# UPMC AUDITED CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2012

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UPMC LIFE CHANGING MEDICINE

# REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

**The Board of Directors**
**UPMC**
**Pittsburgh, Pennsylvania**

We have audited the accompanying consolidated balance sheets of UPMC and subsidiaries as of June 30, 2012 and 2011, and the related consolidated statements of operations and changes in net assets and cash flows for each of the two years in the period ended June 30, 2012. These financial statements are the responsibility of the UPMC and subsidiaries' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of UPMC and subsidiaries at June 30, 2012 and 2011, and the consolidated results of their operations and their cash flows for each of the two years in the period ended June 30, 2012, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, UPMC and subsidiaries adopted the guidance provided by Accounting Standards Codification 954-310, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*, and Accounting Standards Update 2011-08, *Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment*, effective July 1, 2011.

We also have audited, in accordance with attestation standards established by the American Institute of Certified Public Accountants and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States), UPMC and subsidiaries' internal control over financial reporting as of June 30, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated September 6, 2012, expressed an unqualified opinion thereon.

Ernst + Young LLP

**Pittsburgh, Pennsylvania**
**September 6, 2012**

# CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS)

| | June 30 2012 | 2011 |
|---|---|---|
| **CURRENT ASSETS** | | |
| Cash and cash equivalents | **$ 245,824** | $ 386,718 |
| Patient accounts receivable, net of allowance for uncollectible accounts of $130,632 and $120,461 at June 30, 2012 and 2011, respectively | **602,911** | 532,548 |
| Other receivables | **489,319** | 380,415 |
| Other current assets | **120,687** | 99,412 |
| Total current assets | **1,458,741** | 1,399,093 |
| Board-designated, restricted, trusteed, and other investments | **3,725,440** | 3,564,421 |
| Beneficial interests in foundations | **325,525** | 344,344 |
| Property, buildings, and equipment: | | |
| Land and land improvements | **312,909** | 305,921 |
| Buildings and fixed equipment | **4,169,085** | 3,906,346 |
| Movable equipment and internal-use software development costs | **2,078,151** | 2,135,235 |
| Capital leases | **154,772** | 174,706 |
| Construction in progress | **392,770** | 236,192 |
| | **7,107,687** | 6,758,400 |
| Less allowance for depreciation | **(3,512,106)** | (3,318,957) |
| | **3,595,581** | 3,439,443 |
| Other assets | **376,184** | 376,201 |
| Total assets | **$ 9,481,471** | $ 9,123,502 |
| **CURRENT LIABILITIES** | | |
| Accounts payable and accrued expenses | **$ 412,732** | $ 379,451 |
| Accrued salaries and related benefits | **445,728** | 397,493 |
| Current portion of insurance reserves | **291,899** | 283,336 |
| Current portion of long-term obligations | **172,720** | 263,788 |
| Other current liabilities | **344,481** | 245,255 |
| Total current liabilities | **1,667,560** | 1,569,323 |
| Long-term obligations | **3,020,264** | 2,976,925 |
| Pension liability | **240,470** | 155,042 |
| Long-term insurance reserves | **228,857** | 199,028 |
| Other long-term liabilities | **149,101** | 160,676 |
| Total liabilities | **5,306,252** | 5,060,994 |
| Unrestricted net assets | **3,602,674** | 3,489,251 |
| Restricted net assets | **572,545** | 573,257 |
| Total net assets | **4,175,219** | 4,062,508 |
| Total liabilities and net assets | **$ 9,481,471** | $ 9,123,502 |

*See accompanying notes*

# CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS

(IN THOUSANDS)

| | Year Ended June 30 2012 | 2011 |
|---|---|---|
| **UNRESTRICTED NET ASSETS** | | |
| Net patient service revenue: | | |
| Patient service revenue (net of contractual allowances and discounts) | **$ 5,491,950** | $ 5,045,466 |
| Provision for bad debts | **(233,995)** | (198,510) |
| Net patient service revenue less provision for bad debts | **5,257,955** | 4,846,956 |
| Insurance enrollment revenue | **3,642,733** | 3,323,550 |
| Other revenue | **735,933** | 632,029 |
| Total operating revenues | **9,636,621** | 8,802,535 |
| Expenses: | | |
| Salaries, professional fees, and employee benefits | **3,724,710** | 3,258,938 |
| Supplies, purchased services, and general | **5,166,104** | 4,743,034 |
| Depreciation and amortization | **394,521** | 394,538 |
| Total operating expenses | **9,285,335** | 8,396,510 |
| Operating income (excluding inherent contribution - Hamot affiliation, income tax expense and asset impairment charge and other) | **351,286** | 406,025 |
| Inherent contribution - Hamot affiliation | **(1,328)** | 60,868 |
| Income tax expense | **(2,876)** | (8,429) |
| Asset impairment charge and other | **692** | (12,643) |
| After-tax operating income | **$ 347,774** | $ 445,821 |
| Investing and financing activities: | | |
| Investment (loss) revenue | **(6,459)** | 403,528 |
| Interest expense | **(120,605)** | (122,534) |
| (Loss) gain from investing and financing activities | **(127,064)** | 280,994 |
| Excess of revenues over expenses | **220,710** | 726,815 |
| Other changes in unrestricted net assets: | | |
| (Increase) decrease in postretirement benefits liabilities | **(89,083)** | 124,641 |
| Assets released from restriction for capital purchases | **5,153** | 24,626 |
| Other changes in unrestricted net assets | **(23,357)** | (2,032) |
| Increase in unrestricted net assets | **113,423** | 874,050 |
| **RESTRICTED NET ASSETS** | | |
| Contributions | **28,675** | 7,365 |
| Net realized and unrealized (losses) gains on restricted investments | **(1,416)** | 17,421 |
| Assets released from restriction for operations and capital purchases | **(9,152)** | (9,178) |
| Restricted net assets acquired | **-** | 88,587 |
| Net (decrease) increase in beneficial interests in foundations | **(18,819)** | 52,091 |
| (Decrease) increase in restricted net assets | **(712)** | 156,286 |
| Increase in net assets | **112,711** | 1,030,336 |
| Net assets, beginning of period | **4,062,508** | 3,032,172 |
| Net assets, end of period | **$ 4,175,219** | $ 4,062,508 |

*See accompanying notes*

# CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

| | Year Ended June 30 | |
|---|---|---|
| | **2012** | 2011 |
| **OPERATING ACTIVITIES** | | |
| Increase in net assets | **$ 112,711** | $ 1,030,336 |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | **394,521** | 394,538 |
| Provision for bad debts | **233,995** | 198,510 |
| Asset impairment charge and other | **(9,282)** | (2,517) |
| Change in beneficial interest in foundations | **18,819** | (52,091) |
| Net change in pension liability | **85,428** | (145,310) |
| Restricted contributions and investment income | **(27,259)** | (24,786) |
| Inherent contribution - Hamot affiliation | **1,328** | (60,868) |
| Restricted net assets acquired | **-** | (88,587) |
| Net change in trading securities | **(145,865)** | (390,922) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | **(413,262)** | (266,481) |
| Other current assets | **(21,275)** | 15,420 |
| Accounts payable and accrued liabilities | **83,818** | 77,605 |
| Other current liabilities | **99,387** | 5,420 |
| Insurance reserves | **37,798** | 3,518 |
| Other noncurrent liabilities | **(11,995)** | (18,606) |
| Net cash provided by operating activities | **438,867** | 675,179 |
| **INVESTING ACTIVITIES** | | |
| Purchase of property and equipment (net of disposals) | **(589,093)** | (428,871) |
| Investments in joint ventures | **(27,000)** | (14,150) |
| Net (increase) decrease in investments designated as nontrading | **(15,154)** | 3,943 |
| Cash acquired in Hamot affiliation | **-** | 13,892 |
| Net decrease in other assets | **39,406** | 8,915 |
| Net cash used in investing activities | **(591,841)** | (416,271) |
| **FINANCING ACTIVITIES** | | |
| Repayments of long-term obligations | **(232,669)** | (148,393) |
| Borrowings of long-term obligations | **217,490** | 93,350 |
| Restricted contributions and investment income | **27,259** | 24,786 |
| Net cash provided by (used in) financing activities | **12,080** | (30,257) |
| Net change in cash and cash equivalents | **(140,894)** | 228,651 |
| Cash and cash equivalents, beginning of period | **386,718** | 158,067 |
| Cash and cash equivalents, end of period | **$ 245,824** | $ 386,718 |

*See accompanying notes.*

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(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 ("Code") as an organization described in Section 501(c)(3) of the Code. Headquartered in Pittsburgh, Pennsylvania, UPMC is one of the leading integrated delivery and financing systems in the United States. UPMC is an integrated global health enterprise leveraging medical expertise, geographic reach, and financial stability in a model of care excellence that can transform health care nationally and internationally. 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 ("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 consolidated financial statements include the accounts of UPMC and its subsidiaries. The consolidated financial statements are comprised of domestic and foreign nonprofit and for-profit entities that maintain separate books and records as part of their legal incorporation. Intercompany accounts and transactions are eliminated in consolidation.

### Cash and Cash Equivalents

Cash and cash equivalents consist primarily of cash and investments, which are so near to maturity (maturity of three months or less when purchased) that they present insignificant risk of changes in value.

### Net Patient Service Revenue and Accounts Receivable

Net patient service revenue is reported at estimated net realizable amounts in the period in which services are provided. The majority of UPMC's services are rendered to patients under Medicare, Highmark Blue Cross Blue Shield ("Highmark"), and Medical Assistance programs. Reimbursement under these programs is based on a combination of prospectively determined rates and historical costs. Amounts received under Medicare and Medical Assistance programs are subject to review and final determination by program intermediaries or their agents.

For the years ended June 30, 2012 and 2011, the percentage of patient service revenue, net of contractual allowances and discounts, derived from third-party payers and self-pay patients is as follows:

| | June 30 | |
|---|---|---|
| Year Ended | **2012** | 2011 |
| Third party | **94%** | 94% |
| Self-pay | **6%** | 6% |
| | **100%** | 100% |

In 2012 and 2011, the percentage of net patient service revenue derived from Medicare was approximately 33% and 30%, from Highmark was approximately 30% and 26%, and from Medical Assistance programs was approximately 11% and 11%, respectively.

Laws and regulations governing the Medicare and Medical Assistance programs are extremely complex and subject to interpretation. Compliance with such laws and regulations are subject to government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medical Assistance programs. As a result, there is at least a reasonable possibility that the recorded estimates may change.

Provisions for adjustments to net patient service revenue are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Net patient service revenue for 2012 and 2011 was increased by approximately $43,378 and $4,369, respectively, for prior-year settlements, including Medicaid disproportionate share hospital and supplemental security income payments as well as a rural floor budget neutrality appeal payment. See Note 2 for further discussion.

The provision for bad debts is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in health care coverage, and other collection indicators. UPMC records a provision for bad debts in the period services are provided related to self-pay patients, including both uninsured patients and patients with deductible and copayment balances due for which third-party coverage exists for a portion of their balance. Periodically throughout the year, management assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience. The results of this review are then used to make any modifications to the provision for bad debts to establish an appropriate allowance for uncollectible accounts. Accounts receivable are written off after collection efforts have been followed in accordance with internal policies. Significant concentrations of patient accounts receivable at June 30, 2012 and 2011, include: Medicare 31% and 31%, Highmark 17% and 18%, and Medical Assistance 18% and 18%, respectively.

### 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. UPMC's investments in debt and equity securities that are donor-restricted assets are designated as nontrading. Unrealized gains and losses on donor-restricted assets are recorded as changes in restricted net assets in the consolidated statements of operations and changes in net assets. Gains and losses on the sales of securities are determined by the average cost method. Realized gains and losses are included in investment revenue 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 Master Trust Funds ("MTF") and are summarized as nonalternative investments in Note 4.

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. 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. Amounts can be divested only at specified times. The financial statements of the limited partnerships are audited annually, generally as of December 31. These investments are summarized as alternative investments in Note 4.

Investments in limited partnerships that invest in nonmarketable securities (private equity) are primarily recorded at cost if the ownership percentage is less than 5% and are reported using the equity method of accounting if the ownership percentage is greater than 5%. These investments are periodically evaluated for impairment. These investments are summarized as alternative investments in Note 4.

### Financial Instruments

Cash and cash equivalents and investments recorded at fair value aggregate $2,230,808 and $2,429,493 at June 30, 2012 and 2011, respectively. The fair value of these instruments is based on market prices as estimated by financial institutions. The fair value of long-term debt at June 30, 2012 and 2011, is $3,383,968 and $3,243,383, respectively, based on market prices as estimated by financial institutions. The fair value of amounts owed to counterparties under derivative contracts at June 30, 2012 and 2011, is $27,861 and $17,338, respectively, based on pricing models that take into account the present value of estimated future cash flows.

### Beneficial Interests in Foundations

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 restricted net assets because the hospitals' use of these assets is at the discretion of the foundations' independent board of directors.

Beneficial interests in foundations of $325,525 and $344,344 and the net assets of consolidated foundations of $55,354 and $53,791 as of June 30, 2012 and 2011, 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 amortize the assets over their estimated useful lives (predominantly ranging from 3 to 40 years) and includes amortization related to capitalized leases. Certain newly constructed buildings have estimated useful lives up to 60 years.

### 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.

### 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. All other noncontrolled investments, generally less than 20% ownership, are carried at cost. Other assets include approximately $104,230 and $96,918 at June 30, 2012 and 2011, respectively, relating to investments in partnerships 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 June 30, 2012 and 2011, goodwill of $115,401 and $119,445, respectively, is recorded in UPMC's consolidated balance sheets as other assets. 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. In connection with recently adopted accounting guidance as discussed herein, UMPC has the option of performing a qualitative assessment of goodwill test utilizing a "more likely than not" concept. If UPMC determines that there is less than a 50% chance that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. If, however, after performing the qualitative assessment, UPMC determines that there is a greater than 50%chance that the fair value of a reporting unit is less than its carrying amount, then the two-step impairment test is necessary.

The impairment test for goodwill requires a comparison of the fair value of each reporting unit that has goodwill associated with its operations with its carrying amount, including goodwill. The impairment analysis includes estimating the fair market value of each of the reporting units that have goodwill associated with their operations using discounted cash flow and multiples of cash earnings valuation techniques, plus valuation comparisons to recent public sale transactions of similar businesses, if any. These valuation methods require UPMC to make estimates and assumptions regarding future operating results, cash flows, changes in working capital and capital expenditures, profitability, and the cost of capital. Although UPMC believes that the estimates and assumptions used are reasonable, actual results could differ from those estimates and assumptions.

## Health Insurance Revenue and Costs

UPMC's insurance subsidiaries (collectively, "Health Plans") provide health care services on a prepaid basis under various contracts. The Health Plans provide medical services to subscribing participants under agreements that provide for capitated payments based on the number of subscribing enrollees, regardless of the medical services actually performed. Insurance enrollment revenues are recognized as income in the period in which enrollees are entitled to receive health care services. Enrollment revenue from Medicare and Medical Assistance approximates 77% of total enrollment revenue for the years ended June 30, 2012 and 2011.

Health care costs were approximately $3,341,996 and $3,061,590, of which $868,898 and $771,654 were eliminated in consolidation representing medical services performed by other UPMC entities for the years ended June 30, 2012 and 2011, respectively. Such costs are included in supplies, purchased services, and general expenses. These costs include estimates of payments to be made on claims reported as of the balance sheet date and estimates of health care services rendered but not reported to the Health Plans. Such estimates include the cost of services that will continue to be rendered 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. Current accrued insurance reserves include approximately $209,201 and $203,647 at June 30, 2012 and 2011, respectively, relating to estimates of claims payable for health care services.

Unrestricted net assets required to meet statutory requirements of the Health Plans were $256,071 and $212,229 at June 30, 2012 and 2011, respectively.

## 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. UPMC has also entered into equity-related derivatives to manage the asset allocation in its investment portfolio. Under the equity index swap agreements, UPMC pays a fixed income-like return in order to receive an equity-like return. The notional amount of these swaps is based upon UPMC's target asset allocation. None of UPMC's swaps outstanding as of June 30, 2012 and 2011, are designated as hedging instruments and, as such, changes in fair value are recognized in investing and financing activities as investment revenue in the consolidated statements of operations and changes in net assets.

### Restricted Net Assets

Unconditional promises to give cash and other assets are reported at fair value as of the date the promise is received. Conditional promises to give are reported at fair value at the date the condition is met. Contributions are reported as restricted if they are received with donor stipulations that limit the use of the donated assets.

Restricted net assets include $194,829 and $184,547 of permanently restricted net assets held in perpetuity at June 30, 2012 and 2011, respectively. The remainder of restricted net assets is temporarily restricted and primarily represents beneficial interests in foundations that support research and other health care programs. Temporarily restricted net assets are limited by donors and the foundations to a specific time period or purpose. Temporarily restricted net assets are reclassified to unrestricted net assets 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.

### 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 unrestricted net assets except for contributions and distributions from foundations for the purchase of property and equipment, adjustments for pension liability, discontinued operations, and the cumulative effect of changes in accounting principles.

### 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.

### Reclassifications

Certain reclassifications, including the effect of applying the guidance in Accounting Standards Codification ("ASC") 954-310 as described below were made to the 2011 accompanying financial statements to conform to the 2012 presentation. These reclassifications had no impact on the changes in net assets or excess of revenues over expenses previously reported.

### New Accounting Pronouncements

Effective July 1, 2011, UPMC early adopted the guidance provided by Accounting Standards Update ("ASU") 2011-08, *Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment,* issued by the Financial Accounting Standards Board ("FASB"), which simplifies how an entity tests goodwill for impairment. The amendments permit an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Accordingly, an entity will no longer be required to calculate the fair value of a reporting unit in the step one test unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount.

Effective July 1, 2011, UPMC early adopted the guidance provided by ASC 954-310, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities.* The guidance requires certain health care entities to present the bad debt expense associated with patient service revenue as a deduction from patient service revenue (net of contractual allowances and discounts) rather than as operating expense.

In July 2011, the FASB issued ASU 2011-06, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Health Insurers*. ASU 2011-06 addresses the timing, recognition, and classification of the annual health insurance industry assessment fee imposed on health insurers by the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (collectively, "PPACA"). The mandatory annual fee of health insurers will be imposed for each calendar year beginning on or after January 1, 2014. This update requires that the liability for the fee be estimated and recorded in full once the entity provides qualifying health insurance in the applicable calendar year in which the fee is payable with a corresponding deferred cost that is amortized to expense using a straight-line method of allocation unless another method better allocates the fee over the calendar year that it is payable. Although the federally mandated annual fee will be material, the adoption of ASU 2011-06 is not expected to materially affect UPMC's financial position or results of operations.

In December 2011, the FASB issued ASU 2011-11, *Disclosures about Offsetting Assets and Liabilities (Topic 210)*, that describes certain new disclosure requirements about the nature of an entity's rights of setoff and related arrangements associated with its financial instruments and derivative instruments. The disclosure requirements are effective for annual reporting periods beginning on or after January 1, 2013, and interim periods therein, with retrospective application required. UPMC will apply the guidance provided by ASU 2011-11 beginning on July 1, 2013.

## 2. SIGNIFICANT TRANSACTIONS

Under certain provisions of the American Recovery and Reinvestment Act of 2009, federal incentive payments are available to hospitals, physicians and certain other professionals ("providers") when they adopt certified electronic health record ("EHR") technology or become "meaningful users" of EHRs in ways that demonstrate improved quality, safety and effectiveness of care. Medicaid providers can receive their initial incentive payment by adopting, implementing, or upgrading certified EHR technology but must demonstrate meaningful use of EHRs in subsequent years in order to qualify for additional payments. Hospitals may be eligible for both Medicare and Medicaid EHR incentive payments; however, physicians and other professionals may be eligible for either Medicare or Medicaid incentive payments. Medicaid EHR incentive payments to providers are 100% federally funded and administered by the states; however, the states are not required to offer EHR incentive payments to providers. The Centers for Medicare and Medicaid Services ("CMS") established calendar year 2011 as the first year states could offer EHR incentive payments. UPMC is entitled to receive Medicare and Medicaid incentive payments for the adoption of certified EHR technology for its eligible hospitals and employed physicians as UPMC has satisfied the statutory and regulatory requirements. As a result, during the year ended June 30, 2012, UPMC recognized, as part of other revenue, $66,892 of meaningful use revenue. Also, if UPMC satisfies specified meaningful use criteria in future periods, UPMC may become entitled to additional incentive payments.

In April 2012, certain of UPMC's hospitals, the United States Department of Health and Human Services and CMS reached a settlement agreement that corrects the calculations of Medicare reimbursements that were provided to certain UPMC hospitals under the Medicare program's inpatient prospective payment system for federal fiscal years 1998 through 2011. As a result of the settlement, UPMC recognized an increase in net patient service revenue and operating income of $26,122 and $23,023, respectively, during the year ended June 30, 2012.

## 3. 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 from the patient. 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 $96,225 and $96,523 for the years ended June 30, 2012 and 2011, 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
(IN THOUSANDS)

## 4. CASH AND INVESTMENTS

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

| | June 30 | |
|---|---|---|
| | **2012** | 2011 |
| Internally designated: | | |
| Funded depreciation | **$ 12,113** | $ 12,231 |
| Employee benefit and workers' compensation self-insurance programs | **52,070** | 47,850 |
| Professional and general liability insurance program | **324,270** | 302,206 |
| Health insurance programs | **490,904** | 448,667 |
| | **879,357** | 810,954 |
| Externally designated: | | |
| Trusteed assets for capital and debt service payments | **14,391** | 16,382 |
| Donor-restricted assets | **228,520** | 213,366 |
| | **242,911** | 229,748 |
| Other long-term investments | **2,603,172** | 2,523,719 |
| Board-designated, restricted, trusteed, and other investments | **3,725,440** | 3,564,421 |
| Cash and cash equivalents | **245,824** | 386,718 |
| | **$ 3,971,264** | $ 3,951,139 |

Following is a summary of the composition of cash and investments. The table below shows all of UPMC's investments, including nonalternative investments measured at fair value and alternative investments using either the cost or equity method of accounting.

| | June 30 | |
|---|---|---|
| | **2012** | 2011 |
| Cash and cash equivalents | **$ 245,824** | $ 386,718 |
| Nonalternative investments: | | |
| Fixed income | **1,020,926** | 980,483 |
| Domestic equity | **279,506** | 339,262 |
| International equity | **547,586** | 601,430 |
| Public real estate | **39,764** | 41,485 |
| Long/short equity | **60,892** | 40,008 |
| Commodities | **36,310** | 40,107 |
| | **1,984,984** | 2,042,775 |
| Alternative investments: | | |
| Long/short equity | **368,497** | 346,083 |
| Absolute return | **279,103** | 209,423 |
| Private equity | **824,914** | 730,646 |
| Private real estate | **155,670** | 129,132 |
| Natural resources | **112,272** | 106,362 |
| | **1,740,456** | 1,521,646 |
| | **$ 3,971,264** | $ 3,951,139 |

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Investments are primarily maintained in MTF and administered using a bank as trustee. As of June 30, 2012, UPMC utilized 165 external investment managers, including 26 traditional managers, 28 hedge fund managers, and 111 private equity managers. The largest allocation to any alternative investment fund is $43,560. 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.

As of June 30, 2012 and 2011, respectively, UPMC had total investments recorded at cost of $964,085 and $850,551. These investments include private equity limited partnerships recorded at cost, as well as assets recorded as other assets in the consolidated balance sheets.

Investment return from cash and investments is comprised of the following for the years ended June 30, 2012 and 2011, respectively:

| | Year Ended June 30 **2012** | 2011 |
|---|---|---|
| Interest income | **$ 31,043** | $ 42,507 |
| Dividend income | **28,549** | 27,571 |
| Net realized gains on sales of securities | **95,413** | 172,918 |
| | **155,005** | 242,996 |
| Unrealized investment (loss) gain | **(118,116)** | 189,962 |
| Impairment losses on limited partnerships | **(7,658)** | (19,700) |
| Derivative contracts mark to market | **(12,454)** | 12,454 |
| | **(138,228)** | 182,716 |
| Total investment gain | **16,777** | 425,712 |
| Traditional investment manager and trustee fees | **(23,236)** | (22,184) |
| Investment (loss) revenue | **$ (6,459)** | $ 403,528 |

Certain of UPMC's investments in debt and equity securities are designated as nontrading (donor-restricted assets). As of June 30, 2012 and 2011, respectively, UPMC had nontrading investments of $228,520 and $213,366.

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. Investment liquidity as of June 30, 2012, is shown below:

| Liquidity Availability | Cash and Cash Equivalents | Nonalternative Investments | Alternative Investments | Total |
|---|---|---|---|---|
| Within three days | $ 245,824 | $ 1,890,652 | $ – | $ 2,136,476 |
| Within 30 days | – | 94,332 | – | 94,332 |
| Within 60 days | – | – | 57,149 | 57,149 |
| Within 90 days | – | – | 273,045 | 273,045 |
| More than 90 days | – | – | 1,410,262 | 1,410,262 |
| Total | $ 245,824 | $ 1,984,984 | $ 1,740,456 | $ 3,971,264 |

(IN THOUSANDS)

## 5. CREDIT ARRANGEMENTS

UPMC has a revolving line and letter of credit facility (the "Revolving Facility") with an available line of $350,000 and an option to increase the aggregate commitment by $50,000 for a total available line of $400,000. The Revolving Facility expires on June 15, 2016. 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 UPMC Master Trust Indenture ("2007 UPMC MTI") and is secured by a pledge of and security interest in the gross revenues of UPMC parent corporation, UPMC Presbyterian Shadyside, Magee Women's Hospital of UPMC, UPMC Passavant, and UPMC St Margaret as members of the obligated group under the 1995 UPMC Master Trust Indenture ("1995 UPMC MTI").

Advances may be variable rate based on the prime rate or the Federal Funds effective rates, or advances may be fixed on the date of the advance based on the British Bankers' Association Interest Settlement Rate and the reserve requirement on Eurocurrency liabilities. No amounts were outstanding under the Revolving Facility as of June 30, 2012 and 2011.

As of June 30, 2012, UPMC has issued $80,013 of letters of credit under the Revolving Facility. These letters of credit predominantly support the capital requirements of certain insurance subsidiaries. As of June 30, 2012, there was $269,987 available to borrow under the Revolving Facility.

In addition to the Revolving Facility described above, UPMC has a revolving credit facility with an available line of €18,000 ($22,426) that is used to support the working capital needs of UPMC Beacon in Ireland. This line was fully drawn at June 30, 2012.

## 6. LONG-TERM OBLIGATIONS AND DERIVATIVE INSTRUMENTS

Long-term obligations consist of the following:

| | June 30 | |
|---|---|---|
| | **2012** | 2011 |
| Fixed rate revenue bonds | **$ 2,006,834** | $ 2,003,341 |
| Variable rate revenue bonds | **797,939** | 805,180 |
| Capital leases and other | **342,526** | 382,759 |
| Par value of long-term obligations | **3,147,299** | 3,191,280 |
| Net premium and other | **45,685** | 49,433 |
| | **3,192,984** | 3,240,713 |
| Less current portion | **(172,720)** | (263,788) |
| Total long-term obligations | **$ 3,020,264** | $ 2,976,925 |

Revenue instruments 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 bond proceeds were used for the purchase, construction, and renovation of hospital facilities, certain buildings and equipment, as well as the extinguishment of debt. Capital leases and other consist of capital leases that are secured by certain equipment and properties.

The fixed rate revenue instruments bear interest at fixed coupon rates ranging from 2.00% to 6.00% in 2012 and from 2.50% to 6.00% in 2011. The average interest cost for the variable rate instruments was 0.87% and 0.96% during fiscal years 2012 and 2011, respectively. Revenue instruments have varying principal payments and final maturities from 2015 through 2039. Certain revenue bonds are secured by bond insurance ($229,721 and $233,526 in 2012 and 2011, respectively). Reimbursement agreements ($202,103 and $255,890 in 2012 and 2011, respectively) provide loans to UPMC in the amount necessary to purchase the variable rate demand revenue bonds if not remarketed. The agreements have expiration and repayment dates beyond June 30, 2013.

(IN THOUSANDS)

Revenue instruments in the aggregate amount of debt outstanding of $2,773,128 and $2,784,428 as of June 30, 2012 and 2011, respectively, are issued under the 1995 UPMC MTI. Included in this amount are instruments totaling $2,614,120 and $2,615,388 as of June 30, 2012 and 2011, respectively, which are also secured under the 2007 UPMC MTI. The instruments are secured by a pledge of and security interest in gross revenues of each of the respective MTI obligated groups. Certain amounts borrowed under the 1995 UPMC 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 June 30, 2012 and 2011.

Aggregate maturities of long-term obligations for the next five years, assuming remarketing of UPMC's variable rate debt, are as follows:

| | |
|---|---|
| 2013 | $ 172,720 |
| 2014 | 128,199 |
| 2015 | 299,012 |
| 2016 | 194,917 |
| 2017 | 118,299 |

Interest paid, net of amounts capitalized, on all obligations was $133,442 and $131,990 during the years ended June 30, 2012 and 2011, respectively. Capitalized interest of $5,546 and $2,964 was recorded in 2012 and 2011, respectively.

UPMC uses derivatives to manage its exposure on its debt instruments and its asset allocation. 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.

UPMC maintains interest rate swap programs on certain of its revenue bonds in order to manage its interest rate risk. To meet this objective and to take advantage of low interest rates, UPMC entered into several 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 swap converts 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").

(IN THOUSANDS)

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 0.06% to 0.26% (weighted average rate of 0.15%) in 2012 and from 0.11% to 0.34% (weighted average rate of 0.26%) in 2011.

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

| Swap | Maturity Date | UPMC Pays | UPMC Receives | Notional Amount at June 30 2012 | 2011 |
|---|---|---|---|---|---|
| Floating to fixed | 2025 | 3.6% | 68% one-month LIBOR | **$ 134,735** | $ 141,030 |
| Basis | 2021 | SIFMA Index | 67% three-month LIBOR plus .2077% | **53,905** | 53,905 |
| Basis | 2037 | SIFMA Index | 67% three-month LIBOR plus .3217% | **46,095** | 46,095 |
| | | | | **$ 234,735** | $ 241,030 |

After giving effect to the above derivative transactions, UPMC's variable rate debt was approximately 21% of the total debt outstanding as of June 30, 2012 and 2011.

UPMC has also entered into equity-related derivative instruments to manage the asset allocation in its investment portfolio. Under the equity index swap agreements UPMC pays a fixed income-like return in order to receive an equity-like return. The notional amount of these swaps is based upon UPMC's target asset allocation.

The following table summarizes UPMC's equity swap agreements:

| Maturity Date | UPMC Pays | UPMC Receives | Notional Amount at June 30 2012 | 2011 |
|---|---|---|---|---|
| 2011 | Three-Month LIBOR plus .0600% | S&P 500 Total Return Index | **$ -** | $ 75,000 |
| 2012 | Three-Month LIBOR minus .2500% | MSCI EAFE Daily Total Return[1] | **-** | 50,001 |
| 2012 | Three-Month LIBOR plus .1700% | S&P 500 Total Return Index | **-** | 25,000 |
| 2013 | Three-Month LIBOR minus .2000% | MSCI EAFE Daily Total Return[1] | **100,001** | - |
| 2013 | Three-Month LIBOR | S&P 500 Total Return Index | **74,999** | - |
| 2013 | Three-Month LIBOR minus .1400% | MSCI All Country World Daily Total Return[2] | **75,019** | - |
| 2012 | Three-Month LIBOR | S&P 500 Total Return Index | **100,000** | - |
| | | | **$ 350,019** | $ 150,001 |

[1] *The MSCI EAFE Index is a free-float adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US and Canada.*

[2] *The MSCI All Country World Index is a free-float adjusted market capitalization index that is designed to measure the equity market performance of developed and emerging markets.*

(IN THOUSANDS)

The fair value of UPMC's derivative instruments at June 30, 2012 and 2011, was classified in the consolidated balance sheets as follows:

| | June 30 | |
|---|---|---|
| | **2012** | 2011 |
| Other assets | **$ 1,257** | $ 2,962 |
| Long-term obligations | **(27,861)** | (17,338) |
| | **$ (26,604)** | $ (14,376) |

The effects of changes in the fair value of the derivative instruments on the consolidated statements of operations and changes in net assets for the years ended June 30, 2012 and 2011, are as follows:

| Type of Derivative | Classification of Unrealized (Loss) Gain in Excess of Revenues Over Expenses | Amount of Unrealized (Loss) Gain in Excess of Revenues Over Expenses | |
|---|---|---|---|
| | | **2012** | 2011 |
| Interest rate contracts | Investment (loss) revenue | **$ (7,540)** | $ 4,188 |
| Equity index contracts | Investment (loss) revenue | **(4,688)** | 9,014 |
| | | **$ (12,228)** | $ 13,202 |

UPMC's derivatives contain provisions that require UPMC's debt to maintain an investment grade credit rating from certain major credit rating agencies. If UPMC's debt were to fall below investment grade, it would be in violation of these provisions, and the counterparties to the derivatives could request payment or demand immediate and ongoing full overnight collateralization on derivatives in net liability positions. The aggregate fair value of all derivatives with credit-risk-related contingent features that are in a liability position at June 30, 2012 and 2011, is $25,676 and $16,942, respectively, for which UPMC has posted collateral of $400 and $0, respectively, in the normal course of business. If the credit-risk-related contingent features underlying these derivatives were triggered to the fullest extent on June 30, 2012, UPMC would be required to post an additional $27,177 of collateral to its counterparties. Pursuant to master netting arrangements, UPMC offsets the fair value of amounts recognized for derivatives, including the right to reclaim or obligation to return cash collateral from/to counterparties.

## 7. FAIR VALUE MEASUREMENTS

As of June 30, 2012, 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, trusteed, and other investments and derivatives. UPMC's alternative investments are measured using either the cost or equity method of accounting and are therefore excluded from the fair value hierarchy table 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, include:

- *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.

(IN THOUSANDS)

The following tables represent UPMC's fair value hierarchy for its financial assets (cash and investments) and liabilities measured at fair value on a recurring basis as of June 30, 2012 and 2011. 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. The net asset value has been derived using quoted market prices for the underlying securities.

### FAIR VALUE MEASUREMENTS AS OF JUNE 30, 2012

| | Level 1 | Level 2 | Level 3 | Total Carrying Amount |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and cash equivalents | $ 245,824 | $ – | $ – | $ 245,824 |
| Fixed income | 422,566 | 598,360 | – | 1,020,926 |
| Domestic equity | 271,652 | 7,854 | – | 279,506 |
| International equity | 447,925 | 99,661 | – | 547,586 |
| Public real estate | 39,764 | – | – | 39,764 |
| Commodities | 36,310 | – | – | 36,310 |
| Long/short equity | 60,892 | – | – | 60,892 |
| Derivative instruments | – | 1,257 | – | 1,257 |
| Total assets | $ 1,524,933 | $ 707,132 | $ – | $ 2,232,065 |
| **LIABILITIES** | | | | |
| Derivative instruments | – | 27,861 | – | 27,861 |
| Total liabilities | $ – | $ 27,861 | $ – | $ 27,861 |

### FAIR VALUE MEASUREMENTS AS OF JUNE 30, 2011

| | Level 1 | Level 2 | Level 3 | Total Carrying Amount |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and cash equivalents | $ 386,718 | $ – | $ – | $ 386,718 |
| Fixed income | 361,037 | 619,446 | – | 980,483 |
| Domestic equity | 338,263 | 999 | – | 339,262 |
| International equity | 488,501 | 112,929 | – | 601,430 |
| Public real estate | 41,485 | – | – | 41,485 |
| Commodities | 40,107 | – | – | 40,107 |
| Long/short equity | 40,008 | – | – | 40,008 |
| Derivative instruments | – | 2,962 | – | 2,962 |
| Total assets | $ 1,696,119 | $ 736,336 | $ – | $ 2,432,455 |
| **LIABILITIES** | | | | |
| Derivative instruments | $ – | $ 17,338 | $ – | $ 17,338 |
| Total liabilities | $ – | $ 17,338 | $ – | $ 17,338 |

(IN THOUSANDS)

## 8. 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 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 $134,661 and $125,194 for the years ended June 30, 2012 and 2011, respectively. Total expense related to the defined contribution plans and nonqualified plans was $67,042 and $49,745 for the years ended June 30, 2012 and 2011, respectively.

Benefits under the Plans 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 Plans were $69,090 and $136,946 for the years ended June 30, 2012 and 2011, respectively.

The table below sets forth the accumulated benefit obligation, the change in the projected benefit obligation, and the change in the assets of the Plans. The table also reflects the funded status of the Plans as well as recognized and unrecognized amounts in the consolidated balance sheets.

| | June 30 | |
|---|---|---|
| | **2012** | 2011 |
| Accumulated benefit obligation | **$ 1,207,824** | $ 1,069,052 |
| **CHANGE IN PROJECTED BENEFIT OBLIGATION** | | |
| Projected benefit obligation at beginning of year | **$ 1,149,267** | $ 1,010,224 |
| Service cost | **64,842** | 59,082 |
| Interest cost | **58,520** | 50,176 |
| Actuarial loss | **27,940** | 22,086 |
| Benefits paid | **(60,754)** | (53,654) |
| Effect of Hamot affiliation | **-** | 61,353 |
| Projected benefit obligation at end of year | **1,239,815** | 1,149,267 |
| **CHANGE IN PLAN ASSETS** | | |
| Fair value of plan assets at beginning of year | **994,225** | 709,872 |
| Actual return on plan assets | **(3,216)** | 153,861 |
| Employer contributions | **69,090** | 134,647 |
| Benefits paid | **(60,754)** | (53,654) |
| Effect of Hamot affiliation | **-** | 49,499 |
| Fair value of plan assets at end of year | **999,345** | 994,225 |
| Accrued pension liability | **$ 240,470** | $ 155,042 |

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Included in unrestricted net assets at June 30, 2012 and 2011, respectively, are the following amounts that have not yet been recognized in net periodic pension cost:

| | June 30 2012 | 2011 |
|---|---|---|
| Unrecognized prior service credit | **$ 1,603** | $ 5,029 |
| Unrecognized actuarial loss | **(394,316)** | (292,883) |
| Unrecognized transition asset | **15** | 20 |
| Effect of Hamot affiliation | **-** | (17,996) |
| | **$ (392,698)** | $ (305,830) |

Changes in plan assets and benefit obligations recognized in unrestricted net assets during 2012 and 2011 include:

| | June 30 2012 | 2011 |
|---|---|---|
| Current year actuarial (loss) gain | **$ (110,806)** | $ 69,934 |
| Amortization of actuarial gain | **26,036** | 32,144 |
| Amortization of prior service cost | **(2,098)** | (4,946) |
| Effect of Hamot affiliation | **-** | 5,778 |
| | **$ (86,868)** | $ 102,910 |

No plan assets are expected to be returned to UPMC during the year ending June 30, 2013.

The components of net periodic pension cost for the Plans were as follows:

| | Year Ended June 30 2012 | 2011 |
|---|---|---|
| Service cost | **$ 64,842** | $ 59,082 |
| Interest cost | **58,520** | 50,176 |
| Expected return on plan assets | **(79,650)** | (62,797) |
| Recognized net actuarial loss | **26,036** | 33,106 |
| Amortization of prior service credit | **(2,098)** | (4,952) |
| Effect of Hamot affiliation | **-** | 834 |
| Net periodic pension cost | **$ 67,650** | $ 75,449 |

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

| | June 30 2012 | 2011 |
|---|---|---|
| Discount rates: | | |
| Used for benefit obligations | **4.32%** | 5.35% |
| Used for net periodic pension cost | **5.35%** | 5.19% |
| 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 | **8.00%** | 8.00% |
| Interest crediting rate | **3.32%** | 4.35% |

The change in discount rate from 5.35% to 4.32% and the change in interest crediting rate from 4.35% to 3.32% increased the projected benefit obligation by $81,082.

(IN THOUSANDS)

The following pension benefit payments, which reflect expected future service, as appropriate, are expected to be paid in the years ending June 30:

| | |
|---|---|
| 2013 | $ 112,130 |
| 2014 | 101,975 |
| 2015 | 105,230 |
| 2016 | 107,497 |
| 2017 | 110,587 |
| 2018–2022 | 563,727 |

UPMC employs a total return investment approach whereby a mix of equities and fixed income investments are used to maximize the long-term return of 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. UPMC's external investment managers may use derivatives to gain market exposure in an efficient and timely manner. 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 June 30, 2012, UPMC employed 104 external investment managers to handle the investment of the assets in the pension portfolio. Of these, 15 managers manage equity investments, 4 manage fixed income investments, and 85 managers oversee alternative investment strategies. The largest allocation to any alternative investment manager is $14,322.

The following is a summary of the pension plan asset allocations at June 30, 2012 and 2011:

| | **2012** | 2011 | Target |
|---|---|---|---|
| Nonalternative investments: | | | |
| Fixed income | **11.0%** | 13.1% | 10.0% |
| Domestic equity | **15.0%** | 19.6% | 15.0% |
| International equity | **22.0%** | 25.7% | 25.0% |
| Total nonalternative investments | **48.0%** | 58.4% | 50.0% |
| Real assets: | | | |
| Real estate | **4.9%** | 3.0% | 4.0% |
| Income opportunities | **0.1%** | 0.1% | 2.0% |
| Natural resources | **2.9%** | 2.4% | 4.0% |
| Total real assets | **7.9%** | 5.5% | 10.0% |
| Alternative investments: | | | |
| Long/short equity | **10.7%** | 9.3% | 15.0% |
| Absolute return | **9.0%** | 6.5% | 10.0% |
| Private equity | **24.4%** | 20.3% | 15.0% |
| Total alternative investments | **44.1%** | 36.1% | 40.0% |
| Total | **100.0%** | 100.0% | 100.0% |

(IN THOUSANDS)

All of the Plans' assets are measured at fair value, including its alternative investments. The same levels of the fair value hierarchy as described in Note 7 are used to categorize the Plans' 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 net asset value ("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.

The fair values of the Plans' assets at June 30, 2012, by asset category and by the level of inputs used to determine fair value, were as follows:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash | $ 326 | $ – | $ – | $ 326 |
| Equity securities: | | | | |
| Domestic equity | 172,434 | – | – | 172,434 |
| International equity | 168,540 | – | – | 168,540 |
| U.S. REITS | 17,017 | – | – | 17,017 |
| Fixed income: | | | | |
| Government securities | 6,341 | – | – | 6,341 |
| Corporate debt instruments | – | 9,210 | – | 9,210 |
| Common collective trusts | – | 104,881 | – | 104,881 |
| Private equity and hedge partnerships: | | | | |
| Private real estate | – | – | 47,557 | 47,557 |
| Private natural resources | – | – | 29,316 | 29,316 |
| Absolute return hedge funds | – | – | 77,623 | 77,623 |
| Long/short hedge funds | 15,081 | – | 104,548 | 119,629 |
| Private equity | – | – | 246,002 | 246,002 |
| Net receivables | 469 | – | – | 469 |
| Plans' assets at fair value | $ 380,208 | $ 114,091 | $ 505,046 | $ 999,345 |

(IN THOUSANDS)

The fair values of the Plans' assets at June 30, 2011, by asset category and by the level of inputs used to determine fair value, were as follows:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash | $ 1,370 | $ – | $ – | $ 1,370 |
| Equity securities: | | | | |
| Domestic equity | 301,038 | – | – | 301,038 |
| International equity | 192,242 | – | – | 192,242 |
| U.S. REITS | 33,150 | – | – | 33,150 |
| Corporate debt instruments | – | 402 | – | 402 |
| Common collective trusts | – | 52,122 | – | 52,122 |
| Private equity and hedge partnerships: | | | | |
| Private real estate | – | – | 29,970 | 29,970 |
| Private natural resources | – | – | 23,943 | 23,943 |
| Absolute return hedge funds | – | – | 64,728 | 64,728 |
| Long/short hedge funds | 15,014 | – | 77,742 | 92,756 |
| Private equity | – | – | 203,007 | 203,007 |
| | 542,814 | 52,524 | 399,390 | 994,728 |
| **LIABILITIES** | | | | |
| Net payables | (503) | – | – | (503) |
| Plans' assets at fair value | $ 542,311 | $ 52,524 | $ 399,390 | $ 994,225 |

Changes in the fair value of the Plans' Level 3 assets for the year ended June 30, 2012, were as follows:

| | Level 3 |
|---|---|
| Balance, June 30, 2011 | $ 399,390 |
| Actual return on plan assets: | |
| Related to assets still held at the reporting date | 14,958 |
| Related to assets sold during the period | 5,598 |
| Purchases, sales, issuances and settlements (net) | 85,100 |
| Balance, June 30, 2012 | $ 505,046 |

## 9. PROFESSIONAL AND GENERAL LIABILITY INSURANCE

UPMC is insured for professional and general liability losses through wholly owned, multiprovider insurance companies ("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.

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 statistical analyses and represents an estimate of reported claims and claims incurred but not reported. Those estimates are subject to the effects of trends in loss severity and 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 approximately $272,976 and $237,706 discounted at 1.25% and 2.00% were recorded as of June 30, 2012 and 2011, respectively. The effect of the change in discount rate from 2.00% to 1.25% increased the reserves for professional and general liability losses by approximately $4,500. At June 30, 2012 and 2011, respectively, $60,209 and $55,141 of the loss reserves are included in current accrued insurance reserves and $212,767 and $182,565 are reported as accrued long-term insurance reserves.

The Medical Care Availability and Reduction of Error ("MCARE") Act was enacted by the legislature of the Commonwealth of Pennsylvania ("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.

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 PA Insurance Commissioner. To date, the PA Insurance Commissioner has deferred the change in coverage and eventual phaseout of the MCARE Fund to future years.

## 10. WORKERS' COMPENSATION SELF-INSURANCE

UPMC is self-insured for workers' compensation losses up to a maximum limit of $1,000 per occurrence. Losses incurred over this limit are covered by a supplemental catastrophic policy up to specified limits with a commercial insurer. Estimated accruals for workers' compensation were $25,109 and $26,334 discounted at 4.00% as of June 30, 2012 and 2011.

## 11. RELATED-PARTY TRANSACTIONS

UPMC purchases and sells certain services from and to the University. The most significant payment to the University is for physician services whereby the University, acting as a common paymaster, invoices UPMC for the clinical services rendered by certain faculty and medical residents. Payments to the University related to physician services amounted to $144,265 and $130,494 for the years ended June 30, 2012 and 2011, respectively. UPMC provides direct financial support to the University to sustain the research and academic medical enterprise of the University. Payments to the University related to research and academic support amounted to $94,255 and $102,477 for the years ended June 30, 2012 and 2011, respectively.

UPMC has various facility rental agreements with the University. UPMC received rent income of $23,686 and $22,847 and incurred rent expense of $10,132 and $9,974 related to rental arrangements with the University for the years ended June 30, 2012 and 2011, respectively, which are also included in Note 12.

The University subcontracts with UPMC to perform research activity. Payments from the University related to research activity were $37,766 and $40,637 for the years ended June 30, 2012 and 2011, respectively.

UPMC has equity investments in entities that sell and purchase various patient care-related services to and from UPMC. Payments to equity investment entities were $49,580 and $49,313 for the years ended June 30, 2012 and 2011, respectively. Revenues from equity investment entities were $58,680 and $50,222 for the years ended June 30, 2012 and 2011, respectively.

Receivables and payables are settled with affiliated entities in the normal course of business. Other receivables include $18,099 and $8,764 as of June 30, 2012 and 2011, respectively, relating to amounts due from affiliates in connection with these transactions.

## 12. OPERATING LEASES AND OTHER LONG-TERM AGREEMENTS

UPMC has entered into certain long-term agreements with respect to facilities, equipment, and services with affiliated and other entities. The terms of the agreements generally range from 1 to 25 years with renewal options up to 15 years. Total expense under these agreements was approximately $115,971 and $110,947 for the years ended June 30, 2012 and 2011, respectively, for all long-term agreements.

Future payments under noncancelable long-term agreements for the next five years approximate $89,238 in 2013, $81,950 in 2014, $66,408 in 2015, $52,251 in 2016, $34,196 in 2017, and $311,002 thereafter. Approximately 3.2% of total future payments are subject to adjustment based upon inflation or mutual negotiations. Approximately 5.6% of these payments are due to the University.

## 13. 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.

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 June 30, 2012, UPMC does not have any unrecorded tax benefits.

As of June 30, 2012, the for-profit entities of UPMC had gross federal net operating loss (“NOL”) carryforwards of $280,809 (expiring in years 2013 through 2032) and gross state NOL carryforwards of $115,736 (expiring in years 2019 through 2032) that are available to offset future taxable income. Utilization of the state NOL carryforwards in any one year is limited to the greater of $3,000 or 20% of taxable income on an annual basis per company. During the year ended June 30, 2012, UPMC realized tax benefits of $2,002 from the use of NOL carryforwards. Net deferred tax assets of $124,096, primarily related to NOL carryforwards, have a valuation allowance recorded against them of $118,508 due to the uncertainty of realizing these benefits in the future.

(IN THOUSANDS)

The following table presents deferred tax assets as of June 30:

| | 2012 | 2011 |
|---|---|---|
| Deferred tax assets: | | |
| Federal NOL | **$ 95,475** | $ 92,281 |
| Accrued benefits | **7,851** | 7,248 |
| Alternative minimum tax credit carryover and other | **20,770** | 24,665 |
| | **124,096** | 124,194 |
| Less valuation allowance | **(118,508)** | (118,606) |
| | **$ 5,588** | $ 5,588 |

## 14. FUNCTIONAL EXPENSES

UPMC provides general health care services primarily to residents within its geographic location and supports research and education programs. For the years ended June 30, 2012 and 2011, expenses related to providing these services were as follows:

| | 2012 | 2011 |
|---|---|---|
| Hospital health care services, including health insurance costs | **$ 6,984,597** | $ 6,229,610 |
| Other health care services | **1,225,599** | 1,195,332 |
| Academic and research activities | **398,419** | 419,471 |
| Administrative support | **1,033,504** | 895,234 |
| | **$ 9,642,119** | $ 8,739,647 |

## 15. COMMITMENTS

In December 2000, UPMC entered into a long-term agreement with a software vendor in connection with a system-wide technology initiative to improve the quality of patient care through the development of a real-time patient electronic health record providing for clinical documentation and order entry. Under the agreement, UPMC will receive the right to the license, installation, upgrade, and maintenance related to all current fixed fee software through December 2019. As of June 30, 2012, there were future purchase commitments of $20,625 related to software upgrades and maintenance payable in annual installments through December 2019.

In April 2005, UPMC entered into an eight-year, joint development agreement with IBM to transform UPMC's information technology infrastructure and to create new technology solutions. UPMC's technology infrastructure was reengineered to an on-demand computing model that is geared toward innovation, yet adaptable and flexible to meet ongoing business needs and growth. In return for these products and services, UPMC contractually committed $350,010 payable over 13 years, roughly in equal monthly installments. As of June 30, 2012, $60,671 of this commitment remained. In June 2012, UPMC executed a four-year agreement beginning July 1, 2012, under which UPMC will purchase a broad array of software and associated maintenance totaling approximately $50,475. In addition, UPMC executed an agreement for the purchase of hardware used within its technology infrastructure, which effectively extends the existing agreement through June 30, 2016. UPMC's commitment to purchase hardware approximates $70,502 during the period through June 30, 2016.

UPMC has executed several co-development agreements with various software and technology vendors to invest in the development of medical technologies and information systems to enhance health care delivery. The total amount committed to these agreements is $115,580, and $71,149 has been spent through June 30, 2012, on various projects. As of June 30, 2012, $6,446 remains committed to projects in development and $37,985 is allocable to projects subject to approval of UPMC and the respective counterparty.

In December 2007, UPMC pledged $100,000 to the Pittsburgh Promise Foundation. The Pittsburgh Promise Foundation, which operates as a Type I Supporting Organization, supporting the Pittsburgh Foundation, is charged with creating and managing an endowment fund to (a) help eligible students graduating from Pittsburgh Public Schools to further their education after high school by funding certain tuition costs regardless of needs or income, and (b) enhance the growth, stability, and economic development of the city of Pittsburgh by providing a sustainable incentive for families with school-aged children to remain in, and to move into, the city of Pittsburgh to take advantage of scholarship funding for postsecondary education. The initial $10,000 was an unconditional pledge. The remaining $90,000 is designated to match contributions provided by other organizations and individual donors over a nine-year period beginning in fiscal year 2009. UPMC will match $2.00 for every $3.00 contributed, with a yearly match obligation not to exceed $10,000. As of June 30, 2012, UPMC has contributed $40,533 to the Pittsburgh Promise Foundation and $59,467 of the total pledge is considered a conditional promise to give.

## 16. CONTINGENCIES

UPMC is involved in litigation and responding to requests for information from governmental agencies occurring in the normal course of business. Certain of these matters are in the preliminary stages and legal counsel is unable to estimate the potential effect, if any, upon operations or financial condition of UPMC. Management believes that these matters will be resolved without material adverse effect on UPMC's financial position or results of operations. However, the ultimate outcome and effect on UPMC's financial statements is unknown.

During August 2007, UPMC received a request for information from the Civil Division of the Department of Justice ("DOJ") relating to an investigation into the health insurance and hospital services market in and around Pittsburgh, including any potentially anticompetitive agreements. This request covered several prior years. No specific violations, claims or assessments were ever made. Management cooperated with the information requests. In July 2011, the DOJ contacted counsel for UPMC to advise that the DOJ had formally closed its investigation of UPMC. Accordingly, UPMC believes that the matter has been resolved with no material adverse effect on UPMC's financial position or results of operations.

In April 2009, a lawsuit was filed by West Penn Allegheny Health System ("WPAHS") against UPMC and Highmark in the United States District Court for the Western District of Pennsylvania. WPAHS alleged that UPMC and Highmark violated the Sherman Antitrust Act and that UPMC tortiously interfered with WPAHS' existing and prospective business relations. WPAHS sought equitable relief and unspecified compensatory, treble, and punitive damages. In October 2009, WPAHS' lawsuit was dismissed by the District Court. In November 2009, WPAHS appealed the District Court's dismissal. In November 2010, the Court of Appeals reversed the District Court's dismissal and remanded the case to the District Court for further proceedings. In December 2010, UPMC and Highmark sought rehearing before the Third Circuit en banc, which was denied. In May 2011, UPMC and Highmark filed petitions for certiorari with the United States Supreme Court, asking the Court to uphold the District Court's dismissal and reverse the Court of Appeals. The District Court stayed further proceedings pending resolution of the petitions for certiorari. In October 2011, the United States Supreme Court denied those petitions for certiorari. On October 31, 2011, WPAHS voluntarily dismissed all of its claims against Highmark and moved for leave to file a Second Amended Complaint (the "SAC"). In particular, WPAHS sought leave to drop its claims that a UPMC-Highmark conspiracy caused its decline and to focus all of its remaining claims on a theory that UPMC's allegedly "predatory tactics" were solely responsible for its decline. Although UPMC opposed WPAHS' motion for leave, on April 23, 2012, the Court granted WPAHS' motion to file the SAC. On May 2, 2012, UPMC and Highmark entered into a Mediated Agreement, a material term of which is that once Highmark acquires control of WPAHS, Highmark will dismiss WPAHS' antitrust claims against UPMC with prejudice. On May 23, 2012, UPMC answered the SAC, denying that it had any liability for the claims asserted therein. In addition, UPMC filed a counterclaim against WPAHS, alleging that it has conspired with Highmark to allow Highmark to prevent the entry and expansion of other national insurers in the market and to impair the UPMC Health Plan's viability as a potential insurance competitor. UPMC filed a companion lawsuit alleging similar allegations and claims against Highmark and WPAHS. On June 29, 2012, WPAHS moved to dismiss UPMC's counterclaim. The parties await a ruling on WPAHS' motion. In the interim, discovery regarding WPAHS' claims is under way. UPMC continues to believe that WPAHS' allegations have no merit and expects that the matter will be resolved without any material adverse effect on UPMC's financial position or results of operations. However, the ultimate outcome and effect on UPMC's financial statements is unknown.

In December 2010, a proposed class action was filed in United States District Court for the Western District of Pennsylvania by Royal Mile Company, Inc., and certain related entities and persons against UPMC and Highmark. In that action the plaintiffs alleged that UPMC and Highmark had conspired to allow Highmark to charge excessive, above-market premiums for health insurance. The complaint closely tracks the allegations made by WPAHS in its lawsuit (described above). The action has been designated as "related" to the WPAHS lawsuit and has been assigned to the same District Court Judge. Although the case had been stayed pending the disposition of petitions for certiorari being filed in the WPAHS lawsuit, the District Court Judge lifted the stay following the denial of the petitions for certiorari as detailed above. The plaintiffs filed an Amended Complaint on August 16, 2012, which included two additional antitrust counts against UPMC based on its alleged conspiracy with Highmark. UPMC continues to believe that the plaintiffs' allegations have no merit and expects that the matter will be resolved without any material adverse effect on UPMC's financial position or results of operations. However, the ultimate outcome and effect on UPMC's financial statements is unknown.

In March and April 2009, several related class action lawsuits were filed against UPMC and certain of its affiliates in the Federal District Court for the Western District of Pennsylvania ("District Court") and the Court of Common Pleas for Allegheny County, Pennsylvania. The Federal District Court cases allege violations of The Fair Labor Standards Act ("FLSA") on the basis that certain employees were not paid for all hours that they worked and were not properly paid overtime and, further, that these actions also violated the Employee Retirement Income Security Act ("ERISA") and the Racketeer Influenced and Corrupt Organizations Act ("RICO"). The state court actions allege violations of the Pennsylvania Minimum Wage Act, The Wage Payment and Collection Act, and common law on the same factual basis noted above. The lawsuits seek recovery of alleged unpaid wages and benefits and other monetary damages and costs. In 2012, the Court in two of the federal class action lawsuits entered an Order granting UPMC's motion to decertify the collective action that had been conditionally entered at an earlier date. The Plaintiff's filed an unopposed Motion for Voluntary Dismissal with Prejudice for the purposes of appeal in both cases. The District Court signed a generic 'Order of Dismissal with Prejudice' in both cases, which includes the named Plaintiffs. One case is now on appeal to Third Circuit, and one case is pending appeal, on the issue of the denial of the class certification. UPMC is currently evaluating the effect of the lawsuits on UPMC's financial position and results of operations. However, the ultimate outcome and effect on UPMC's financial statements is unknown.

In November 2010, the DOJ opened an investigation into whether or not certain hospitals nationwide submitted claims to Medicare for payment related to the implantation of implantable cardioverter defibrillators ("ICDs") that were excluded from Medicare coverage. UPMC is in the process of reviewing these claims related to this investigation. The outcome and ultimate effect on UPMC's financial statements cannot be determined at this time. However, it is not expected to have a material impact on operating results.

In July 2011, a lawsuit was filed by Highmark, Inc. and Keystone Health Plan West, Inc. ("Highmark") against UPMC, UPMC Presbyterian Shadyside, Magee-Womens Hospital of UPMC, UPMC Northwest, UPMC St. Margaret, UPMC Passavant, UPMC Horizon, UPMC Bedford, and UPMC McKeesport ("UPMC") in the United States District Court for the Western District of Pennsylvania. Highmark alleged that UPMC violated the Lanham Act, breached certain contracts and tortiously interfered with Highmark's existing and prospective business relations by making certain statements regarding the status of the Highmark/ UPMC relationship. Highmark sought equitable relief, including a preliminary injunction and unspecified compensatory and punitive damages. In August 2011, UPMC moved to dismiss all of Highmark's claims and opposed Highmark's motion for a preliminary injunction. In October 2011, Magistrate Judge Cathy Bissoon issued a Report and Recommendation recommending that Highmark's motion for preliminary injunction be denied. Highmark filed objections to that Report and Recommendation on October 31, 2011. UPMC responded to Highmark's objections on November 17, 2011. On January 25, 2012, the Court denied Highmark's motion for preliminary injunction and UPMC's motion to dismiss without prejudice. On February 1, 2012, Highmark filed a renewed motion for preliminary injunction. UPMC opposed that motion on February 23, 2012, and filed a renewed motion to dismiss. Highmark opposed UPMC's motion to dismiss on March 18, 2012. On July 2, 2012, Highmark dismissed its Lanham Act claims with prejudice.

In January 2012, UPMC Hamot was served with a Complaint in Pennsylvania federal court naming it as a defendant in a qui tam action, along with a private physician practice. UPMC Hamot moved to dismiss the Complaint on April 5, 2012. The Relator opposed UPMC Hamot's motion to dismiss on June 7, 2012. The parties await a ruling from the Court. The outcome and ultimate effect on UPMC's financial statements cannot be determined at this time. However, it is not expected to have a material impact on operating results.

## 17. SUBSEQUENT EVENTS

Management evaluated subsequent events occurring subsequent to June 30, 2012 through September 6, 2012, the date the audited consolidated financial statements of UPMC were issued. During this period, there were no subsequent events requiring recognition in the consolidated financial statements that have not been recorded.

In July 2012, UPMC and Highmark agreed to terms of a definitive agreement for commercial and Medicare Advantage services. The terms of the commercial agreement include a December 31, 2014 date-certain expiration of the existing contracts between Highmark and UPMC. The agreement also defines each parties' obligations after that date, including access to certain unique UPMC services or facilities.

On July 31, 2012, UPMC issued $356 million of fixed rate bonds. The proceeds of these bonds were used to retire certain existing debt and to fund future capital projects.

On August 16, 2012, UPMC completed the standardization of its major bond covenants by defeasing the 1995 UPMC MTI.