2020
Reserve for professional and general liability costs (beginning balance)	\$ 479,421	\$ 393,400
Add: Provisions for expenses occurring in:		
Current year	125,437	112,556
Prior year	5,292	(1,651)
Change in discount rate	(8,100)	20,000
Net incurred expenses	122,629	130,905
Deduct: Payments for expenses occurring in:		
Current year	363	759
Prior year	81,791	84,931
Net paid expenses	82,154	85,690
Changes in other reserves	13,419	40,806
Reserve for professional and general liability costs (ending balance)	\$ 533,315	\$ 479,421

The foregoing rollforward shows unfavorable development of \$5,292 and favorable development \$1,651 for the years ended December 31, 2021 and 2020, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

The following table provides undiscounted information for claims development for incurred losses and paid claim loss by incident year for the year ended December 31, 2021. The information about incurred and paid claims development for the years ended December 2012 to 2020 is presented as supplementary information. For the reported development, the adequacy of case reserves has been consistent and favorable over time, and there have been no significant changes in the rate at which claims have been reported. For the paid development, the rate of payment of claims has been relatively consistent over time.

DIRECT CLAIM LOSS INCURRED

Accident Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
	Unaudited									
2012	\$ 78,082	\$ 86,177	\$ 81,507	\$ 75,921	\$ 74,831	\$ 77,367	\$ 74,732	\$ 71,171	\$ 71,345	\$ 71,924
2013	-	77,146	79,850	72,831	68,055	72,144	68,116	68,529	69,693	72,457
2014	-	-	86,191	84,910	83,562	78,108	75,644	73,443	74,808	76,487
2015	-	-	-	96,593	102,111	89,569	88,801	83,033	80,946	79,273
2016	-	-	-	-	90,844	94,155	91,655	84,615	73,214	72,195
2017	-	-	-	-	-	100,732	99,428	104,403	103,570	100,146
2018	-	-	-	-	-	-	100,781	97,451	96,836	93,128
2019	-	-	-	-	-	-	-	103,995	106,787	109,126
2020	-	-	-	-	-	-	-	-	108,482	109,915
2021	-	-	-	-	-	-	-	-	-	125,438
									Total	\$ 910,089

DIRECT CLAIM LOSS PAID

Accident Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
	Unaudited									
2012	\$ 1,029	\$ 6,777	\$ 16,334	\$ 27,212	\$ 47,768	\$ 57,588	\$ 62,641	\$ 66,886	\$ 67,407	\$ 68,588
2013	-	353	5,861	12,020	28,016	42,775	49,807	56,494	58,760	64,342
2014	-	-	467	7,771	16,949	40,736	48,191	57,372	61,217	64,744
2015	-	-	-	355	16,914	26,838	43,634	58,646	65,427	68,562
2016	-	-	-	-	446	6,375	14,220	27,736	39,232	46,946
2017	-	-	-	-	-	1,610	10,168	27,867	50,244	55,202
2018	-	-	-	-	-	-	251	3,555	22,235	37,270
2019	-	-	-	-	-	-	-	216	13,936	25,751
2020	-	-	-	-	-	-	-	-	759	12,369
2021	-	-	-	-	-	-	-	-	-	361
									Total	\$ 444,135

Net reserves	\$ 465,954
Other reserves	54,239
Risk retention group	25,520
Discount adjustment	(12,398)
Total reserves	\$ 533,315

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

AVERAGE ANNUAL PERCENTAGE PAYOUT OF INCURRED CLAIMS (UNAUDITED)

Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10 and Prior
0.7%	9.9%	13.2%	21.0%	16.4%	10.9%	6.3%	4.5%	4.2%	12.9%

In addition, the following table shows the total of IBNR plus expected development on reported claims by incident year and the cumulative number of reported claims by incident year. The cumulative number of reported claims are counted on a per occurrence and per coverage basis. Claim counts include open claims, claims that have been paid and closed, and asserted reported claims that have been closed without the need for any payment.

Incident Year	Incurred Claim Loss and Adjustment Expenses for the Year Ended December 31, 2021	Total Incurred but Not Reported as of December 31, 2021	Cumulative Number of Claims Reported as of December 31, 2021
2012	\$ 71,924	\$ -	303
2013	72,457	-	275
2014	76,487	424	275
2015	79,273	1,697	301
2016	72,195	7,807	309
2017	100,146	27,440	295
2018	93,128	37,080	281
2019	109,126	55,237	331
2020	109,915	85,612	165
2021	125,438	115,880	83

The methodology for reserving and determining the reserve for loss and loss adjustment expenses, IBNR reserves, considers, among other things, the line of business, the number of years of experience and the age of the experience year being developed.

Loss development factors are also applied to the current evaluations of losses to project the ultimate incurred losses arising from each period of coverage. The selected loss development factors are based on the historical loss experience of UPMC. Therefore, it is assumed that the selected loss development factors coupled with UPMC's experience and actuarial support are appropriate to project the loss development that will be experienced.

The reserve for costs and claims adjustment expenses was based on the best data available to UPMC; however, these estimates are subject to a degree of inherent variability. It is possible that UPMC's actual incurred costs and claim adjustment expenses will not conform to the assumptions inherent in the determination of the liability; accordingly, the ultimate settlement of costs and the related claims adjustment expenses may vary from the estimates included in the consolidated financial statements.

The Medical Care Availability and Reduction of Error ("MCARE") Act was enacted by the legislature of the Commonwealth of Pennsylvania (the "Commonwealth") in 2002. This Act created the MCARE Fund, which replaced The Pennsylvania Medical Professional Liability Catastrophe Loss Fund (the "Medical CAT Fund"), as the agency for the Commonwealth to facilitate the payment of medical malpractice claims exceeding the primary layer of professional liability insurance carried by UPMC and other health care providers practicing in the Commonwealth.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

The MCARE Fund is funded on a “pay as you go basis” and assesses health care providers based on a percentage of the rates established by the Joint Underwriting Association (also a Commonwealth agency) for basic coverage. The MCARE Act of 2002 provides for a further reduction to the current MCARE coverage of \$500 per occurrence to \$250 per occurrence and the eventual phaseout of the MCARE Fund, subject to the approval of the Pennsylvania Insurance Commissioner. To date, the Pennsylvania Insurance Commissioner has deferred the change in coverage and eventual phaseout of the MCARE Fund to future years.

12. RELATED-PARTY TRANSACTIONS

UPMC monitors its relationships with related or affiliated entities on an ongoing basis. The most significant of these relationships is with the University in which UPMC purchases and sells certain services from and to the University. With shared academic and research objectives, UPMC provides financial support annually to the University to advance these objectives recognizing the long-term inherent benefit to UPMC’s core clinical operations. UPMC looks to the University to lead the efforts related to the academic and research support objectives of UPMC and believes that, while complementary to its mission, the support provided to the University for academics and research is not part of UPMC’s core operating activities of providing direct patient care or offering health insurance coverage. For the years ended December 31, 2021 and 2020, UPMC incurred expenses of \$240,300 and \$227,409, respectively, for academic and research support. Payments to the University that are core to UPMC’s missions related to providing clinical care and insurance coverage totaled \$208,854 and \$229,242 for the years ended December 31, 2021 and 2020, respectively, which includes clinical services rendered by certain faculty and medical residents, facility rental agreements and other related services, and are reflected within operating expense.

13. LEASES

UPMC has operating and finance leases for corporate offices, physician offices and various equipment types, among others. These lease arrangements have remaining lease terms of one year to 25 years, some of which include options to extend the leases for several periods, and some of which include options to terminate the leases within one year. Balance sheet information related to leases were as follows:

	Year Ended December 31	
	2021	2020
Finance lease cost:		
Depreciation	\$ 26,975	\$ 26,037
Interest on lease liabilities	2,115	2,638
Total finance lease cost	29,090	28,675
Operating lease cost	152,068	142,887
Short-term/variable lease cost	30,554	37,596
Total	\$ 211,712	\$ 209,158

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

Supplemental balance sheet information related to leases was as follows:

	Year Ended December 31	
	2021	2020
OPERATING LEASES		
Operating lease right-of-use assets	\$ 976,026	\$ 1,033,598
Other current liabilities	127,194	119,135
Operating lease liabilities	895,949	963,812
Total operating lease liabilities	\$ 1,023,143	\$ 1,082,947
FINANCE LEASES		
Property, plant and equipment, net	\$ 60,501	\$ 74,143
Other current liabilities	24,555	24,245
Other noncurrent liabilities	47,269	54,866
Total finance lease liabilities	\$ 71,824	\$ 79,111
WEIGHTED AVERAGE REMAINING LEASE TERM		
Operating leases	11.7 years	12.8 years
Finance leases	7.4 years	7.3 years
WEIGHTED AVERAGE DISCOUNT RATE		
Operating leases	2.9%	3.0%
Finance leases	2.9%	3.1%

Undiscounted maturities of lease liabilities were as follows:

For the Years Ended December 31	Operating Leases	Finance Leases
2022	\$ 148,097	\$ 24,446
2023	138,096	15,983
2024	120,988	8,111
2025	103,140	3,383
2026	92,316	1,983
Thereafter	615,932	47,629
Total undiscounted maturities of lease liabilities	\$ 1,218,569	\$ 101,535
Less: discount on lease liabilities	(195,426)	(29,711)
Total lease liabilities	\$ 1,023,143	\$ 71,824

14. INCOME TAXES

UPMC calculates income taxes using the balance sheet method for its taxable subsidiaries. Taxable income differs from pretax book income principally due to certain income and deductions for tax purposes being recorded in the financial statements in different periods. Deferred income tax assets and liabilities are recorded for the tax effect of these differences using enacted tax rates for the years in which the differences are expected to reverse. UPMC assesses the realization of deferred tax assets and the need for a valuation allowance to reduce those assets to their net realizable value based on future operations, reversal of existing temporary differences, carryforward and carryback periods for credits and net operating losses, and potential tax planning strategies that may exist.

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(DOLLARS IN THOUSANDS)

As of December 31, 2021, the for-profit entities of UPMC had gross federal net operating loss (“NOL”) carryforwards of \$799,670 (expiring in years 2022 through 2041) and gross state NOL carryforwards of \$1,754,109 (expiring in years 2022 through 2041) that are available to offset future taxable income. Utilization of the state NOL carryforwards in any one year is limited to 40% of taxable income on an annual basis per company. Non-insurance NOL’s generated subsequent to December 31, 2017, carryforward indefinitely. During the calendar years ended December 31, 2021 and 2020, UPMC generated future tax benefits of \$30,304 and \$18,210, respectively, from the use of NOL carryforwards.

The following is a reconciliation of income taxes computed at the statutory U.S. federal income tax rate to the actual effective income tax expense:

Years Ended December 31	2021	2020
Taxes computed at the federal rate	\$ (60,405)	\$ 41,783
State income taxes, net of federal tax benefit	1,384	1,052
Valuation allowance	58,291	(10,773)
Permanent differences	4,730	(28,687)
Other items, net	2,032	1,719
Income tax expense	\$ 6,032	\$ 5,094

The following table presents deferred tax assets as of December 31, 2021 and 2020:

	2021	2020
Deferred tax assets:		
Net operating losses	\$ 306,814	\$ 226,909
Accrued benefits	18,922	17,439
Other	33,895	17,472
	359,631	261,820
Less valuation allowance	(359,631)	(261,820)
	\$ -	\$ -

Tax benefits are recognized when it is more likely than not that a tax position will be sustained upon examination by the tax authorities based on the technical merits of the position. Such tax positions are measured as the largest amount of tax benefit that is greater than 50% likely to be realized upon ultimate settlement with the tax authorities assuming full knowledge of the position and all relevant facts. As of December 31, 2021 and 2020, there were no uncertain tax positions. Certain of UPMC’s subsidiaries are subject to taxation in the United States and foreign jurisdictions. As of December 31, 2021, UPMC’s returns for the calendar years ended December 31, 2018 through December 31, 2020, are open for examination by the various taxing authorities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

15. FUNCTIONAL EXPENSES

UPMC provides general health care services primarily to residents within its geographic locations and supports related research and education programs. For the years ended December 31, 2021 and 2020, expenses related to providing these services were as follows:

FOR THE YEAR ENDED DECEMBER 31, 2021

	Hospital & health care services	Insurance services	Academic & research activities	UPMC Enterprises activity	Admin support	Total
Salaries, professional fees and employee benefits	\$ 6,718,365	\$ 537,570	\$ -	\$ -	\$ 951,496	\$ 8,207,431
Insurance claims expense	-	8,469,749	-	-	-	8,469,749
Supplies, purchased services and general	4,916,400	846,517	-	-	394,085	6,157,002
Depreciation and amortization	504,900	11,330	-	-	173,159	689,389
Academic and research support provided	-	-	240,300	-	-	240,300
Income tax expense	-	-	-	-	6,032	6,032
Interest expense	161,976	-	-	-	-	161,976
Portfolio company and development expense	-	-	86,582	113,203	-	199,785
	\$ 12,301,641	\$ 9,865,166	\$ 326,882	\$ 113,203	\$ 1,524,772	\$ 24,131,664

FOR THE YEAR ENDED DECEMBER 31, 2020

	Hospital & health care services	Insurance services	Academic & research activities	UPMC Enterprises activity	Admin support	Total
Salaries, professional fees and employee benefits	\$ 6,356,072	\$ 511,334	\$ -	\$ -	\$ 911,044	\$ 7,778,450
Insurance claims expense	-	7,915,612	-	-	-	7,915,612
Supplies, purchased services and general	4,491,307	844,079	-	-	500,115	5,835,501
Depreciation and amortization	506,891	14,597	-	-	164,097	685,585
Academic and research support provided	-	-	227,409	-	-	227,409
Income tax expense	-	-	-	-	5,094	5,094
Interest expense	177,244	-	-	-	-	177,244
Portfolio company and development expense	-	-	116,889	84,703	-	201,592
	\$ 11,531,514	\$ 9,285,622	\$ 344,298	\$ 84,703	\$ 1,580,350	\$ 22,826,487

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

16. UPMC ENTERPRISES ACTIVITY

UPMC Enterprises conducts research, development and innovation activities on behalf of UPMC primarily focused on technologies for use in the health care industry to lower costs and improve care; such activities are expensed as incurred. From time to time, UPMC invests in companies that are developing technologies that align with its strategic imperatives, including companies that are not yet at the commercialization stage. UPMC's level of investment is dependent on numerous strategic considerations and may provide either a controlling or a non-controlling ownership interest. UPMC Enterprises also seeks partnerships with external companies to accelerate commercial growth of innovation activities, which may include the sale of internally developed technology solutions. Leveraging UPMC's long-standing reputation for academic and research excellence, UPMC Enterprises also sponsors the translation of basic science conducted in a research setting to its commercial use in bedside clinical practice, application in medical laboratories or use across emerging venues where medicine is delivered; such activities are expensed as incurred.

UPMC Enterprises activity is comprised of the following for the years ended December 31:

	2021	2020
Technology research and development costs	\$ (48,211)	\$ (70,962)
Investments in translational sciences	(38,371)	(45,927)
Revenue from portfolio companies with controlling interest	37,828	36,521
Expenses of portfolio companies with controlling interest	(108,251)	(87,424)
Net loss from non-consolidated interest in portfolio companies	(4,952)	2,721
Net gains from technology-related investments	233,654	16,994
UPMC Enterprises activity	\$ 71,697	\$ (148,077)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS)

17. CONTINGENCIES

On October 9, 2012, UPMC received a Civil Investigative Demand (“CID”) from the Department of Justice (“DOJ”) that sought records relating to 40 surgical procedures performed between January 25, 2008 and June 24, 2010. UPMC timely responded to that CID. In November 2013, the DOJ advised UPMC that the CID had been served as part of the DOJ’s investigation of allegations asserted by Relators in a federal qui tam lawsuit filed under seal. On July 27, 2016, the DOJ announced that it had reached an agreement with UPMC to settle certain allegations that UPMC had violated the False Claims Act for approximately \$2,500. UPMC admitted no liability in settling those claims. The DOJ declined to intervene in the remaining allegations of the Relators’ lawsuit, which was also unsealed on July 27, 2016. In their Second Amended Complaint against UPMC and UPP, Inc., Relators allege that UPMC violated the False Claims Act by overpaying physicians and encouraging physicians to perform medically unnecessary procedures. After fact discovery and expert discovery concluded, motions for summary judgment were filed in October 2021 with briefing concluding in December 2021. The outcome and ultimate effect on UPMC’s condensed consolidated financial statements cannot be determined at this time.

On July 29, 2019, UPMC received two grand jury subpoenas and an unexecuted search warrant from the DOJ seeking various records from one of UPMC’s clinical departments. On or about September 2, 2021, the United States filed a Complaint in Partial Intervention against UPMC, UPP and a UPMC cardiothoracic surgeon, in the matter previously filed under seal in the United States District Court of the Western District of Pennsylvania as U.S. ex. rel. Jonathan D’Cunha, M.D. v. UPMC et al, alleging that the Defendants violated the False Claims Act by, inter alia, performing concurrent surgeries. UPMC plans to zealously defend against the United States’ claims. On November 1, 2021, Defendants moved to dismiss the United States’ claims, contending, among other things, that no federal regulations prohibit the surgeons from conducting concurrent or overlapping surgeries in the manner that they do. The American Hospital Association (“AHA”) and the Hospital & Healthsystem Association of Pennsylvania (“HAP”) filed a friend-of-the-court brief in support of the Defendants’ motion, which criticized the government’s attempt to impose its “own view of proper medicine” over hospitals, particularly when experts have deemed such surgeries to be safe and a practice that allows more patients to receive necessary health care. The ultimate outcome and effect on UPMC’s condensed consolidated financial statements cannot be determined at this time.

On or about December 15, 2020, a current employee filed a claim against UPMC, the University of Pittsburgh and other defendants, contending that the Defendants retaliated against him for authoring an article asserting that the medical profession discriminates against applicants from underrepresented races and ethnicities. On April 11, 2021, the UPMC Defendants moved to dismiss most of the claims in the Complaint. On December 21, 2021, the Court entered an Order granted the UPMC Defendants motion in part and denying it in part and provided the employee with leave to amend certain of his claims. On January 11, 2022, the employee filed an Amended Complaint that would ultimately assert two claims. On January 25, 2022, the UPMC Defendants moved to dismiss one of the claims and answered the other. The ultimate outcome and effect on UPMC’s condensed consolidated financial statements cannot be determined at this time.

On or about March 9, 2021, Vince Ranalli and Lou Ranalli filed a putative class action in the Allegheny County Court of Common Pleas against UPMC and a local law firm that UPMC had retained. The lawsuit alleges that a data breach at the law firm exposed the plaintiffs’ personal medical and financial information. Michael Bowen was later substituted as the named plaintiff. The parties have reached a tentative settlement that will result in no material impact to UPMC’s financial condition.

18. SUBSEQUENT EVENTS

Management evaluated events occurring subsequent to December 31, 2021 through February 28, 2022, the date the consolidated financial statements of UPMC were issued. During this period, there were no subsequent events requiring recognition or disclosure in the consolidated financial statements.

Supplemental Information

UPMC
Supplemental Consolidating Balance Sheet
As of December 31, 2021
(IN THOUSANDS)

	UPMC Western Maryland	Western Maryland Health System Foundation	Haystack Consolidated Services	All Other Western Maryland	Total Western Maryland	All Other UPMC	Total UPMC
Cash and cash equivalents	\$ 12,000	\$ (348)	\$ -	\$ 3,477	\$ 15,129	\$ 915,247	\$ 930,376
Patient accounts receivable	53,771	-	-	-	53,771	1,350,924	1,404,695
Insurance and other receivables	2,863	12	1,212	4,980	9,067	1,625,457	1,634,524
Other current assets	(3,885)	(3)	-	1	(3,887)	595,457	591,570
Total current assets	\$ 64,749	\$ (339)	\$ 1,212	\$ 8,458	\$ 74,080	\$ 4,487,085	\$ 4,561,165
Board-designated, restricted, trustee and other investments	6,921	16,642	-	13,751	37,314	9,729,235	9,766,549
Beneficial interests in foundations and trusts	-	2,388	-	-	2,388	781,391	783,779
Property, buildings and equipment:							
Land and land improvements	14,294	-	-	-	14,294	518,270	532,564
Buildings and fixed equipment	187,142	-	-	-	187,142	8,127,157	8,314,299
Movable equipment	39,332	-	-	1,851	41,183	3,253,738	3,294,921
Finance leases	-	-	-	-	-	194,118	194,118
Construction in progress	6,805	-	-	-	6,805	583,280	590,085
	247,573	-	-	1,851	249,424	12,676,563	12,925,987
Less allowance for depreciation	(39,713)	-	-	(1,796)	(41,509)	(6,673,882)	(6,715,391)
	\$ 207,860	\$ -	\$ -	\$ 55	\$ 207,915	\$ 6,002,681	\$ 6,210,596
Operating lease right-of-use assets	-	-	-	-	-	976,026	976,026
Other assets	124,453	448	-	(614)	124,287	666,013	790,300
Total assets	\$ 403,983	\$ 19,139	\$ 1,212	\$ 21,650	\$ 445,984	\$ 22,642,431	\$ 23,088,415
				\$ -	\$ -	\$ -	\$ -
Accounts payable and accrued expenses	\$ 8,248	\$ -	\$ -	\$ 71	\$ 8,319	\$ 775,158	\$ 783,477
Accrued salaries and related benefits	2,558	-	-	-	2,558	960,518	963,076
Current portion of insurance reserves	-	-	-	9,205	9,205	1,009,213	1,018,418
Current portion of long-term obligations	-	-	-	-	-	280,793	280,793
Other current liabilities	59,328	1,783	-	(146)	60,965	1,510,816	1,571,781
Total current liabilities	\$ 70,134	\$ 1,783	\$ -	\$ 9,130	\$ 81,047	\$ 4,536,498	\$ 4,617,545
Long-term obligations	782	-	-	-	782	5,300,067	5,300,849
Pension liability	-	-	-	-	-	-	-
Long-term insurance reserves	30	-	-	-	30	429,152	429,182
Operating lease noncurrent liabilities	-	-	-	-	-	895,949	895,949
Other noncurrent liabilities	5,324	-	-	-	5,324	561,206	566,530
Total liabilities	\$ 76,270	\$ 1,783	\$ -	\$ 9,130	\$ 87,183	\$ 11,722,872	\$ 11,810,055
Net assets without donor restrictions	326,825	8,682	1,212	12,520	349,239	9,534,458	9,883,697
Net assets with donor restrictions	888	8,674	-	-	9,562	1,385,101	1,394,663
Total net assets	\$ 327,713	\$ 17,356	\$ 1,212	\$ 12,520	\$ 358,801	\$ 10,919,559	\$ 11,278,360
Total liabilities and net assets	\$ 403,983	\$ 19,139	\$ 1,212	\$ 21,650	\$ 445,984	\$ 22,642,431	\$ 23,088,415

UPMC
Supplemental Consolidating Statement of Operations
For the Year Ended December 31, 2021
(IN THOUSANDS)

	UPMC Western Maryland	Western Maryland Health System Foundation	Haystack Consolidated Services	All Other Western Maryland	Total Western Maryland	All Other UPMC	Total UPMC
Net patient service revenue	\$ 354,488	\$ -	\$ -	\$ -	\$ 354,488	\$ 9,651,068	\$ 10,005,556
Insurance enrollment revenue	-	-	-	-	-	12,110,124	12,110,124
Other revenue	11,405	2,990	-	2,705	17,100	2,233,704	2,250,804
Total operating revenues	\$ 365,893	\$ 2,990	\$ -	\$ 2,705	\$ 371,588	\$ 23,994,896	\$ 24,366,484
Salaries, professional fees and employee benefits	196,164	191	-	-	196,355	8,011,076	8,207,431
Insurance claims expense	1,634	-	-	-	1,634	8,468,115	8,469,749
Supplies, purchased services and general	105,818	2,900	-	123	108,841	6,048,161	6,157,002
Depreciation and amortization	23,425	-	-	37	23,462	665,927	689,389
Total operating expenses	327,041	3,091	-	160	330,292	23,193,279	23,523,571
Operating income	\$ 38,852	\$ (101)	\$ -	\$ 2,545	\$ 41,296	\$ 801,617	\$ 842,913
Academic and research support provided	-	-	-	-	-	(240,300)	(240,300)
Inherent contribution	-	-	-	-	-	-	-
Other non-operating activities	1	-	-	(320)	(319)	87,490	87,171
Income tax expense	-	-	-	-	-	(6,032)	(6,032)
After-tax income	\$ 38,853	\$ (101)	\$ -	\$ 2,225	\$ 40,977	\$ 642,775	\$ 683,752
Investing and financing activities:							
Investment gain	3,913	1,452	-	2,421	7,786	894,783	902,569
Interest expense	(6,189)	-	-	-	(6,189)	(155,787)	(161,976)
(Loss) gain on extinguishment of debt	-	-	-	-	-	(2,342)	(2,342)
UPMC Enterprises activity:							
Portfolio company revenue and net gains from sales	-	-	-	-	-	271,482	271,482
Portfolio company and research and development expense	-	-	-	-	-	(199,785)	(199,785)
Gain from investing and financing activities	\$ (2,276)	\$ 1,452	\$ -	\$ 2,421	\$ 1,597	\$ 808,351	\$ 809,948
Excess of revenues over expenses	36,577	1,351	-	4,646	42,574	1,451,126	1,493,700
Excess of revenues over expenses attributable to noncontrolling interest	-	-	-	-	2,291	31,383	33,674
Excess of revenues over expenses attributable to controlling interest	\$ 36,577	\$ 1,351	\$ -	\$ 4,646	\$ 40,283	\$ 1,419,743	\$ 1,460,026