



Hospital Sisters
HEALTH SYSTEM

**Annual Report and Audited
Financial Statements**

June 30, 2018



Hospital Sisters Services, Inc.

This report is delivered in satisfaction of the obligations created by the Disclosure Agreement dated February 8, 2017 (the "Master Agreement") and, executed and delivered by Hospital Sisters Services, Inc. (the "Corporation") in connection with the issuance of the Bonds listed on Exhibit C. Terms used herein and not otherwise defined shall have the meanings ascribed thereto in the Disclosure Agreement.

Section 2 of the Disclosure Certificate requires the Corporation to provide an Annual Report which updates certain information which was originally provided in its Official Statement dated January 18, 2017 (the "Official Statement") relating to the issuance of the Bonds.

FINANCIAL INFORMATION

Attached to this Annual Report as EXHIBIT A are the audited consolidated financial statements of the Corporation for the fiscal years ended 2017 and 2018 which have been prepared in accordance with generally accepted accounting principles as promulgated from time to time by the Financial Accounting Standards Board, and have been audited by the accounting firm, KPMG, LLP.

INFORMATION REGARDING THE CORPORATION AND RESULTS FROM OPERATIONS

Attached to this Annual Report as EXHIBIT B is the following information, substantially similar in form and scope to the financial information and operating data originally set forth in Appendix A to the Official Statement under the captions

- (i) List of Obligated Group
- (ii) List of Affiliates of the Corporation
- (iii) Total licensed and staffed beds of Obligated Group
- (iv) Updated tables provided under the heading "SELECTED OPERATIONAL, STATISTICAL, AND FINANCIAL INFORMATION – Condensed Consolidated Balance Sheet of Hospital Sisters Health System";
- (v) Updated table provided under the heading "SELECTED OPERATIONAL, STATISTICAL, AND FINANCIAL INFORMATION – Consolidated Summary Statements of Operations of Hospital Sisters Health System";
- (vi) Updated table provided under the heading "SELECTED OPERATIONAL, STATISTICAL AND FINANCIAL INFORMATION – Obligated Group Relative to HSHS";
- (vii) Updated Income Available for Debt Service table provided under the heading "SELECTED OPERATIONAL, STATISTICAL AND FINANCIAL INFORMATION – Coverage of Historical and Pro Forma Historical Maximum Annual Debt Service" (Historical Maximum Annual only) for the most recent fiscal year;
- (viii) Updated information provided under the heading "SELECTED OPERATIONAL, STATISTICAL, AND FINANCIAL INFORMATION – Outstanding Indebtedness of the Obligated Group;
- (ix) Updated table provided under the heading "SELECTED OPERATIONAL, STATISTICAL AND FINANCIAL INFORMATION – Historical and Pro Forma Capitalization" (Historical Only);
- (x) Updated table provided under the heading "SELECTED OPERATIONAL, STATISTICAL, AND FINANCIAL INFORMATION – Liquidity and Investments";

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*An Affiliate of
Hospital Sisters
Health System*

- (xi) Updated asset allocation table provided under the heading "SELECTED OPERATIONAL, STATISTICAL AND FINANCIAL INFORMATION - Investment Policy";

The information provided in the attached Exhibit B is true and correct as of the date of this Annual Report.

IN WITNESS WHEREOF the undersigned has executed and delivered the Annual Report to the Dissemination Agent, for distribution for the benefit of Holders of the Bonds, all as of this 30th day of October, 2018.

HOSPITALSISTERS SERVICES, INC.

By: 
Ann M. Carr
Its: Obligated Group Agent



HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES
Springfield, Illinois

Consolidated Financial Statements and Supplementary Information

June 30, 2018 and 2017

(With Independent Auditors' Report Thereon)



KPMG LLP
Aon Center
Suite 5500
200 East Randolph Drive
Chicago, IL 60601-6436

Independent Auditors' Report

The Board of Directors
Hospital Sisters Health System:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Hospital Sisters Health System and Subsidiaries, which comprise the consolidated balance sheets as of June 30, 2018 and 2017, and the related consolidated statements of operations and change 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 Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We 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 Hospital Sisters Health System and Subsidiaries as of June 30, 2018 and 2017, and the results of their operations, the changes in their net assets, and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.



Other Matters

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included in schedules 1 through 6 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Chicago, Illinois
October 22, 2018

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES

Springfield, Illinois

Consolidated Balance Sheets

June 30, 2018 and 2017

(Dollars in thousands)

Assets	2018	2017
Current assets:		
Cash and cash equivalents	\$ 128,198	112,810
Receivables:		
Patients' accounts, less allowance for uncollectible accounts of approximately \$132,682 in 2018 and \$115,900 in 2017	373,261	426,821
Due from third-party reimbursement programs	989	2,491
Other	42,870	37,641
Total receivables	417,120	466,953
Current portion of assets whose use is limited or restricted	303,153	317,603
Inventories	48,386	48,021
Prepaid expenses	29,306	29,615
Total current assets	926,163	975,002
Assets whose use is limited or restricted, net of current portion	1,536,881	1,613,977
Property, plant, and equipment, net	1,492,701	1,410,180
Other assets	100,348	97,809
	<u>\$ 4,056,093</u>	<u>4,096,968</u>
Liabilities and Net Assets		
Current liabilities:		
Current installments of long-term debt	\$ 30,131	30,257
Long-term debt subject to short-term remarketing agreements	220,215	220,215
Current portion of estimated self-insurance liabilities	49,035	51,911
Accounts payable	100,137	105,770
Accrued liabilities	179,238	160,514
Estimated payables under third-party reimbursement programs	52,820	59,981
Total current liabilities	631,576	628,648
Long-term debt, excluding current installments	488,201	522,114
Estimated self-insurance liabilities	76,020	78,564
Derivative instruments	34,527	47,906
Accrued benefit liability	192,077	346,812
Other noncurrent liabilities	48,064	51,640
Total liabilities	1,470,465	1,675,684
Net assets:		
Unrestricted	2,519,588	2,353,270
Temporarily restricted	37,669	40,145
Permanently restricted	28,371	27,869
Total net assets	2,585,628	2,421,284
	<u>\$ 4,056,093</u>	<u>4,096,968</u>

See accompanying notes to consolidated financial statements.

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES

Springfield, Illinois

Consolidated Statements of Operations and Change in Unrestricted Net Assets

Years ended June 30, 2018 and 2017

(Dollars in thousands)

	<u>2018</u>	<u>2017</u>
Net patient service revenues	\$ 2,360,764	2,323,186
Provision for uncollectible accounts	(49,157)	(40,871)
Net patient service revenue less provision for uncollectible accounts	2,311,607	2,282,315
Other revenues:		
Investment income	559	595
Net assets released from restrictions used for operations	6,817	4,207
Other	92,278	77,425
Total revenues	<u>2,411,261</u>	<u>2,364,542</u>
Expenses:		
Sisters' services	725	1,036
Salaries and wages	867,247	851,307
Employee benefits	201,505	209,560
Pension expense, excluding mark-to-market adjustment	7,667	23,359
Pension expense, mark-to-market adjustment	(48,915)	(59,761)
Professional fees	150,859	121,882
Supplies	353,691	342,568
Depreciation and amortization, excluding Belleville campus	154,534	155,159
Accelerated depreciation on Belleville campus	9,076	7,479
Interest	13,504	11,213
Other	661,494	634,159
Total expenses	<u>2,371,387</u>	<u>2,297,961</u>
Income from operations	39,874	66,581
Nonoperating gains:		
Investment income	107,411	147,152
Contributions of Good Shepherd unrestricted net assets	—	19,124
Change in fair value of interest rate swaps	13,379	23,361
Revenues and gains in excess of expenses and losses before discontinued operations	160,664	256,218
Net gains from discontinued operations	—	2,933
Revenues and gains in excess of expenses and losses	160,664	259,151
Other changes in unrestricted net assets:		
Net assets released from restrictions used for the purchase of property, plant, and equipment	5,483	92
Recognition of change in pension funded status	171	301
Change in unrestricted net assets	\$ <u>166,318</u>	<u>259,544</u>

See accompanying notes to consolidated financial statements.

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES

Springfield, Illinois

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2018 and 2017

(Dollars in thousands)

	<u>2018</u>	<u>2017</u>
Unrestricted net assets:		
Revenues and gains in excess of expenses and losses	\$ 160,664	259,151
Other changes in unrestricted net assets:		
Net assets released from restrictions used for the purchase of property, plant, and equipment	5,483	92
Recognition of change in pension funded status	171	301
Change in unrestricted net assets	<u>166,318</u>	<u>259,544</u>
Temporarily restricted net assets:		
Investment income	448	1,284
Contributions	9,376	10,470
Contribution of Good Shepherd restricted net assets	—	1,258
Net assets released from restrictions	<u>(12,300)</u>	<u>(4,299)</u>
Change in temporarily restricted net assets	<u>(2,476)</u>	<u>8,713</u>
Permanently restricted net assets:		
Investment income	37	21
Contributions	465	352
Contribution of Good Shepherd restricted net assets	—	60
Change in permanently restricted net assets	<u>502</u>	<u>433</u>
Change in net assets	164,344	268,690
Net assets at beginning of year	<u>2,421,284</u>	<u>2,152,594</u>
Net assets at end of year	<u>\$ 2,585,628</u>	<u>2,421,284</u>

See accompanying notes to consolidated financial statements.

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES

Springfield, Illinois

Consolidated Statements of Cash Flows

Years ended June 30, 2018 and 2017

(Dollars in thousands)

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:		
Change in net assets	\$ 164,344	268,690
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Pension expense, mark-to-market adjustment	(48,915)	(59,761)
Recognition of change in pension funded status	(171)	(301)
Income from equity basis investments	(87)	(3,123)
Cash distributions received from equity basis investments	3,707	4,928
Net assets released from restrictions and used for operations	6,817	4,207
Contribution of Good Shepherd net assets	—	(20,442)
Restricted contributions and investment return	(10,326)	(12,127)
Amortization of bond issuance costs and premiums/discounts included in interest expense	(5,532)	(5,638)
Depreciation and amortization	163,610	162,638
Provision for uncollectible accounts	49,157	40,871
Change in net unrealized gains and losses on investments	(47,610)	(64,832)
Net realized gains on sale of investments	(37,040)	(65,425)
Change in the fair value of derivative instruments	(13,379)	(23,361)
Changes in assets and liabilities:		
Patients' accounts receivable	4,403	(70,603)
Other receivables	(5,229)	(3,549)
Inventories	(365)	(2,272)
Prepaid expenses	309	(3,936)
Net amounts due to third-party reimbursement programs	(5,659)	2,683
Accounts payable and accrued liabilities	13,091	(1,126)
Estimated self-insurance liabilities and other noncurrent liabilities	<u>(114,645)</u>	<u>(82,106)</u>
Net cash provided by operating activities	<u>116,480</u>	<u>65,415</u>
Cash flows from investing activities:		
Acquisition of property, plant, and equipment	(246,131)	(219,221)
Cash received from contribution of Good Shepard	—	412
Cash paid for Door County	—	(40,000)
Gross purchases of investments	(2,120,790)	(2,088,241)
Gross proceeds from sale or maturity of investments	2,296,986	2,181,971
Change in other assets	<u>(6,159)</u>	<u>6,812</u>
Net cash used in investing activities	<u>(76,094)</u>	<u>(158,267)</u>
Cash flows from financing activities:		
Repayment of long-term debt	(28,507)	(101,508)
Proceeds from issuance of debt	—	206,902
Payment of bond issuance cost	—	(2,059)
Net assets released from restrictions and used for operations	(6,817)	(4,207)
Restricted contributions and investment return	<u>10,326</u>	<u>12,127</u>
Net cash provided by (used in) financing activities	<u>(24,998)</u>	<u>111,255</u>
Change in cash and cash equivalents	15,388	18,403
Cash and cash equivalents at beginning of year	<u>112,810</u>	<u>94,407</u>
Cash and cash equivalents at end of year	\$ <u><u>128,198</u></u>	\$ <u><u>112,810</u></u>

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES

Springfield, Illinois

Consolidated Statements of Cash Flows

Years ended June 30, 2018 and 2017

(Dollars in thousands)

	<u>2018</u>	<u>2017</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest, net of amounts capitalized	\$ 15,184	14,809
Supplemental disclosure of noncash transactions:		
Assets acquired under capital lease	\$ 1,845	1,045
Noncash transactions associated with acquisitions:		
Patients' account receivable	\$ —	2,210
Inventories	—	175
Prepaid expenses	—	261
Investments	—	16,564
Property, plant, and equipment	—	10,136
Other assets	—	507
Estimated third-party payor settlements	—	(297)
Accounts payable and accrued expenses	—	(2,626)
Long-term debt	—	(6,900)

See accompanying notes to consolidated financial statements.

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES

Springfield, Illinois

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(Dollars in thousands)

(1) Organization and Purpose

Hospital Sisters Health System (HSHS), an Illinois not-for-profit corporation, considers all wholly owned or controlled entities as subsidiaries for consolidated financial statement purposes. The accompanying consolidated financial statements include the accounts of HSHS and its subsidiaries. HSHS is the parent corporation for several subsidiary corporations and exerts control through various reserved powers. The subsidiary corporations and controlled entities presented in the accompanying consolidated financial statements include Hospital Sisters Services, Inc. (HSSI), HSHS System Office (the SSC), Hospital Sisters of St. Francis Foundation, Inc. (the Foundation), and Kiara, Inc. HSSI, an Illinois not-for-profit holding company, is the sole member of 15 hospitals in Illinois and Wisconsin, Hospital Sisters Healthcare – West, Inc. (HCW), HSHS Medical Group, Inc., and HSHS Wisconsin Medical Group, Inc. (collectively, referred to as the Medical Group), Unity Limited Partnership, Kiara Clinical Integration Network (KCIN), Prairie Education & Research Cooperative (PERC), and Renaissance Quality Insurance, Ltd. (RQIL).

The hospitals are organized for the purpose of providing inpatient and outpatient healthcare services. HSSI formed the Medical Group for the purpose of affiliating with physicians. RQIL is a captive insurance company incorporated in the Cayman Islands to provide professional and general liability insurance coverage to HSHS and affiliates and workers compensation coverage for the hospitals.

15 hospitals within HSSI have formed an Obligated Group for debt financing purposes through the use of a Master Trust Indenture (MTI) (note 12).

The 15 hospitals, of which HSSI is the sole corporate member, are as follows:

<u>Hospital</u>	<u>Location</u>
	Illinois:
St. Elizabeth's Hospital (SEO)	O'Fallon
St. Joseph's Hospital (SJB)	Breese
St. Mary's Hospital (SMD)	Decatur
St. Anthony's Memorial Hospital (SAE)	Effingham
Holy Family Hospital (HFG)	Greenville
St. Joseph's Hospital (SJH)	Highland
St. Francis Hospital (SFL)	Litchfield
St. John's Hospital (SJS)	Springfield
Good Shepherd Hospital (GSS)	Shelbyville

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES

Springfield, Illinois

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(Dollars in thousands)

<u>Hospital</u>	<u>Location</u>
	Wisconsin:
St. Joseph's Hospital (SJCF)	Chippewa Falls
Sacred Heart Hospital (SHEC)	Eau Claire
St. Mary's Hospital Medical Center (SMGB)	Green Bay
St. Vincent Hospital (SVGB)	Green Bay
St. Nicholas Hospital (SNS)	Sheboygan
St. Clare Memorial Hospital (SCO)	Oconto Falls

The SSC administers healthcare claims for the benefit of HSHS colleagues. The SSC is supported by annual fees paid by the HSHS' affiliated hospitals and certain other HSHS-controlled entities to the SSC. The SSC utilizes these funds to provide centralized management and information services to the 15 affiliated hospitals and employee health administration. In addition, the SSC administers a centralized investment program and defined-contribution and defined-benefit pension plans on behalf of all HSHS entities.

The Foundation, an Illinois not-for-profit corporation, is an entity whose purpose is to solicit and administer philanthropic funds. The Foundation is structured into 16 separate divisions to administer restricted and unrestricted gifts and bequests at each of the respective hospital locations and the SSC.

Kiara, Inc., an Illinois for-profit corporation, provides a vehicle for joint ventures with physicians and an entry into those health-related services, which do not qualify as tax-exempt services, such as durable medical equipment, nonaffiliated electronic health records (EHR) implementations, and real estate holdings. Kiara, Inc. is the sole stockholder of LaSante, Inc., LaSante Wisconsin, Inc., and Prairie Cardiovascular Consultants, Inc. The operations of these three wholly owned subsidiaries are consolidated into the financial statements of Kiara, Inc.

Effective November 1, 2016, HSHS, HSSI, and SVGB entered into an affiliation agreement with Door County Memorial Hospital and Door County Medical Corporation. SVGB became a 40% minority member of Door County Memorial Hospital for \$40,000. Other assets include \$5,735 of goodwill as of June 30, 2018 and 2017 related to this investment.

On January 16, 2017, HSSI became the sole corporate member of Shelby Memorial Hospital, Inc. (SMH) in Shelbyville, Illinois. Effective on the acquisition date, SMH became a Catholic entity and the hospital name was changed to HSHS Good Shepherd Hospital, Inc. effective on the acquisition. Revised governing documents are consistent with HSHS policies applicable to affiliates. HSSI will retain certain reserve powers over GSS consistent with other HSSI subsidiaries. As a part of the change in sponsorship, HSHS recorded \$19,124 of contribution of unrestricted net assets. HSHS acquired \$30,265 of total assets, \$9,823 of total liabilities, and \$20,442 of net assets. The valuation of property, plant, and equipment, other current and long-term assets, including any identifiable intangible assets, and current and long-term liabilities has been completed. In valuing these assets and liabilities acquired, fair values were based on, but not limited to, independent appraisals, discounted cash flows, and replacement costs.

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES

Springfield, Illinois

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(Dollars in thousands)

All significant intercompany transactions have been eliminated in consolidation.

(2) Summary of Significant Accounting Policies

The significant accounting policies of HSHS are as follows:

(a) Presentation

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as revenues and expenses. Peripheral or incidental transactions are reported as nonoperating gains or losses. Nonoperating gains or losses include investment income, other than that which is associated with self-insurance programs, or funds held by trustee under indenture agreements, contributions of excess assets over liabilities, discontinued operations, and the change in fair value of the interest rate swaps.

(b) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Significant estimates include allowances for contractual allowances and uncollectible accounts, third-party payor settlements, valuation of investments, recoverability of property, plant, and equipment, self-insurance liabilities, derivative instruments, accrued benefit liability, and other liabilities. Actual results could differ from those estimates.

(c) Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with a maturity of three months or less when purchased, excluding those amounts included as assets whose use is limited or restricted.

(d) Assets Whose Use is Limited or Restricted

Assets whose use is limited or restricted include assets set aside by the board of directors for future capital improvements, self-insurance funding, and for other purposes over which the board of directors retains control and may at its discretion subsequently use for other purposes; assets held by third-party trustees under indenture agreements; and funds temporarily or permanently restricted by donors. Management classifies the current portion of assets whose use is limited or restricted based on the approximate amount of the current portion of long-term debt and self-insurance.

Investments in equity securities with readily determinable values and all investments in debt securities are measured at fair value in the accompanying consolidated balance sheets. Investment return on assets associated with self-insurance programs and assets deposited in funds held by trustee under indenture agreements are reported as other revenues. Investment return from all other investments is reported as nonoperating gains (losses), unless the income or loss is restricted by donor or law.

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES

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Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(Dollars in thousands)

Changes in net unrealized gains and losses on investments are included in revenues and gains in excess (deficient) of expenses and losses as all investments are considered to be trading securities.

(e) Inventories

Inventories are stated at the lower of cost or market. Cost is determined on a first-in, first-out basis.

(f) Property, Plant, and Equipment

Property, plant, and equipment additions are stated at cost or fair value at the date of acquisition or donation. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method of accounting. Useful lives may be reassessed from time to time as facts and circumstances change in regards to how assets are being used. Interest costs incurred on borrowed funds during the period of construction of major projects are capitalized as a component of the cost of acquiring those assets. Capitalized interest is reduced by the amount of investment income earned on unexpended proceeds from project-specific borrowings. HSHS has repurposed the current campus to continue providing certain healthcare services in Belleville.

In 2018, HSHS, using a valuation consultant, performed asset useful life studies at four hospitals on the major fixed assets, primarily buildings, in order to more appropriately assign useful lives reflective of the remaining expected lives of those assets taking into consideration the longevity and functional use of such long-lived assets. As a result of these studies and the change in estimated useful lives, annual depreciation expense was reduced by \$3,076 in 2018.

(g) Other Assets – Joint Ventures

HSHS invests in various organizations that are not wholly owned or controlled by HSHS. Investments in affiliates in which HSHS has significant influence but does not control are reported on the equity method of accounting, which represents HSHS' equity in the underlying net book value. The equity method of accounting is discontinued when the investment is reduced to zero unless HSHS has guaranteed the obligations of the organization or is committed to provide additional capital support.

(h) Loss Reserves

HSHS is self-insured for professional and general liability, workers' compensation, and employee health claims. The provision for loss reserves include the ultimate cost for both reported losses and losses incurred, but not reported as of the respective consolidated balance sheet dates. HSHS reports the amount predicted to settle within one year as the current portion of estimated self-insurance liabilities with the corresponding investments held as current portion of assets whose use is limited or restricted. The long-term portion is reported as estimated self-insurance liabilities with the corresponding investments held as assets whose use is limited or restricted.

The liability for loss reserves represents an estimate of the net cost of all such amounts that are unpaid at the consolidated balance sheet dates. The liability is based on projections and the historical claim experience of HSHS and gives effect to estimates of trends. Although management believes the estimate of the liability for claims is reasonable, it is possible HSHS' actual incurred claims will not conform to the assumptions' variability with respect to the assumptions utilized. The settlement of

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES

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Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(Dollars in thousands)

claims may vary from the liability for unpaid claims included in the accompanying consolidated financial statements.

(i) Derivative Instruments

HSHS accounts for derivatives and hedging activities in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 815-10, *Accounting for Derivative Instruments and Hedging Activities*, which requires that an entity recognize all derivatives as either assets or liabilities in the consolidated balance sheet and measure those instruments at fair value. HSHS is involved in five interest rate swaps. The fair value of the interest rate swap programs is included as derivative instruments in the accompanying consolidated balance sheets. For HSHS, the derivatives are not designated as hedge instruments, and therefore, settlements on derivative instruments and the change in fair values of the interest rate swap agreements are recognized in the consolidated statements of operations and change in unrestricted net assets as a component of nonoperating gains (losses).

(j) Asbestos Removal Costs

HSHS accounts for asbestos removal costs in accordance with ASC Subtopic 410-20, *Accounting for Conditional Asset Retirement Obligations*. ASC Subtopic 410-20 requires the current recognition of a liability when a legal obligation exists to perform an asset retirement obligation (ARO) in which the timing or method of settlement is conditional on a future event that may or may not be under the control of the entity. ASC Subtopic 410-20 requires an ARO liability be recorded at its net present value with recognition of a related long-lived asset in a corresponding amount. The ARO liability is accreted through periodic charges to depreciation expense. The initially capitalized ARO long-lived asset is depreciated over the corresponding long-lived asset's remaining useful life. HSHS is legally liable to remove asbestos from existing buildings prior to future remodeling or demolishing of the existing hospital buildings. The estimated asbestos removal cost at June 30, 2018 and 2017 is \$26,364 and \$26,377, respectively, and is included within other noncurrent liabilities in the accompanying consolidated balance sheets.

(k) Donor-Restricted Net Assets

Net assets and activities are classified into three classes based on the existence or absence of donor-imposed restrictions: unrestricted, temporarily restricted, and permanently restricted. Temporarily restricted net assets represent those net assets whose use by HSHS has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by HSHS in perpetuity.

(l) Gifts, Bequests, and Grants

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received, which is then treated as cost. The gifts are reported as either temporarily or permanently restricted support if they 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 change in unrestricted net assets as assets

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES

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Notes to Consolidated Financial Statements

June 30, 2018 and 2017

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released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are recorded as unrestricted contributions. Unrestricted contributions are included in other revenues.

Gifts of long-lived assets, such as property, plant, and equipment, are reported as unrestricted gifts and bequests and are excluded from revenue and gains in excess (deficient) of expenses and losses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted contributions. In the absence of 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.

(m) Net Patient Service Revenues

Net patient service revenues are reported at the estimated net realizable amounts due from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors and amounts received under the Medicaid assessment tax programs. 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.

(n) Charity Care

HSHS provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are not reported as net patient service revenues, since HSHS does not pursue collection of such amounts.

(o) Revenues and Gains in Excess (Deficient) of Expenses and Losses

The consolidated statements of operations and change in unrestricted net assets include revenues and gains in excess (deficient) of expenses and losses. Changes in unrestricted net assets that are excluded from revenues and gains in excess (deficient) of expenses and losses, consistent with industry practice, include contributions of property, plant, and equipment (including assets acquired using contributions that by donor restrictions or grants were to be used for the purpose of acquiring such assets), net assets released from restrictions used for the purpose of property, plant, and equipment, and the change in pension funded status.

(p) Income Taxes

HSHS and the Foundation are Illinois not-for-profit organizations as described in Section 501(c) (3) of the Internal Revenue Code (the Code) and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. Kiara, Inc. is an Illinois for-profit corporation that recognizes 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 basis 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

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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.

Kiara, Inc.'s tax effects of temporary differences that give rise to significant portions of the deferred tax assets at June 30, 2018 and 2017 are primarily the result of net operating loss carryforwards of \$198,196 and \$163,075 at June 30, 2018 and 2017, respectively, which expire at various future dates through 2037.

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 projected future taxable income and tax planning strategies in making this assessment. Based upon the level of historical taxable losses and projections for future taxable losses over the periods for which the deferred tax assets are deductible, management believes it is more likely than not Kiara, Inc. will not realize the majority of the benefits of these deductible differences. Full valuation allowances have been applied against the deferred tax assets attributable to the net operating loss carryforwards not realized as of June 30, 2018 and 2017 in the accompanying consolidated financial statements due to the uncertainty of realization.

HSHS recognizes the tax benefit from an uncertain tax position only if it is more likely than not the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. As of June 30, 2018 and 2017, HSHS does not have any liabilities for unrecognized tax benefits.

(g) Fair Value

HSHS records the 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 in accordance with the provisions of ASC Topic 820, *Fair Value Measurement*. 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. ASC Topic 820 also establishes a framework for measuring fair value and expands disclosures about fair value measurements.

HSHS has certain investments in funds that do not have readily determinable fair values including private investments, hedge funds, real estate, and other funds. ASC Subtopic 820-10-35 allows for HSHS to estimate 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.

Additionally, in accordance with ASC Subtopic 820-10-50, HSHS categorizes within the fair value hierarchy all investments for which fair value is measured using the NAV per share practical expedient.

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(r) Pension

HSHS calculates and reports pension expense under the mark-to-market (MTM) methodology. Under this method, HSHS immediately recognizes actuarial gains and losses as a separate component of net periodic pension costs as of the financial reporting date. Prior methodology smoothed the effects of actuarially determined gains and losses over future periods. HSHS has made this change to improve transparency of its underlying operational performance by immediate recognition of the effects of investment performance and interest rates, which historically have caused high volatility in the conventional calculation of pension expense.

Reported in the accompanying consolidated financial statements, pension expense is reported in two elements: 1) pension expense, excluding mark-to-market adjustment comprising service cost, interest cost, assumed returns on plan assets, and recognition of prior service cost and 2) pension expense, mark-to-market adjustment is the gains and losses resulting from change in the discount rates and/or the difference between actual experience and assumed experience including the return on plan assets.

(s) New Accounting Presentation

In April 2015, the FASB issued ASU No. 2015-03, *Interest – Imputation of Interest*. ASU No. 2015-03 amends ASC Topic 835, *Interest*, by requiring debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability, consistent with the debt discounts and premiums. HSHS adopted ASU No. 2015-03 in 2017 and applied changes retrospectively to 2016.

In May 2014, FASB issued ASU No. 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, 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 HSHS for the year ending June 30, 2019. HSHS 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 August 2016, FASB issued ASU No. 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 the results will require net assets to be categorized either as net assets with donor restrictions or net assets without donor restrictions rather than the currently required three classes of net assets. 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 HSHS for the year ending June 30, 2019. HSHS is in process of evaluating the effect this guidance will have on the consolidated financial statements. The guidance is not expected to have a material effect on revenues and gains in excess (deficient) of expenses and losses.

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In February 2016, FASB issued ASU No. 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 HSHS for the year ending June 30, 2020. HSHS is in process of evaluating the impact of this statement.

In November 2016, FASB issued ASU No. 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 HSHS for the year ending June 30, 2020. HSHS has not evaluated the impact of this statement.

In March 2017, FASB issued ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, which changes the presentation of periodic benefit cost components. ASU 2017-07 permits services costs to be presented in operating expenses but present amortization of prior service credits and other components of net periodic benefit cost in nonoperating gains in the consolidated statements of operations and change in unrestricted net assets. ASU 2017-07 is effective for annual reporting periods beginning after December 15, 2017. The impact of adoption will result in the nonservice cost components of pension benefit costs, previously classified as an operating expense, being reported as nonoperating gains (losses).

(3) Community Benefit

Consistent with its mission, HSHS provides medical care to all patients regardless of their ability to pay. In addition, HSHS provides services intended to benefit the poor and underserved, including those persons who cannot afford health insurance because of inadequate resources and/or are uninsured or underinsured, and to enhance the health status of the communities in which it operates.

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The following summary has been prepared in accordance with the Catholic Health Association of the United States' policy document, *A Guide for Planning and Reporting Community Benefit*, released in May 2006. HSHS uses a cost-to-charge ratio to calculate the cost of charity care and the unpaid cost of Medicaid. The amounts in the following table reflect the quantifiable costs of HSHS' community benefit for the years ended June 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Benefits for the poor:		
Charity care at cost	\$ 25,650	26,006
Unpaid cost of Medicaid and other public programs	133,668	128,559
Community health services	2,584	2,370
Other	<u>4,109</u>	<u>5,039</u>
	<u>166,011</u>	<u>161,974</u>
Benefits for the broader community:		
Community health services	3,940	5,915
Health professions education	18,593	20,044
Other	<u>9,869</u>	<u>9,596</u>
	<u>32,402</u>	<u>35,555</u>
Total community benefit	\$ <u>198,413</u>	<u>197,529</u>

Benefits for the poor represent the cost of services provided to persons who cannot afford healthcare because of inadequate resources and who are uninsured or underinsured.

Benefits for the broader community represent the cost of services provided to other needy populations that may not qualify as poor, but that need special services and support. It also includes the cost of services for the general benefit of the communities in which HSHS operates. Many programs are targeted toward populations that may be poor, but also include those areas that may need special health services and support. These programs are not financially self-supporting.

Charity care at cost represents the cost of services provided to patients who cannot afford healthcare services due to inadequate resources. All or a portion of a patient's services may be considered charity care for which no payment is anticipated in accordance with HSHS' established policies.

Unpaid cost of Medicaid and other public programs represents the cost of providing services to beneficiaries of public programs, including state Medicaid and indigent care programs, in excess of payments for those services. (See note 4 for an explanation of changes to the Medicaid reimbursement from the State of Illinois.)

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Community health services are activities and services for which no patient bill exists although there may be nominal patient fees. These services are not expected to be financially self-supporting, although some may be partially supported by outside grants or funding.

Health professions education includes the unreimbursed cost of training health professionals, such as medical residents, nursing students, technicians, and students, in allied health professions.

Other benefits include subsidized health services, in-kind donations, and other benefits.

A related organization, the Foundation, funded \$14,218 and \$6,303 for charity care or other operating expenses on behalf of the hospitals during the years ended June 30, 2018 and 2017, respectively. The community benefits reported above are net of the contributions from the Foundation for such benefits.

HSHS also provides a significant amount of uncompensated care for patients, which is not included above, but is reported in the consolidated statements of operations and change in unrestricted net assets as a provision for uncollectible accounts. Many of those patients are uninsured or underinsured, but did not apply for, or qualify for, charity care.

(4) Net Patient Service Revenues

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

Medicare – Inpatient acute care services rendered to Medicare program beneficiaries are generally 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. Certain patient services related to Medicare beneficiaries are paid based upon a cost reimbursement method, prospectively determined rates, established fee screens, or a combination thereof. The hospitals are reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the hospitals and audits by the Medicare fiscal intermediary. Certain outpatient services performed by the hospitals are reimbursed at a prospectively determined rate per service based upon their ambulatory payment classification. Home health services performed by the hospitals are reimbursed at a prospectively determined rate per episodic treatment.

As of June 30, 2018, Medicare cost reports have been audited and final settled through June 30, 2013.

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 based upon per visit rates. Medicaid payment methodologies and rates for services are based on the amount of funding available to state Medicaid programs.

The Illinois Hospital Assessment Program and the Enhanced Illinois Hospital Assessment Program (collectively referred to herein as HAP) have been approved by CMS through June 30, 2018. Under HAP, the state receives additional federal Medicaid funds for the state's healthcare system, administered by the Illinois Department of Healthcare and Family Services. Included in the accompanying consolidated statements of operations and changes in unrestricted net assets for the

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years ended June 30, 2018 and 2017, is \$93,196 and \$94,528, respectively, of net patient service revenue from the HAP and \$41,799 and \$40,550, respectively, of other expense for provider taxes for the HSHS Illinois hospitals.

The State of Wisconsin has an assessment tax on the gross revenue of all Wisconsin hospitals, which is used to increase reimbursements made under its Medicaid program. During the years ended June 30, 2018 and 2017, the HSHS Wisconsin hospitals were assessed \$20,684 and \$20,192, respectively, related to this tax, which is included as a component of other expenses in the accompanying consolidated statements of operations and change in unrestricted net assets, and received \$23,003 and \$22,434, respectively, in supplemental Medicaid reimbursement, which is included as a component of net patient service revenues in the accompanying consolidated statements of operations and change in unrestricted net assets.

Other – HSHS has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined per diem rates.

A summary of gross and net patient service revenues for the years ended June 30, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
Inpatient revenue	\$ 2,688,409	2,611,541
Outpatient revenue	4,399,471	4,229,599
Less provisions for estimated contractual adjustments under third-party reimbursement programs	<u>4,727,116</u>	<u>4,517,954</u>
Net patient service revenues	<u>\$ 2,360,764</u>	<u>2,323,186</u>

Net patient service revenues for the years ended June 30, 2018 and 2017 include \$3,294 and \$9,944, respectively, of favorable retrospectively determined prior year settlements with third-party payors.

A summary of Medicare, Medicaid, and managed care/contracted payor utilization percentages, based upon gross patient service revenue, is as follows:

	<u>2018</u>	<u>2017</u>
Medicare	49 %	48 %
Medicaid	16	17
Managed care/contracted payor	31	32
Self-pay	1	1
Other	3	2

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Patients' accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectibility of patients' accounts receivable, HSHS 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, HSHS analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (e.g., for expected uncollectible deductibles and co-payments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which include both patients without insurance and patients with deductible and co-payment balances due for which third-party coverage exists for part of the bill), HSHS records a provision for bad debts in the period of service on the basis of its past experience, which indicates that some 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 against the allowance for doubtful accounts.

The allowance for uncollectible accounts was \$132,682 and \$115,900, or 26.2% and 21.4%, of the related patient accounts receivable, net of contractual adjustments as of June 30, 2018 and 2017. Gross write-offs decreased from approximately \$45,171 in fiscal year 2017 to \$32,375 in fiscal year 2018.

HSHS recognizes patient service revenues 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, HSHS recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of HSHS' uninsured patients will be unable or unwilling to pay for the services provided. Thus, HSHS records a significant provision for bad debts related to uninsured patients in the period the services are provided. Patient service revenue, net of contractual allowances and discounts (before the provision for bad debts) is recognized in the period from these major payor sources, as follows:

	<u>2018</u>	<u>2017</u>
Medicare	\$ 811,950	795,748
Medicaid	276,595	295,356
Managed care/contracted payor	1,105,681	1,109,615
Self-pay	48,559	42,854
Other	117,979	79,613
	<u>2,360,764</u>	<u>2,323,186</u>
Net patient service revenue	\$ 2,360,764	2,323,186

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(5) Concentration of Credit Risk

HSHS provides healthcare services through their inpatient and outpatient facilities located in Illinois and Wisconsin. HSHS grants credit to patients, substantially all of whom are local residents. HSHS does not require collateral or other security in extending credit to patients; however, they routinely obtain assignment of (or are otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, Blue Cross, health maintenance organizations, and commercial insurance policies).

The mix of net receivables from patients and third-party payors as of June 30, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
Medicare	32 %	23 %
Medicaid	9	18
Managed care/contracted payor	46	48
Self-pay	5	4
Other	8	7

(6) Investment Composition and Fair Value Measurements

(a) Overall Investment Objective

The overall investment objective of HSHS 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. HSHS' invested assets maintain sufficient liquidity to fund a portion of HSHS' annual operating activities and structure the invested assets to maintain a high percentage of available liquidity. HSHS diversifies its investments among various asset classes incorporating multiple strategies and managers. The HSHS board approves the Investment Policy Statement (IPS). The investment subcommittee oversees the investment program in accordance with the IPS.

(b) Allocation of Investment Strategies

To manage risk, HSHS invests in fixed income, domestic equities, international equities, custom hedge funds, real assets, and private equity. HSHS engages outside portfolio managers as follows: 5 fixed income managers, 11 domestic equity managers, 6 international managers, 2 custom hedge fund portfolio managers (K2 and Mesirow), 2 real estate managers, and 1 private equity manager. 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.

The investment objective of the K2 Custom Solutions Hospital Sisters Fund is to achieve equity type returns with reduced volatility and risk. This is achieved through a diversified portfolio targeting allocations of long strategies and low volatility strategies and spread across 35 separate underlying funds.

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The investment objective of the Mesirov Custom Solutions Hospital Sisters Fund is to achieve positive returns with low volatility and risk. This is achieved through a multimanager, multistrategy, and diversified investment approach and spread across 38 separate underlying funds.

A summary of the strategies used by the hedge fund managers is as follows:

- *Commodities* include investment entities that may trade in agricultural, metal, and energy markets at various stages of the commodity cycle.
- *Event Driven* includes investment entities that focus on identifying and analyzing securities that may benefit from the occurrence of specific corporate events.
- *Global Macro* includes investment entities, which invest in products that may benefit from overall economic and political events of various countries.
- *Insurance-Linked* includes investment entities with an income-based strategy that invest across instruments, the value of which is driven by insurance-related events primarily related to property and life insurance. Risk is managed by diversifying over geography, insurance type, and sensitivity to insured losses amongst other factors. The strategy is a tool to reduce overall investment risk as underlying insurance risk factors are less sensitive to general market factors.
- *Long/Short Equity* includes investment entities that invest both long and short, primarily in common stocks and debt instruments, based on the manager's perception of such securities being undervalued or overvalued by the market.
- *Multistrategy* includes investment entities that pursue multiple strategies to diversify risks and reduce volatility.
- *Relative Value* includes investment entities that utilize nondirectional strategies. Relative value investing involves trading around the mispricing of two related securities using various types of securities or instruments.
- *Specialist Credit* includes investment entities that seek to generate superior risk-adjusted returns from a combination of capital appreciation and current income by opportunistically investing and trading in a diversified portfolio of credit-related securities and other instruments.
- *Structured Credit* includes investment entities that invest across structured credit markets, including agency and nonagency residential mortgage-backed securities, commercial mortgage-backed securities, and various asset-backed securities. Strategies can be trading oriented or directional, and may include a hedging component to offset market risks.
- *Hedge Overlay Strategy* involves the measuring, monitoring, and management of the primary beta sensitivities contained within the fund. Futures, options, swaps, and ETF positions will be taken (or overlaid) alongside the core portfolio in order to fine tune any market sensitivities or hedge any undersigned directional biases.

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(c) Basis of Reporting

Assets whose use is limited or restricted are reported at estimated fair value. If an investment is held directly by HSHS 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. HSHS' interests in alternative investment funds are generally reported at the NAV reported by the fund managers, which is used as a practical expedient to estimate the fair value of the HSHS' interest therein, unless it is probable that all or a portion of the investment will be sold for an amount different from NAV. As of June 30, 2018, HSHS had no plans or intentions to sell investments at amounts different from NAV. During the 2018 fiscal year, HSHS decided to terminate their investment in the Mesirow multi-strategy hedge fund and transfer the assets to K2 fund manager. As of June 30, 2018, the fund has not been terminated and HSHS does not plan or intend the Mesirow multi-strategy fund to sell at an amount different from NAV. Subsequent to June 30, 2018, HSHS has begun liquidating the fund, which has been performed at NAV.

(d) Fair Value of Financial Instruments

The following methods and assumptions were used by HSHS 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, receivables, accounts payable, accrued liabilities, and estimated payables under third-party reimbursement programs.
- Fair values of HSHS' investments held as assets whose use is limited or restricted are estimated based on prices provided by its investment managers and its custodian bank except pledges receivable and other, whereby carrying amounts approximate fair value. Fair value for cash and cash equivalents, common stocks, foreign securities, U.S. government securities, corporate bonds, taxable municipals, and commingled mutual funds are measured using quoted market prices at the reporting date multiplied by the quantity held. The carrying value equals fair value.
- HSHS has two real estate fund investments for which quoted market prices are not available. The estimated fair value of these real estate fund investments includes estimates, appraisals, assumptions, and methods provided by external financial advisers and reviewed by HSHS.
- HSHS has two hedge fund investments for which quoted market prices are not available. The estimated fair value of these hedge fund investments includes estimates, appraisals, assumptions, and methods provided by external financial advisers and reviewed by HSHS.
- Fair value of interest rate swaps is determined using pricing models developed based on the LIBOR swap rate and other observable market data by financial advisers. The value was determined after considering the potential impact of collateralization and netting agreements, adjusted to reflect nonperformance risk of the counterparties and HSHS. The carrying value equals fair value.

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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 HSHS 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.

(e) Fair Value Hierarchy

For fair value measurements of financial assets and 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, HSHS records these under ASC Topic 820. ASC Topic 820 includes 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 HSHS has the ability to access at the measurement date.
- Level 2 inputs 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.
- Level 3 inputs are unobservable inputs for the asset or liability.

The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period. There were no transfers between Level 1, Level 2, or Level 3 for the fiscal year ended June 30, 2018 or 2017.

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The following table summarizes HSHS' fair values of cash and cash equivalents, assets whose use is limited or restricted by major category and derivative instruments in the fair value hierarchy as of June 30, 2018, as well as related strategy, liquidity, and funding commitments:

	June 30, 2018				Redemption or liquidation	Days' notice
	Level 1	Level 2	Level 3	Total		
Cash and cash equivalents	\$ 128,198	—	—	128,198	Daily	One
Assets whose use is limited or restricted excluding accrued interest and other of \$4,461 and pledges receivable and other of \$17,870:						
Cash and cash equivalents	7,634	—	—	7,634	Daily	One
Common stocks	353,639	—	—	353,639	Daily	One
U.S. government securities	—	177,229	—	177,229	Daily	One
Taxable municipals	—	28,052	—	28,052	Daily	Two
Corporate bonds	—	152,636	—	152,636	Daily	Two
Foreign securities	364,607	33,162	—	397,769	Daily	Three
Commingled mutual funds	—	149,580	—	149,580	Daily	Three
Subtotal	<u>854,078</u>	<u>540,659</u>	<u>—</u>	1,394,737		
Real-estate funds ¹ :						
JLL Income Property Trust, Inc.				88,874	Daily	Zero
J.P. Morgan U.S. Real Estate Income and Growth Fund				38,237	Quarterly	Sixty
Hedge funds ¹ :						
K2 multistrategy fund				331,532	See below	
Mesirov multistrategy				91,200	See below	
Hamilton Lane Private Equity				1,321	See below	
Total financial assets				<u>\$ 1,945,901</u>		
Liabilities:						
Derivative instruments	\$ —	34,527	—	34,527		

¹ Certain investments that are measured at fair value using the NAV per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

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The following table summarizes HSHS' fair values of cash and cash equivalents, assets whose use is limited or restricted by major category and derivative instruments in the fair value hierarchy as of June 30, 2017, as well as related strategy, liquidity, and funding commitments:

	June 30, 2017				Redemption or liquidation	Days' notice
	Level 1	Level 2	Level 3	Total		
Cash and cash equivalents	\$ 112,810	—	—	112,810	Daily	One
Assets whose use is limited or restricted excluding accrued interest and other of \$3,618 and pledges receivable and other of \$15,794:						
Cash and cash equivalents	118,206	—	—	118,206	Daily	One
Common stocks	368,562	—	—	368,562	Daily	One
U.S. government securities	—	146,290	—	146,290	Daily	One
Taxable municipals	—	30,042	—	30,042	Daily	Two
Corporate bonds	—	129,995	—	129,995	Daily	Two
Foreign securities	384,938	17,861	—	402,799	Daily	Three
Commingled mutual funds	—	187,452	—	187,452	Daily	Three
Subtotal	<u>984,516</u>	<u>511,640</u>	<u>—</u>	1,496,156		
Real-estate funds ¹ :						
JLL Income Property Trust, Inc.				90,864	Daily	Zero
J.P. Morgan U.S. Real Estate Income and Growth Fund				37,853	Quarterly	Sixty
Hedge funds ¹ :						
K2 multistrategy fund				312,138	See below	
Mesirow multistrategy				87,967	See below	
Total financial assets				<u>\$ 2,024,978</u>		
Liabilities:						
Derivative instruments	\$ —	47,906	—	47,906		

¹ Certain investments that are measured at fair value using the NAV per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

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The following tables present information about the redemption terms and restrictions as of June 30, 2018 and 2017 for the alternative investments:

(i) *K2 Custom Solutions Hospital Sisters Fund*

	Fair value		Notice period (days) minimum/ maximum
	2018	2017	
Redemption terms:			
Monthly	\$ 102,775	96,763	15–90 Days
Quarterly	147,532	131,098	30–90 Days
Semi-annual	72,937	74,913	60–90 Days
Annually	8,288	9,364	90 Days
Total	\$ 331,532	312,138	

(ii) *Mesirow Custom Solutions Hospital Sisters Fund*

	Fair value		Notice period (days) minimum/ maximum
	2018	2017	
Redemption terms:			
Monthly	\$ 35,658	16,626	15–90 Days
Quarterly	35,657	16,801	30–90 Days
Semi-annual	4,130	40,025	60–90 Days
Annually	15,755	14,515	90 Days
Total	\$ 91,200	87,967	

(iii) *Hamilton Lane Private Equity*

On January 1, 2018, HSHS entered into an agreement to invest in the Hamilton Lane Private Equity Fund. The purpose of the private equity investment is to further diversify the Strategic Fund portfolio by reducing volatility and increasing the expected return. The Hamilton Lane Private Equity Fund looks to invest in various strategies including primary, secondary, and co-investments involving credit, buyout, and venture/growth equity across all geographies. HSHS has a required commitment to fund the Hamilton Lane Private Equity Fund \$200,000 over a five-year period.

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A summary of assets whose use is limited or restricted as of June 30, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
Assets whose use is limited or restricted:		
By the board for capital improvements	\$ 1,538,550	1,566,541
Funds held by custodian/trustee under indenture agreements	121	58,078
Funds held by trustee for self-insurance	70,658	72,092
Funds held by RQIL	116,763	120,349
Funds temporarily restricted by donors	1,844	2,868
Investments held at the Foundation	112,098	111,652
Total assets whose use is limited or restricted	<u>\$ 1,840,034</u>	<u>1,931,580</u>

The composition of investment return for the years ended June 30, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
Investment return:		
Interest and dividend income	\$ 23,805	18,795
Net realized gains on sale of investments	37,040	65,425
Change in net unrealized gains and losses	47,610	64,832
Total investment return	<u>\$ 108,455</u>	<u>149,052</u>

Investment returns are included in the accompanying consolidated statements of operations and change in unrestricted net assets, and changes in net assets for the years ended June 30, 2018 and 2017 as follows:

	<u>2018</u>	<u>2017</u>
Other revenue – investment income	\$ 559	595
Nonoperating gains – investment return	107,411	147,152
Temporarily restricted net assets – income	448	1,284
Permanently restricted net assets – income	37	21
Total investment return	<u>\$ 108,455</u>	<u>149,052</u>

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(7) Derivative Instruments

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

By using derivative financial instruments to hedge exposures to changes in interest rates, HSHS 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 contract. When the fair value of a derivative contract is positive, the counterparty owes HSHS, which creates credit risk for HSHS. When the fair value of a derivative contract is negative, HSHS owes the counterparty, and therefore, it does not possess credit risk. HSHS minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties.

Tax risk is the adverse effect that HSHS takes on to the extent tax law changes impact the rates paid to a variable rate bondholder (either positively or negatively) that would affect the variable rate received from the counterparty under a LIBOR-based swap that may not match the tax-exempt equivalent rate being paid. HSHS 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 the derivative 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.

HSHS 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 year ended June 30, 2018 or 2017, neither HSHS or its counterparties were required to post collateral.

HSHS maintains interest rate swap agreements, which effectively change the interest rate exposure on a portion of its variable rate bonds to fixed rates. HSHS receives 86.10% of the three-month LIBOR (\$76,750 notional amount) and 67.00% of the one-month LIBOR (\$41,300 and \$100,425 notional amounts) and pays a fixed rate of 4.02% (\$76,750 notional amount) and 3.47% (\$41,300 and \$100,425 notional amounts). The interest rate swap agreements have notional amounts of \$218,475 at June 30, 2018 and 2017, respectively, which will amortize through March 2036.

HSHS maintains a fixed spread basis swap that removes the tax risk from the bondholders and transfers the risk to HSHS. The premium that HSHS receives for taking on this risk is 67.00% of the one-month LIBOR plus a fixed spread of 48 basis points less the Securities Industry and Financial Markets Association (SIFMA) index rate. The fixed spread basis swap has a notional amount of \$150,000 with a final maturity in May 2033.

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HSSI and JPMorgan Chase Bank, N.A. (the Counterparty) entered into the 2016 Swap simultaneously with the sale of the Series 2016 Bonds. The 2016 Swap will be governed by an ISDA Master Agreement under the terms of which the provider will pay to HSSI an amount equal to the interest paid on the bonds, and the HSSI will pay the Counterparty an amount equal to the SIFMA rate plus a spread. If the 2016 Swap is not extended, on the termination date, HSSI is obligated to pay to the Counterparty an amount equal to the loss in value of the bonds, if any. The 2016 swap has a notional amount of \$75,000 with a final maturity in December 2021.

The following is a summary of the swaps as of June 30, 2018:

<u>Type of interest swap</u>	<u>Notional amount</u>	<u>Settlement value</u>	<u>Fair value</u>
Fixed payor	\$ 76,750	\$ (13,257)	(12,492)
Fixed spread basis	150,000	2,113	2,132
Fixed payor	41,300	(7,444)	(7,033)
Fixed payor	100,425	(18,138)	(17,134)
Fixed receiver	75,000	442	—
Fixed payor		\$ (36,284)	(34,527)

The following is a summary of the swaps as of June 30, 2017:

<u>Type of interest swap</u>	<u>Notional amount</u>	<u>Settlement value</u>	<u>Fair value</u>
Fixed payor	\$ 76,750	\$ (19,115)	(18,111)
Fixed spread basis	150,000	1,593	1,681
Fixed payor	41,300	(10,101)	(9,563)
Fixed payor	100,425	(24,660)	(23,290)
Fixed receiver	75,000	1,377	1,377
Fixed payor		\$ (50,906)	(47,906)

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(8) Property, Plant, and Equipment

A summary of property, plant, and equipment at June 30, 2018 and 2017 is as follows:

	2018	2017
Land	\$ 81,056	79,663
Land improvements	59,071	45,743
Buildings and permanent fixtures	1,716,509	1,622,492
Equipment and furnishings	1,321,823	1,238,895
	3,178,459	2,986,793
Less accumulated depreciation	1,788,743	1,791,671
	1,389,716	1,195,122
Construction in progress	102,985	215,058
	\$ 1,492,701	1,410,180

As of June 30, 2018, construction in progress represents various building and remodeling projects. These projects, which have remaining contracted costs at June 30, 2018 of \$85,114, will be financed with board-designated assets or from operations.

A reconciliation of total interest costs, as reported in the accompanying consolidated statements of operations and change in unrestricted net assets for 2018 and 2017, is as follows:

	2018	2017
Interest cost capitalized	\$ 1,856	3,596
Interest cost charged to expense	13,504	11,213
Total interest cost	\$ 15,360	14,809

(9) Discontinued Operations

SMS in Streator, Illinois was an inpatient hospital previously operated by HSSI. HSSI and SMS submitted a Certificate of Exemption application to the Health Facilities and Services Review Board for the State of Illinois to discontinue all services, both inpatient and outpatient at SMS, which was approved in fiscal year 2016.

The operations of SMS are presented in the accompanying consolidated statements of operations and changes in unrestricted net assets as discontinued operations.

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A summary of the operating components of the loss from discontinued operations for SMS for the years ended June 30, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
Revenue	\$ —	—
Expenses	—	<u>(2,933)</u>
Loss from discontinued operations	<u>\$ —</u>	<u>2,933</u>

(10) Self-Insurance

(a) Workers' Compensation, Professional, and General Liability

RQIL provides insurance coverage in addition to Workers' Compensation, Professional, and General Liability, but the associated liabilities for the other coverages are less than 3% of the total RQIL liabilities at June 30, 2018 and 2017.

HSHS is involved in litigation arising in the ordinary course of business. Reported claims are in various stages of litigation. Additional claims may be asserted against HSHS arising from services through June 30, 2018. It is the opinion of management that the estimated liabilities accrued at June 30, 2018 are adequate to provide for potential losses resulting from pending or threatened litigation.

Under the System's Workers' Compensation, Professional, and General Liability self-insurance program through RQIL, claims are reflected based upon actuarial estimation, including both reported and incurred but not reported claims, taking into consideration the severity of incidents and the expected timing of claim payments. At June 30, 2018 and 2017, funds held by RQIL were \$116,763 and \$120,349, respectively. The related current estimated self-insurance liabilities for June 30, 2018 and 2017 were \$33,611 and \$34,623, respectively. The related long-term estimated self-insurance liabilities for June 30, 2018 and 2017 were \$76,020 and \$78,564, respectively. At June 30, 2018 and 2017, the estimated self-insurance liability for all future claims payments reflects the actuarially determined outstanding losses at the undiscounted/expected level. The amount included in expenses for 2018 and 2017 was \$32,228 and \$33,816, respectively, and is included in other expense in the consolidated statements of operations and change in unrestricted net assets. These calculations take into consideration any liability that may be covered under an extended reporting endorsement and considered tail liability.

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(b) Employee Health

The HSHS self-insurance program provides health insurance for employees. HSHS has developed internal techniques for estimating costs.

At June 30, 2018 and 2017, funds held by HSHS for health insurance liability for employees' self-insurance are \$70,658 and \$72,092, respectively, and are included in current and noncurrent assets whose use is limited or restricted. At June 30, 2018 and 2017, related estimated current self-insurance liabilities are \$15,424 and \$17,288, respectively.

(11) Employee Benefit Plans

(a) Defined-Benefit Plan

HSHS employees participate in The Hospital Sisters Health System Employees Pension Plan (the Plan). This noncontributory defined-benefit pension plan covers substantially all employees of HSHS who have completed 1,000 hours of employment during any calendar year subsequent to the commencement of employment. The Plan recognizes and funds the costs related to employee service using the projected unit credit actuarial cost method. The information below represents the aggregation of HSHS' pension financial status, which is determined by the consulting actuaries on a member-specific basis.

HSHS' retirement program covers all employees under one comprehensive retirement program that administers benefits under two different tracks. Employees hired or rehired on or after July 1, 2014 will receive their employer-provided retirement benefits based a combination of a cash balance formula within the defined-benefit plan and an employer-matching contribution into HSHS defined-contribution plan. Employees hired before July 1, 2014 receive their employer-provided retirement benefits based on a final average pay formula within the defined-benefit plan.

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The following tables set forth the Plan's funded status, amounts recognized in HSHS' consolidated financial statements, and assumptions at June 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 1,856,011	1,789,623
Service cost	52,771	53,777
Interest cost	69,702	64,214
Actuarial loss(gain)	(37,411)	(6,937)
Benefits paid	<u>(51,551)</u>	<u>(44,666)</u>
Benefit obligation at end of year	\$ <u>1,889,522</u>	<u>1,856,011</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 1,509,199	1,275,350
Actual gain on plan assets	133,915	157,324
Employer contributions	113,319	130,756
Expenses paid	(7,435)	(9,565)
Benefits paid	<u>(51,551)</u>	<u>(44,666)</u>
Fair value of plan assets at end of year	\$ <u>1,697,447</u>	<u>1,509,199</u>
Reconciliation of funded status:		
Funded status	\$ (192,077)	(346,812)
Amounts recognized in the accompanying consolidated balance sheets:		
Accrued benefit liability	(192,077)	(346,812)
Amounts not yet reflected in net periodic benefit cost and included as an accumulated charge to unrestricted net assets:		
Prior service cost	\$ <u>(442)</u>	<u>(613)</u>
	\$ <u>(442)</u>	<u>(613)</u>

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	<u>2018</u>	<u>2017</u>
Changes recognized in unrestricted net assets:		
Net gain arising during the period	\$ (48,915)	(59,761)
Amortization of prior service credit	(171)	(301)
Amortization or settlement recognition of net loss	48,915	59,761
Total recognized in unrestricted net assets	\$ <u>(171)</u>	<u>(301)</u>
Total recognized in net periodic pension cost and unrestricted net assets	\$ (41,419)	(36,703)
Estimated amounts that will be amortized from unrestricted net assets over the next fiscal year:		
Prior service credit	(171)	(171)
Accumulated benefit obligation	1,749,212	1,707,130
Components of net periodic benefit cost:		
Service cost	\$ 52,771	53,777
Interest cost	69,702	64,214
Expected return on plan assets	(114,977)	(94,933)
Amortization of prior service cost	171	301
Net periodic benefit cost excluding MTM adjustment*	7,667	23,359
MTM adjustment*	<u>(48,915)</u>	<u>(59,761)</u>
Net periodic benefit cost	\$ <u><u>(41,248)</u></u>	<u><u>(36,402)</u></u>

* Includes amounts for SMS in Streator, Illinois

	<u>2018</u>	<u>2017</u>
Weighted average assumptions used to determine benefit obligations at June 30:		
Discount rate	4.52 %	4.29 %
Average rate of compensation increase	3.00	3.00
Measurement date	June 30, 2018	June 30, 2017
Weighted average assumptions used to determine net periodic benefit cost for the year ended June 30:		
Discount rate	4.29 %	4.16 %
Expected long-term return on plan assets	8.00	8.00
Average rate of compensation increase	3.00	3.00
Measurement date	June 30, 2017	June 30, 2016

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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 assets categories. The return is based exclusively on historical returns without adjustments.

The Plan's liability at the measurement date is determined by discounting cash flows by the corresponding annual spot rate on the client-specific yield curve. The spot rate approach uses the actuarially projected benefit payment cash flows for each future period over the life of the plan and discounts them back to the measurement date using the spot interest rate associated with each respective period in the high-quality corporate bond yield curve. The sum of the discounted amounts is the benefit obligation. Interest cost under the spot rate approach is determined by multiplying the individual spot rates from the exact same yield curve by each year's present value of future projected benefit payments. The sum of those products is the interest cost for the period. The same approach is used to calculate the plan's service cost, except that the actuarially projected benefit payment cash flows are associated with the plan's service cost and not the plan's projected benefit obligation.

HSBS expects to contribute to its pension plan for the 2018 fiscal year the following amount	\$	90,886
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The following benefit payments that reflect expected future service, as appropriate, are expected to be paid:

2019	\$	62,441
2020		70,097
2021		76,601
2022		83,509
2023		90,497
2024–2028		546,959

The expected benefits are based on the same assumptions used to measure HSBS' benefit obligation at June 30, 2018 and 2017 and include estimated future employee service.

As of June 30, 2017, HSBS adopted the new RP-2014 Society of Actuaries Employee and Retiree Healthy no Collar Mortality Table backed off to 2007 with generational mortality improvements projected using the mortality improvement projection scale implied by the Social Security Administration's rate of mortality (MSS-2016). As a result of the adoption, the projected benefit obligation decreased in 2017 by approximately \$4,200. As of June 30, 2018, HSBS updated the mortality improvement projection scale to be MSS-2017. This scale is also based on the Social Security Administration's rate of mortality improvement but uses an additional year of data when compared to MSS-2016. As a result of this change the projected benefit obligation decreased in 2018 by approximately \$2,600.

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The Plan has developed an Investment Policy Statement (the IPS), which is reviewed and approved by the HSHS board of directors. The IPS establishes goals and objectives of the fund, asset allocations, allowable and prohibited investments, socially responsible guidelines, and asset classifications. The IPS dictates that assets should be rebalanced back to target allocation on a quarterly basis. Investments are managed by independent managers. Management monitors the performance of these managers on a quarterly basis.

The table below lists the target asset allocation and acceptable ranges and actual asset allocations as of June 30, 2018 and 2017:

Asset	Target allocation	Acceptable range	Actual allocation at June 30	
			2018	2017
Equities	57 %	30%–70%	54 %	54 %
Debt securities	30	20–70	31	30
Alternative investments	13	0–15	12	12
Cash and cash equivalents	—	0–6	3	4

(b) Overall Investment Objective

The overall investment objective of the Plan is to invest the Plan's assets in a prudent manner to best serve the participants of the Plan. Plan investment assets are to produce investment results that achieve the Plan's actuarial assumed rate of return, protect the integrity of the Plan, assist HSHS in meeting the obligations to the Plan's participants, manage risk exposures, focus on downside protection, and maintain enough liquidity in the portfolio to ensure timely cash outflows and beneficiary payments. The Plans' investments are diversified among various asset classes incorporating multiple strategies and managers to exceed a weighted benchmark return based upon policy asset allocation targets and standard index returns. Major investment decisions are authorized by the HSHS' retirement committee, which oversees the Plan's investment program in accordance with established guidelines.

(c) Allocation of Investment Strategies

The Plan maintains a percentage of assets in domestic and international equity stocks to achieve the expected rate of return. To manage risk exposure, up to 30% of the Plans' assets are invested in a liability-driven investment strategy.

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(d) Basis of Reporting

Investments are reported at estimated fair value. If an investment is held directly by the Plan 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 mutual funds are based on share prices reported by the funds as of the last business day of the fiscal year. The Plan's ownership in alternative investment funds are generally reported at the NAV reported by the fund managers, which is used as a practical expedient to estimate the fair value of the Plan's ownership therein, unless it is probable that all or a portion of the investment will be sold for an amount different from NAV. As of June 30, 2018, the Plan had no plans or intentions to sell investments at amounts different from NAV. During the 2018 fiscal year, the Retirement Committee decided to terminate the Mesirow multi-strategy hedge fund and transfer the assets to K2 fund manager. As of June 30, 2018, the fund has not been terminated, and HSHS does not plan or intend the Mesirow multi-strategy fund to sell at an amount different from NAV. Subsequent to June 30, 2018, HSHS has begun liquidating the fund which has been performed at NAV.

The fair values of the Plan's assets at June 30, 2018, by asset category class, are as follows:

	June 30, 2018				Redemption or liquidation	Days' notice
	Level 1	Level 2	Level 3	Total		
Pension plan assets excluding accrued interest of \$577:						
Cash and cash equivalents	\$ 52,249	—	—	52,249	Daily	One
Common stocks	662,683	—	—	662,683	Daily	One
U.S. government securities	—	174,466	—	174,466	Daily	One
Commingled mutual funds	—	324,083	—	324,083	Daily	Three
Corporate bonds, notes, and debentures	—	22,708	—	22,708	Daily	Two
Foreign securities	249,104	10,206	—	259,310	Daily	Three
Subtotal	<u>\$ 964,036</u>	<u>531,463</u>	<u>—</u>	1,495,499		
Hedge funds ¹ :						
K2 multistrategy fund				61,744	Note 6(e)*	Note 6(e)*
Mesirow multistrategy fund				<u>139,627</u>	Note 6(e)*	Note 6(e)*
Total assets at fair value				<u>\$ 1,696,870</u>		

* Liquidity terms are allocated the same as disclosed in note 6(e) for plan assets.

¹ Certain investments that are measured at fair value using the NAV per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

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The fair values of the Plan's assets at June 30, 2017, by asset category class, are as follows:

	June 30, 2017			Total	Redemption or liquidation	Days' notice
	Level 1	Level 2	Level 3			
Pension plan assets excluding accrued interest of \$745:						
Cash and cash equivalents	\$ 68,240	—	—	68,240	Daily	One
Common stocks	565,887	—	—	565,887	Daily	One
U.S. government securities	—	138,520	—	138,520	Daily	One
Commingled mutual funds	—	292,414	—	292,414	Daily	Three
Municipal bonds	—	1,221	—	1,221	Daily	Two
Corporate bonds, notes, and debentures	—	17,179	—	17,179	Daily	Two
Foreign securities	234,207	7,641	—	241,848	Daily	Three
Subtotal	\$ 868,334	456,975	—	1,325,309		
Hedge funds ¹ :						
K2 multistrategy fund				48,482	Note 6(e)*	Note 6(e)*
Mesirov multistrategy fund				134,663	Note 6(e)*	Note 6(e)*
Total assets at fair value				\$ 1,508,454		

* Liquidity terms are allocated the same as disclosed in note 6(e) for plan assets.

¹ Certain investments that are measured at fair value using the NAV per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

(e) 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 June 30, 2018 or 2017.

- Cash and cash equivalents: Valued at the carrying amount that approximates fair value because of the short-term maturity of these investments
- Common and preferred stocks, U.S. government securities, commingled mutual funds, and foreign securities: Valued at the closing price reported on the active market on which the individual securities are traded
- Municipal bonds, corporate bonds, notes, and debentures: Certain corporate bonds are valued at the closing price reported in the active market in which the bond is traded. Other corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. When quoted prices are not available for identical or similar bonds, the bond is valued under a discounted cash flows approach that maximizes observable inputs, such as current yields of similar instruments, but includes adjustments for certain risks that may not be observable, such as credit and liquidity.

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The Plan has certain hedge fund investments for which quoted market prices are not available. The estimated fair value of these hedge fund investments includes estimates, appraisals, assumptions, and methods provided by external financial advisers and reviewed by HSHS.

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.

(f) Fair Value Hierarchy

The Plan records 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 under ASC Section 715-20-50, *Compensation – Retirement Benefits: Defined Benefit Plans – General: Disclosures*. ASC Section 715-20-50 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value.

(g) 403(b) Plan

HSHS' Tax Deferred Annuity Program is a 403(b) retirement saving plan for its colleagues. Colleagues hired or rehired on or after July 1, 2014 are eligible for an employer paid match of 50 cents per \$1 contributed by the participating colleague up to the first 4% of eligible pay for each calendar year. Eligible colleagues must have a minimum of 1,000 paid hours during the fiscal year to participate. For fiscal years ended June 30, 2018 and June 30, 2017, HSHS contributed \$3,477 and \$2,574, respectively, in matching contributions.

(12) Long-Term Debt

Under the terms of the Obligated Group MTI, each member of the Obligated Group is jointly and severally liable for all obligations issued thereunder. Bonds issued are unsecured general obligations but carry covenants regarding withdrawals from the Obligated Group, issuance of additional debt, and creations of liens on property. Obligations outstanding under the Obligated Group MTI are issued through state authorities and comprise both serial and term bonds with varying maturities.

On December 22, 2016, HSSI issued \$75,000 in fixed rate debt Series 2016 bonds. The bonds were issued at par, and HSSI paid bond issue costs of \$577 related to this issuance. On February 8, 2017, HSSI issued no call option bonds of \$57,710 in fixed rate debt Series 2017A. HSSI received a bond premium of \$9,322 and paid bond issue costs of \$800 related to this issuance. On February 8, 2017, HSSI issued variable rate bonds Series 2017B of \$64,870 and paid issue costs of \$682 for this issuance.

On December 22, 2016, HSSI entered into an escrow agreement with the Illinois Finance Authority and The Bank of New York Mellon Trust Company N.A. to legally defease the Series 2007A Bonds. The par value of the Bonds was \$72,035 and the escrow was funded with \$73,753 of cash from HSSI to refund the bonds and interest due on March 15, 2017, the first call date of the 2007A Bonds.

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As of June 30, 2018, long-term debt consisted of the following:

Series	Interest rates	Final maturity dates	2018
Fixed interest rate issues:			
2012B	4.000% and 5.000%	August 15, 2021	\$ 38,415
2012C	5.000%	August 15, 2021	33,715
2014A	5.000%	November 15, 2029	161,520
2016A	5.375%	November 15, 2046	75,000
2017A	5.000%	February 15, 2028	57,710
SCO	2.870%	January 15, 2033	7,138
HFG	2.500%	November 15, 2026	5,970
GSS	2.140%	September 1, 2040	6,750
Variable interest rate issues:			
2012A	Variable 2.20% at June 30, 2018	June 30, 2041	50,160
2012G	Variable 1.50% at June 30, 2018	August 1, 2041	31,645
2012H	Variable 1.30% to 1.68% at June 30, 2018	August 1, 2041	65,885
2012I	Variable 1.36% to 1.49% at June 30, 2018	August 1, 2041	89,460
2017B	Variable 1.42% to 1.64% at June 30, 2018	March 15, 2044	64,870
Total fixed and variable interest debt			688,238
Other long-term debt			22,286
Less unamortized bond issue costs			(4,449)
Plus unamortized bond issue premiums			32,472
Total debt			738,547
Less:			
Current installments			30,131
Long-term debt subject to short-term remarketing agreements			220,215
Total long-term debt, excluding current installments			\$ 488,201

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As of June 30, 2017, long-term debt consisted of the following:

Series	Interest rates	Final maturity dates	2017
Fixed interest rate issues:			
2012B	4.000% and 5.000%	August 15, 2021	\$ 46,800
2012C	5.000%	August 15, 2021	41,365
2014A	5.000%	November 15, 2029	167,990
2016A	5.375%	November 15, 2046	75,000
2017A	5.000%	February 15, 2028	57,710
SCO	2.720%	January 15, 2033	7,530
HFG	2.500%	November 15, 2026	6,601
GSS	2.140%	September 1, 2040	7,050
Variable interest rate issues:			
2012A	Variable 1.51% at June 30, 2017	June 30, 2041	50,160
2012G	Variable 0.90% at June 30, 2017	August 1, 2041	31,645
2012H	Variable 0.75% to 0.93% at June 30, 2017	August 1, 2041	65,885
2012I	Variable 0.94% to 0.99% at June 30, 2017	August 1, 2041	89,460
2017B	Variable 0.90% to 0.97% at June 30, 2017	March 15, 2044	<u>64,870</u>
Total fixed and variable interest debt			712,066
Other long-term debt			26,965
Less unamortized bond issue costs			(5,269)
Plus unamortized bond issue premiums			<u>38,824</u>
Total debt			772,586
Less:			
Current installments			30,257
Long-term debt subject to short-term remarketing agreements			<u>220,215</u>
Total long-term debt, excluding current installments			<u>\$ 522,114</u>

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The Obligated Group's effective interest rates for variable debt for the years ended June 30, 2018 and 2017 are as follows:

	<u>2018</u>	<u>2017</u>
Variable interest rate issues:		
2012A	1.73 %	1.28 %
2012G	1.12	0.68
2012H	1.02	0.78
2012I	1.13	0.74
2017B	1.11	0.81

Bond issue premiums and costs are amortized over 10 years using the straight-line method. Bond issuance costs, net of amortization, are reported as other assets in the accompanying consolidated balance sheets.

HSSI has variable rate bonds, a portion of which has a put option available to the holder. If the put option is exercised, the bonds are presented to the bank, which in turn draws on the underlying direct pay letter of credit, if available. Self-liquidity bonds are backed by the financial assets of HSSI and are presented as long-term debt subject to short-term remarketing agreements in the accompanying consolidated balance sheets. The bond series and the underlying credit facility terms are described as follows as of June 30, 2018:

<u>Series</u>	<u>Term</u>
Series 2012G	Equal quarterly installments on the first business day of each January, April, July, or October whichever occurs first on or following the 367th day after the purchase date and paid in full no later than the third anniversary of the purchase date
Series 2012H, 2012I, and 2017B	Self-liquidity – 270 days

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Scheduled principal repayments on long-term debt based on the variable rate demand notes being put back to HSHS and a corresponding draw being made on the underlying credit facility, if available, are as follows:

Year ending June 30:		
2019	\$	250,346
2020		29,068
2021		29,410
2022		30,430
2023		31,411
Thereafter		<u>339,859</u>
	\$	<u><u>710,524</u></u>

Scheduled principal repayments on the long-term debt based on the scheduled redemptions according to the Obligated Group MTI are as follows:

Year ending June 30:		
2019	\$	30,131
2020		29,068
2021		29,410
2022		30,430
2023		31,411
Thereafter		<u>560,074</u>
	\$	<u><u>710,524</u></u>

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(13) Capital Leases

HSHS leases certain equipment under capital leases. Included with property, plant, and equipment are \$42,147 and \$40,618 of assets held under capital leases and \$26,675 and \$20,222 of related accumulated amortization at June 30, 2018 and 2017, respectively. A summary of future minimum lease payments and the present value of future minimum lease payments related to capital leases at June 30, 2018 are as follows:

	<u>Amount</u>
Year:	
2019	\$ 5,853
2020	3,385
2021	2,311
2022	1,929
2023	1,628
Thereafter	<u>8,825</u>
Total future minimum lease payments	23,931
Less amount representing interest at rates ranging from 5.0% to 6.5%	<u>6,091</u>
Present value of future minimum lease payments	17,840
Less current portion of obligations under capital leases included in current installments of long-term debt	<u>4,829</u>
Obligations under capital leases, excluding current portion included in long-term debt, excluding current installments	<u><u>\$ 13,011</u></u>

(14) Functional Expenses

HSHS provides general healthcare services to residents within its respective geographic regions. Expenses related to providing these services for the years ended June 30, 2018 and 2017 are as follows:

	<u>2018</u>	<u>2017</u>
Healthcare services	\$ 1,817,318	1,758,815
General and administrative services	<u>554,069</u>	<u>539,146</u>
	<u><u>\$ 2,371,387</u></u>	<u><u>2,297,961</u></u>

(15) Prevea

SVGB and SMGB (collectively, referred to as the Green Bay Hospitals), two members of the Obligated Group located in Green Bay, Wisconsin, each have a 25% interest in Prevea Health Systems, Inc.

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(Prevea). The Green Bay Hospitals held \$21,989 (21,989 shares), at June 30, 2018 and 2017, of Prevea preferred stock. Prevea has 9,000 shares of authorized stock consisting of 900 shares of Class P voting common stock, 3,600 shares of Class P nonvoting, and 4,500 shares of Class H common stock.

With respect to all matters upon which shareholders are entitled to vote or give consent, the outstanding shares of Class P voting common stock constitute one voting group and the holders of outstanding shares of Class H common stock constitute a separate voting group. Each voting group gets 50% of the total voting privileges (with each entitled to elect one half of the total authorized number of directors of the corporation). As of June 30, 2018 and 2017, there are 100 voting shares for the Green Bay Hospitals (Class H) and 146 voting shares for Physicians (Class P). There are 457 nonvoting shares. The preferred stockholders of Prevea have liquidation preferences to common stockholders, as defined in the Articles of Incorporation of Prevea. The preferred stock entitles the Green Bay Hospitals to receive dividends equal to 7% of the face value of the preferred stock. Additionally, preferred stock dividends are cumulative. The Green Bay Hospitals' policy is to recognize preferred stock dividends when the dividends are declared. Dividends were declared and paid by Prevea totaling \$1,127 in 2018 and \$3,188 in 2017. The investment in Prevea is accounted for using the equity method. The carrying value of the Green Bay Hospitals' investment in Prevea, inclusive of preferred stock holdings, is reported as other assets in the accompanying consolidated balance sheets.

During the years ended June 30, 2018 and 2017, the Green Bay Hospitals have \$774 and \$803, respectively, of notes receivable for cash advances to Prevea.

The following are Prevea's condensed unaudited financial statement data as of and for the years ended June 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Total assets	\$ 88,749	91,866
Total liabilities	52,194	53,023
Total equity	37,555	38,843
Total net revenue	244,589	267,733
Net income	(166)	522

The Green Bay Hospitals' equity portion in Prevea at June 30, 2018 and 2017 decreased by \$1,256 and \$1,394, respectively, and is included in other revenues in the accompanying consolidated statements of operations and change in unrestricted net assets.

In fiscal year 2014, the Obligated Group guaranteed all outstanding debt of Prevea. The Obligated Group will be paid 1.25% of the average outstanding principal amount of the outstanding notes. Included in the guarantee are \$2,920 taxable variable rate demand notes of PHP Insurance Plan, Inc. (PHP). PHP, a former health maintenance organization, sold its insurance license, changed its corporate structure, and became Prevea Ventures, LLC (PV). Prevea is the sole corporate member of PV. At June 30, 2018 and 2017, the Clinic has commercial loans outstanding, which replaced these notes with balances of \$17,255

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and \$18,044, respectively. At June 30, 2018 and 2017, PV has notes outstanding of \$1,880 and \$1,976, respectively. Relative to the Guarantee Agreement, no amounts have been paid or accrued as of June 30, 2018 or 2017.

(16) Joint Ventures

Joint ventures are accounted for using the equity method of accounting and represent \$39,624 and \$45,853 of other long-term assets in the accompanying consolidated balance sheets at June 30, 2018 and 2017, respectively. The most significant of these investments, excluding Prevea (note 15), include:

- Protestant Memorial Medical Center and St. Elizabeth's Healthcare Services, LLP (held by SEB) – 50% ownership interest, which was sold on November 30, 2017
- Southwest Illinois Health Ventures, Inc. and St. Elizabeth's Hospital on November 30, 2017 created Southwest Illinois Health Services Real Estate, LLP, which SEO has a 50% ownership interest
- Pain Center of Wisconsin (held by SVGB) – 50% ownership interest
- Door County Memorial Hospital (held by SVGB) – 40% ownership interest
- Orange Cross Ambulance, Inc. (held by SNS) – 50% ownership interest
- Pain Centers of Wisconsin-Oconto Falls, LLC (held by SCO) – 50% ownership interest

For the years ended June 30, 2018 and 2017, HSHS recognized income of \$1,343 and \$1,329, respectively, in investments in affiliated companies. This activity is included as a component of other revenues in the accompanying consolidated statements of operations and change in unrestricted net assets. During 2018 and 2017, HSHS received cash distributions of \$2,580 and \$1,740, respectively, from the joint ventures.

The following table summarizes the unaudited aggregated financial information of unconsolidated affiliated companies of HSHS as of June 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Total assets	\$ 112,941	116,080
Total liabilities	20,568	19,072
Total equity	92,373	97,008
Total net revenue	90,625	66,633
Net income	3,090	2,997

(17) Pledges Receivable

Pledges, net of a present value discount rate, determined in the year the pledge is made, and an allowance for uncollectible pledges are recorded as a component of assets whose use is limited or restricted in the accompanying consolidated financial statements based on their expected collection date.

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Included in assets whose use is limited or restricted at June 30, 2018 and 2017 are the following unconditional promises to give:

	2018	2017
Unconditional promises to give	\$ 8,264	6,249
Less unamortized discount	367	287
	7,897	5,962
Less allowance for uncollectible pledges	192	163
Net pledges receivable	\$ 7,705	5,799
Amounts due in:		
Less than one year	\$ 1,340	1,060
One to five years	5,471	4,374
More than five years	1,453	815
Total	\$ 8,264	6,249

(18) Temporarily and Permanently Restricted Assets

Temporarily restricted assets are available for the following purposes or periods at June 30, 2018 and 2017:

	2018	2017
Healthcare services	\$ 28,868	29,588
Capital expenditures	8,308	10,067
Catholic radio	261	264
College of nursing	232	226
	\$ 37,669	40,145

HSHS' endowments consist of individual donor restricted endowment and board-designated endowment funds for a variety of purposes plus the following where the assets have been designated for endowment: pledge receivable, split-interest agreements, and other net assets. The endowment includes both donor-restricted endowment funds and funds designated by the board of directors to function as endowments. The net assets associated with endowment funds, including funds designated by the board of directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Illinois is governed by the Uniform Prudent Management of Institutional Funds Act (UPMIFA). The board of directors of HSHS has interpreted UPMIFA as sustaining the preservation of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result

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of this interpretation, HSHS classifies as permanently restricted net assets, (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulates to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by HSHS in a manner consistent with the standard of prudence prescribed by UPMIFA.

HSHS has the following donor-restricted endowment activities during the years ended June 30, 2018 and 2017 delineated by net asset class:

	Unrestricted funds functioning	Temporarily restricted	Permanently restricted	2018 Total
Endowment net assets, beginning of year	\$ 4,744	3,230	27,869	35,843
Investment return:				
Investment income	24	33	37	94
Net appreciation (realized and unrealized)	391	533	—	924
Total investment return	415	566	37	1,018
Contributions and bequests	—	—	465	465
Appropriation of endowment assets for expenditure	(223)	(235)	—	(458)
Other	(585)	(47)	—	(632)
Endowment net assets, end of year	\$ 4,351	3,514	28,371	36,236

	Unrestricted funds functioning	Temporarily restricted	Permanently restricted	2017 Total
Endowment net assets, beginning of year	\$ 4,607	3,835	27,436	35,878
Investment return:				
Investment income	10	1	21	32
Net appreciation (realized and unrealized)	679	(22)	—	657
Total investment return	689	(21)	21	689
Contributions and bequests	—	—	352	352
Contribution of GSS net assets	—	—	60	60
Appropriation of endowment assets for expenditure	(552)	(584)	—	(1,136)
Endowment net assets, end of year	\$ 4,744	3,230	27,869	35,843

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(Dollars in thousands)

As of June 30, 2018 and 2017, HSHS has permanently restricted endowments as follows:

	<u>2018</u>	<u>2017</u>
Assets to be held in perpetuity, the income from which expendable to support nursing schools	\$ 4,691	4,510
Assets to be held in perpetuity, the income from which expendable to support specific operations of HSHS facilities	<u>23,680</u>	<u>23,359</u>
	<u>\$ 28,371</u>	<u>27,869</u>

HSHS has established a spending policy, which is evaluated and approved by the Foundation's board every year. The approved spending rate for fiscal year 2018 and 2017 is 2.79%. In establishing this policy, the long-term expected return on the endowment is considered. This is consistent with HSHS' objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term.

Endowment funds are commingled with the pooled investment fund administered by HSHS. HSHS relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). HSHS targets a diversified asset allocation of 27.0% fixed income, 17.0% domestic equities, 16.0% international equities, 23.0% custom hedge funds, 7.0% real assets, and 10.0% private equity to achieve its long-term return objectives within prudent risk constraints.

As of June 30, 2018 and 2017, HSHS has unrestricted and temporarily restricted funds that represent the unspent accumulation of earnings for endowment funds as follows:

	<u>2018</u>	<u>2017</u>
Unspent income from which is expendable to support nursing schools	\$ 142	182
Unspent income from which is expendable to support specific operations of HSHS facilities	<u>7,723</u>	<u>7,792</u>
	<u>\$ 7,865</u>	<u>7,974</u>

(19) Commitments and Contingencies

(a) Operating Leases

HSHS occupies space in certain facilities and leases various pieces of equipment under long-term noncancelable operating lease arrangements. Total equipment rental, asset lease, and facility rental expense in 2018 and 2017 were \$45,555 and \$44,076, respectively.

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(Dollars in thousands)

The following is a schedule by year of future minimum lease payments to be made under operating leases as of June 30, 2018 that have initial or remaining lease terms in excess of one year:

	<u>Amount</u>
Year ending June 30:	
2019	\$ 31,341
2020	26,455
2021	23,318
2022	20,868
2023	19,803
Thereafter	73,777

(b) 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 HSHS and other healthcare organizations. The federal government has increased its enforcement activity, including audits and investigations related to billing practices, clinical documentation, and related matters. HSHS maintains a compliance program designed to educate employees and to detect and correct possible violations.

(c) Litigation

HSHS is 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 the HSHS's future consolidated financial position or results of operations.

(d) Unemployment

The Wisconsin hospitals of HSHS pledged a U.S. Treasury note as collateral for any unpaid unemployment compensation claims with a face value of \$4,630 for 2018 and 2017 to the Wisconsin Unemployment Reserve Fund. The pledged U.S. Treasury note remained unused at June 30, 2018 and 2017.

(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 creates new standards for state sales tax and property tax exemptions in Illinois. The law establishes 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. HSHS certified in 2018 and 2017 and has not recorded a liability for related property taxes based upon management's current determination of qualified services provided.

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(f) Investment Risk and Uncertainties

HSHS 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 change could materially affect the amounts reported in the accompanying consolidated balance sheets.

(g) Guarantee Agreement

During fiscal year 2014, the Obligated Group executed a Guarantee Agreement with JPMorgan Chase, N.A. to guaranty \$10,000 of debt for Touchette Regional Hospital in East Saint Louis, Illinois. The Obligated Group will be paid a fee of 0.90% of the average outstanding principal amount of the outstanding debt. Relative to the Guarantee Agreement, no amounts have been paid or accrued as of June 30, 2018 or 2017.

(20) Subsequent Events

In connection with the preparation of the consolidated financial statements and in accordance with ASC Topic 855, *Subsequent Events*, HSHS evaluated subsequent events after the consolidated balance sheet date of June 30, 2018 through October 22, 2018, which was the date the financial statements were issued and other than noted above, there were no other items to disclose.

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Consolidating Balance Sheet Information

June 30, 2018

(Dollars in thousands)

Assets	HSSI – Obligated Group	RQIL	Unity Limited Partnership	KCIN	Healthcare West
Current assets:					
Cash and cash equivalents	\$ 92,134	—	3,101	6,258	67
Receivables:					
Patients' accounts, net of uncollectible amounts	357,950	—	4,016	—	—
Due from third-party reimbursement programs	45,989	—	—	—	—
Other	34,059	—	122	2,673	—
Total receivables	392,998	—	4,138	2,673	—
Current portion of assets whose use is limited or restricted	195,323	33,714	9,767	—	—
Inventories	45,687	—	—	—	—
Prepaid expenses	12,059	—	—	1,575	—
Total current assets	738,201	33,714	17,006	10,506	67
Assets whose use is limited or restricted	1,736,706	83,049	430	—	10,903
Property, plant, and equipment, net	1,293,449	—	4,403	1,669	2,586
Other assets	116,598	—	—	—	—
	<u>\$ 3,884,954</u>	<u>116,763</u>	<u>21,839</u>	<u>12,175</u>	<u>13,556</u>
Liabilities and Net Assets					
Current liabilities:					
Current installments of long-term debt	\$ 25,980	—	—	—	—
Long-term debt subject to short-term remarketing agreements	220,215	—	—	—	—
Current portion of estimated self-insurance liabilities	—	33,611	—	—	—
Accounts payable	86,195	—	2,232	3,199	105
Accrued liabilities	135,285	103	57	1,218	—
Estimated payables under third-party reimbursement programs	52,820	—	—	—	—
Total current liabilities	520,495	33,714	2,289	4,417	105
Long-term debt, excluding current installments	829,372	—	—	2,840	—
Estimated self-insurance liabilities	—	76,020	—	—	—
Derivative instruments	34,527	—	—	—	—
Accrued benefit liability	159,167	—	—	—	—
Other noncurrent liabilities	29,556	—	8,797	—	404
Total liabilities	1,573,117	109,734	11,086	7,257	509
Net assets:					
Unrestricted	2,203,167	7,029	10,753	4,918	13,047
Temporarily restricted	81,299	—	—	—	—
Permanently restricted	27,371	—	—	—	—
Total net assets	2,311,837	7,029	10,753	4,918	13,047
Stockholder's equity	—	—	—	—	—
	<u>\$ 3,884,954</u>	<u>116,763</u>	<u>21,839</u>	<u>12,175</u>	<u>13,556</u>

See accompanying independent auditors' report.

System Office	Medical Group	Health Care Fund	Flex Plan	Foundation	Kiara, Inc.	PERC	Eliminations	Total
13,233	8,534	—	1,342	2,259	859	2,670	(2,259)	128,198
—	6,296	—	—	—	4,999	—	—	373,261
—	—	—	—	—	—	—	—	989
8,563	4,649	—	—	7,706	2,393	733	(18,028)	42,870
8,563	10,945	—	—	7,706	7,392	733	(18,028)	417,120
—	7,877	19,093	—	—	—	1,132	36,247	303,153
—	451	—	—	—	2,248	—	—	48,386
13,828	1,355	—	—	—	441	48	—	29,306
35,624	29,162	19,093	1,342	9,965	10,940	4,583	15,960	926,163
147,383	—	51,069	—	102,870	8,285	—	(603,814)	1,536,881
164,466	19,260	—	—	—	6,762	106	—	1,492,701
11,372	576	—	—	496	3,769	—	(32,463)	100,348
358,845	48,998	70,162	1,342	113,331	29,756	4,689	(620,317)	4,056,093
3,984	—	—	—	—	163	4	—	30,131
—	—	—	—	—	—	—	—	220,215
—	—	15,424	—	—	—	—	—	49,035
5,213	5,970	3,624	751	—	3,109	61	(10,322)	100,137
11,708	22,039	45	—	113,331	8,364	419	(113,331)	179,238
—	—	—	—	—	—	—	—	52,820
20,905	28,009	19,093	751	113,331	11,636	484	(123,653)	631,576
118,602	—	—	—	—	4,910	14	(467,537)	488,201
—	—	—	—	—	—	—	—	76,020
—	—	—	—	—	—	—	—	34,527
26,503	5,125	—	—	—	1,091	191	—	192,077
8,126	407	—	—	—	774	—	—	48,064
174,136	33,541	19,093	751	113,331	18,411	689	(591,190)	1,470,465
179,438	15,457	51,069	591	—	—	4,000	30,119	2,519,588
4,271	—	—	—	—	—	—	(47,901)	37,669
1,000	—	—	—	—	—	—	—	28,371
184,709	15,457	51,069	591	—	—	4,000	(17,782)	2,585,628
—	—	—	—	—	11,345	—	(11,345)	—
358,845	48,998	70,162	1,342	113,331	29,756	4,689	(620,317)	4,056,093

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES
Springfield, Illinois

Consolidating Statement of Operations Information and Change in Unrestricted Net Assets

Year ended June 30, 2018

(Dollars in thousands)

	HSSI – Obligated Group	RQIL	Unity Limited Partnership	KCIN	Healthcare West
Net patient service revenues	\$ 2,227,748		21,930	—	—
Provision for uncollectible accounts	(45,855)	—	—	—	—
Net patient service revenue, less provision for uncollectible accounts	2,181,893	—	21,930	—	—
Other revenues:					
Investment income (loss)	—	7,944	—	—	—
Net assets released from restrictions used for operations	2,393	—	—	—	—
Other	48,959	24,284	1,772	7,740	741
Total revenues	<u>2,233,245</u>	<u>32,228</u>	<u>23,702</u>	<u>7,740</u>	<u>741</u>
Expenses:					
Sisters' services	65	—	—	—	—
Salaries and wages	584,000	—	10,149	—	—
Employee benefits	159,330	—	4,543	—	—
Pension expense, excluding mark to market adjustment	(1,589)	—	—	—	—
Pension expense, mark to market adjustment	(43,147)	—	—	—	—
Professional fees	119,061	—	329	59	10
Supplies	353,032	—	281	8	23
Depreciation and amortization, excluding Belleville campus	108,676	—	447	1,172	249
Accelerated depreciation of Belleville campus	9,076	—	—	—	—
Interest	12,932	—	—	—	—
Other	831,783	32,228	6,347	8,274	323
Total expenses	<u>2,133,219</u>	<u>32,228</u>	<u>22,096</u>	<u>9,513</u>	<u>605</u>
Income (loss) from operations	100,026	—	1,606	(1,773)	136
Nonoperating gains (losses):					
Investment income (losses)	72,236	—	—	—	446
Change in fair value of interest rate swaps	13,379	—	—	—	—
Revenues and gains in excess (deficient) of expenses and losses	185,641	—	1,606	(1,773)	582
Other changes in unrestricted net assets:					
Net assets released from restrictions used for the purchase of property, plant, and equipment	12,409	—	—	—	—
Recognition of change in pension funded status	—	—	—	—	—
Transfers (to) from affiliates	(62,835)	—	—	4,522	—
Change in unrestricted net assets	<u>\$ 135,215</u>	<u>—</u>	<u>1,606</u>	<u>2,749</u>	<u>582</u>

See accompanying independent auditors' report.

Schedule 2

System Office	Medical Group	Health Care Fund	Flex Plan	Foundation	Kiara, Inc.	PERC	Eliminations	Total
—	77,793	—	—	—	33,293	—	—	2,360,764
—	(2,834)	—	—	—	(468)	—	—	(49,157)
—	74,959	—	—	—	32,825	—	—	2,311,607
—	—	2,472	1	—	559	—	(10,417)	559
—	—	—	—	11,699	—	—	(7,275)	6,817
145,176	115,454	159,399	226	4,734	29,803	3,449	(449,459)	92,278
145,176	190,413	161,871	227	16,433	63,187	3,449	(467,151)	2,411,261
660	—	—	—	—	—	—	—	725
67,859	137,080	—	—	—	66,553	1,606	—	867,247
14,436	14,147	160,519	36	—	10,197	395	(162,098)	201,505
1,463	4,742	—	—	—	2,901	150	—	7,667
(6,201)	1,059	—	—	—	(876)	250	—	(48,915)
6,573	24,197	—	—	—	439	191	—	150,859
271	4,277	—	—	—	1,519	9	(5,729)	353,691
37,714	4,517	—	—	—	1,680	79	—	154,534
—	—	—	—	—	—	—	—	9,076
459	—	—	—	—	113	—	—	13,504
60,110	26,961	—	—	18,574	13,433	715	(337,254)	661,494
183,344	216,980	160,519	36	18,574	95,959	3,395	(505,081)	2,371,387
(38,168)	(26,567)	1,352	191	(2,141)	(32,772)	54	37,930	39,874
31,568	(464)	—	—	3,533	—	60	32	107,411
—	—	—	—	—	—	—	—	13,379
(6,600)	(27,031)	1,352	191	1,392	(32,772)	114	37,962	160,664
22	—	—	—	—	—	—	(6,948)	5,483
—	—	—	—	—	154	17	—	171
30,337	17,976	10,000	—	(1,392)	32,618	—	(31,226)	—
23,759	(9,055)	11,352	191	—	—	131	(212)	166,318

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES

Springfield, Illinois

Consolidating Statement of Changes in Net Assets Information

Year ended June 30, 2018

(Dollars in thousands)

	HSSI – Obligated Group	RQIL	Unity Limited Partnership	KCIN	Healthcare West
Unrestricted net assets:					
Revenues and gains in excess (deficient) of expenses and losses	\$ 185,641	—	1,606	(1,773)	582
Other changes in unrestricted net assets:					
Net assets released from restrictions use for the purchase of property, plant, and equipment	12,409	—	—	—	—
Recognition of change in pension funded status	—	—	—	—	—
Transfers (to) from affiliates	(62,835)	—	—	4,522	—
Change in unrestricted net assets	<u>135,215</u>	<u>—</u>	<u>1,606</u>	<u>2,749</u>	<u>582</u>
Temporarily restricted net assets:					
Investment income (losses)	(213)	—	—	—	—
Contributions	10,646	—	—	—	—
Transfers (to) from affiliates	3,917	—	—	—	—
Net assets released from restrictions	(14,802)	—	—	—	—
Change in temporarily restricted net assets	<u>(452)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Permanently restricted net assets:					
Investment income	37	—	—	—	—
Contributions	465	—	—	—	—
Transfers (to) from affiliates	—	—	—	—	—
Change in permanently restricted net assets	<u>502</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Change in net assets	135,265	—	1,606	2,749	582
Net assets (deficit) at beginning of year	<u>2,176,572</u>	<u>7,029</u>	<u>9,147</u>	<u>2,169</u>	<u>12,465</u>
Net assets (deficit) at end of year	\$ <u><u>2,311,837</u></u>	<u><u>7,029</u></u>	<u><u>10,753</u></u>	<u><u>4,918</u></u>	<u><u>13,047</u></u>

See accompanying independent auditors' report.

System Office	Medical Group	Health Care Fund	Flex Plan	Foundation	Kiara, Inc.	PERC	Eliminations	Total
(6,600)	(27,031)	1,352	191	1,392	(32,772)	114	37,962	160,664
22	—	—	—	—	—	—	(6,948)	5,483
—	—	—	—	—	154	17	—	171
30,337	17,976	10,000	—	(1,392)	32,618	—	(31,226)	—
23,759	(9,055)	11,352	191	—	—	131	(212)	166,318
4,226	—	—	—	873	—	—	(4,438)	448
(917)	—	—	—	9,335	—	—	(9,688)	9,376
(3,917)	—	—	—	1,491	—	—	(1,491)	—
(22)	—	—	—	(11,699)	—	—	14,223	(12,300)
(630)	—	—	—	—	—	—	(1,394)	(2,476)
—	—	—	—	17	—	—	(17)	37
—	—	—	—	528	—	—	(528)	465
—	—	—	—	(545)	—	—	545	—
—	—	—	—	—	—	—	—	502
23,129	(9,055)	11,352	191	—	—	131	(1,606)	164,344
161,580	24,512	39,717	400	—	—	3,869	(16,176)	2,421,284
184,709	15,457	51,069	591	—	—	4,000	(17,782)	2,585,628

**HOSPITAL SISTERS SERVICES, INC. –
OBLIGATED GROUP**
Springfield, Illinois

Consolidating Balance Sheet Information

June 30, 2018

(Dollars in thousands)

Assets	St. Elizabeth's O'Fallon, Illinois	St. Joseph's Breese, Illinois	St. Mary's Decatur, Illinois	St. Anthony's Effingham, Illinois	Holy Family Greenville, Illinois	St. Joseph's Highland, Illinois	St. Francis Litchfield, Illinois	Good Shepherd Shelbyville, Illinois
Current assets:								
Cash and cash equivalents	\$ 7,984	3,041	4,038	12,175	2,540	(1,355)	4,321	787
Receivables:								
Patients' accounts, net of uncollectible amounts	27,709	8,884	31,876	22,379	3,871	7,155	4,027	3,178
Due from third-party reimbursement programs	130	108	(655)	520	55	71	—	—
Other	3,892	318	2,613	704	—	(42)	14	—
Total receivables	31,731	9,310	33,834	23,603	3,926	7,184	4,041	3,178
Current portion of assets whose use is limited or restricted	333	3,495	139	7,594	653	296	1,866	—
Inventories	3,155	691	2,460	4,682	441	619	462	335
Prepaid expenses	886	84	1,658	265	334	280	144	243
Total current assets	44,089	16,621	42,129	48,319	7,894	7,024	10,834	4,543
Assets whose use is limited or restricted, net of current portion	6,422	133,242	9,875	345,170	625	3,944	52,618	21,308
Property, plant, and equipment, net	261,079	27,006	81,969	64,756	10,636	39,313	25,827	5,230
Other assets	2,467	—	—	—	—	—	2,154	492
	\$ 314,057	176,869	133,973	458,245	19,155	50,281	91,433	31,573
Liabilities and Net Assets								
Current liabilities:								
Current installments of long-term debt	\$ 1,927	338	1,218	1,180	676	1,990	181	300
Long-term-debt subject to short-term remarketing agreements	17,966	3,157	11,358	9,423	—	18,517	1,685	—
Accounts payable	19,956	2,571	4,243	4,223	1,810	919	1,187	1,056
Accrued liabilities	10,231	1,822	5,994	5,116	2,070	1,142	1,448	2,118
Estimated payables under third-party reimbursement programs	6,621	3,629	9,469	1,766	580	1,562	1,899	494
Total current liabilities	56,701	11,517	32,282	21,708	5,136	24,130	6,400	3,968
Long-term debt, excluding current installments	431,598	13,041	52,002	12,764	15,671	25,000	7,359	6,393
Derivative instruments	6	2,594	—	6,728	—	6	1,037	—
Accrued benefit liability	13,963	3,253	12,484	7,963	(12)	2,923	4,912	—
Other noncurrent liabilities	8,864	2,897	1,932	507	1,583	—	972	1,059
Total liabilities	511,132	33,302	98,700	49,670	22,378	52,059	20,680	11,420
Net assets (deficit):								
Unrestricted	(203,491)	141,962	25,398	406,809	(4,379)	(5,716)	66,565	19,765
Temporarily restricted	5,992	1,595	8,674	1,588	148	3,938	2,940	328
Permanently restricted	424	10	1,201	178	1,008	—	1,248	60
Total net assets (deficit)	(197,075)	143,567	35,273	408,575	(3,223)	(1,778)	70,753	20,153
	\$ 314,057	176,869	133,973	458,245	19,155	50,281	91,433	31,573

See accompanying independent auditors' report.

St. John's Springfield, Illinois	St. Mary's Streator, Illinois	St. Joseph's Chippewa Falls, Wisconsin	Sacred Heart Eau Claire, Wisconsin	St. Mary's Green Bay, Wisconsin	St. Vincent Green Bay, Wisconsin	St. Clare Oconoto Falls, Wisconsin	St. Nicholas Sheboygan, Wisconsin	Hospital Sisters Services, Inc.	Eliminations	Total
11,689	—	1,671	9,052	(2,244)	23,189	1,537	3,532	10,177	—	92,134
122,224	—	6,658	21,306	14,581	66,568	3,961	13,573	—	—	357,950
—	—	—	—	22	15	722	1	—	—	989
3,880	—	88	1,005	1,911	26,218	855	1,305	207	(8,909)	34,059
126,104	—	6,746	22,311	16,514	92,801	5,538	14,879	207	(8,909)	392,998
93,576	—	6,449	24,013	13,310	31,219	403	6,589	5,388	—	195,323
13,311	—	488	5,340	2,705	7,628	1,378	1,992	—	—	45,687
4,069	—	136	748	132	2,636	31	413	—	—	12,059
248,749	—	15,490	61,464	30,417	157,473	8,887	27,405	15,772	(8,909)	738,201
18,648	—	105,892	542,854	96,782	343,086	1,236	55,004	—	—	1,736,706
359,527	—	27,319	90,643	73,153	164,346	11,658	50,987	—	—	1,293,449
2,548	—	—	11,541	8,621	79,582	(97)	1,084	8,206	—	116,598
629,472	—	148,701	706,502	208,973	744,487	21,684	134,480	23,978	(8,909)	3,884,954
9,060	—	712	2,325	1,289	3,401	409	974	—	—	25,980
84,516	—	5,737	21,688	12,021	28,196	—	5,951	—	—	220,215
18,168	—	2,313	10,741	2,987	10,412	2,879	4,406	33	(1,709)	86,195
26,821	—	3,988	8,929	7,893	45,929	9,341	5,219	4,424	(7,200)	135,285
22,545	—	918	3,311	3	22	—	1	—	—	52,820
161,110	—	13,668	46,994	24,193	87,960	12,629	16,551	4,457	(8,909)	520,495
158,671	—	9,900	24,675	13,676	35,864	6,605	9,914	6,239	—	829,372
1,580	—	2,042	10,676	1,965	6,865	—	1,028	—	—	34,527
33,425	—	10,235	15,283	12,378	37,444	59	4,857	—	—	159,167
8,009	—	—	1,067	236	780	128	345	1,177	—	29,556
362,795	—	35,845	98,695	52,448	168,913	19,421	32,695	11,873	(8,909)	1,573,117
236,771	—	107,135	597,977	149,229	556,945	1,918	94,174	12,105	—	2,203,167
26,814	—	2,731	3,350	4,997	11,954	335	5,915	—	—	81,299
3,092	—	2,990	6,480	2,299	6,675	10	1,696	—	—	27,371
266,677	—	112,856	607,807	156,525	575,574	2,263	101,785	12,105	—	2,311,837
629,472	—	148,701	706,502	208,973	744,487	21,684	134,480	23,978	(8,909)	3,884,954

**HOSPITAL SISTERS SERVICES, INC. –
OBLIGATED GROUP**
Springfield, Illinois

Consolidating Statement of Operations Information and Change in Unrestricted Net Assets

Year ended June 30, 2018

(Dollars in thousands)

	St. Elizabeth's O'Fallon, Illinois	St. Joseph's Breese, Illinois	St. Mary's Decatur, Illinois	St. Anthony's Effingham, Illinois	Holy Family Greenville, Illinois	St. Joseph's Highland, Illinois	St. Francis Litchfield, Illinois
Net patient service revenues	\$ 177,027	55,808	138,669	141,407	26,892	37,062	49,147
Provision for uncollectible accounts	(13,055)	(26)	(2,779)	(3,204)	(1,891)	(2,161)	(866)
Net patient service revenue less provision for uncollectible accounts	163,972	55,782	135,890	138,203	25,001	34,901	48,281
Other revenues:							
Net assets released from restrictions used for operations	3	9	—	—	13	8	3
Other	5,038	1,427	2,345	3,687	1,761	3,210	1,132
Total revenues	<u>169,013</u>	<u>57,218</u>	<u>138,235</u>	<u>141,890</u>	<u>26,775</u>	<u>38,119</u>	<u>49,416</u>
Expenses:							
Sisters' services	—	—	—	—	—	—	—
Salaries and wages	55,862	15,571	43,188	43,893	10,475	11,696	11,612
Employee benefits	14,034	4,893	11,205	14,241	2,754	3,530	3,526
Pension expense, excluding mark to market adjustment	(238)	370	(214)	321	131	63	(316)
Pension expense, mark to market adjustment	(6,188)	(2,488)	(1,660)	(3,880)	(12)	(851)	(1,541)
Professional fees	11,485	2,098	8,613	11,086	3,309	2,476	3,529
Supplies	28,938	5,105	21,152	19,009	2,608	3,697	4,145
Depreciation and amortization, excluding Belleville campus	9,221	2,405	8,231	4,041	549	2,255	2,633
Accelerated depreciation on Belleville campus	9,076	—	—	—	—	—	—
Interest	1,852	355	477	387	176	1,956	479
Other	82,220	20,976	50,031	35,701	11,453	13,780	11,546
Total expenses	<u>206,262</u>	<u>49,285</u>	<u>141,023</u>	<u>124,799</u>	<u>31,443</u>	<u>38,602</u>	<u>35,613</u>
Income (loss) from operations	(37,249)	7,933	(2,788)	17,091	(4,668)	(483)	13,803
Nonoperating income (loss):							
Investment income (loss)	787	4,834	(11)	13,511	1	(38)	1,777
Change in fair value of interest rate swap	3	803	—	2,627	—	30	67
Revenues and gains in excess (deficient) of expenses and	(36,459)	13,570	(2,799)	33,229	(4,667)	(491)	15,647
Other changes in unrestricted net assets (deficit):							
Net assets released from restrictions used for the purchase of property, plant, and equipment	5,109	521	340	108	14	170	476
Transfer from (to) affiliate	(9,214)	(1,146)	(7,994)	(3,525)	(172)	(1,145)	(998)
Change in unrestricted net assets (deficit)	<u>\$ (40,564)</u>	<u>12,945</u>	<u>(10,453)</u>	<u>29,812</u>	<u>(4,825)</u>	<u>(1,466)</u>	<u>15,125</u>

See accompanying independent auditors' report.

Good Shepherd Shebyville, Illinois	St. John's Springfield, Illinois	St. Mary's Streator, Illinois	St. Joseph's Chippewa Falls, Wisconsin	Sacred Heart Eau Claire, Wisconsin	St. Mary's Green Bay, Wisconsin	St. Vincent Green Bay, Wisconsin	St. Clare Oconto Falls, Wisconsin	St. Nicholas Sheboygan, Wisconsin	Hospital Sisters Services, Inc.	Eliminations	Total
15,633 (956)	511,996 (7,427)	—	60,143 (564)	215,505 (1,311)	124,188 (2,911)	534,888 (5,878)	26,008 (563)	113,375 (2,263)	—	—	2,227,748 (45,855)
14,677	504,569	—	59,579	214,194	121,277	529,010	25,445	111,112	—	—	2,181,893
587	1,770	—	—	—	—	—	—	—	—	—	2,393
342	23,507	—	936	1,062	5,116	7,465	5,509	1,613	327	(15,518)	48,959
15,606	529,846	—	60,515	215,256	126,393	536,475	30,954	112,725	327	(15,518)	2,233,245
—	34	—	—	—	—	31	—	—	—	—	65
5,406	146,816	—	24,460	61,715	34,038	89,555	7,746	21,966	—	1	584,000
1,654	39,233	—	5,393	17,339	10,051	23,771	2,200	5,506	—	—	159,330
—	(1,665)	—	25	390	(215)	(450)	266	(57)	—	—	(1,589)
—	(8,099)	—	(2,407)	(4,177)	(1,563)	(9,121)	96	(1,256)	—	—	(43,147)
1,147	37,945	—	6,655	5,620	4,417	15,911	2,981	1,881	—	(92)	119,061
1,184	101,224	—	4,372	32,501	20,454	88,550	7,388	12,680	—	25	353,032
752	30,056	—	3,534	11,508	6,397	19,089	1,536	6,469	—	—	108,676
—	—	—	—	—	—	—	—	—	—	—	9,076
151	4,448	—	192	732	406	918	202	201	—	—	12,932
5,765	157,771	—	15,252	59,128	43,828	268,541	12,095	59,147	1	(15,452)	831,783
16,059	507,763	—	57,476	184,756	117,813	496,795	34,510	106,537	1	(15,518)	2,133,219
(453)	22,083	—	3,039	30,500	8,580	39,680	(3,556)	6,188	326	—	100,026
869	3,044	28	4,086	20,968	3,450	13,933	78	1,928	2,991	—	72,236
—	1,391	209	771	3,779	610	2,804	—	285	—	—	13,379
416	26,518	237	7,896	55,247	12,640	56,417	(3,478)	8,401	3,317	—	185,641
—	476	—	81	546	425	1,945	109	2,089	—	—	12,409
(46)	(32,796)	(237)	(385)	(1,449)	(835)	(2,346)	(148)	(399)	—	—	(62,835)
370	(5,802)	—	7,592	54,344	12,230	56,016	(3,517)	10,091	3,317	—	135,215

**HOSPITAL SISTERS SERVICES, INC. –
OBLIGATED GROUP**
Springfield, Illinois

Consolidating Statement of Changes in Net Assets Information

Year ended June 30, 2018

(Dollars in thousands)

	St. Elizabeth's O'Fallon, Illinois	St. Joseph's Breese, Illinois	St. Mary's Decatur, Illinois	St. Anthony's Effingham, Illinois	Holy Family Greenville, Illinois	St. Joseph's Highland, Illinois	St. Francis Litchfield, Illinois	Good Shepherd Shelbyville, Illinois
Unrestricted net assets:								
Revenues and gains in excess (deficient) of expenses and losses	\$ (36,459)	13,570	(2,799)	33,229	(4,667)	(491)	15,647	416
Other changes in unrestricted net assets:								
Net assets released from restrictions used for the purchase of property, plant, and equipment	5,109	521	340	108	14	170	476	—
Transfer from (to) affiliate	(9,214)	(1,146)	(7,994)	(3,525)	(172)	(1,145)	(998)	(46)
Change in unrestricted net assets	(40,564)	12,945	(10,453)	29,812	(4,825)	(1,466)	15,125	370
Temporarily restricted net assets:								
Investment income (losses)	(36)	(34)	(50)	(16)	28	(80)	27	(427)
Contributions	94	295	965	29	45	812	214	84
Transfer from (to) affiliate	281	16	228	191	2	246	166	—
Net assets released from restrictions	(5,112)	(530)	(340)	(108)	(27)	(178)	(479)	(587)
Change in temporarily restricted net assets	(4,773)	(253)	803	96	48	800	(72)	(930)
Permanently restricted net assets:								
Investment income	—	—	—	—	20	—	—	—
Contributions	—	10	—	—	—	—	—	—
Change in permanently restricted net assets	—	10	—	—	20	—	—	—
Change in net assets	(45,337)	12,702	(9,650)	29,908	(4,757)	(666)	15,053	(560)
Net assets (deficit) at beginning of year	(151,738)	130,865	44,923	378,667	1,534	(1,112)	55,700	20,713
Net assets (deficit) at end of year	\$ (197,075)	143,567	35,273	408,575	(3,223)	(1,778)	70,753	20,153

See accompanying independent auditors' report.

St. John's Springfield, Illinois	St. Mary's Streator, Illinois	St. Joseph's Chippewa Falls, Wisconsin	Sacred Heart Eau Claire, Wisconsin	St. Mary's Green Bay, Wisconsin	St. Vincent Green Bay, Wisconsin	St. Clare Oconto Falls Wisconsin	St. Nicholas Sheboygan, Wisconsin	Hospital Sisters Services, Inc.	Eliminations	Total
26,518	237	7,896	55,247	12,640	56,417	(3,478)	8,401	3,317	—	185,641
476	—	81	546	425	1,945	109	2,089	—	—	12,409
(32,796)	(237)	(385)	(1,449)	(835)	(2,346)	(148)	(399)	—	—	(62,835)
(5,802)	—	7,592	54,344	12,230	56,016	(3,517)	10,091	3,317	—	135,215
(154)	—	148	274	8	90	(4)	13	—	—	(213)
3,245	—	254	250	158	3,967	108	126	—	—	10,646
1,343	—	1	602	58	645	50	88	—	—	3,917
(2,246)	—	(81)	(546)	(425)	(1,945)	(109)	(2,089)	—	—	(14,802)
2,188	—	322	580	(201)	2,757	45	(1,862)	—	—	(452)
—	—	—	17	—	—	—	—	—	—	37
208	—	67	57	—	123	—	—	—	—	465
208	—	67	74	—	123	—	—	—	—	502
(3,406)	—	7,981	54,998	12,029	58,896	(3,472)	8,229	3,317	—	135,265
270,083	—	104,875	552,809	144,496	516,678	5,735	93,556	8,788	—	2,176,572
266,677	—	112,856	607,807	156,525	575,574	2,263	101,785	12,105	—	2,311,837