KPMG

# OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

Consolidated Financial Statements

September 30, 2016 and 2015

(With Independent Auditors' Report Thereon)

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

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# Independent Auditors' Report

OSF Healthcare System
Peoria, Illinois:

## Report on the Financial Statements

We have audited the accompanying consolidated financial statements of OSF Healthcare System and Subsidiaries (OSF), which comprise the consolidated balance sheets as of September 30, 2016 and 2015, and the related consolidated statements of operations and changes in unrestricted net assets, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

*Management's Responsibility for the Financial Statements*

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

*Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

*Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of OSF Healthcare System and Subsidiaries as of September 30, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Chicago, Illinois
February 15, 2017

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Consolidated Balance Sheets

September 30, 2016 and 2015

(In thousands)

| **Assets** | | **2016** | **2015** |
|---|---|---|---|
| Current assets: | | | |
| Cash and cash equivalents | $ | 157,568 | 368,762 |
| Patients' and residents' accounts receivable, net of allowance for doubtful accounts of approximately $158,473 in 2016 and $158,596 in 2015 | | 469,611 | 424,507 |
| Assets limited as to use | | 31,590 | 27,540 |
| Other | | 107,439 | 109,941 |
| Total current assets | | 766,208 | 930,750 |
| Investments | | 1,159,621 | 961,331 |
| Assets limited as to use, net of current portion | | 254,958 | 280,050 |
| Property and equipment, net | | 1,117,437 | 1,017,960 |
| Restricted assets | | 92,638 | 69,293 |
| Goodwill | | 39,567 | 38,405 |
| Other assets | | 57,796 | 48,634 |
| Total assets | $ | 3,488,225 | 3,346,423 |
| **Liabilities and Net Assets** | | | |
| Current liabilities: | | | |
| Current portion of long-term debt | $ | 24,875 | 13,493 |
| Accounts payable and accrued expenses | | 326,713 | 337,598 |
| Estimated third-party payor settlements | | 103,486 | 106,862 |
| Estimated self-insurance liabilities | | 31,590 | 27,540 |
| Total current liabilities | | 486,664 | 485,493 |
| Long-term debt, net of current portion | | 1,177,361 | 1,175,050 |
| Accrued benefit liability | | 510,322 | 399,053 |
| Estimated self-insurance liabilities, net of current portion | | 156,339 | 152,603 |
| Other liabilities | | 82,454 | 69,686 |
| Total liabilities | | 2,413,140 | 2,281,885 |
| Net assets: | | | |
| Unrestricted: | | | |
| Unrestricted net assets of OSF | | 971,481 | 985,890 |
| Noncontrolling interests in subsidiaries | | 10,966 | 9,355 |
| Total unrestricted net assets | | 982,447 | 995,245 |
| Temporarily restricted | | 55,985 | 40,473 |
| Permanently restricted | | 36,653 | 28,820 |
| Total net assets | | 1,075,085 | 1,064,538 |
| Total liabilities and net assets | $ | 3,488,225 | 3,346,423 |

See accompanying notes to consolidated financial statements.

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Consolidated Statements of Operations and Changes in Unrestricted Net Assets

Years ended September 30, 2016 and 2015

(In thousands)

| | | 2016 | 2015 |
|---|---|---|---|
| Net patient service revenue, net of contractual allowances and discounts | $ | 2,412,462 | 2,294,956 |
| Provision for uncollectible accounts | | (67,912) | (71,421) |
| Net patient service revenues less provision for uncollectible accounts | | 2,344,550 | 2,223,535 |
| Other revenues: | | | |
| Contributions | | 7,899 | 3,944 |
| Other | | 68,033 | 81,446 |
| Net assets released from restrictions used for operations | | 2,398 | 3,307 |
| Total revenues | | 2,422,880 | 2,312,232 |
| Expenses: | | | |
| Salaries and benefits | | 1,347,321 | 1,251,858 |
| Sisters' evaluated services | | 2,077 | 1,894 |
| Supplies and other expenses | | 873,114 | 815,577 |
| Depreciation and amortization | | 104,078 | 100,738 |
| Interest | | 39,656 | 38,489 |
| Total expenses | | 2,366,246 | 2,208,556 |
| Income from operations | | 56,634 | 103,676 |
| Nonoperating gains (losses): | | | |
| Investment return | | 82,930 | 4,093 |
| Income taxes | | (7,648) | (1,807) |
| Net settlement of derivative instruments | | (8,786) | (9,889) |
| Loss on early extinguishment of debt | | (20,482) | (28,880) |
| Change in fair value of derivative instruments | | (9,591) | (13,417) |
| Contribution of excess assets over liabilities | | 6,094 | — |
| Total nonoperating gains (losses), net | | 42,517 | (49,900) |
| Net income | | 99,151 | 53,776 |
| Other changes in unrestricted net assets: | | | |
| Net assets released from restrictions used for the purchase of property and equipment | | 1,084 | 2,234 |
| Transfer to affiliate | | — | (150) |
| Recognition of change in pension funded status | | (108,889) | 9,970 |
| Net distributions made to noncontrolling shareholders | | (4,144) | (5,099) |
| Change in unrestricted net assets | $ | (12,798) | 60,731 |

See accompanying notes to consolidated financial statements.

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Consolidated Statements of Changes in Net Assets

Years ended September 30, 2016 and 2015

(In thousands)

| | | 2016 | 2015 |
|---|---|---|---|
| Unrestricted net assets: | | | |
| Net income | $ | 99,151 | 53,776 |
| Other changes in unrestricted net assets: | | | |
| Net assets released from restrictions used for the purchase of property and equipment | | 1,084 | 2,234 |
| Transfer to affiliate | | — | (150) |
| Recognition of change in pension funded status | | (108,889) | 9,970 |
| Net distributions made to noncontrolling shareholders | | (4,144) | (5,099) |
| Change in unrestricted net assets | | (12,798) | 60,731 |
| Temporarily restricted net assets: | | | |
| Contributions | | 15,107 | 10,294 |
| Investment return | | 3,887 | (1,246) |
| Net assets released from restrictions | | (3,482) | (5,541) |
| Change in temporarily restricted net assets | | 15,512 | 3,507 |
| Permanently restricted net assets: | | | |
| Contributions | | 7,779 | 6,054 |
| Investment return | | 54 | (35) |
| Change in permanently restricted net assets | | 7,833 | 6,019 |
| Change in net assets | | 10,547 | 70,257 |
| Net assets, beginning of year | | 1,064,538 | 994,281 |
| Net assets, end of year | $ | 1,075,085 | 1,064,538 |

See accompanying notes to consolidated financial statements.

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years ended September 30, 2016 and 2015

(In thousands)

| | | 2016 | 2015 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Change in net assets | $ | 10,547 | 70,257 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | | |
| Income from equity basis investments and gain on sale | | 164 | (616) |
| Contribution of excess assets over liabilities | | (6,094) | — |
| Distributions from equity basis investments | | 1,334 | 464 |
| Loss on early extinguishment of debt | | 20,482 | 28,880 |
| Amortization of bond issue costs and premiums/discounts included in interest expense | | (887) | 67 |
| Change in fair value of derivative instruments | | 9,591 | 13,417 |
| Change in fair value of trading securities | | (53,961) | 32,562 |
| Transfer to affiliate | | — | 150 |
| Net realized gains on investments | | (15,867) | (11,605) |
| Net distributions paid to noncontrolling interests | | 4,144 | 5,099 |
| Depreciation and amortization | | 104,078 | 100,738 |
| Restricted contributions and investment return | | (26,827) | (15,067) |
| Net assets released from restrictions | | 2,398 | 3,307 |
| Provision for uncollectible accounts | | 67,912 | 71,421 |
| Recognition of change in pension funded status | | 108,889 | (9,970) |
| Changes in assets and liabilities: | | | |
| Patients' and residents' accounts receivable | | (111,576) | (82,217) |
| Other current assets | | 2,745 | (35,189) |
| Other assets | | (26,834) | 1,917 |
| Other liabilities | | 2,213 | (50,279) |
| Accounts payable and accrued expenses | | (12,404) | 61,543 |
| Estimated third-party payor settlements | | (3,376) | 14,524 |
| Estimated self-insurance liabilities | | 7,786 | 3,117 |
| Net cash provided by operating activities | | 84,457 | 202,520 |
| Cash flows from investing activities: | | | |
| Acquisition of property and equipment | | (194,738) | (106,262) |
| Asset/stock purchase of affiliates | | (4,583) | — |
| Change in restricted assets | | (23,345) | (9,526) |
| Cash received from acquisitions | | 283 | 7,914 |
| Gross purchases of investments | | (2,518,057) | (1,061,419) |
| Gross proceeds from the sale of investments | | 2,411,111 | 850,129 |
| Net cash used in investing activities | | (329,329) | (319,164) |
| Cash flows from financing activities: | | | |
| Restricted contributions and investment return | | 26,827 | 15,067 |
| Net assets released from restriction for operations | | (2,398) | (3,307) |
| Net distributions paid to noncontrolling interests | | (4,144) | (5,099) |
| Proceeds from issuance of long-term debt, including premium | | 127,630 | 491,335 |
| Transfer to affiliate | | — | (150) |
| Extinguishment of long-term debt, including redemption premium | | (105,730) | (281,341) |
| Repayment of long-term debt | | (8,507) | (11,189) |
| Net cash provided by financing activities | | 33,678 | 205,316 |
| Net change in cash and cash equivalents | | (211,194) | 88,672 |
| Cash and cash equivalents: | | | |
| Beginning of year | | 368,762 | 280,090 |
| End of year | $ | 157,568 | 368,762 |
| Supplemental disclosures of cash flow information: | | | |
| Cash paid for interest, net of amounts capitalized | $ | 34,999 | 43,162 |
| Cash paid for income taxes | | 4,389 | 32 |

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years ended September 30, 2016 and 2015

(In thousands)

| | 2016 | 2015 |
|---|---|---|
| Noncash transactions associated with acquisitions: | | |
| Patient accounts receivable | $ 1,440 | 14,859 |
| Other current assets | 243 | 5,997 |
| Investments | 474 | 4,680 |
| Property and equipment | 12,314 | 39,414 |
| Restricted assets | 3 | 2,926 |
| Other long-term assets | — | 4,344 |
| Goodwill | — | 16,396 |
| Accounts payable and accrued expenses | (2,450) | (10,835) |
| Estimated third-party payor settlements | — | (9,852) |
| Long-term debt | (300) | (40,654) |
| Other liabilities | (2,413) | (32,263) |

See accompanying notes to consolidated financial statements.

## (1) Organization

OSF Healthcare System (OSF) is an Illinois not-for-profit corporation incorporated in 1880 as The Sisters of the Third Order of St. Francis. OSF's current name was adopted as part of a corporate restructuring in 1989 at which time a new Illinois not-for-profit corporation known as The Sisters of the Third Order of St. Francis (Parent) was incorporated by a religious congregation of the Roman Catholic Church having the same name. The Parent is the sole member of OSF and OSF Healthcare Foundation (the Foundation). OSF currently owns and operates eleven acute care hospitals and other healthcare-related entities. OSF operates nine of its healthcare facilities as a single corporation, with each healthcare facility functioning as an operating division of OSF. OSF consists of the following healthcare providers (Providers):

OSF St. Francis Hospital, Escanaba, Michigan (SFH)
OSF Saint Anthony Medical Center, Rockford, Illinois (SAMC)
OSF Saint James-John W. Albrecht Medical Center, Pontiac, Illinois (SJJWAMC)
OSF St. Joseph Medical Center, Bloomington, Illinois (SJMC)
OSF Saint Francis Medical Center, Peoria, Illinois (SFMC)
OSF St. Mary Medical Center, Galesburg, Illinois (SMMC)
OSF Holy Family Medical Center, Monmouth, Illinois (HFMC)
OSF Home Care, Peoria, Illinois
OSF Saint Luke Medical Center, Kewanee, Illinois (SLMC)
OSF Saint Anthony Health Center, Alton, Illinois (SAHC)

In addition to the Providers, the consolidated financial statements include activities of the OSF Corporate Office and OSF's subsidiaries: Ottawa Regional Hospital & Healthcare Center and Subsidiaries, Mendota Community Hospital, OSF Saint Francis, Inc. and Subsidiaries (SFI), OSF Lifeline Ambulance, LLC, 12 wholly owned physician group subsidiaries, PointCore, LLC, Institute of Physical Medicine and Rehabilitation (IPMR), and OSF Multi-Specialty Group (OSF MSG).

On April 30, 2012, OSF became the sole corporate member of Ottawa Regional Hospital & Healthcare Center d/b/a OSF Saint Elizabeth Medical Center (SEMC), an Illinois not-for-profit corporation. SEMC owns all of the capital stock of Ottawa Regional Healthcare Affiliates, Inc. (ORHA) and Ottawa Regional Hospital Auxiliary. SEMC is the sole member of Ottawa Regional Hospital Foundation. As of September 30, 2016 and 2015, SEMC has a 100% and 57%, respectively, ownership in Radiation Oncology of Northern Illinois, LLC (RONI). RONI has been consolidated by SEMC for 2016 and 2015. On June 30, 2016, SEMC purchased the additional 43% of RONI for $621, which created $733 of goodwill.

OSF is the sole member of the Board of Managers of Pointcore, LLC, a limited liability company organized under the laws of the State of Delaware on December 20, 2013 the purpose of which is to pool resources, such as data storage and telecommunications, to improve the quality of healthcare services to its Members and to third parties.

SAHC, Alton, Illinois merged into OSF pursuant to a statutory merger on November 1, 2014. SAHC is a dual campus (including OSF Saint Clare Hospital), single license, 173-licensed acute care beds, and 30 bed skilled nursing care hospital. The transaction resulted in goodwill of $5,579 being recorded in the consolidated balance sheet during 2015.

(In thousands)

The sole member of SAHC was Saint Anthony's Health System (SAHS), an Illinois not-for-profit corporation.

SAHC is the sole member of Saint Anthony's LLC, a Delaware limited liability company incorporated in April 2000 to operate as the general partner of Saint Clare's Villa, an Illinois limited liability partnership. This partnership was created to own and operate a 64-unit assisted living apartment complex for low-income residents.

The following table represents the balance sheet as of November 1, 2014 for SAHC:

| **Assets** | | |
|---|---|---|
| Current: | | |
| Cash and cash equivalents | $ | 5,333 |
| Patients' accounts receivable, net | | 10,805 |
| Other current assets | | 4,770 |
| Total current assets | | 20,908 |
| Investments | | 4,371 |
| Property and equipment, net | | 22,133 |
| Restricted assets | | 1,303 |
| Goodwill | | 5,579 |
| Other long-term assets | | 2,092 |
| Total assets | $ | 56,386 |

(In thousands)

**Liabilities and Net Assets**

| | | |
|---|---|---|
| Current liabilities: | | |
| Current portion of long-term debt | $ | 5,488 |
| Accounts payable and accrued expenses | | 7,044 |
| Estimated third-party payor settlements | | 9,350 |
| Total current liabilities | | 21,882 |
| Long-term debt, net of current portion | | 938 |
| Other long-term liabilities | | 32,263 |
| Total liabilities | | 55,083 |
| Net assets: | | |
| Unrestricted | | — |
| Temporarily restricted | | 1,302 |
| Permanently restricted | | 1 |
| Total net assets | | 1,303 |
| Total liabilities and net assets | $ | 56,386 |

On April 1, 2015, OSF became the sole corporate member of Mendota Community Hospital d/b/a OSF Saint Paul Medical Center, an Illinois not-for-profit corporation (SPMC). SPMC is a critical access hospital with 25 inpatient beds, which includes 21 Medicare approved swing beds. The transaction resulted in goodwill of $10,818 being recorded in the consolidated balance sheet during 2015.

(In thousands)

The following table represents the balance sheet as of April 1, 2015 for SPMC:

| | | |
|---|---|---|
| **Assets** | | |
| Current: | | |
| Cash and cash equivalents | $ | 2,581 |
| Patients' accounts receivable, net | | 4,054 |
| Other current assets | | 1,227 |
| Total current assets | | 7,862 |
| Investments | | 309 |
| Assets limited as to use | | 2,251 |
| Property and equipment, net | | 17,281 |
| Goodwill | | 10,818 |
| Restricted assets | | 1,623 |
| Total assets | $ | 40,144 |
| **Liabilities and Net Liabilities** | | |
| Current liabilities: | | |
| Current portion of long-term debt | $ | 1,752 |
| Accounts payable and accrued expenses | | 3,791 |
| Estimated third-party payor settlements | | 502 |
| Total current liabilities | | 6,045 |
| Long-term debt, net of current portion | | 32,476 |
| Total liabilities | | 38,521 |
| Net assets: | | |
| Unrestricted | | — |
| Temporarily restricted | | 1,002 |
| Permanently restricted | | 621 |
| Total net assets | | 1,623 |
| Total liabilities and net assets | $ | 40,144 |

On October 1, 2015, OSF became the sole corporate member of IPMR, an Illinois not-for-profit corporation. IPMR offers various outpatient rehabilitation services at twenty service locations and eight outpatient clinics primary throughout central Illinois.



(Continued)

(In thousands)

The following table represents the balance sheet as of October 1, 2015 for IPMR:

| | | |
|---|---|---|
| **Assets** | | |
| Current: | | |
| Cash and cash equivalents | $ | 76 |
| Patients' accounts receivable, net | | 1,440 |
| Other current assets | | 242 |
| Total current assets | | 1,758 |
| Investments | | 474 |
| Property and equipment, net | | 3,903 |
| Restricted assets | | 3 |
| Total assets | $ | 6,138 |
| **Liabilities and Net Liabilities** | | |
| Current liabilities: | | |
| Notes payable | $ | 300 |
| Accounts payable and accrued expenses | | 1,519 |
| Total current liabilities | | 1,819 |
| Other long-term liabilities | | 809 |
| Total liabilities | | 2,628 |
| Net assets: | | |
| Unrestricted | | 3,507 |
| Permanently restricted | | 3 |
| Total net assets | | 3,510 |
| Total liabilities and net assets | $ | 6,138 |

On January 4, 2016, OSF expanded operations in Streator, Illinois through the purchase of several medical office buildings and the receipt of a donated hospital facility. OSF paid $6,069 to an unaffiliated Catholic health system for the purchase of the medical office buildings and OSF's Foundation received a contribution of $2,757 as part of the agreement. OSF also recognized a contribution of $2,587 for the donated hospital facility that was received during the year ended September 30, 2016 in the accompanying consolidated statement of operations and changes in unrestricted net assets. This contribution represents the fair value of the building received, net of liabilities. The hospital facility was converted into an outpatient care facility and began operations as the OSF Center for Health – Streator, a division of SEMC.

SFI is an Illinois for-profit corporation incorporated in 1986 and is engaged in the following lines of business: medical practice management (through December 31, 2015), retail pharmacies, mobile medical systems, durable medical equipment, home therapeutics, real estate rental, and equipment technology services. SFI also participates in various health-related joint ventures and is the sole corporate member of OSF Aviation, Inc., OSF Design Group, Inc., OSF Assurance Company, and OSF Finance Company LLC (OSFFC), and as of February 29, 2016, SFI purchased State and Roxbury, LLC (SAR). OSF Aviation, Inc. is an Illinois limited liability corporation formed on January 28, 2002 for the purpose of acquiring and operating emergency medical equipped helicopters in support of the trauma services programs of SFMC and SAMC. OSF Design Group, Inc. is an Illinois limited liability corporation formed on October 1, 2004 to provide professional architectural services as a registered professional design firm to OSF and its subsidiaries. OSF Assurance Company is a Vermont general corporation incorporated on December 8, 2004 and organized for the purpose of writing insurance and reinsurance as a captive insurance company. OSFFC, an Illinois limited liability company, was organized in November 2007 to be a nominal issuer of taxable corporate notes or other debt instruments used to finance certain capital expenditures that would not be eligible for tax-exempt financing. OSF is not a borrower, obligor, or guarantor of any indebtedness issued by OSFFC. SAR was formed in 2009 to establish and operate a real estate management organization in Rockford, Illinois.

OSF Lifeline Ambulance, LLC is an Illinois limited liability corporation that commenced operations on October 1, 2003, to provide emergency ground transportation services.

OSF has 12 wholly owned physician group subsidiaries, which were formed or acquired to provide physician services and function as physician groups. On January 1, 2016, the medical practice management formerly provided by SFI and the operations of the wholly owned physician groups, except for Illinois Pathologist Services, LLC and Preferred Emergency Physicians of Illinois, LLC, were transferred to OSF MSG. Due to the nature of the transaction and common control, no gain or loss was recorded in connection with the transaction.

OSF owns 50% or more and has management control in the following consolidated joint venture entities:

The Center for Health Ambulatory Surgery Center, LLC (CHASC) was formed in 2007 to establish and operate a multispecialty ambulatory surgical center in Peoria, Illinois. SFMC has a 55.60% controlling interest in CHASC as of September 30, 2016 and 2015.

Fort Jesse Imaging Center, LLC (FJIC) was formed in 2002 to establish and operate a medical imaging center in Bloomington, Illinois. SJMC has a 50.19% controlling interest in FJIC as of September 30, 2016 and 2015.

Eastland Medical Plaza SurgiCenter, LLC (EMPS) was formed in 2000 to establish and operate an ambulatory surgery treatment center in Bloomington, Illinois. SJMC has a 51.84% and 53.03% controlling interest in EMPS as of September 30, 2016 and 2015, respectively.

Fox River Cancer Center (FRCC), an Illinois limited liability company, was formed in 2007 to establish and operate a cancer treatment center in Ottawa, Illinois. SEMC has a 66.67% controlling ownership as of September 30, 2016, the accompanying 2016 consolidated financial statements include the balance sheet and results of operations of FRCC. Goodwill of $429 was recognized as a result of the purchase of additional shares during 2016. As of September 30, 2015, SEMC owned 38.00% interest; therefore, FRCC was not consolidated and the joint venture activity was recorded as an investment using the equity method of accounting.

(In thousands)

The following represents a reconciliation of beginning and ending balances of OSF's interest and the noncontrolling interests for each class of net assets for which a noncontrolling interest exists during the years ended September 30, 2016 and 2015:

| | | Unrestricted net assets | | |
|---|---|---|---|---|
| | | Total | Controlling interest | Noncontrolling interest |
| Balance at September 30, 2014 | $ | 934,514 | 925,538 | 8,976 |
| Net income | | 53,776 | 48,298 | 5,478 |
| Transfer to affiliate | | (150) | (150) | — |
| Net assets released from restrictions used for the purchase of property and equipment | | 2,234 | 2,234 | — |
| Recognition of change in pension funded status | | 9,970 | 9,970 | — |
| Net distributions made to noncontrolling shareholders | | (5,099) | — | (5,099) |
| Balance at September 30, 2015 | | 995,245 | 985,890 | 9,355 |
| Net income | | 99,151 | 93,396 | 5,755 |
| Net assets released from restrictions used for the purchase of property and equipment | | 1,084 | 1,084 | — |
| Recognition of change in pension funded status | | (108,889) | (108,889) | — |
| Net distributions made to noncontrolling shareholders | | (4,144) | — | (4,144) |
| Balance at September 30, 2016 | $ | 982,447 | 971,481 | 10,966 |

The accompanying consolidated financial statements do not include the accounts of the Parent and the Foundation. The Foundation is an Illinois not-for-profit corporation, created to promote, encourage, and solicit, as well as receive and accept, funds in support of the purposes and functions of OSF and the Parent by establishing a council at each of OSF's Provider locations. It is the responsibility of the Foundation staff to develop and implement sound, practical, fund-raising strategies and tactics, the ultimate goal of which is to produce philanthropic support for the various OSF facilities. All funds collected and pledges received are done on behalf of the various OSF facilities and, therefore, shown as due to affiliates by the Foundation. OSF recognizes its net interest in the net assets of the Foundation based on contributions and pledges received by the Foundation on its behalf. The

(In thousands)

Foundation is a controlled subsidiary of the Parent and, therefore, is not required to be consolidated in the accompanying consolidated financial statements.

Summarized financial information of the Foundation for the years ended September 30, 2016 and 2015 is as follows:

| | | 2016 | 2015 |
|---|---|---|---|
| Cash, investments, pledges, and other | $ | 140,466 | 99,405 |
| Accounts payable and due to affiliates | | 12,611 | 4,932 |
| Unrestricted net assets | | 49,652 | 38,959 |
| Temporarily restricted net assets | | 47,386 | 32,529 |
| Permanently restricted net assets | | 30,817 | 28,985 |
| Cash transfers to OSF during the year | | 4,964 | 7,350 |

The amount due from the Foundation recognized at September 30, 2016 and 2015 consists of $2,962 and $2,061, respectively, in other current assets, $49,936 and $38,713, respectively, in investments, and $78,203 and $55,514, respectively, in restricted assets in the accompanying consolidated balance sheets.

Expenses included in the accompanying consolidated financial statements relate primarily to the provision of healthcare services and general and administrative costs.

## (2) Summary of Significant Accounting Policies

### *(a) Use of Estimates*

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

### *(b) Cash and Cash Equivalents*

Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less when purchased, except amounts shown as assets limited as to use, investments (including amounts held at the Foundation), and restricted assets.

### *(c) Investments and Investment Return*

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated balance sheets.

Investment return on funds held in trust for self-insurance purposes is included in other revenue. Investment return or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is reported as nonoperating gains or losses in the accompanying consolidated statements of operations and changes in unrestricted net assets, unless the income or loss is restricted by donor or law. Management considers all investments to be trading securities.

***(d) Assets Limited as to Use***

Assets limited as to use include amounts held by the bond trustee for payment of principal, interest, and acquisition and construction of equipment and facilities as defined in the loan agreement along with designated assets set aside for self-insurance of medical malpractice, unemployment compensation, and workers' compensation. Amounts required to meet current liabilities have been classified as current assets.

***(e) Other Assets – Joint Ventures***

OSF and certain subsidiaries have investments in organizations that are not majority owned or controlled by OSF organizations. OSF and its subsidiaries account for their investments in these organizations using the cost or equity method of accounting. The equity method of accounting is discontinued when investment is reduced to zero unless OSF or its subsidiary has guaranteed the obligations of the organization or is committed to provide additional capital support.

Investments in organizations using the equity method of accounting are reflected as a component of other assets in the accompanying consolidated balance sheets.

***(f) Property and Equipment***

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed primarily using the straight-line method. Included in property and equipment are leasehold improvements that are amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the improvement. Net interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Interest costs are not capitalized if the capital assets are acquired using donor-restricted funds.

Gifts of long-lived assets such as land, building, or equipment are reported at fair market value at the time of the donation and are excluded from the excess of unrestricted revenues, gains, and other support and nonoperating gains, net over expenses. Gifts of long-lived assets and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

***(g) Long-Lived Assets***

Long-lived assets (including property and equipment) are periodically assessed for recoverability based on the occurrence of a significant adverse event or change in the environment in which OSF operates or if the expected future cash flows (undiscounted and without interest) would become less than the carrying amount of the asset. An impairment loss would be recorded in the period such determination is made based on the fair value of the related entity. No impairments were recorded for the years ended September 30, 2016 and 2015.

(In thousands)

### *(h) Goodwill*

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. Goodwill is reviewed for impairment at least annually. In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-08, *Testing Goodwill for Impairment*, which provides an entity the option to perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount prior to performing the two-step goodwill impairment test. If this is the case, the two-step goodwill impairment test is required. If it is more likely than not that the fair value of a reporting is greater than its carrying amount, the two-step goodwill impairment test is not required. OSF adopted this guidance in 2014.

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

OSF has determined the proper reporting unit for goodwill is the consolidated OSF entity unless the goodwill is related to a joint venture, in which case the reporting unit is the joint venture. OSF performs its annual impairment review of goodwill at September 30, and when a triggering event occurs between annual impairment tests. At September 30, 2016 and 2015, OSF performed a qualitative assessment of goodwill and determined that it is not more likely than not that the fair values of its reporting units are less than the carrying amounts. Accordingly, no impairment loss was recorded in 2016 and 2015.

The composition of goodwill at September 30, 2016 and 2015 is set forth in the following table:

| | | 2016 | 2015 |
|---|---|---|---|
| OSF | $ | 23,458 | 23,029 |
| Joint ventures | | 16,109 | 15,376 |
| | $ | 39,567 | 38,405 |

### *(i) Temporarily and Permanently Restricted Net Assets*

Temporarily restricted net assets are those whose use has been limited by the donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by OSF in perpetuity.

Resources restricted by donors for replacement and expansion of property and equipment are added to unrestricted net assets to the extent expended within the period.

Resources restricted by donors or grantors for specific operating purposes are reported in unrestricted revenues, gains, and other support to the extent used within the period.

OSF classifies as permanently restricted net assets the original fair value of gifts donated to the permanent endowment, the original value of subsequent gifts to the permanent endowment, and accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument. Investment returns in excess of spending are classified as increases in temporarily restricted net assets until appropriated for expenditure by OSF.

The Foundation has established an investment policy that is reviewed annually by the Foundation Board of Directors. The policy directs at the discretion of the local facility Foundation Council that funds may be invested and supervised locally or pooled with other Foundation funds.

Currently, the investment of endowment funds are invested and supervised by each local Foundation Council following the guidelines established by the Foundation investment policy.

### *(j) Net Income*

The consolidated statements of operations and changes in unrestricted net assets include a performance indicator, net income. Changes in unrestricted net assets, which are excluded from net income, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions that were used for the purpose of acquiring such assets by donor restriction), recognition of change in pension funded status, net distributions made to noncontrolling shareholders, and transfers to affiliate.

### *(k) Net Patient Service Revenue*

OSF has agreements with third-party payors that provide for payments to OSF at amounts different from its established rates. Payment arrangements include prospectively determined rates-per-discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

### *(l) Charity Care*

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



(Continued)

(In thousands)

***(m) Donor-Restricted Gifts***

Unconditional promises to give cash and other assets to OSF are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are pledges or are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in unrestricted net assets as net assets released from restrictions.

Pledges receivable, included as restricted assets, at September 30, 2016 are expected to be collected according to the following schedule:

| | | Amount |
|---|---|---|
| 2017 | $ | 491 |
| 2018 | | 491 |
| 2019 | | 491 |
| 2020 | | 491 |
| 2021 | | 491 |
| Pledges receivable | $ | 2,455 |

***(n) Estimated Self-Insurance Liabilities***

The provisions for estimated self-insured medical malpractice, workers' compensation, health and dental, and unemployment claims include estimates of the ultimate costs for both reported claims and claims incurred but not reported. OSF reports the amount predicted to settle within one year as the current portion of the estimated self-insurance liabilities with the corresponding investments held as current portion of assets limited as to use. The long-term portion is reported as estimated self-insurance liabilities with the corresponding investments held as assets limited as to use.

***(o) Services Provided by the Religious Community***

Services provided by the individuals in the religious community are recorded as expense at lay-equivalent values.

***(p) Derivative Instruments***

OSF accounts for derivatives and hedging activities in accordance with Accounting Standards Codification (ASC) Subtopic 815-10, *Derivatives and Hedging – Overall*, as amended, which requires that an entity recognize all derivatives as either assets or liabilities in the consolidated balance sheets and measure those instruments at fair values. OSF and SFI are involved in various interest rate swap programs. The fair values of the interest rate swap programs are included as a component of the other liabilities in the accompanying consolidated balance sheets. The derivatives are not designated as hedge instruments, and therefore, the change in fair value of the interest rate swap is recorded as a component of nonoperating gains (losses) – change in fair value of derivative instruments in the period of change as well as net settlement of derivative instruments.

### *(q) Income Taxes*

OSF is a not-for-profit corporation as described by Section 501(c)(3) of the Internal Revenue Code (the Code) and is exempt from federal income taxes on related income pursuant to Section 501(c)(3) of the Code.

SFI and various subsidiaries are for-profit corporations that recognize income taxes under the asset-and-liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Under ASC Subtopic 740-10, *Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109*, OSF and SFI must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the consolidated financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. As of September 30, 2016 and 2015, OSF and SFI do not have any uncertain tax positions.

### *(r) Fair Value*

OSF adopted the provisions of ASC Topic 820, *Fair Value Measurements and Disclosures*, for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

In conjunction with the adoption of ASC Topic 820, OSF adopted the measurement provisions for investments in funds that do not have readily determinable fair values, including domestic and foreign mutual funds and commingled funds. This guidance amended ASC Topic 820 and allows for the estimation of the fair value of investments in investment companies for which the investment does not have a readily determinable fair value using net asset value (NAV) per share or its equivalent.

In May 2015, the FASB issued ASU No. 2015-07, *Fair Value Measurement (Topic 820), Disclosures for Investment in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*.
ASU No. 2015-07 removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the NAV per share practical expedient. It also removes the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the NAV per share practical expedient. The requirements of the standard are effective for

reporting periods in fiscal years that begin after December 15, 2016 with early adoption permitted. ASU No. 2015-07 is to be applied retrospectively. OSF has elected to early adopt ASU No. 2015-07 in 2016. The adoption resulted in the elimination of the disclosure noted above. There was no effect on OSF's consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities* (ASU No. 2016-01). ASU No. 2016-01 eliminates the requirement for not-for-profit organizations to disclose fair value information for financial instruments measured at amortized cost (e.g., debt). OSF has elected to early adopt this part of ASU 2016-01. The remaining parts of the ASU are effective for the year ending September 30, 2020. There was no effect on OSF's consolidated financial statements.

***(s) New Accounting Pronouncements***

In May 2014, FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU establishes principles for reporting useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts with customers. Particularly, that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The requirements of this statement are effective for OSF for the year ending September 30, 2019. OSF expects to record a decrease in net patient service revenue and a corresponding decrease in the provision for uncollectible accounts upon adoption of the standard.

In April 2015, FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. ASU 2015-03 required that cost related to a recognized debt liability be presented as a direct reduction of the debt liability in the balance sheet similar to premiums and discounts. ASU 2015-03 is effective for Nonpublic business entities for annual reporting periods beginning after December 15, 2015 with retrospective application and disclosure. The requirements of this statement are effective for OSF for the year ending September 30, 2017. The adoption of this standard will not have a material impact to the financial position or results of operations of OSF.

In November 2016, FASB issued ASU 2016-18, *Restricted Cash, a consensus of the FASB Emerging Issues Task Force*. ASU 2016-18 requires an entity to include amounts generally described as restricted cash and restricted cash equivalents, along with cash and cash equivalents when reconciling beginning and ending balances on the statement of cash flows. ASU 2016-18 is effective for Nonpublic business entities for annual reporting periods beginning after December 15, 2018, with retrospective application and disclosure. Early adoption of ASU 2016-18 is permitted. The requirements of this statement are effective for OSF for the year ending September 30, 2020. OSF has not evaluated the impact of this statement.

In August 2016, FASB issued ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. ASU 2016-14 represents phase 1 of FASB's Not-for-Profit financial reporting project and results reduces the number of net asset classes, requires expense presentation by functional and natural classification, requires quantitative and qualitative information in liquidity, retains the option to present the cash flow statement on a direct or indirect method as well as includes various other additional disclosure requirements. ASU 2016-14 is effective for annual reporting periods beginning after December 15, 2017 with retrospective application. Early adoption of ASU 2016-14 is permitted. The requirements of this statement are effective for OSF for the year ending September 30, 2019. OSF has not evaluated the impact of this statement.

In February 2016, FASB issues ASU 2016-02, *Leases*. ASU 2016-02 requires entities to recognize all leased assets as assets on the balance sheet with a corresponding liability resulting in a gross up of the balance sheet. Entities will also be required to present additional disclosures as the nature and extent of leasing activities. ASU 2016-02 is effective for nonpublic business entities for the annual reporting period beginning after December 31, 2018. The requirements of this statement are effective for OSF for the year ending September 30, 2020. OSF has not evaluated the impact of this statement.

### *(t) Reclassifications*

Certain 2015 amounts have been reclassified to conform to the 2016 consolidated financial statement presentation.

## (3) Net Patient and Resident Service Revenue

OSF has agreements with third-party payors that provide for payment at amounts different from its established rates. A summary of the payment arrangements with major third-party payors is as follows:

### *(a) Medicare*

Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient nonacute services and certain outpatient services are paid based upon a cost-reimbursement method, established fee screens, or a combination thereof. OSF is reimbursed for cost reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by OSF and audits by the Medicare fiscal intermediary. Certain outpatient services are reimbursed at a prospectively determined rate per service based upon their ambulatory payment classification. As of September 30, 2016, Medicare cost reports have been audited and final-settled through September 30, 2012 for all providers. Medicare cost reports have been audited and final settled through September 30, 2013 for the following providers: SFH, SJH, SJMC, SAHC, and SEMC. Medicare cost reports have been audited and final settled through September 30, 2014 for SFH. Various re-opening letters have been received for certain providers in the normal course of the intermediaries review.

OSF participates in various shared risk programs. OSF shared risk with the Centers of Medicare and Medicaid Services for the cost of providers through the Pioneer and Next Generation ACO programs during 2016. OSF completed its last year of participation in the Pioneer ACO program at December 31, 2015. As of January 1, 2016, OSF transitioned from the Pioneer ACO programs to the Next Generation ACO program, sponsored by the Centers for Medicare and Medicaid Innovation. A letter of credit is required for the Next Generation ACO program in which OSF has provided.


(Continued)

As of September 30, 2016, OSF has recorded a payable of $14,087 as a component of accounts payable and accrued expenses for outstanding risk contracts compared to a receivable of $288 as of September 30, 2015.

***(b) Medicaid***

Inpatient services rendered to Medicaid program beneficiaries are reimbursed at prospectively determined rates per discharge. Outpatient services rendered to Medicaid program beneficiaries are reimbursed upon per-visit rates. Medicaid payment methodologies and rates for services are based on the amount of funding available to the State of Illinois Medicaid program.

OSF participates in all State of Illinois Hospital Assessment programs. Assessment programs provide hospitals within the State additional Medicaid reimbursement based on funding formulas approved by the Centers for Medicare and Medicaid Services (CMS). OSF has included its reimbursement for the years ended September 30, 2016 and 2015 of $113,450 and $113,627 within net patient service revenue in the accompanying consolidated statements of operations and changes in unrestricted net assets.

OSF included its related assessment tax payments of $55,992 and $54,570 for the years ended September 30, 2016 and 2015, respectively, within other expense in the accompanying consolidated statements of operations and changes in unrestricted net assets.

***(c) Other***

OSF has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to OSF under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined per diem rates. OSF shares risk and receives bonuses for a portion of managed care payors.

Net patient service revenue for the years ended September 30, 2016 and 2015 includes approximately $3,268 and $2,314, respectively, of net favorable retroactively determined settlements from third-party payors relating to prior years exclusive of the amounts related to the aforementioned Medicaid program.

Patients' accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectability of patients' accounts receivable, OSF analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectible accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, OSF analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary. For receivables associated with patient responsibility (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the patients are screened against the OSF charity care policy and uninsured discount policy. For any remaining patient responsibility balance, OSF records a provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

(In thousands)

OSF's allowance for uncollectible accounts for self-pay patients, which includes uninsured patients and residual copayments and deductibles for which managed care has already paid, decreased from 79.52% of self-pay accounts receivable at September 30, 2015, to 64.84% of self-pay accounts receivable at September 30, 2016. In addition, OSF's self-pay write-offs increased from $70,045 for fiscal year 2015 to $70,823 for fiscal year 2016. During fiscal year 2016, OSF revised the financial assistance and uninsured discount policies to reflect updates in Federal and State regulatory changes. OSF does not maintain a material allowance for uncollectible accounts from third-party payors, nor did it have significant write-offs from third-party payors.

OSF recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, OSF recognizes revenue for services provided (on the basis of discounted rates, as provided by policy). On the basis of historical experience, a portion of OSF's uninsured patients will be unable or unwilling to pay for the services provided. Thus, OSF records a provision for bad debts related to uninsured patients in the period the services are provided. Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period from these major payor sources, is as follows:

| | 2016 | 2015 |
|---|---|---|
| Medicare | $ 680,646 | 611,837 |
| Medicaid | 396,887 | 383,917 |
| Managed care/contracted payor | 1,180,993 | 1,136,285 |
| Self-pay | 45,054 | 37,767 |
| Other | 108,882 | 125,150 |
| Net patient service revenues | $ 2,412,462 | 2,294,956 |

(In thousands)

## (4) Concentration of Credit Risk

OSF grants credit without collateral to its patients and residents, most of whom are local residents and are insured under third-party payor arrangements. The mix of receivables from patients, residents, and third-party payors at September 30, 2016 and 2015 was as follows:

| | 2016 | 2015 |
|---|---|---|
| Medicare | 20% | 20% |
| Medicaid | 39 | 35 |
| Blue cross | 7 | 10 |
| Other third-party payors | 27 | 27 |
| Patients | 7 | 8 |
| | 100% | 100% |

As of September 30, 2016 and 2015, Medicaid fee for service and Medicaid managed care net receivables aggregate to $110,861 and $78,652, respectively. OSF values these receivables using historical collection on enacted rates at the time of the estimate. OSF continues to monitor the State budget matters impacting the Medicaid program.

## (5) Charity Care

OSF affirms and maintains its commitment to serve its communities in a manner consistent with the philosophy of OSF and the Parent. The philosophy is that adequate access to healthcare is a basic human right for all. OSF is committed to the promotion, preservation, protection, and restoration of wellness, whenever possible. OSF's services are provided to all persons with compassion and regardless of a patient's financial resources. To support this statement, the costs (determined using an estimated current year Medicare cost-to-charge ratio) incurred for services and supplies furnished under OSF's charity assistance policy aggregated $29,301 and $24,282 in 2016 and 2015, respectively. Not included in these amounts are benefits provided to the poor through the unpaid cost of Medicaid and other public programs. Additional other benefits provided are for the broader community that represents the unpaid cost of health education, research, and other community health services responding to a special need in the communities that OSF serves.

(In thousands)

## (6) Investments

### *(a) Investments*

The composition of investments, at fair value, at September 30, 2016 and 2015 is set forth in the following table:

| | | 2016 | 2015 |
|---|---|---|---|
| Cash and cash equivalents | $ | 13,885 | 10,878 |
| Domestic equities | | 195,602 | 166,886 |
| U.S. Treasury obligations | | 225,321 | 78,907 |
| U.S. government agencies | | 67,959 | 3,923 |
| Municipal securities | | 5,240 | 2,892 |
| Domestic corporate obligations | | 238,430 | 91,797 |
| Domestic mutual funds – equities | | 25,891 | 23,393 |
| Domestic mutual funds – bonds | | 166,723 | 414,574 |
| Domestic commingled funds | | 79,293 | 69,200 |
| Foreign equities | | 83,084 | 56,116 |
| Foreign bonds | | 20,046 | 8,790 |
| Foreign mutual funds – equities | | 252 | 433 |
| Foreign mutual funds – bonds | | 250 | 156 |
| Foreign securities – commingled | | 36,915 | 33,153 |
| Other | | 730 | 233 |
| | $ | 1,159,621 | 961,331 |

(In thousands)

***(b) Restricted Assets***

The composition of restricted assets, at fair value, except other – farmland, at September 30, 2016 and 2015 is set forth in the following table:

| | 2016 | 2015 |
|---|---|---|
| Cash and cash equivalents | $ 855 | 953 |
| Domestic equities | 3,797 | 3,555 |
| Domestic corporate obligations | 309 | 280 |
| Domestic mutual funds – equities | 1,879 | 1,736 |
| Domestic mutual funds – bonds | 1,435 | 1,431 |
| Foreign mutual funds – equities | 957 | 851 |
| Foreign mutual funds – bonds | 314 | 198 |
| Foreign equities | 111 | — |
| Foreign bonds | 152 | 152 |
| Other | 99 | 96 |
| Pledges receivable and other | 21,449 | 13,489 |
| Investments held at Foundation: | | |
| Cash and cash equivalents | 11,104 | 7,827 |
| U.S. government agencies | 11 | 14 |
| Domestic equities | 9,048 | 6,746 |
| Domestic corporate obligations | 90 | 272 |
| Domestic mutual funds – equities | 19,437 | 14,525 |
| Domestic mutual funds – bonds | 14,918 | 11,853 |
| Foreign equities | — | 93 |
| Foreign bonds | 1 | 1 |
| Foreign mutual funds – equities | 5,438 | 4,061 |
| Foreign mutual funds – bonds | 274 | 200 |
| Other – Farmland | 960 | 960 |
| | $ 92,638 | 69,293 |

(In thousands)

***(c) Assets Limited as to Use***

The composition of assets limited as to use at fair value, at September 30, 2016 and 2015 is set forth in the following table:

| | | 2016 | 2015 |
|---|---|---|---|
| Held by trustee under indenture agreement: | | | |
| Cash and cash equivalents | $ | 5,157 | 131,717 |
| U.S. Treasury obligations | | 20,719 | — |
| U.S. government agencies | | 10,548 | — |
| Municipal securities | | 8,540 | — |
| Domestic corporate obligations | | 53,204 | — |
| Domestic mutual funds – equities | | 696 | 382 |
| Domestic mutual funds – bonds | | 1,038 | |
| Foreign mutual funds – equities | | 165 | 248 |
| Domestic commingled funds | | — | 2,758 |
| | | 100,067 | 135,105 |
| Board-designated for self-insurance, including $31,590 and $27,540 designated as current portion of September 30, 2016 and 2015, respectively: | | | |
| Cash and cash equivalents | | 19,693 | 26,457 |
| Domestic equities | | 7,939 | 7,121 |
| U.S. Treasury obligations | | 43,685 | 46,992 |
| U.S. government agencies | | 7,308 | 1,779 |
| Domestic corporate obligations | | 48,281 | 43,864 |
| Domestic mutual funds – equities | | 262 | 140 |
| Domestic commingled funds | | 36,335 | 28,063 |
| Foreign bonds | | 10,152 | 6,643 |
| Foreign equities | | 520 | 374 |
| Foreign commingled funds | | 12,306 | 11,052 |
| | | 186,481 | 172,485 |
| | | 286,548 | 307,590 |
| Less current portion | | (31,590) | (27,540) |
| | $ | 254,958 | 280,050 |

(In thousands)

The composition of OSF's investment return for the years ended September 30, 2016 and 2015 is as follows:

| | | 2016 | 2015 |
|---|---|---|---|
| Investment return: | | | |
| Interest and dividend income | $ | 26,558 | 19,953 |
| Net realized gains | | 15,867 | 11,605 |
| Change in net unrealized gains on trading securities | | 53,961 | (32,562) |
| Total investment return | $ | 96,386 | (1,004) |

Investment returns included in the accompanying consolidated statements of operations and changes in unrestricted net assets and changes in net assets for the years ended September 30, 2016 and 2015 are as follows:

| | | 2016 | 2015 |
|---|---|---|---|
| Unrestricted revenue, gains, and other support: | | | |
| Other | $ | 9,515 | (3,816) |
| Nonoperating gains: | | | |
| Investment return | | 82,930 | 4,093 |
| Other changes in net assets: | | | |
| Temporarily restricted net assets: | | | |
| Investment return | | 3,887 | (1,246) |
| Permanently restricted net assets: | | | |
| Investment return | | 54 | (35) |
| Total investment return | $ | 96,386 | (1,004) |

(In thousands)

## (7) Property and Equipment

A summary of property and equipment at September 30 is as follows:

| | 2016 | 2015 |
|---|---|---|
| Land | $ 36,601 | 34,151 |
| Land improvements | 31,137 | 36,778 |
| Buildings | 1,407,495 | 1,348,050 |
| Equipment | 933,360 | 952,110 |
| | 2,408,593 | 2,371,089 |
| Less accumulated depreciation | 1,380,536 | 1,416,365 |
| | 1,028,057 | 954,724 |
| Construction in progress | 89,380 | 63,236 |
| Property and equipment, net | $ 1,117,437 | 1,017,960 |

At September 30, 2016, the remaining contractual commitment on construction in progress approximated $45,000 and will be financed by operations and existing funds. OSF capitalized interest, net of interest income on project funds in the amount of $3,187 and $0 for the years ended September 30, 2016 and 2015, respectively.

## (8) Other Assets

Included in other assets at September 30 are the following:

- Bond financing costs, net of accumulated amortization of $8,394 in 2016 and $8,326 in 2015
- Escrow deposits of $3,749 in 2016 and $4,249 in 2015 for the self-insured workers' compensation program and are comprised of cash and cash equivalents.
- Deferred tax assets of $15,215 and $15,532 at September 30, 2016 and 2015, respectively (note 15).
- Other miscellaneous assets of $8,393 and $8,752 at September 30, 2016 and 2015, respectively.
- Venture capital investments of $10,602 and $0 at cost at September 30, 2016 and 2015, respectively.
- The investments in joint ventures accounted for using the equity method of accounting totaled $11,443 and $11,775 at September 30, 2016 and 2015, respectively. The most significant of these investments include:
  - Community Cancer, LLC – 50.0% ownership interest
  - Renal Intervention Center, LLC – 34.0% ownership interest
  - SimNext, LLC – 50.0% ownership interest

(In thousands)

- River Plex Fitness Center, LLC – 50.0% ownership interest (in operating results only)
- McLean Imaging Properties, LLC – 49.9% ownership interest
- Rockford Orthopedic Surgery Center, LLC (ROSC) – 25.0% ownership interest
- Fox River Cancer Center, LLC – 38.0% ownership interest as of September 30, 2015

For the years ended September 30, 2016 and 2015, OSF recognized (loss) income of ($164) and $616 in investments in joint ventures, respectively, as a component of other revenue.

The following table summarizes the aggregated unaudited financial information of unconsolidated joint ventures of OSF as of September 30, 2016 and 2015:

| | | 2016 | 2015 |
|---|---|---|---|
| Total assets | $ | 31,416 | 36,744 |
| Total liabilities | | 9,645 | 13,176 |
| Total net assets | $ | 21,771 | 23,568 |
| Total revenues | $ | 19,028 | 22,296 |
| Operating expenses | | 18,915 | 18,510 |
| Net income | $ | 113 | 3,786 |

## (9) Long-Term Debt

A summary of long-term debt at September 30, 2016 and 2015 is as follows:

| | | 2016 | 2015 |
|---|---|---|---|
| OSF Master Trust Indenture Obligations: | | | |
| Revenue Bonds (Illinois Finance Authority Bonds, Series 2016), payable in annual installments of varying amounts, commencing on May 15, 2021 at fixed interest rates between 3.125% and 5.00% depending on the date of maturity through May 15, 2039 | $ | 114,375 | — |
| Revenue Bonds (Illinois Finance Authority Bonds, Series 2015A), payable in annual installments of varying amounts, commencing on November 15, 2017 at fixed interest rates between 3.00% and 5.00% depending on the date of maturity through November 15, 2045 | | 368,150 | 368,150 |



(Continued)

(In thousands)

| | | 2016 | 2015 |
|---|---|---|---|
| Taxable Revenue Bonds (Illinois Finance Authority Bonds, Series 2015B), payable in annual installments of varying amounts, commencing on November 1, 2024 through November 1, 2045. Interest is determined monthly based on current market conditions (1.44% at September 30, 2016 and 1.11% at September 30, 2015) | $ | 94,270 | 94,270 |
| Revenue Refunding Bonds (Illinois Finance Authority Bonds, Series 2012A), payable in annual installments of varying amounts, commencing on May 15, 2013 at fixed interest rates between 4.00% and 5.00% depending on the date of maturity through May 15, 2041 | | 173,345 | 174,845 |
| Revenue Refunding Bonds (Illinois Finance Authority Bonds, Series 2010A), payable in annual installments of varying amounts, commencing on May 15, 2011 at a fixed interest rate of 6.00%. The bonds mature on May 15, 2039. Debt with maturities after May 15, 2020 was defeased in the amount of $100,710 on September 29, 2016 | | 56,170 | 156,880 |
| Revenue Bonds (Illinois Finance Authority Bonds, Series 2009B, Series 2009C, and Series 2009D), payable in annual installments of varying amounts, commencing November 15, 2021 through November 15, 2037. Interest is determined weekly based on current market conditions (0.86%, 0.73%, and 0.88%, respectively, as of September 30, 2016 and 0.02%, 0.02%, and 0.02%, respectively, as of September 30, 2015) | | 125,000 | 125,000 |
| Revenue Bonds (Illinois Finance Authority Bonds, Series 2009G), payable in annual installments of varying amounts, commencing August 1, 2010 through August 1, 2029. Interest is determined monthly based on the current market conditions (1.02% as of September 30, 2016 and 0.80% as of September 30, 2015) | | 16,500 | 17,000 |



(Continued)

(In thousands)

| | | 2016 | 2015 |
|---|---|---|---|
| Revenue Bonds (Illinois Finance Authority Bonds, Series 2007E and Series 2007F) payable in annual installments of varying amounts commencing November 15, 2024 through November 15, 2037. Interest is determined weekly based on current market conditions (0.88% and 0.88%, respectively, as of September 30, 2016 and 0.02% and 0.02%, respectively, as of September 30, 2015) | $ | 125,000 | 125,000 |
| Other debt: | | | |
| Mortgage note payable to Byron Bank, secured by an EMS training facility. The note bears interest at a rate of 2.91%. Principal and interest of $3 are payable monthly through October 30, 2017 with a balloon payment of $489 due on November 30, 2017 | | 494 | 517 |
| HUD insured mortgage under Section 242 of the *National Housing Act* . The mortgage bears interest at a rate of 4.425%. Principal and interest of $190 is due monthly through December 2036 | | 30,502 | 31,414 |
| Revenue Bonds (OSF Finance Company, LLC, Adjustable Rate Taxable Securities, Series 2007-A) payable in annual installments of varying amounts commencing on December 1, 2009 through December 1, 2037. Interest rate varies weekly based on current market conditions (0.87% as of September 30, 2016 and 0.015% as of September 30, 2015) | | 24,170 | 24,650 |
| Mortgage note payable to Rockford Bank and Trust, secured by medical office building. The note bears an interest rate of 3.80% payable monthly. Principal and interest of $22 is payable monthly with a balloon payment of $2,906 on June 20, 2020 | | 3,411 | 3,540 |
| Mortgage note payable to Busey Bank, secured by a medical office building. The note bears an interest rate of 3.25% payable monthly. Principal and interest of $16 are due monthly through May 2024 | | 1,233 | 1,367 |

(In thousands)

| | | 2016 | 2015 |
|---|---|---|---|
| Mortgage note payable to JP Morgan Chase Bank, N.A., secured by a medical office building. The interest rate varies monthly based on current market conditions (2.27% and 1.95% as of September 30, 2016 and 2015, respectively). Principal payment of $47 plus accrued interest is due monthly through August 2017 with a balloon payment of $3,556 due September 30, 2017, plus interest | $ | 4,069 | 4,628 |
| Mortgage note payable to Commerce Bank, secured by a medical office building. The note bears an interest rate of 3.32% payable monthly. Principal and interest of $31 are payable monthly through June 30, 2022 with a balloon payment of $1,087 due July 31, 2022 | | 2,828 | 3,098 |
| Mortgage note payable to Busey Bank, secured by an office building. The note bears an interest rate of 4.36% payable monthly. Principal and interest of $68 is payable monthly through March 2024 with a balloon payment of $6,641 due April 1, 2024 | | 9,944 | 10,309 |
| Mortgage note payable to Byron Bank, secured by a medical office building. The note bears an interest rate of 4.42% payable monthly. Principal and interest of $10 is payable monthly through August 2029 | | 1,118 | 1,180 |
| Mortgage note payable to Commerce Bank, secured by a medical office building. The note bears an interest rate of 3.32% payable monthly. Principal and interest of $15 are payable monthly through June 30, 2022 with a balloon payment of $513 due July 30, 2022 | | 1,336 | 1,464 |
| Mortgage note payable to Heartland Bank, secured by a medical office building. The note bears an interest rate of 4.24% payable monthly. Principal and interest of $32 are payable monthly through May 19, 2017 with a balloon payment of $3,174 due June 19, 2017 | | 3,326 | 3,566 |
| Note payable to Commerce Bank, secured by an aviation hangar. The note bears an interest rate of 3.05%. Principal and interest of $14 are payable monthly through May 1, 2017 with a balloon payment of $1,064 due June 1, 2017 | | 1,149 | 1,279 |



(Continued)

(In thousands)

| | | 2016 | 2015 |
|---|---|---|---|
| Mortgage note payable to Commerce Bank, secured by a medical office building. The note bears an interest rate of 2.96% payable monthly. Principal and interest payments of $42 are payable monthly through October 1, 2022 with a balloon payment of $1,485 due November 1, 2022 | $ | 4,033 | 4,376 |
| Mortgage note payable to Busey Bank, secured by a medical office building. The note bears interest at a rate of 3.08%. Principal and interest of $6 are payable monthly through April 1, 2018 with a balloon payment of $804 due on May 21, 2018 | | 867 | 906 |
| Other miscellaneous notes payable and capital leases | | 2,014 | 3,963 |
| | | 1,163,304 | 1,157,402 |
| Plus original issue premium, net | | 38,932 | 31,141 |
| Total debt | | 1,202,236 | 1,188,543 |
| Less current installments | | 24,875 | 13,493 |
| Total long-term debt, excluding current installments | $ | 1,177,361 | 1,175,050 |

OSF's average interest rates for variable rate debt for the years ended September 30, 2016 and 2015 are as follows:

| | 2016 | 2015 |
|---|---|---|
| Variable interest rate issues: | | |
| 2007E | 0.25 % | 0.04 % |
| 2007F | 0.25 | 0.04 |
| 2009B | 0.25 | 0.04 |
| 2009C | 0.23 | 0.04 |
| 2009D | 0.25 | 0.04 |
| 2009G | 0.96 | 0.81 |
| 2015B | 1.44 | 1.11 |

On September 29, 2015, OSF entered into a Second Amended and Restated Master Trust Indenture (MTI) dated September 1, 2015. The purpose of the MTI is to provide a mechanism for the efficient and economical advancement of funds to various operating divisions of OSF using the collective borrowing capacity and credit rating of OSF. OSF has pledged letters of credit as collateral on certain borrowings under the MTI. Under the terms of the MTI, OSF is also required to maintain certain deposits with a trustee.

(In thousands)

Such deposits are included with assets limited as to use. The MTI also places limits on the incurrence of additional borrowings and requires that OSF satisfy certain measures of financial performance as long as the notes are outstanding. As of September 30, 2016 and 2015, amounts outstanding under the MTI totaled $1,072,810 and $1,061,145, respectively.

Bond issue premiums and costs are amortized over the term of the related bonds using a weighted average method, based on outstanding debt.

In September 2016, OSF refinanced a portion of the Series 2010A bonds with the issuance of the Series 2016 bonds. The result of the refinancing was a loss on early extinguishment of debt of $20,482.

In September 2015, OSF refinanced Series 2007A and 2009A bonds and paid in full Series 2009E bonds and the PNC Direct Note Obligation, as well as obtained additional funds for capital projects and pension funding with the issuance of Revenue Bonds, Series 2015A and Taxable Revenue Bonds, Series 2015B. The result of the refinancing was a loss on early extinguishment of debt of $28,880.

OSF has variable rate demand notes that have a put option available to the creditor. If the put option is exercised, the bonds are presented to the bank, which in turn draws on the underlying letter of credit or liquidity facility. The series and the underlying credit facility terms are described as follows as of September 30, 2016:

| | Term |
|---|---|
| OSF Master Trust Indenture Obligations: | |
| 2007E | Quarterly beginning 367 days after bank purchase date and ending on the fifth anniversary of the bank purchase date. The letter of credit expires September 25, 2019. |
| 2007F | Quarterly beginning 367 days after bank purchase date and ending on the fifth anniversary of the bank purchase date. The letter of credit expires September 25, 2019. |
| 2009B | Quarterly over three years beginning three months after 366 days elapsed since liquidity advance. The letter of credit expires September 15, 2021. |
| 2009C | Quarterly over three years beginning on the first day of the calendar quarter after 366 days elapsed since liquidity advance. The letter of credit expires October 2, 2018. |
| 2009D | Quarterly over two years beginning after 367 days elapsed since liquidity advance. The letter of credit expires October 2, 2019. |
| Other debt: | |
| 2007A | Quarterly over three years beginning after 366 days elapsed since liquidity advance. The letter of credit expires December 20, 2020. |

(In thousands)

Scheduled principal payments on OSF's long-term debt is as follows:

| | | |
|---|---|---|
| Year ending September 30: | | |
| 2017 | $ | 24,875 |
| 2018 | | 22,959 |
| 2019 | | 22,571 |
| 2020 | | 26,530 |
| 2021 | | 26,879 |
| Thereafter | | 1,078,422 |

Principal payments on long-term debt if (i) variable rate bonds are put and not remarketed resulting in draws on letters of credit or (ii) certain SFI debt is not refinanced in the ordinary course is as follows:

| | | |
|---|---|---|
| Year ending September 30: | | |
| 2017 | $ | 24,875 |
| 2018 | | 103,104 |
| 2019 | | 106,843 |
| 2020 | | 98,262 |
| 2021 | | 61,535 |
| Thereafter | | 807,617 |

A summary of interest cost on borrowed funds held by the trustee under the MTI during the years ended September 30, 2016 and 2015 is as follows:

| | | 2016 | 2015 |
|---|---|---|---|
| Interest cost – charged to operations | $ | 33,034 | 31,249 |

## (10) Derivative Instruments and Hedging Activities

OSF has interest-rate-related derivative instruments to manage its exposure on its variable-rate debt instruments and does not enter into derivative instruments for any purpose other than cash flow hedging purposes.

By using derivative financial instruments to hedge exposures to changes in interest rates, OSF exposes itself to credit risk, tax risk, and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of a derivative contract is positive, the counterparty owes OSF, which creates credit risk for OSF. When the fair value of a derivative contract is negative, OSF owes the counterparty, and therefore, it does not pose a credit risk. OSF minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties whose credit rating is at least “A” or “A2” by Standard and Poor's or Moody's, respectively.

(In thousands)

Tax risk refers to the potential adverse effect that a change in tax law could have on the relationship between taxable (LIBOR) and tax-exempt (SIFMA) rates. OSF minimizes the tax risk in derivative instruments by maintaining sufficient cash reserves to handle potential tax law changes.

Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate contracts is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

OSF is exposed to credit loss in the event of nonperformance by the counterparty to the interest rate swap agreements; however, this is not anticipated. During the years ended September 30, 2016 and 2015, neither OSF nor any counterparty to the interest rate swap agreements were required to post collateral.

A summary of outstanding positions under OSF's interest rate swap program at September 30, 2016 is as follows:

| Notional amount | Maturity date | Rate received | Rate paid |
|---|---|---|---|
| $ 45,200 | November 2, 2029 | BMA Index | 3.969% |
| 45,475 | October 19, 2029 | BMA Index | 3.969 |
| 9,625 | November 15, 2024 | BMA Index | 3.794 |
| 130,000 | November 15, 2037 | 67% 1 Mo. Libor + 0.70% | 3.651 |
| 126,535 | May 15, 2041 | 84% 1 Mo. Libor | SIFMA |

Net payments equal to the differential to be paid under all interest rate swap agreements are recognized within nonoperating gains (losses) as net settlement of derivative instruments and amounted to approximately $(7,109) and $(7,690) in 2016 and 2015, respectively.

In connection with the planned issuance of the Series 2016 Bonds, OSF entered into an interest rate swap to hedge the risk of rising interest rates. The swap was executed on June 21, 2016 in the notional amount of $100,380. The swap was terminated upon the issuance of the Series 2016 Bonds on September 29, 2016 resulting in cash payments totaling $(1,677), which is recognized within the nonoperating gains (losses) as net settlement of derivative instruments in the consolidated statements of operations and changes in unrestricted net assets.

In addition, in connection with the planned issuance of the Series 2015A Bonds, OSF entered into two interest rate swap agreements to partially hedge the risk of rising interest rates. The first swap was executed on May 20, 2015 in the notional amount of $100,000 and the second on June 19, 2015 in the notional amount of $88,470. Both were terminated upon the issuance of the Series 2015A Bonds on September 29, 2015 resulting in cash payments totaling $(2,199), which is recognized within the nonoperating gains (losses) as net settlement of derivative instruments in the consolidated statements of operations and changes in unrestricted net assets.

The fair value of the swap agreements under ASC Subtopic 820-10 was $(67,938) and $(58,125) and is recorded as a component of other liabilities in the accompanying consolidated balance sheets at

(In thousands)

September 30, 2016 and 2015, respectively. For the years ended September 30, 2016 and 2015, OSF recognized an unrealized gain (loss) of $(9,813) and $(13,646), respectively, as its change in the fair value of the interest rate swaps as a component of nonoperating gains (losses) – change in fair value of derivative instruments.

The following is a summary of the swaps as of September 30, 2016:

| Type of interest swap | Notional amount | Mark to market | Fair value |
|---|---|---|---|
| Floating-to-fixed | $ 45,200 | (10,543) | (10,300) |
| Floating-to-fixed | 45,475 | (10,570) | (10,327) |
| Floating-to-fixed | 9,625 | (1,156) | (1,140) |
| Floating-to-fixed | 130,000 | (46,168) | (44,535) |
| Floating-to-fixed | 126,535 | (1,755) | (1,636) |
| | | $ (70,192) | (67,938) |

The following is a summary of the swaps as of September 30, 2015:

| Type of interest swap | Notional amount | Mark to market | Fair value |
|---|---|---|---|
| Floating-to-fixed | $ 46,475 | (9,845) | (9,584) |
| Floating-to-fixed | 46,750 | (9,874) | (9,612) |
| Floating-to-fixed | 10,500 | (1,365) | (1,342) |
| Floating-to-fixed | 130,000 | (38,528) | (36,869) |
| Floating-to-fixed | 127,630 | (1,016) | (718) |
| | | $ (60,628) | (58,125) |

A summary of outstanding positions under SFI's interest rate swap program at September 30, 2016 is as follows:

| Notional amount | Maturity date | Rate received | Rate paid |
|---|---|---|---|
| $ 13,000 | December 1, 2017 | USD – LIBOR-BBA | 4.353% |

Net payments equal to the differential to be received under the interest rate swap program are recognized as a component of interest expense and amounted to approximately $517 and $723 in 2016 and 2015, respectively.

(In thousands)

The fair value of the SFI swap agreements was $(548) and $(1,022) and is recorded as a component of other liabilities in the accompanying consolidated balance sheets as of September 30, 2016 and 2015, respectively. For the years ended September 30, 2016 and 2015, SFI recognized an unrealized gain (loss) of $474 and $229, respectively, as its change in the fair value of the interest rate swaps as a component of nonoperating gains (losses) – change in fair value of derivative instruments.

The following is a summary of SFI's swaps as of September 30, 2016:

| Type of interest swap | | Notional amount | | Mark to market | Fair value |
|---|---|---|---|---|---|
| Fixed rate payor | $ | 13,000 | | (551) | (548) |
| | | | $ | (551) | (548) |

The following is a summary of SFI's swaps as of September 30, 2015:

| Type of interest swap | | Notional amount | | Mark to market | Fair value |
|---|---|---|---|---|---|
| Fixed rate payor | $ | 13,000 | | (1,024) | (1,022) |
| | | | $ | (1,024) | (1,022) |

## (11) Investment Composition and Fair Value Measurements

### *(a) Overall Investment Objective*

The overall investment objective of OSF is to invest its assets in a prudent manner that will achieve an expected rate of return, manage risk exposure, and focus on downside protection. OSF's invested assets will maintain sufficient liquidity to fund a portion of OSF's annual operating activities and structure the invested assets to maintain a high percentage of available liquidity. OSF diversifies their investments among various asset classes incorporating multiple strategies and managers. Major investment decisions are authorized by the Board's Investment Committee, which oversees the investment program in accordance with established guidelines.

### *(b) Allocation of Investment Strategies*

OSF maintains a percentage of assets in domestic and international stocks. To manage its risk exposure, the majority of assets are invested in intermediate term fixed income funds and invested with intermediate and short-term fixed income managers. Because of the inherent uncertainties for valuation of some holdings, the estimated fair values may differ from values that would have been used had a ready market existed.

### *(c) Basis of Reporting*

Assets whose use is limited or restricted are reported at estimated fair value. If an investment is held directly by OSF and an active market with quoted prices exists, the market price of an identical security is used as reported fair value. Reported fair values for shares in common and preferred stock and fixed income are based on share prices reported by the funds as of the last business day of the fiscal year.

### *(d) Fair Value of Financial Instruments*

The following methods and assumptions were used by OSF in estimating the fair value of its financial instruments:

- The carrying amount reported in the consolidated balance sheets for the following approximates fair value because of the short maturities of these instruments: cash and cash equivalents, other assets, accounts payable and accrued expenses, and estimated third-party payor settlements.
- Fair values of OSF's investments held as investments, assets limited as to use, and restricted assets are estimated based on prices provided by its investment managers and its custodian bank. Fair value for cash and cash equivalents, equities, and foreign equities are measured using quoted market prices at the reporting date multiplied by the quantity held. U.S. Treasury obligations, U.S. government agencies, municipal securities, corporate obligations, and foreign securities are measured using other observable inputs. The carrying value equals fair value.
- Commingled funds and mutual funds that do not have a readily determinable fair value are valued using NAV as a practical expedient to measure fair value as allowed by ASU No. 2009-12.
- Fair value of interest rate swaps is determined using pricing models developed based on the LIBOR swap rate and other observable market data. The value was determined after considering the potential impact of collateralization and netting agreements, adjusted to reflect nonperformance risk of both the counterparty and OSF.

### *(e) Fair Value Hierarchy*

OSF adopted ASC Subtopic 820-10 for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. OSF did not elect to fair value any of its nonfinancial assets or liabilities as of September 30, 2016 and 2015. ASC Subtopic 820-10 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that OSF has the ability to access at the measurement date.
- Level 2 are observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

(In thousands)

- Level 3 inputs are unobservable inputs for the asset or liability.

The following tables present OSF's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2016:

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets: | | | | |
| Cash and cash equivalents | $ 157,568 | 157,568 | — | — |
| Investments: | | | | |
| Cash and cash equivalents | 13,885 | 6,378 | 7,507 | — |
| Domestic equities | 195,602 | 195,602 | — | — |
| U.S. Treasury obligations | 225,321 | 225,321 | — | — |
| U.S. government agencies | 67,959 | — | 67,959 | — |
| Municipal securities | 5,240 | — | 5,240 | — |
| Domestic corporate obligations | 238,430 | — | 238,430 | — |
| Domestic mutual funds – equities | 25,891 | 25,891 | — | — |
| Domestic mutual funds – bonds | 166,723 | 166,723 | — | — |
| Domestic commingled funds | 79,293 | 79,293 | — | — |
| Foreign equities | 83,084 | 83,084 | — | — |
| Foreign bonds | 20,046 | — | 20,046 | — |
| Foreign mutual funds – equities | 252 | 252 | — | — |
| Foreign mutual funds – bonds | 250 | 250 | — | — |
| Other | 520 | — | 520 | — |
| Subtotal | 1,122,496 | $ 782,794 | 339,702 | — |
| Foreign securities – commingled | 36,915 | | | |
| Other | 210 | | | |
| Total investments | $ 1,159,621 | | | |
| Restricted assets – excluding pledges and other of $21,449: | | | | |
| Cash and cash equivalents | $ 855 | 855 | — | — |
| Domestic equities | 3,797 | 3,797 | — | — |
| Domestic corporate obligations | 309 | — | 309 | — |
| Domestic mutual funds – equities | 1,879 | 1,879 | — | — |
| Domestic mutual funds – bonds | 1,435 | 1,435 | — | — |
| Foreign mutual funds – equities | 957 | 957 | — | — |
| Foreign mutual funds – bonds | 314 | 314 | — | — |
| Foreign equities | 111 | 111 | — | — |
| Foreign bonds | 152 | — | 152 | — |
| Other | 3 | — | 3 | — |

(In thousands)

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Investments held at foundation: | | | | |
| Cash and cash equivalents | $ 11,104 | 10,760 | 344 | — |
| U.S. government agencies | 11 | — | 11 | — |
| Domestic equities | 9,048 | 9,048 | — | — |
| Domestic corporate obligations | 90 | — | 90 | — |
| Domestic mutual funds – equities | 19,437 | 19,437 | — | — |
| Domestic mutual funds – bonds | 14,918 | 14,918 | — | — |
| Foreign bonds | 1 | — | 1 | — |
| Foreign mutual funds – equities | 5,438 | 5,438 | — | — |
| Foreign mutual funds – bonds | 274 | 274 | — | — |
| Subtotal | 70,133 | $ 69,223 | 910 | — |
| Other – farmland | 1,056 | | | |
| Total restricted assets | $ 71,189 | | | |
| Assets limited as to use: | | | | |
| Cash and cash equivalents | $ 24,850 | 24,850 | — | — |
| Domestic equities | 7,939 | 7,939 | — | — |
| U.S. Treasury obligations | 64,404 | 64,404 | — | — |
| U.S. government agencies | 17,856 | — | 17,856 | — |
| Municipal securities | 8,540 | — | 8,540 | |
| Domestic corporate obligations | 101,485 | — | 101,485 | — |
| Domestic mutual funds – equities | 958 | 958 | — | — |
| Domestic mutual funds – bonds | 1,038 | 1,038 | — | — |
| Domestic commingled funds | 36,335 | 36,335 | — | — |
| Foreign equities | 520 | 520 | — | — |
| Foreign bonds | 10,152 | — | 10,152 | — |
| Foreign mutual funds – equities | 165 | 165 | — | — |
| Subtotal | 274,242 | $ 136,209 | 138,033 | — |
| Foreign commingled funds | 12,306 | | | |
| Total assets limited as to use | $ 286,548 | | | |

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial liabilities: | | | | |
| Fair value of swap agreements | $ 68,486 | — | 68,486 | — |
| Total financial liabilities | $ 68,486 | — | 68,486 | — |

(In thousands)

The following tables present OSF's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2015:

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets: | | | | |
| Cash and cash equivalents | $ 368,762 | 368,762 | — | — |
| Investments: | | | | |
| Cash and cash equivalents | 10,878 | 3,375 | 7,503 | — |
| Domestic equities | 166,886 | 166,886 | — | — |
| U.S. Treasury obligations | 78,907 | 78,907 | — | — |
| U.S. government agencies | 3,923 | — | 3,923 | — |
| Municipal securities | 2,892 | — | 2,892 | — |
| Domestic corporate obligations | 91,797 | — | 91,797 | — |
| Domestic mutual funds – equities | 23,393 | 23,393 | — | — |
| Domestic mutual funds – bonds | 414,574 | 414,574 | — | — |
| Domestic commingled funds | 69,200 | 68,799 | 401 | — |
| Foreign equities | 56,116 | 56,116 | — | — |
| Foreign bonds | 8,790 | — | 8,790 | — |
| Foreign mutual funds – equities | 433 | 433 | — | — |
| Foreign mutual funds – bonds | 156 | 156 | — | — |
| Subtotal | 927,945 | $ 812,639 | 115,306 | — |
| Foreign securities – commingled | 33,153 | | | |
| Other | 233 | | | |
| Total investments | $ 961,331 | | | |
| Restricted assets – excluding pledges and other of $13,489: | | | | |
| Cash and cash equivalents | $ 953 | 953 | — | — |
| Domestic equities | 3,555 | 3,555 | — | — |
| Domestic corporate obligations | 280 | — | 280 | — |
| Domestic mutual funds – equities | 1,736 | 1,736 | — | — |
| Domestic mutual funds – bonds | 1,431 | 1,431 | — | — |
| Foreign mutual funds – equities | 851 | 851 | — | — |
| Foreign mutual funds – bonds | 198 | 198 | — | — |
| Foreign bonds | 152 | — | 152 | — |
| Other – farmland | 96 | — | — | 96 |
| Investments held at foundation: | | | | |
| Cash and cash equivalents | 7,827 | 7,588 | 239 | — |
| U.S. government agencies | 14 | — | 14 | — |
| Domestic equities | 6,746 | 6,746 | — | — |
| Domestic corporate obligations | 272 | — | 272 | — |
| Domestic mutual funds – equities | 14,525 | 14,525 | — | — |
| Domestic mutual funds – bonds | 11,853 | 11,853 | — | — |

(In thousands)

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Foreign equities | $ 93 | 93 | — | — |
| Foreign bonds | 1 | — | 1 | — |
| Foreign mutual funds – equities | 4,061 | 4,061 | — | — |
| Foreign mutual funds – bonds | 200 | 200 | — | — |
| Subtotal | 54,844 | $ 53,790 | 958 | 96 |
| Other – farmland | 960 | | | |
| Total restricted assets | $ 55,804 | | | |
| Assets limited as to use: | | | | |
| Cash and cash equivalents | $ 158,174 | 158,174 | — | — |
| Domestic equities | 7,121 | 7,121 | — | — |
| U.S. Treasury obligations | 46,992 | 46,992 | — | — |
| U.S. government agencies | 1,779 | — | 1,779 | — |
| Domestic corporate obligations | 43,864 | — | 43,864 | — |
| Domestic mutual funds – equities | 522 | 522 | — | — |
| Domestic commingled funds | 30,821 | 28,912 | 1,909 | — |
| Foreign equities | 374 | 374 | — | — |
| Foreign bonds | 6,643 | — | 6,643 | — |
| Foreign mutual funds – equities | 248 | 248 | — | — |
| Subtotal | 296,538 | $ 242,343 | 54,195 | — |
| Foreign commingled funds | 11,052 | | | |
| Total assets limited as to use | $ 307,590 | | | |

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial liabilities: | | | | |
| Fair value of swap agreements | $ 59,147 | — | 59,147 | — |
| Total financial liabilities | $ 59,147 | — | 59,147 | — |

OSF's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no transfers into or out of Level 1, Level 2, or Level 3 for the years ended September 30, 2016 and 2015.

(In thousands)

None of the assets, except those listed below, have any redemption restrictions so the redemption frequency is daily and would have a one-day notice for redemption:

| | | 2016 | 2015 | Redemption frequency | Days notice |
|---|---|---|---|---|---|
| Investments: | | | | | |
| Foreign securities – commingled | $ | 36,915 | 33,153 | Monthly | 10 |
| Domestic commingled funds | | 79,293 | 68,799 | Daily | 2 |
| Global hedge fund | | 198 | 217 | Monthly | Specific date each month |
| Assets limited as to use: | | | | | |
| Foreign securities – commingled | | 12,306 | 11,052 | Monthly | 10 |
| Domestic commingled funds | | 36,335 | 28,912 | Daily | 2 |

## (12) Temporarily and Permanently Restricted Net Assets

OSF's temporarily restricted net assets of $55,985 and $40,473 at September 30, 2016 and 2015, respectively, are restricted for nursing education and various programs related to the provision of healthcare.

OSF's permanently restricted net assets of $36,653 and $28,820 at September 30, 2016 and 2015, respectively, consist of investments to be held in perpetuity, the majority of income of which is expendable to support healthcare services.

During 2016 and 2015, net assets were released from donor restrictions by purchasing equipment and incurring operating expenses, which satisfied the restricted purpose of healthcare and nursing education in the amount of $3,482 and $5,541, respectively.

## (13) Self-Insurance

OSF has established a self-insurance program for professional and general liability, which provides for both self-insured limits and purchased coverage above such limits. Excess coverage is provided by OSF Assurance Company, who purchases reinsurance from a third-party carrier for professional and general liability that has a limit ranging from $35,000 to $55,000 for each claim and in the aggregate and is in excess of $7,000 for each and every occurrence depending on the year of the claim. There are known claims and incidents that may result in the assertion of additional claims, as well as claims from unknown incidents that may be asserted arising from services provided to patients. OSF has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued professional and general liability losses are recorded on an undiscounted basis. In management's opinion, the accrued professional and general liability losses provide an adequate reserve for loss contingencies.

OSF is self-insured for workers' compensation. OSF has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of workers' compensation claims.

(In thousands)

OSF is also self-insured for unemployment compensation benefits and health and dental claims. OSF has developed internal techniques for estimating the ultimate costs of these claims. Accrued losses are recorded on an undiscounted basis. In management's opinion, accrued losses provide an adequate reserve for loss contingencies. Due to the short-term nature of health and dental claims, estimated liabilities of $15,694 and $12,205 as of September 30, 2016 and 2015, respectively, have been reported as accrued expenses. The associated expense of $136,716 and $135,855 as of September 30, 2016 and 2015, respectively, is included in salaries and benefits in the accompanying consolidated statements of operations and changes in net assets.

As of September 30, 2016 and 2015, estimated self-insurance liabilities are comprised of the following:

| | | 2016 | 2015 |
|---|---|---|---|
| Professional and general liability | $ | 166,519 | 156,442 |
| Workers' compensation | | 18,863 | 20,752 |
| Other | | 2,547 | 2,949 |
| Total estimated self-insurance liabilities | | 187,929 | 180,143 |
| Less current portion | | 31,590 | 27,540 |
| Total estimated self-insurance liabilities, less current portion | $ | 156,339 | 152,603 |

OSF shares certain insurance risks it has underwritten through the use of reinsurance contracts. Amounts that can be claimed from OSF's reinsurers are valued by an independent actuary. Should OSF's reinsurers be unable to reimburse OSF for recoverable claims, OSF would still be liable to pay the claims; however, OSF contracts with various highly rated insurance carriers to mitigate this risk. As of September 30, 2016 and 2015, OSF has recorded no insurance receivables in the accompanying consolidated balance sheets.

Self-insurance expense is included in supplies and other expenses in the accompanying consolidated statements of operations and changes in net assets. As of September 30, 2016 and 2015, self-insurance expense is comprised of the following:

| | | 2016 | 2015 |
|---|---|---|---|
| Professional and general liability | $ | 17,698 | 19,014 |
| Workers' compensation | | 2,971 | 4,933 |
| Total self-insurance expense | $ | 20,669 | 23,947 |

## (14) Retirement Benefits

OSF has a noncontributory defined benefit pension plan (the Plan) covering substantially all employees of the Providers and OSF Corporate Office. The Plan was changed to eliminate benefit accruals after March 5, 2011. Curtailment accounting occurred effective December 31, 2010. Prior to the Plan's change, the benefit was based on a career average benefit based on both pay and service earned at OSF.

(In thousands)

Contributions are made on a monthly basis to improve the Plan's funded status. The Plan is a "Church" plan and is not subject to Employee Retirement Income Security Act (ERISA).

The actuarial funding method used in the actuarial valuation for 2016 and 2015 is the projected unit credit cost method. The measurement date for plan liabilities and assets is September 30 for the years ended September 30, 2016 and 2015. The following tables set forth the Plan's funded status and amounts recognized in OSF's consolidated financial statements at September 30, 2016 and 2015:

| | | 2016 | 2015 |
|---|---|---|---|
| Change in benefit obligation: | | | |
| Benefit obligation at beginning of year | $ | 881,863 | 910,468 |
| Interest cost | | 40,042 | 40,508 |
| Actuarial loss (gain) | | 114,586 | (47,731) |
| Benefits paid | | (23,895) | (21,382) |
| Benefit obligation at end of year | $ | 1,012,596 | 881,863 |
| Change in plan assets: | | | |
| Fair value of plan assets at beginning of year | $ | 533,025 | 499,690 |
| Actual return on plan assets | | 52,188 | (7,382) |
| Employer contributions | | 4,586 | 62,099 |
| Benefits paid | | (23,895) | (21,382) |
| Fair value of plan assets at end of year | $ | 565,904 | 533,025 |
| Reconciliation of funded status: | | | |
| Funded status | $ | (446,692) | (348,838) |
| Net amount recognized at year-end | $ | (446,692) | (348,838) |
| Amounts recognized in the accompanying consolidated balance sheets: | | | |
| Accrued benefit liability | $ | (446,692) | (348,838) |
| Amounts not yet reflected in net periodic benefit cost and included as an accumulated credit to unrestricted net assets: | | | |
| Net actuarial loss | $ | (483,281) | (385,194) |
| Prior service cost | | (7,085) | (7,319) |
| Net amounts recognized in the accompanying consolidated balance sheets | $ | (490,366) | (392,513) |



(Continued)

(In thousands)

| | | 2016 | 2015 |
|---|---|---|---|
| Weighted average assumptions: | | | |
| Discount rate: | | | |
| Benefit obligation | | 3.75% | 4.60% |
| Net periodic benefit cost | | 4.60 | 4.50 |
| Rate of compensation increase: | | | |
| Benefit obligation | | N/A | N/A |
| Net periodic benefit cost | | N/A | N/A |
| Expected return on plan assets | | 8.00 | 8.00 |
| Components of net periodic benefit cost: | | | |
| Interest cost | $ | 40,042 | 40,508 |
| Expected return on plan assets | | (43,841) | (37,851) |
| Amortization of prior service cost | | 234 | 234 |
| Amortization of actuarial loss | | 8,151 | 9,197 |
| Net periodic benefit cost | $ | 4,586 | 12,088 |

The accumulated benefit obligation for the Plan was $1,012,596 and $881,863 at September 30, 2016 and 2015, respectively. As of September 30, 2016, OSF adopted the RP-2016 Mortality Table with generational improvements using a modified projection scale MP-2016.

Benefit costs are included in salaries and benefits in the accompanying consolidated financial statements.

The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

OSF is expected to contribute approximately $6,103 to the Plan in 2017.

The benefits expected to be paid in each year 2017 through 2021 are approximately $25,895, $30,576, $33,905, $37,194, and $40,379, respectively. The aggregate benefits expected to be paid in the five years from 2022 through 2026 are approximately $240,609. The expected benefits are based on the same assumptions used to measure OSF's benefit obligation at September 30, 2016.

The Plan has a statement of investment policy, which is reviewed and approved by the OSF board of directors. The policy establishes goals and objectives of the fund, asset allocations, allowable and prohibited investments, socially responsible guidelines, and asset classifications, as well as specific investment manager guidelines. The policy states that the rebalancing of these assets to the target allocations will be reviewed on a semiannual basis. Investments are managed by independent advisors. Management monitors the performance of these managers on a monthly basis.

(In thousands)

The table below lists the target asset allocation and acceptable ranges and actual asset allocations as of September 30, 2016 and 2015:

| Asset | Target allocation | Acceptable range | Actual allocation at September 30 2016 | Actual allocation at September 30 2015 |
|---|---|---|---|---|
| Large cap equity | 39% | 34% to 44% | 41.3% | 39.2% |
| Small cap equity | 6 | 1 to 11 | 6.4 | 6.0 |
| International equity | 20 | 15 to 25 | 18.7 | 16.7 |
| Fixed income | 35 | 30 to 40 | 32.6 | 35.2 |
| Cash | — | — | 1.0 | 2.9 |

*Fair Value of Financial Instruments*

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at September 30, 2016 and 2015.

- Fair values of the Plan's assets are estimated based on prices provided by its investment managers and its custodian bank except for commingled funds. Fair value for cash and cash equivalents, equities, and foreign equities are measured using quoted market prices at the reporting date multiplied by the quantity held. U.S. Treasury obligations, U.S. government agencies, municipal securities, corporate obligations, and foreign securities are measured using other observable inputs. The carrying value equals fair value.
- Commingled funds and mutual funds that do not have a readily determinable fair value are valued using NAV as a practical expedient to measure fair value as allowed by ASU No. 2009-12.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

*Fair Value Hierarchy*

The Plan adopted ASC Subtopic 715-20-50, *Compensation – Retirement Benefits*, on October 1, 2009 for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. ASC Subtopic 715-20-50 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value.

(In thousands)

The following table presents the Plan's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2016:

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets: | | | | |
| Investments: | | | | |
| Cash and cash equivalents | $ 13,513 | 13,513 | — | — |
| Domestic equities | 163,636 | 163,636 | — | — |
| U.S. Treasury obligations | 47,983 | 47,983 | — | — |
| U.S. government agencies | 22,865 | — | 22,865 | — |
| Municipal securities | 1,650 | — | 1,650 | — |
| Domestic corporate obligations | 51,389 | — | 51,389 | — |
| Domestic mutual funds – equities | 1,100 | 1,100 | — | — |
| Domestic mutual funds – bonds | 52,998 | 52,998 | — | — |
| Domestic commingled funds | 78,764 | 77,839 | 925 | — |
| Foreign equities | 66,053 | 66,053 | — | — |
| Foreign bonds | 4,636 | — | 4,636 | — |
| Subtotal | 504,587 | $ 423,122 | 81,465 | — |
| Foreign commingled funds | 61,276 | | | |
| Partnership | 41 | | | |
| Total financial assets | $ 565,904 | | | |

(In thousands)

The following table presents the Plan's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2015:

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets: | | | | |
| Investments: | | | | |
| Cash and cash equivalents | $ 57,767 | 57,767 | — | — |
| Domestic equities | 136,349 | 136,349 | — | — |
| U.S. Treasury obligations | 52,278 | 52,278 | — | — |
| U.S. government agencies | 11,520 | — | 11,520 | — |
| Municipal securities | 1,030 | — | 1,030 | — |
| Domestic corporate obligations | 46,381 | — | 46,381 | — |
| Domestic mutual funds – equities | 1,117 | 1,117 | — | — |
| Domestic mutual funds – bonds | 50,873 | 50,873 | — | — |
| Domestic commingled funds | 71,257 | 70,331 | 926 | — |
| Foreign equities | 53,626 | 53,626 | — | — |
| Foreign bonds | 3,669 | — | 3,669 | — |
| Subtotal | 485,867 | $ 422,341 | 63,526 | — |
| Foreign commingled funds | 47,032 | | | |
| Partnership | 126 | | | |
| Total financial assets | $ 533,025 | | | |

The Plan's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no transfers into or out of Level 1, Level 2, or Level 3 for the years ended September 30, 2016 and 2015.

None of the assets, except those listed below, have any redemption restrictions so the redemption frequency is daily and would have a one-day notice for redemption.

| | 2016 | 2015 | Redemption frequency | Days notice |
|---|---|---|---|---|
| Foreign commingled funds | $ 61,276 | 47,032 | Monthly | 10 |
| Domestic commingled funds | 77,839 | 70,331 | Daily | 2 |
| Partnership | 41 | 126 | At GP discretion | N/A |

In addition, OSF sponsors a retirement savings plan that includes a 401(k) feature. In conjunction with the change in the pension plan on March 5, 2011, OSF enhanced the retirement savings plan by increasing the match and adding an annual discretionary contribution. In 2015 and 2016, participants may deposit an amount from 1% to 90% of their eligible compensation up to the Internal Revenue Services (IRS) limit. OSF contributes 100% of the employee contribution up to 5% of eligible compensation. OSF may also make annual discretionary contributions based on a participant's age and years of service. OSF contributed $61,657 in 2016 and $53,696 in 2015 to the retirement savings plan, which has been expensed as salaries and benefits expense. OSF also accrued for an anticipated discretionary contribution of $22,139 in 2016 and $18,791 in 2015, which has been expensed as salaries and benefits expense.

(In thousands)

SFI has a defined benefit pension plan (SFI Plan) covering substantially all of its employees. The plan was changed to eliminate benefit accruals after March 5, 2011. Curtailment accounting occurred effective December 31, 2010. Prior to the plan change, SFI Plan benefits were based on years of service and the employee's compensation during those years of service. SFI's funding policy is to contribute an amount not less than the minimum required contribution under the ERISA of 1974.

The actuarial funding method used in the actuarial valuation for 2016 and 2015 for the SFI Plan is the projected unit credit cost method. The measurement date for plan liabilities and assets is September 30. The following tables set forth the SFI Plan's funded status and amounts recognized in the consolidated financial statements at September 30, 2016:

| | | 2016 | 2015 |
|---|---|---|---|
| Change in benefit obligation: | | | |
| Benefit obligation at beginning of year | $ | 64,076 | 65,911 |
| Interest cost | | 2,950 | 2,974 |
| Actuarial loss (gain) | | 9,205 | (3,606) |
| Benefits paid | | (1,468) | (1,203) |
| Benefit obligation at end of year | $ | 74,763 | 64,076 |
| Change in plan assets: | | | |
| Fair value of plan assets at beginning of year | $ | 46,303 | 47,884 |
| Actual return on plan assets | | 4,634 | (1,078) |
| Employer contributions | | 500 | 700 |
| Benefits paid | | (1,468) | (1,203) |
| Fair value of plan assets at end of year | $ | 49,969 | 46,303 |
| Reconciliation of funded status: | | | |
| Funded status | $ | (24,794) | (17,773) |
| Net amount recognized at year-end | $ | (24,794) | (17,773) |

(In thousands)

| | | 2016 | 2015 |
|---|---|---|---|
| Amounts recognized in the accompanying consolidated balance sheets: | | | |
| Accrued benefit liability | $ | (24,794) | (17,773) |
| Amounts not yet reflected in net periodic benefit cost and included as an accumulated credit to stockholder's equity: | | | |
| Net actuarial loss | $ | (32,464) | (24,646) |
| Prior service cost | | (289) | (298) |
| Net amounts recognized in the accompanying consolidated balance sheets | $ | (32,753) | (24,944) |

| | | 2016 | 2015 |
|---|---|---|---|
| Weighted average assumptions: | | | |
| Discount rate: | | | |
| Benefit obligation | | 3.75% | 4.65% |
| Net periodic benefit cost | | 4.65 | 4.55 |
| Rate of compensation increase: | | | |
| Benefit obligation | | NA | N/A |
| Net periodic benefit cost | | NA | N/A |
| Expected return on plan assets | | 8.00 | 8.00 |
| Components of net periodic benefit cost: | | | |
| Interest cost | $ | 2,950 | 2,974 |
| Expected return on plan assets | | (3,745) | (3,431) |
| Amortization of actuarial loss | | 499 | 608 |
| Amortization of prior service cost | | 9 | 9 |
| Net periodic benefit cost | $ | (287) | 160 |

The accumulated benefit obligation for the SFI Plan was $74,763 and $64,076 at September 30, 2016 and 2015, respectively. As of September 30, 2016, SFI adopted the RP-2016 Mortality Table with generational improvements using a modified projection scale MP-2016.

The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

SFI does not expect to contribute to the SFI Plan in 2017.



(Continued)

(In thousands)

The benefits expected to be paid in each year 2017 through 2021 for the SFI Plan are approximately $1,602, $1,945, $2,169, $2,384, and $2,617, respectively. The aggregate benefits expected to be paid in the five years from 2022 through 2026 are approximately $16,425.

The SFI Plan has a statement of investment policy, which is reviewed and approved by the SFI board of directors. The policy establishes goals and objectives of the fund, asset allocations, allowable and prohibited investments, socially responsible guidelines, and asset classifications as well as specific investment manager guidelines. The policy states that the rebalancing of these assets to the target allocations will be reviewed on a semiannual basis. Investments are managed by independent advisors. Management monitors the performance of these managers on a monthly basis.

The table below lists the target asset allocation and acceptable ranges and actual asset allocations for the SFI Plan as of September 30, 2016 and 2015:

| | | | Actual allocation at September 30 | |
|---|---|---|---|---|
| **Asset** | **Target allocation** | **Acceptable range** | **2016** | **2015** |
| Large cap equity | 39% | 34% to 44% | 40.4% | 39.7% |
| Small cap equity | 6 | 1 to 11 | 6.6 | 6.3 |
| International equity | 20 | 15 to 25 | 18.0 | 16.8 |
| Fixed income | 35 | 30 to 40 | 34.2 | 35.3 |
| Cash | — | — | 0.8 | 1.9 |

The following table presents the SFI Plan’s fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2016:

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets: | | | | |
| Investments: | | | | |
| Cash and cash equivalents | $ 377 | 377 | — | — |
| Domestic mutual funds – equities | 3,315 | 3,315 | — | — |
| Domestic mutual funds – bonds | 17,083 | 17,083 | — | — |
| Domestic commingled funds | 20,178 | 20,178 | — | — |
| Foreign securities | 9,016 | 9,016 | — | — |
| Total financial assets | $ 49,969 | 49,969 | — | — |

(In thousands)

The following table presents the SFI Plan's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2015:

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets: | | | | |
| Investments: | | | | |
| Cash and cash equivalents | $ 929 | 929 | — | — |
| Domestic mutual funds – equities | 2,913 | 2,913 | — | — |
| Domestic mutual funds – bonds | 16,328 | 16,328 | — | — |
| Domestic commingled funds | 18,371 | 18,371 | — | — |
| Foreign securities | 7,762 | 7,762 | — | — |
| Total financial assets | $ 46,303 | 46,303 | — | — |

The SFI Plan's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no transfers into or out of Level 1, Level 2, or Level 3 for the years ended September 30, 2016 and 2015.

None of the assets, except those listed below, have any redemption restrictions so the redemption frequency is daily and would have a one-day notice for redemption:

| | 2016 | 2015 | Redemption frequency | Days notice |
|---|---|---|---|---|
| Domestic commingled funds | $ 20,178 | 18,371 | Daily | 2 |

In addition, SFI sponsors a retirement savings plan that includes a 401(k) feature. In 2015 and 2016, participants may deposit an amount from 1% to 90% of their eligible compensation up to the IRS limit. SFI may make matching contributions equal to a discretionary percentage of the participant's contributions. SFI may also make annual discretionary contributions based on a participant's age and years of service. SFI contributed $3,834 in 2016 and $5,833 in 2015 to the retirement savings plan, which has been expensed as salaries and benefits expense. SFI also accrued for an anticipated discretionary contribution of $265 in 2016 and $2,222 in 2015, which has been expensed as salaries and benefits expense.

SAHC has a noncontributory defined benefit pension plan (SAHC Plan) covering all employees who met the eligibility requirements. The SAHC Plan was changed to eliminate benefit accruals after February 29, 2012. Prior to the SAHC Plan's change, the benefit was based on a career average benefit based on both pay and service earned at SAHC. Contributions are made on a monthly basis to improve the SAHC Plan's funded status. The SAHC Plan is a "Church" plan and is not subject to ERISA. As discussed in note 1, OSF assumed SAHC's pension plan in 2015 in connection with the merger of SAHC.

(In thousands)

The actuarial funding method used in the actuarial valuation for 2016 and 2015 for the SAHC Plan is the projected unit credit cost method. The measurement date for plan liabilities and assets is September 30 for the years ended September 30, 2016 and 2015. The following tables set forth the SAHC Plan's funded status and amounts recognized in OSF's consolidated financial statements at September 30, 2016 and 2015:

| | | 2016 | 2015 |
|---|---|---|---|
| Change in benefit obligation: | | | |
| Benefit obligation at beginning of year | $ | 70,170 | 70,373 |
| Interest cost | | 3,118 | 2,856 |
| Actuarial loss (gain) | | 5,697 | (982) |
| Benefits paid | | (2,389) | (2,077) |
| Benefit obligation at end of year | $ | 76,596 | 70,170 |
| Change in plan assets: | | | |
| Fair value of plan assets at beginning of year | $ | 37,728 | 39,206 |
| Actual return on plan assets | | 2,162 | (772) |
| Employer contributions | | 1,209 | 1,371 |
| Benefits paid | | (2,389) | (2,077) |
| Fair value of plan assets at end of year | $ | 38,710 | 37,728 |
| Reconciliation of funded status: | | | |
| Funded status | $ | (37,886) | (32,442) |
| Net amount recognized at year-end | $ | (37,886) | (32,442) |
| Amounts recognized in the accompanying consolidated balance sheets: | | | |
| Accrued benefit liability | $ | (37,886) | (32,442) |
| Amounts not yet reflected in net periodic benefit cost and included as an accumulated credit to unrestricted net assets: | | | |
| Net actuarial loss | $ | (31,525) | (25,608) |
| Net amounts recognized in the accompanying consolidated balance sheets | $ | (31,525) | (25,608) |

(In thousands)

| | | 2016 | 2015 |
|---|---|---|---|
| Weighted average assumptions: | | | |
| Discount rate: | | | |
| Benefit obligation | | 3.75% | 4.54% |
| Net periodic benefit cost | | 4.54 | 4.49 |
| Rate of compensation increase: | | | |
| Benefit obligation | | N/A | N/A |
| Net periodic benefit cost | | N/A | N/A |
| Expected return on plan assets | | 7.50 | 7.50 |
| Components of net periodic benefit cost: | | | |
| Interest cost | $ | 3,118 | 2,856 |
| Expected return on plan assets | | (2,932) | (2,590) |
| Amortization of net loss | | 551 | 520 |
| Net periodic benefit cost | $ | 737 | 786 |

The accumulated benefit obligation for the SAHC Plan was $76,596 and $70,170 at September 30, 2016 and 2015, respectively. As of September 30, 2016, SAHC adopted the RP-2016 Mortality Table with generational improvements using a modified projection scale MP-2016.

The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

SAHC expects to contribute $606 to the SAHC Plan in 2017.

The benefits expected to be paid in each year 2017 through 2021 for the SAHC Plan are approximately $2,600, $2,834, $2,990, $3,148, and $3,389, respectively. The aggregate benefits expected to be paid in the five years from 2022 through 2026 are approximately $19,479. The expected benefits are based on the same assumptions used to measure the SAHC Plan's benefit obligation at September 30, 2016.

The SAHC Plan has a statement of investment policy. The policy establishes goals and objectives of the fund, asset allocations, allowable and prohibited investments, socially responsible guidelines, and asset classifications, as well as specific investment manager guidelines. The policy states that the rebalancing of these assets to the target allocations will be reviewed on a semiannual basis. Investments are managed by independent advisors. Management monitors the performance of these managers on a monthly basis.



(Continued)

(In thousands)

The table below lists the target asset allocation and acceptable ranges and actual asset allocations for the SAHC Plan as of September 30, 2016 and 2015:

| Asset | Target allocation | Acceptable range | September 30, 2016 | September 30, 2015 |
|---|---|---|---|---|
| Large cap equity | 30% | 20% to 40% | 22.9% | 26.5% |
| Small cap equity | 20 | 10 to 30 | 20.1 | 21.3 |
| International equity | 10 | 0 to 15 | 15.9 | 11.1 |
| Real estate securities | 5 | 0 to 10 | 6.5 | 6.0 |
| Fixed income | 25 | 20 to 35 | 19.8 | 20.0 |
| Cash | — | 0 to 10 | 5.1 | 5.1 |
| Alternative investments | 10 | 0 to 10 | 9.7 | 10.0 |

The following table presents the SAHC Plan’s fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2016:

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets: | | | | |
| Investments: | | | | |
| Cash and cash equivalents | $ 1,974 | 1,974 | — | — |
| Domestic equities | 15,071 | 15,071 | — | — |
| U. S. Treasury obligations | 3,672 | 3,672 | — | — |
| U. S. government agencies | 384 | — | 384 | — |
| Domestic corporate obligations | 3,284 | — | 3,284 | — |
| Domestic mutual funds – equities | 5,938 | 5,938 | — | — |
| Foreign equities | 1,668 | 1,668 | — | — |
| Foreign bonds | 345 | — | 345 | — |
| Foreign mutual funds – equities | 2,623 | 2,623 | — | — |
| Subtotal | 34,959 | $ 30,946 | 4,013 | — |
| Other – Global investment hedge fund | 3,751 | | | |
| Total financial assets | $ 38,710 | | | |

(In thousands)

The following table presents the SAHC Plan’s fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2015:

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets: | | | | |
| Investments: | | | | |
| Cash and cash equivalents | $ 1,899 | 1,899 | — | — |
| Domestic equities | 14,042 | 14,042 | — | — |
| U. S. Treasury obligations | 2,856 | 2,856 | — | — |
| U. S. government agencies | 666 | — | 666 | — |
| Domestic corporate obligations | 3,646 | — | 3,646 | — |
| Domestic mutual funds – equities | 6,030 | 6,030 | — | — |
| Foreign equities | 1,511 | 1,511 | — | — |
| Foreign bonds | 305 | — | 305 | — |
| Foreign mutual funds – equities | 2,665 | 2,665 | — | — |
| Subtotal | 33,620 | $ 29,003 | 4,617 | — |
| Other – Global investment hedge fund | 4,108 | | | |
| Total financial assets | $ 37,728 | | | |

The SAHC Plan’s accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no transfers into or out of Level 1, Level 2, or Level 3 for the years ended September 30, 2016 and 2015.

None of the assets, except those listed below, have any redemption restrictions so the redemption frequency is daily and would have a one-day notice for redemption:

| | 2016 | 2015 | Redemption frequency | Days notice |
|---|---|---|---|---|
| Global investment hedge fund | $ 3,751 | 4,108 | Monthly | Specific date each month |

IPMR has a noncontributory defined benefit pension plan (IPMR Plan) covering all employees who met the eligibility requirements. The IPMR Plan was changed to eliminate benefit accruals after January 1, 2016. Curtailment accounting occurred effective January 1, 2016. Prior to the IPMR Plan’s change, the benefit was based on a career average benefit based on both pay and service earned at IPMR.

The actuarial funding method used in the actuarial valuation for 2016 for the IPMR Plan is the projected unit credit cost method. The measurement date for plan liabilities and assets is September 30 for the year



(Continued)

(In thousands)

ended September 30, 2016. The following table sets forth the IPMR Plan's funded status and amounts recognized in OSF's consolidated financial statements at September 30, 2016:

| | | 2016 |
|---|---|---|
| Benefit obligation at end of year | $ | 3,357 |
| Fair value of plan assets at end of year – Level 1 investments | | 2,407 |
| Reconciliation of funded status | | — |
| Funded status – Accrued benefit liability | $ | (950) |
| Amounts not yet reflected in net periodic benefit cost and included as an accumulated credit to unrestricted net assets: | | |
| Net actuarial loss | $ | 1,357 |
| Weighted average assumptions: | | |
| Discount rate: | | |
| Benefit obligation | | 3.50% |
| Net periodic benefit cost | | 4.13 |
| Rate of compensation increase: | | |
| Benefit obligation | | N/A |
| Net periodic benefit cost | | 2.00 |
| Expected return on plan assets | | 8.00 |

The accumulated benefit obligation for the IPMR Plan was $3,357 at September 30, 2016. Settlement accounting occurred September 30, 2016 due to the amount of lump sums paid from the plan during fiscal 2016. As of September 30, 2016, OSF adopted the RP-2016 Mortality Table with generational improvements using a modified projection scale MP-2016.

## (15) Income Taxes

Income tax expense (benefit) for SFI, Illinois Pathologist Services, LLC, and FRCC for the years ended September 30, 2016 and 2015 consist of the following:

| | | 2016 | | |
|---|---|---|---|---|
| | | Current | Deferred | Total |
| U.S. federal | $ | (1,783) | 2,380 | 597 |
| State | | (482) | 631 | 149 |
| | $ | (2,265) | 3,011 | 746 |

(In thousands)

| | 2015 | | |
|---|---|---|---|
| | Current | Deferred | Total |
| U.S. federal | $ 567 | 922 | 1,489 |
| State | 166 | 152 | 318 |
| | $ 733 | 1,074 | 1,807 |

Income tax expense attributable from revenues, gains, and other support over expenses was $746 and $1,807 for the years ended September 30, 2016 and 2015, respectively, and differed from the amounts computed by applying the U.S. federal income tax rate of 34% to pretax income as a result of the following:

| | 2016 | 2015 |
|---|---|---|
| Computed "expected" tax expense | $ 1,110 | 1,739 |
| (Decrease) increase in income taxes resulting from: | | |
| State income taxes, net of federal income tax effect | 294 | 460 |
| Other nondeductible expenses and other | (658) | (392) |
| Total income tax expense | $ 746 | 1,807 |

Significant components of deferred tax assets and liabilities, using a combined federal and state income tax rate of 43% at September 30, 2016 and 2015, are as follows:

| | 2016 | 2015 |
|---|---|---|
| Deferred tax assets: | | |
| Accounts receivable reserves | $ 349 | 404 |
| Benefit accruals, including pension | 14,091 | 13,234 |
| Investments in joint ventures | 178 | (43) |
| Pledges and contributions | — | 6 |
| Contribution carryover | 139 | 656 |
| Market valuation of derivatives | 344 | 439 |
| 401(k) discretionary | 114 | 836 |
| Total gross deferred tax assets | 15,215 | 15,532 |
| Less valuation allowance | — | — |
| Net deferred tax assets | $ 15,215 | 15,532 |

Deferred tax assets are recorded as other assets in the accompanying consolidated balance sheets.



(Continued)

(In thousands)

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes that it is more likely than not that OSF will realize the benefits of these deductible differences to the extent they exceed the valuation allowance reported above.

OSF generates “unrelated business” income subject to federal and state income taxes (UBIT). During 2016, OSF was audited by the IRS. OSF had historical net operating losses (NOL) that were being used to offset current unrelated business income but as part of the audit, the NOL carryforwards were disallowed. The disallowance of the NOLs resulted in OSF owing tax for 2012 through 2016 related to UBIT. OSF recorded a UBIT liability of $3,377 for the year ended September 30, 2016. UBIT expense of $6,902 was recorded for the year ended September 30, 2016, and is included in income tax expense within the statement of operations and unrestricted changes in net assets.

## (16) Commitments and Contingencies

### *(a) Operating Leases*

OSF occupies space in certain facilities under long-term noncancelable operating lease arrangements. Total equipment rental, asset lease, and facility rental expenses in 2016 and 2015 were $63,105 and $58,201, respectively.

The following is a schedule by year of future minimum lease payments to be made under operating leases as of September 30, 2016 that have initial or remaining lease terms in excess of one year:

| | Amount |
|---|---|
| Year ending September 30: | |
| 2017 | $ 40,942 |
| 2018 | 34,282 |
| 2019 | 22,674 |
| 2020 | 16,915 |
| 2021 | 10,475 |
| Thereafter | 49,356 |

### *(b) Litigation*

OSF and its subsidiaries are involved in litigation arising in the ordinary course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on OSF and its subsidiaries’ future financial position or results from operations.

On February 5, 2013, Methodist Health Services Corporation (Methodist) filed a complaint against OSF Healthcare System d/b/a Saint Francis Medical Center in the United States District Court for the Central District of Illinois, Peoria Division. Methodist's complaint alleges violations of Sections 1 and 2 of the Sherman Act, Illinois state antitrust laws, and the Illinois Consumer Fraud Act, as well as multiple common law claims of tortious interference with prospective economic advantage. The complaint seeks damages in excess of $100 million, treble damages, reasonable attorneys' fees and costs, punitive damages, and a permanent injunction against OSF from any further conduct calculated to prevent Methodist from participating in certain PPO networks.

Each side has issued discovery requests and several third parties subpoenas. Fact and expert depositions have been taken. Discovery is complete and OSF has filed a Motion for Summary Judgment, which was granted on September 30, 2016 in its entirety. Methodist has filed an appeal to the Summary Judgment. Management strongly denies the substantive allegations of the complaint and intends to vigorously defend the litigation. As of September 30, 2016, no amounts have been accrued in the consolidated financial statements for this case.

As disclosed in note 14, Retirement Benefits, OSF sponsors various types of employee benefit plans. On May 3, 2016, a lawsuit was filed in the U.S. District Court for the Central District of Illinois against OSF Healthcare System, on behalf of the participants of the Plan. On May 6, 2016, a lawsuit was filed in the U.S. District Court for the Southern District of Illinois against SAHC, on behalf of the participants of the SAHC Plan. The lawsuits challenge the eligibility of the Plan and the SAHC Plan to be treated as "Church Plans" exempt from the Employee Retirement Income Security Act of 1974. OSF intends to vigorously defend the Plan and the SAHC Plan statuses as eligible Church Plans, consistent with long-standing positions of the U.S. Department of Treasury, including the IRS, the Department of Justice, the Pension Benefit Guaranty Corporation, and the U.S. Department of Labor. A similar case against a Catholic healthcare system is scheduled for oral argument before the United States Supreme Court on March 27, 2017. If in the future, a final, nonappealable ruling was made in OSF's case that was adverse to OSF's position such ruling could, under certain circumstances, have an adverse effect on the financial condition or operations of OSF, when taken as a whole, as a result of requirements to comply with ERISA funding obligations and to pay annual premiums to the Pension Benefit Guaranty Corporation.

### *(c) Legal, Regulatory, and Other Contingencies and Commitments*

The laws and regulations governing the Medicare, Medicaid, and other government healthcare programs are extremely complex and subject to interpretation, making compliance an ongoing challenge for OSF and other healthcare organizations. Recently, the federal government has increased its enforcement activity, including audits and investigations related to billing practices, clinical documentation, and related matters. OSF maintains a compliance program designed to educate employees and to prevent, detect, and correct possible violations.

***(d) The Patient Protection and Affordable Care Act***

In March 2010, the Patient Protection and Affordable Care Act of 2010 (the Affordable Care Act) was enacted. Some of the provisions of the Affordable Care Act took effect immediately, while others will take effect or will be phased in over time, ranging from a few months to ten years following approval. The Affordable Care Act was designed to make available, or subsidize the premium costs of, healthcare insurance for some of the millions of currently uninsured or underinsured consumers below certain income levels. An increase in utilization of healthcare services by those who are currently avoiding or rationing their healthcare was expected. Although bad debt expenses and/or charity care provided were expected to be reduced, increased utilization would be associated with increased variable and fixed costs of providing healthcare services, which may or may not be offset by increased revenues.

The Affordable Care Act contains more than 32 Sections related to healthcare fraud and abuse and program integrity. The potential for increased legal exposure related to the Affordable Care Act's enhanced compliance and regulatory requirements could increase operating expenses.

OSF continues to analyze the Affordable Care Act to assess its effects on current and projected operations, financial performance, and financial condition.

***(e) Tax Exemption for Sales Tax and Property Tax***

Effective June 14, 2012, the Governor of Illinois signed into law, *Public Act 97-0688*, which created an additional method for state sales tax and property tax exemptions to be granted to hospitals in Illinois. The law established new standards for the issuance of charitable exemptions, including requirements for a nonprofit hospital to certify annually that in the prior year, it provided an amount of qualified services and activities to low-income and underserved individuals with a value at least equal to the hospital's estimated property tax liability. This law applies only to those OSF properties for which OSF applied for new property tax exemption after the law's enactment. The primary facilities exempt under the new law are as follows: HFMC, SLMC, SPMC, SEMC, and SAHC. On January 5, 2016, the Fourth District of Illinois Appellate Court ruled that Public Act 97-0688 was unconstitutional under the Illinois Constitution. OSF expects this case will ultimately be taken by the parties to the Illinois Supreme Court. Meanwhile OSF's property tax exemptions under the law remain intact. All of the other OSF Illinois facilities, which consist of SAMC, SJJWAMC, SJMC, SFMC, and SMMC, are exempt under a separate section of the property tax code that has not been deemed unconstitutional. OSF has not accrued any liability for property taxes and maintains the position that all of the facilities listed above are exempt for property taxes.

***(f) Investment Risk and Uncertainties***

OSF invests in various investment securities. Investment securities are exposed to various risks such as interest rate, credit, and overall market volatility risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the accompanying consolidated balance sheets.



(Continued)

## (17) Subsequent Events

In connection with the preparation of the consolidated financial statements and in accordance with ASC Topic 855, *Subsequent Events*, OSF evaluated events and transactions through February 15, 2017, the date the financial statements were issued, noting no subsequent events requiring recording or disclosure in the financial statements or related notes to the financial statements.