# OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

Consolidated Financial Statements

September 30, 2018 and 2017

(With Independent Auditors' Report Thereon)

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

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## Independent Auditors' Report

OSF HealthCare System
Peoria, Illinois:

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of OSF HealthCare System and Subsidiaries (OSF), which comprise the consolidated balance sheets as of September 30, 2018 and 2017, and the related consolidated statements of operations and changes in unrestricted net assets, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

*Management's Responsibility for the Financial Statements*

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

*Auditors' Responsibility*

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

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

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

*Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of OSF Healthcare System and Subsidiaries as of September 30, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Chicago, Illinois
January 21, 2019

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

Consolidated Balance Sheets

September 30, 2018 and 2017

(In thousands)

| Assets | | 2018 | 2017 |
|---|---|---|---|
| Current assets: | | | |
| Cash and cash equivalents | $ | 233,445 | 195,990 |
| Receivables: | | | |
| Patients' and residents' accounts receivable, net of allowance for doubtful accounts of approximately $212,859 in 2018 and $188,709 in 2017 | | 515,247 | 565,929 |
| Due from third party reimbursement programs | | 16,919 | 36,653 |
| Other | | 14,610 | 17,772 |
| Total receivables | | 546,776 | 620,354 |
| Assets limited as to use | | 31,330 | 32,860 |
| Inventory | | 52,521 | 39,717 |
| Prepaid expense | | 17,646 | 16,698 |
| Total current assets | | 881,718 | 905,619 |
| Investments | | 1,249,517 | 1,049,555 |
| Assets limited as to use, net of current portion | | 197,089 | 237,338 |
| Property and equipment, net | | 1,380,172 | 1,185,164 |
| Restricted assets | | 121,841 | 108,197 |
| Goodwill | | 46,394 | 42,832 |
| Other assets | | 137,234 | 51,434 |
| Total assets | $ | 4,013,965 | 3,580,139 |
| **Liabilities and Net Assets** | | | |
| Current liabilities: | | | |
| Current portion of long-term debt | $ | 25,856 | 24,419 |
| Accounts payable and accrued expenses | | 350,943 | 307,589 |
| Estimated third-party payor settlements | | 137,966 | 98,967 |
| Estimated self-insurance liabilities | | 31,330 | 32,860 |
| Total current liabilities | | 546,095 | 463,835 |
| Long-term debt, net of current portion | | 1,315,887 | 1,152,745 |
| Accrued benefit liability | | 335,931 | 437,196 |
| Estimated self-insurance liabilities, net of current portion | | 146,167 | 163,876 |
| Other liabilities | | 105,015 | 60,720 |
| Total liabilities | | 2,449,095 | 2,278,372 |
| Net assets: | | | |
| Unrestricted: | | | |
| Unrestricted net assets of OSF | | 1,438,153 | 1,182,830 |
| Noncontrolling interests in subsidiaries | | 4,876 | 10,740 |
| Total unrestricted net assets | | 1,443,029 | 1,193,570 |
| Temporarily restricted | | 69,992 | 64,684 |
| Permanently restricted | | 51,849 | 43,513 |
| Total net assets | | 1,564,870 | 1,301,767 |
| Total liabilities and net assets | $ | 4,013,965 | 3,580,139 |

See accompanying notes to consolidated financial statements.

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Consolidated Statements of Operations and Changes in Unrestricted Net Assets

Years ended September 30, 2018 and 2017

(In thousands)

| | | 2018 | 2017 |
|---|---|---|---|
| Net patient service revenue, net of contractual allowances and discounts | $ | 2,822,284 | 2,554,396 |
| Provision for uncollectible accounts | | (125,887) | (87,259) |
| Net patient service revenues, less provision for uncollectible accounts | | 2,696,397 | 2,467,137 |
| Other revenues: | | | |
| Contributions | | 3,190 | 2,915 |
| Other | | 121,974 | 88,286 |
| Net assets released from restrictions used for operations | | 4,508 | 3,057 |
| Total revenues | | 2,826,069 | 2,561,395 |
| Expenses: | | | |
| Salaries and benefits | | 1,581,603 | 1,418,777 |
| Sisters' evaluated services | | 2,159 | 1,962 |
| Supplies and other expenses | | 1,002,248 | 930,964 |
| Depreciation and amortization | | 123,684 | 110,929 |
| Impairment loss | | — | 822 |
| Interest | | 43,463 | 38,890 |
| Total expenses | | 2,753,157 | 2,502,344 |
| Income from operations | | 72,912 | 59,051 |
| Nonoperating gains (losses): | | | |
| Investment return | | 71,746 | 69,869 |
| Income taxes | | (940) | (1,809) |
| Net settlement of derivative instruments | | (5,375) | (7,048) |
| Loss on early extinguishment of debt | | (1,500) | — |
| Change in fair value of derivative instruments | | 16,992 | 22,380 |
| Contribution of excess assets over liabilities | | 1,535 | 2,372 |
| Total nonoperating gains, net | | 82,458 | 85,764 |
| Net income | | 155,370 | 144,815 |
| Other changes in unrestricted net assets: | | | |
| Net assets released from restrictions used for the purchase of property and equipment | | 6,561 | 1,500 |
| Recognition of change in pension funded status | | 96,088 | 69,726 |
| Net distributions made to noncontrolling shareholders and other | | (8,560) | (4,918) |
| Change in unrestricted net assets | $ | 249,459 | 211,123 |

See accompanying notes to consolidated financial statements.

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Consolidated Statements of Changes in Net Assets

Years ended September 30, 2018 and 2017

(In thousands)

| | | 2018 | 2017 |
|---|---|---|---|
| Unrestricted net assets: | | | |
| Net income | $ | 155,370 | 144,815 |
| Other changes in unrestricted net assets: | | | |
| Net assets released from restrictions used for the purchase of property and equipment | | 6,561 | 1,500 |
| Recognition of change in pension funded status | | 96,088 | 69,726 |
| Net distributions made to noncontrolling shareholders and other | | (8,560) | (4,918) |
| Change in unrestricted net assets | | 249,459 | 211,123 |
| Temporarily restricted net assets: | | | |
| Contributions | | 12,408 | 7,535 |
| Investment return | | 3,969 | 5,721 |
| Net assets released from restrictions | | (11,069) | (4,557) |
| Change in temporarily restricted net assets | | 5,308 | 8,699 |
| Permanently restricted net assets: | | | |
| Contributions | | 8,305 | 6,794 |
| Investment return | | 31 | 66 |
| Change in permanently restricted net assets | | 8,336 | 6,860 |
| Change in net assets | | 263,103 | 226,682 |
| Net assets, beginning of year | | 1,301,767 | 1,075,085 |
| Net assets, end of year | $ | 1,564,870 | 1,301,767 |

See accompanying notes to consolidated financial statements.

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended September 30, 2018 and 2017

(In thousands)

| | | 2018 | 2017 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Change in net assets | $ | 263,103 | 226,682 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | | |
| (Gain) loss from equity basis investments | | (338) | 117 |
| Loss on impairment | | — | 822 |
| Contribution of excess assets over liabilities | | (1,535) | (2,372) |
| Distributions from equity basis investments | | 2,225 | 1,222 |
| Loss on early extinguishment of debt | | 1,500 | — |
| Amortization of bond issue costs and premiums/discounts included in interest expense | | (965) | (987) |
| Change in fair value of derivative instruments | | (16,992) | (22,380) |
| Change in fair value of trading securities | | (28,341) | (14,523) |
| Net realized gains on investments | | (19,940) | (41,229) |
| Net distributions paid to noncontrolling interests and other | | 8,560 | 4,918 |
| Depreciation and amortization | | 123,684 | 110,929 |
| Restricted contributions and investment return | | (24,713) | (20,116) |
| Net assets released from restrictions used for operations | | 4,508 | 3,057 |
| Provision for uncollectible accounts | | 125,887 | 87,259 |
| Recognition of change in pension funded status | | (96,088) | (69,726) |
| Changes in assets and liabilities: | | | |
| Patients' and residents' accounts receivable | | (77,807) | (182,760) |
| Due from third party reimbursement programs | | 19,734 | 3,707 |
| Other receivables | | 3,150 | 807 |
| Inventory | | (8,126) | (5,034) |
| Prepaid expense | | (966) | (2,881) |
| Other assets | | (11,748) | (1,332) |
| Other liabilities | | 6,055 | (3,825) |
| Accounts payable and accrued expenses | | 37,922 | (19,177) |
| Estimated third-party payor settlements | | 38,999 | (4,519) |
| Estimated self-insurance liabilities | | (19,239) | 8,807 |
| Net cash provided by operating activities | | 328,529 | 57,466 |
| Cash flows from investing activities: | | | |
| Acquisition of property and equipment | | (177,068) | (175,025) |
| Asset/stock purchase of affiliates | | (12,817) | (8,049) |
| Change in restricted assets | | (13,912) | (15,264) |
| Change in other assets – retirement plan assets | | (8,051) | — |
| Purchase of OSF Heart of Mary Medical Center | | (95,479) | — |
| Purchase of OSF Sacred Heart Medical Center | | (59,239) | — |
| Purchase of Urbana Home Health | | (1,000) | — |
| Cash proceeds from sale of affiliates | | 1,179 | — |
| Cash (contributed) received from acquisitions | | (660) | 52 |
| Gross purchases of investments | | (2,291,932) | (2,283,837) |
| Gross proceeds from the sale of investments | | 2,182,030 | 2,468,968 |
| Net cash used in investing activities | | (476,949) | (13,155) |
| Cash flows from financing activities: | | | |
| Restricted contributions and investment return | | 24,713 | 20,116 |
| Net assets released from restrictions used for operations | | (4,508) | (3,057) |
| Net distributions paid to noncontrolling interests | | (243) | (4,918) |
| Proceeds from issuance of long-term debt, including premium | | 235,068 | 4,485 |
| Extinguishment of long-term debt, including redemption premium | | (46,050) | (1,691) |
| Repayment of long-term debt | | (23,105) | (20,824) |
| Net cash provided by (used in) financing activities | | 185,875 | (5,889) |
| Net change in cash and cash equivalents | | 37,455 | 38,422 |
| Cash and cash equivalents: | | | |
| Beginning of year | | 195,990 | 157,568 |
| End of year | $ | 233,445 | 195,990 |
| Supplemental disclosures of cash flow information: | | | |
| Cash paid for interest, net of amounts capitalized | $ | 43,322 | 37,343 |
| Cash paid for income taxes | | 233 | 3,889 |

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years ended September 30, 2018 and 2017

(In thousands)

| | | 2018 | 2017 |
|---|---|---|---|
| Noncash transactions associated with joint venture activity and acquisitions: | | | |
| Patient accounts receivable | $ | (2,602) | 817 |
| Property and equipment | | 454 | 4,453 |
| Restricted assets | | (268) | 295 |
| Goodwill | | (15,378) | — |
| Inventory | | (322) | — |
| Prepaid expense | | (18) | — |
| Other current assets | | (12) | — |
| Other long-term assets | | 7,428 | 18 |
| Accounts payable and accrued expenses | | 211 | (53) |
| Long-term debt | | 369 | (647) |
| Other liabilities | | 2,837 | (1,071) |

See accompanying notes to consolidated financial statements.

## (1) Organization

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

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

In addition to the Providers, the consolidated financial statements include activities of the OSF Corporate Office and OSF's subsidiaries: Ottawa Regional Hospital & Healthcare Center and Subsidiaries, Mendota Community Hospital, OSF Saint Francis, Inc. and Subsidiaries (SFI), OSF Lifeline Ambulance, LLC, 2 wholly owned physician group subsidiaries, PointCore, LLC, Institute of Physical Medicine and Rehabilitation (IPMR), and OSF Multi-Specialty Group (OSF MSG).

On April 30, 2012, OSF became the sole corporate member of Ottawa Regional Hospital & Healthcare Center d/b/a OSF Saint Elizabeth Medical Center (SEMC), an Illinois not-for-profit corporation. SEMC owns all of the capital stock of Ottawa Regional Healthcare Affiliates, Inc. (ORHA) and Ottawa Regional Hospital Auxiliary. ORHA was dissolved on January 5, 2017. SEMC is the sole member of Ottawa Regional Hospital Foundation and Radiation Oncology of Northern Illinois, LLC (RONI).

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

(In thousands)

On February 1, 2018, OSF acquired certain assets and assumed certain liabilities of two hospitals from Presence Health. OSF paid $154,718 for the assets, of which $2,211 was paid to the Foundation for restricted assets that were received as part of the transaction, which resulted in $14,191 of goodwill. The two hospitals acquired are SHMC (formerly known as Presence United Samaritans Medical Center), Danville, Illinois and HMMC (formerly known as Presence Covenant Medical Center), Urbana, Illinois. SHMC is a 174 licensed acute bed hospital and HMMC is a 210 licensed acute bed hospital.

The following table represents the balance sheets as of February 1, 2018 for SHMC and HMMC after including the impact of certain adjustments to reflect the fair value of the acquired assets and assumed liabilities:

| | | SHMC | HMMC | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Current assets: | | | | |
| Inventory | $ | 1,901 | 3,099 | 5,000 |
| Property and equipment, net | | 52,247 | 88,923 | 141,170 |
| Restricted assets | | 1,421 | 790 | 2,211 |
| Goodwill | | 6,601 | 7,590 | 14,191 |
| Total assets | $ | 62,170 | 100,402 | 162,572 |
| **Liabilities and Net Assets** | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued expenses | $ | 193 | 26 | 219 |
| Other liabilities | | 1,318 | 4,106 | 5,424 |
| Total liabilities | | 1,511 | 4,132 | 5,643 |
| Net assets: | | | | |
| Unrestricted | | 59,238 | 95,480 | 154,718 |
| Temporarily restricted | | 1,421 | 640 | 2,061 |
| Permanently restricted | | — | 150 | 150 |
| Total net assets | | 60,659 | 96,270 | 156,929 |
| Total liabilities and net assets | $ | 62,170 | 100,402 | 162,572 |

The valuation of the fair value of identifiable assets and liabilities has been completed. In valuing these assets and liabilities, fair values were based on, but not limited to, independent appraisals, market approaches, discounted cash flows, and replacement costs.

Operating expenses for the year ended September 30, 2018 include costs related to the integration of SHMC and HMMC into OSF, including support services, operating programs with other health practitioners, as well as costs of valuation and integration consulting.

(In thousands)

Operating results and changes in net assets attributable to SHMC and HMMC since the date of the acquisition included in the accompanying consolidated statement of operations and changes in unrestricted net assets for the year ended September 30, 2018 are as follows:

| | | |
|---|---|---|
| Total operating revenue | $ | 144,517 |
| Income from operations | | 137 |
| Change in net assets | | 152,300 |

The unaudited supplemental pro forma operating results of OSF as if the SHMC and HMMC acquisition had occurred on October 1, 2016 are as follows:

| | | Year ended September 30 | |
|---|---|---|---|
| | | 2018 | 2017 |
| | | (Unaudited) | |
| Total operating revenue | $ | 2,898,328 | 2,792,662 |
| Income fom operations | | 72,981 | 74,715 |
| Net income | | 155,419 | 162,043 |

The pro forma information provided should not be construed to be indicative of OSF's results of operations had the acquisition been consummated on October 1, 2016 and is not intended to project OSF's results of operations for any future period. OSF will continue to monitor SHMC's and HMMC's operations to identify post acquisition efficiencies that may impact the results of operations going forward.

On February 28, 2018, OSF acquired Presence Home Health Agency for $1,000, which created $985 of goodwill.

On October 1, 2015, OSF became the sole corporate member of IPMR, an Illinois not-for-profit corporation. IPMR offers various outpatient rehabilitation services at twenty service locations and eight outpatient clinics primary throughout central Illinois. Effective January 1, 2017, IPMR was merged into OSF and no longer exists as a separate corporation. The assets and activity are all now reflected as part of SFMC.

On January 1, 2017, OSF became the sole member of Saint Anthony LLC, a Delaware limited liability company incorporated in April 2000 to operate as the general partner of Saint Clare's Villa. Saint Anthony LLC is considered a disregarded entity for income tax purposes. St. Clare Villa owns and operates a 64-unit assisted living apartment complex for low-income residents. St. Clare Villa's balance sheet at January 1, 2017 included total assets of $5,635, total liabilities of $1,771, and total net assets of $3,864.

SFI is an Illinois for-profit corporation incorporated in 1986 and is engaged in the following lines of business: retail pharmacies, mobile medical systems, durable medical equipment, home therapeutics, real estate rental, and equipment technology services. SFI also participates in various health-related joint ventures and is the sole corporate member of OSF Aviation, Inc., OSF Design Group, Inc., OSF Assurance Company, OSF Finance Company LLC (OSFFC), State and Roxbury, LLC (SAR), and 124 Adams Property Management, LLC. OSF Aviation, Inc. is an Illinois limited liability corporation formed on January 28, 2002 for the purpose of acquiring and operating emergency medical equipped helicopters in support of the trauma services programs of SFMC and SAMC. OSF Design Group, Inc. is an Illinois limited liability corporation formed on October 1, 2004 to provide professional architectural services as a registered professional design firm to OSF and its subsidiaries. OSF Assurance Company is a Vermont general corporation incorporated on December 8, 2004 and organized for the purpose of writing insurance and reinsurance as a captive insurance company. OSFFC, an Illinois limited liability company, was organized in November 2007 to be a nominal issuer of taxable corporate notes or other debt instruments used to finance certain capital expenditures that would not be eligible for tax-exempt financing. OSF is not a borrower, obligor, or guarantor of any indebtedness issued by OSFFC. SAR was formed in 2009 to establish and operate a real estate management organization in Rockford, Illinois.

SFI formed 124 Adams Property Management, LLC (Management) on December 7, 2017, the sole purpose of which is to manage 124 Adams Property Holdings LLC (Holdings). Holdings was formed on December 11, 2017. The operating agreement of Holdings was effective December 28, 2017 between Management, as the managing member, and Caterpillar, Inc, as the investor member. Management owns 1% and Caterpillar, Inc owns 99% of Holdings. Holdings was formed as a collaborative between OSF and Caterpillar, Inc. to completely renovate a historic building located at 124 Adams Street in Peoria, Illinois with the utilization of federal and state historic tax credits.

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

OSF has 12 wholly owned physician group subsidiaries, which were formed or acquired to provide physician services and function as physician groups. On December 31, 2016, 10 of the wholly owned physician group subsidiary corporations were dissolved. As of September 30, 2018 and 2017, the only two remaining physician group subsidiaries are Illinois Pathologists Services, LLC and Saint Anthony Physician Group.

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

The Center for Health Ambulatory Surgery Center, LLC (CHASC) was formed in 2007 to establish and operate a multispecialty ambulatory surgical center in Peoria, Illinois. SFMC has a 61.95% and 74.58% controlling interest in CHASC as of September 30, 2018 and 2017, respectively. On October 1, 2016, SFMC purchased an additional 19.08% of CHASC for $4,632, which created $3,265 of goodwill. On April 18, 2018, CHASC purchased Musculoskeletal Surgery Center, LLC for $3,950, which created $3,764 of goodwill. During 2018, OSF sold 12.63% of CHASC for $1,466. The sale resulted in a gain of $1,151 included in other revenue on the consolidated statement of operations and changes in unrestricted net assets for the year ended September 30, 2018.

Fort Jesse Imaging Center, LLC (FJIC) was formed in 2002 to establish and operate a medical imaging center in Bloomington, Illinois. SJMC has a 50.28% and 50.17% controlling interest in FJIC as of September 30, 2018 and 2017, respectively.

Eastland Medical Plaza SurgiCenter, LLC (EMPS) was formed in 2000 to establish and operate an ambulatory surgery treatment center in Bloomington, Illinois. SJMC had a 52.43% controlling interest and management control in EMPS as of September 30, 2017, the accompanying 2017 consolidated financial statements include the balance sheets and results of operations of EMPS. During 2018, SJMC sold 2.43% of its interest in EMPS for $1,179. As of September 30, 2018, SJMC has a 50.00% interest and no longer has management control in EMPS; therefore, EMPS was deconsolidated in the accompanying consolidated financial statements, and the joint venture activity is recorded as an investment using the equity method of accounting. The result of the deconsolidation removed $15,378 from goodwill, as SJMC recognizes its 50.00% interest in EMPS in other assets at September 30, 2018.

Fox River Cancer Center (FRCC) was formed in 2007 to establish and operate a cancer treatment center in Ottawa, Illinois. SEMC has a 66.67% controlling ownership as of September 30, 2018 and 2017.

(In thousands)

The following represents a reconciliation of beginning and ending balances of OSF's interest and the noncontrolling interests for each class of net assets for which a noncontrolling interest exists during the years ended September 30, 2018 and 2017:

| | Unrestricted net assets | | |
|---|---|---|---|
| | Total | Controlling interest | Noncontrolling interest |
| Balance at September 30, 2016 | $ 982,447 | 971,481 | 10,966 |
| Net income | 144,815 | 140,123 | 4,692 |
| Net assets released from restrictions used for the purchase of property and equipment | 1,500 | 1,500 | — |
| Recognition of change in pension funded status | 69,726 | 69,726 | — |
| Net distributions made to noncontrolling shareholders and other | (4,918) | — | (4,918) |
| Balance at September 30, 2017 | 1,193,570 | 1,182,830 | 10,740 |
| Net income | 155,370 | 152,674 | 2,696 |
| Net assets released from restrictions used for the purchase of property and equipment | 6,561 | 6,561 | — |
| Recognition of change in pension funded status | 96,088 | 96,088 | — |
| Net distributions made to noncontrolling shareholders and other | (8,560) | — | (8,560) |
| Balance at September 30, 2018 | $ 1,443,029 | 1,438,153 | 4,876 |

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

(In thousands)

Summarized financial information of the Foundation for the years ended September 30, 2018 and 2017 is as follows:

| | | 2018 | 2017 |
|---|---|---|---|
| Cash, investments, pledges, and other | $ | 161,887 | 151,559 |
| Accounts payable and due to affiliates | | 2,538 | 1,713 |
| Unrestricted net assets | | 53,664 | 56,981 |
| Temporarily restricted net assets | | 59,682 | 55,190 |
| Permanently restricted net assets | | 46,003 | 37,676 |
| Cash transfers to OSF during the year | | 19,743 | 7,412 |

Amounts due from the Foundation recognized at September 30, 2018 and 2017 consists of $862 and $568, respectively, in other receivables, $53,456 and $56,593, respectively, in investments, and $105,685 and $92,866, respectively, in restricted assets in the accompanying consolidated balance sheets.

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

## (2) Summary of Significant Accounting Policies

### *(a) Use of Estimates*

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

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

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

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

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

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

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

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

### *(e) Inventories*

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

### *(f) Other Assets – Joint Ventures*

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

Investments in organizations using the equity method of accounting are reflected as a component of other assets in the accompanying consolidated balance sheets. The related earnings (losses) are included in other operating revenues in the consolidated statements of operations and changes in unrestricted net assets.

### *(g) Property and Equipment*

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

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

### *(h) Long-Lived Assets*

OSF periodically assesses the recoverability of long-lived assets (including property, plant, and equipment) when indications of potential impairment, based on estimated, undiscounted future cash flows exist. Management considers such factors as current results, trends, and future prospects, in addition to other economic factors, in determining whether there is an impairment of the asset. An impairment of $822 was recorded in 2017 and is included in operating expenses within the consolidated statements of operations and changes in unrestricted net assets related to SAHC's medical office building. Other than this impairment, OSF does not believe that there are any factors or circumstances indicating impairment of its long-lived assets for the years ended September 30, 2018 and 2017.

(In thousands)

***(i) Goodwill***

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

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

OSF has determined the proper reporting unit for goodwill is the consolidated OSF entity unless the goodwill is related to a joint venture, in which case the reporting unit is the joint venture. OSF performs its annual impairment review of goodwill at September 30 and when a triggering event occurs between annual impairment tests. At September 30, 2018 and 2017, OSF performed a qualitative assessment of goodwill and determined that it is not more likely than not that the fair values of its reporting units are less than the carrying amounts. Accordingly, no impairment loss was recorded in 2018 and 2017.

The composition of goodwill at September 30, 2018 and 2017 is set forth in the following table:

| | | 2018 | 2017 |
|---|---|---|---|
| OSF | $ | 42,630 | 27,454 |
| Joint ventures | | 3,764 | 15,378 |
| | $ | 46,394 | 42,832 |

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

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

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

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

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

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

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

### *(k) Net Income*

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

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

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

### *(m) Charity Care*

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

### *(n) Donor-Restricted Gifts*

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

### *(o) Estimated Self-Insurance Liabilities*

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

### *(p) Services Provided by the Religious Community*

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

### *(q) Derivative Instruments*

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

### *(r) Income Taxes*

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



(Continued)

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

Under ASC Subtopic 740-10, *Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109*, OSF and SFI must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the consolidated financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. As of September 30, 2018 and 2017, OSF and SFI do not have any uncertain tax positions.

On December 22, 2017, the President signed into law H.R. 1, originally known as the Tax Cuts and Jobs Act. The new law (Public Law No. 115-97) includes substantial changes to the taxation of individuals, businesses, multinational enterprises, and others. In addition to many generally applicable provisions, the law contains several specific provisions that result in changes to the tax treatment of tax-exempt organizations and their donors. OSF has reviewed these provisions and the potential impact and concluded the enactment of H.R. 1 will not have a material effect on the operations of the organization.

### *(s) Fair Value*

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

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

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

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

### *(t) New Accounting Pronouncements*

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, that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The requirements of this statement are effective for OSF for the year ending September 30, 2019. Management expects that OSF will record a decrease in net patient service revenue, net of contractual allowances and discounts and a corresponding decrease in the provision for uncollectible accounts in the consolidated statements of operations and changes in unrestricted net assets upon adoption of the standard during 2019.

In November 2016, FASB issued ASU No. 2016-18, *Restricted Cash, a consensus of the FASB Emerging Issues Task Force*. ASU No. 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 No. 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 No. 2016-18 is permitted. The requirements of this statement are effective for OSF for the year ending September 30, 2020. OSF is currently evaluating the impact of this statement.

In August 2016, FASB issued ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. ASU No. 2016-14 represents phase 1 of FASB's Not-for-Profit financial reporting project and results reduces the number of net asset classes, requires expense presentation by functional and natural classification, requires quantitative and qualitative information in liquidity, retains the option to present the cash flow statement on a direct or indirect method, as well as includes various other additional disclosure requirements. ASU No. 2016-14 is effective for annual reporting periods beginning after December 15, 2017 with retrospective application. Early adoption of ASU No. 2016-14 is permitted. The requirements of this statement are effective for OSF for the year ending September 30, 2019. OSF is currently evaluating the impact of this statement.

In February 2016, FASB issued ASU No. 2016-02, *Leases*. ASU No. 2016-02 requires entities to recognize all leased assets as assets on the balance sheet with a corresponding liability which management expects that OSF's assets and liabilities on the balance sheet to increase. Entities will also be required to present additional disclosures as to the nature and extent of leasing activities. ASU No. 2016-02 is effective for nonpublic business entities for the annual reporting period beginning after December 31, 2018. The requirements of this statement are effective for OSF for the year ending September 30, 2020. OSF is currently evaluating the impact of this statement.

### *(u) Reclassifications*

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

## (3) Net Patient and Resident Service Revenue

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

### *(a) Medicare*

Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient nonacute services and certain outpatient services are paid based upon a cost-reimbursement method, established fee screens, or a combination thereof. OSF is reimbursed for cost reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by OSF and audits by the Medicare fiscal intermediary. Certain outpatient services are reimbursed at a prospectively determined rate per service based upon their ambulatory payment classification. As of September 30, 2018, Medicare cost reports have been audited and final-settled through September 30, 2014 for all hospitals. Medicare cost reports have been audited and final settled through September 30, 2015 for the following hospitals: SJH, SJMC, SLMC, SFMC, SMMC, HFMC, and SEMC. Medicare cost reports have been audited and final settled through September 30, 2016 for SJMC, SLMC, and HFMC. Various re-opening letters have been received for certain providers in the normal course of the intermediaries review.

OSF participates in various shared risk programs. OSF shares risk with the Centers for Medicare and Medicaid Services (CMS) for the cost of providers through the Medicare Shared Savings Program (MSSP) and Quality Incentives during 2017 and 2018. As of January 1, 2017, OSF transitioned from the Next Generation ACO program to the MSSP program, sponsored by the Centers for Medicare and Medicaid Innovation. OSF earned shared savings through the Blue Cross Blue Shield of Illinois ACO program for calendar year 2017.

As of September 30, 2018, OSF has recorded a receivable of $8,515 for outstanding risk contracts compared to a payable of $6,825 as of September 30, 2017.

### *(b) Medicaid*

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

OSF participates in all State of Illinois Hospital Assessment programs. Assessment programs provide hospitals within the State additional Medicaid reimbursement based on funding formulas approved by

CMS. OSF has included its reimbursement for the years ended September 30, 2018 and 2017 of $134,257 and $122,855, respectively, within net patient service revenue in the accompanying consolidated statements of operations and changes in unrestricted net assets.

OSF included its related assessment tax payments of $77,549 and $64,267 for the years ended September 30, 2018 and 2017, respectively, within other expense in the accompanying consolidated statements of operations and changes in unrestricted net assets.

Effective July 1, 2018, the State of Illinois implemented a new Hospital Assessment Program pursuant to Public Act 100-581, replacing the previous program, which expired effective June 30, 2018. Under the new program the Illinois hospital community will have increased revenue related to Medicaid patient claims and less revenue related to the supplemental payments through the assessment program.

***(c) Other***

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

Net patient service revenue for the years ended September 30, 2018 and 2017 includes approximately $(2,532) and $1,773, respectively, of net retroactively determined settlements from third-party payors relating to prior years exclusive of the amounts related to the aforementioned Medicaid program.

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

OSF's allowance for uncollectible accounts for self-pay patients, which includes uninsured patients and residual copayments and deductibles for which managed care has already paid, increased from 68.86% of self-pay accounts receivable at September 30, 2017 to 71.59% of self-pay accounts receivable at September 30, 2018. In addition, OSF's self-pay write-offs increased from $79,555 for fiscal year 2017 to $84,613 for the year ended September 30, 2018. During the year ended September 30, 2018, OSF revised the financial assistance and uninsured discount policies to reflect updates in Federal and State regulatory changes.

(In thousands)

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

| | | 2018 | 2017 |
|---|---|---|---|
| Medicare | $ | 838,264 | 780,535 |
| Medicaid | | 433,634 | 425,701 |
| Managed care/contracted payor | | 1,387,410 | 1,215,251 |
| Self-pay | | 75,968 | 52,924 |
| Other | | 87,008 | 79,985 |
| Net patient service revenues | $ | 2,822,284 | 2,554,396 |

## (4) Concentration of Credit Risk

OSF grants credit without collateral to its patients and residents, most of whom are local residents and are insured under third-party payor arrangements. The mix of receivables from patients, residents, and third-party payors at September 30, 2018 and 2017 was as follows:

| | 2018 | 2017 |
|---|---|---|
| Medicare | 19% | 15% |
| Medicaid | 34 | 48 |
| Blue cross | 9 | 7 |
| Other third-party payors | 29 | 24 |
| Patients | 9 | 6 |
| | 100% | 100% |

As of September 30, 2018 and 2017, Medicaid fee for service and Medicaid managed care net receivables aggregate to $97,602 and $169,389, respectively. OSF values these receivables using historical collection on enacted rates at the time of the estimate. OSF continues to monitor the State budget matters impacting the Medicaid program.

(In thousands)

## (5) Charity Care

OSF affirms and maintains its commitment to serve its communities in a manner consistent with the philosophy of OSF and the Parent. The philosophy is that adequate access to healthcare is a basic human right for all. OSF is committed to the promotion, preservation, protection, and restoration of wellness, whenever possible. OSF's services are provided to all persons with compassion and regardless of a patient's financial resources. To support this statement, the costs (determined using an estimated current year Medicare cost-to-charge ratio) incurred for services and supplies furnished under OSF's charity assistance policy aggregated $34,440 and $30,632 in 2018 and 2017, respectively. Not included in these amounts are benefits provided to the poor through the unpaid cost of Medicaid and other public programs. Additional other benefits provided are for the broader community that represents the unpaid cost of health education, research, and other community health services responding to a special need in the communities that OSF serves.

## (6) Investments

### *(a) Investments*

The composition of investments, at fair value, at September 30, 2018 and 2017 is set forth in the following table:

| | | 2018 | 2017 |
|---|---|---|---|
| Cash and cash equivalents | $ | 7,828 | 8,887 |
| Domestic equities | | 330,151 | 196,640 |
| U.S. Treasury obligations | | 132,539 | 131,775 |
| U.S. government agencies | | 81,948 | 81,376 |
| Municipal securities | | 2,388 | 2,551 |
| Domestic corporate obligations | | 213,852 | 235,121 |
| Domestic mutual funds – equities | | 29,594 | 27,566 |
| Domestic mutual funds – bonds | | 92,496 | 145,556 |
| Domestic commingled funds | | 127,008 | 57,011 |
| Foreign equities | | 144,612 | 91,768 |
| Foreign bonds | | 28,975 | 27,261 |
| Foreign mutual funds – equities | | 4,781 | 524 |
| Foreign mutual funds – bonds | | 46 | 164 |
| Foreign securities – commingled | | 53,294 | 43,166 |
| Other | | 5 | 189 |
| | $ | 1,249,517 | 1,049,555 |

(In thousands)

### (b) Restricted Assets

The composition of restricted assets, at fair value, except other – farmland, at September 30, 2018 and 2017 is set forth in the following table:

| | | 2018 | 2017 |
|---|---|---|---|
| Cash and cash equivalents | $ | 900 | 730 |
| U.S. Treasury obligations | | 5 | — |
| Domestic equities | | 4,946 | 4,328 |
| Domestic corporate obligations | | 78 | 74 |
| Domestic mutual funds – equities | | 2,060 | 2,066 |
| Domestic mutual funds – bonds | | 1,915 | 1,856 |
| Foreign mutual funds – equities | | 1,110 | 1,072 |
| Foreign mutual funds – bonds | | 368 | 342 |
| Foreign equities | | 211 | 189 |
| Foreign bonds | | 50 | 101 |
| Other | | 92 | 99 |
| Pledges receivable and other | | 15,920 | 26,787 |
| Investments held at Foundation on behalf of OSF: | | | |
| Cash and cash equivalents | | 1,675 | 2,562 |
| U.S. government agencies | | 48 | 30 |
| Domestic equities | | 16,964 | 10,547 |
| Domestic corporate obligations | | 186 | 128 |
| Domestic mutual funds – equities | | 34,437 | 26,024 |
| Domestic mutual funds – bonds | | 31,029 | 23,049 |
| Foreign equities | | 42 | 524 |
| Foreign mutual funds – equities | | 8,679 | 6,558 |
| Foreign mutual funds – bonds | | 166 | 171 |
| Other – Farmland | | 960 | 960 |
| | $ | 121,841 | 108,197 |



(Continued)

(In thousands)

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

The composition of assets limited as to use at fair value at September 30, 2018 and 2017 is set forth in the following table:

| | | 2018 | 2017 |
|---|---|---|---|
| Held by trustee under indenture agreement: | | | |
| Cash and cash equivalents | $ | 24,004 | 17,177 |
| U.S. Treasury obligations | | — | 5,916 |
| U.S. government agencies | | — | 1,303 |
| Municipal securities | | — | 3,058 |
| Domestic corporate obligations | | — | 27,481 |
| Domestic mutual funds – equities | | — | 798 |
| Domestic mutual funds – bonds | | — | 1,011 |
| Foreign mutual funds – equities | | — | 200 |
| | | 24,004 | 56,944 |
| Board-designated for self-insurance, including $31,330 and $32,860 designated as current portion of September 30, 2018 and 2017, respectively: | | | |
| Cash and cash equivalents | | 25,793 | 42,086 |
| Domestic equities | | 11,222 | 9,573 |
| U.S. Treasury obligations | | 42,199 | 36,483 |
| U.S. government agencies | | 7,382 | 7,505 |
| Domestic corporate obligations | | 52,610 | 50,092 |
| Domestic mutual funds – equities | | 259 | 202 |
| Domestic commingled funds | | 39,133 | 42,750 |
| Foreign bonds | | 9,488 | 9,804 |
| Foreign equities | | 902 | 369 |
| Foreign commingled funds | | 15,427 | 14,390 |
| | | 204,415 | 213,254 |
| | | 228,419 | 270,198 |
| Less current portion | | (31,330) | (32,860) |
| | $ | 197,089 | 237,338 |

(In thousands)

***(d) Other assets – retirement plan assets***

The composition of other assets – retirement plan assets at fair value at September 30, 2018 is set forth in the following table:

| | | 2018 |
|---|---|---|
| Cash and cash equivalents | $ | 4,483 |
| Domestic mutual funds – bonds | | 56,460 |
| | $ | 60,943 |

The composition of OSF's investment return for the years ended September 30, 2018 and 2017 is as follows:

| | | 2018 | 2017 |
|---|---|---|---|
| Investment return: | | | |
| Interest and dividend income | $ | 26,417 | 24,146 |
| Net realized gains | | 21,235 | 41,956 |
| Change in net unrealized gains on trading securities | | 30,220 | 18,963 |
| Total investment return | $ | 77,872 | 85,065 |



(Continued)

(In thousands)

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

| | | 2018 | 2017 |
|---|---|---|---|
| Unrestricted revenue, gains, and other support: | | | |
| Other | $ | 2,126 | 9,409 |
| Nonoperating gains: | | | |
| Investment return | | 71,746 | 69,869 |
| Other changes in net assets: | | | |
| Temporarily restricted net assets: | | | |
| Interest and dividend income | | 818 | 617 |
| Net realized gains | | 1,213 | 714 |
| Change in net unrealized gains on trading securities | | 1,938 | 4,390 |
| Permanently restricted net assets: | | | |
| Interest and dividend income | | 8 | 3 |
| Net realized gains | | 82 | 13 |
| Change in net unrealized gains and losses on trading securities | | (59) | 50 |
| Total investment return | $ | 77,872 | 85,065 |

## (7) Property and Equipment

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

| | | 2018 | 2017 |
|---|---|---|---|
| Land | $ | 58,716 | 37,661 |
| Land improvements | | 34,103 | 31,850 |
| Buildings | | 1,712,085 | 1,495,763 |
| Equipment | | 1,010,042 | 971,385 |
| | | 2,814,946 | 2,536,659 |
| Less accumulated depreciation | | 1,509,010 | 1,448,970 |
| | | 1,305,936 | 1,087,689 |
| Construction in progress | | 74,236 | 97,475 |
| Property and equipment, net | $ | 1,380,172 | 1,185,164 |

At September 30, 2018, the remaining contractual commitment on construction in progress approximated $85,522 and will be financed through operations and existing funds. OSF capitalized interest, net of interest income on project funds in the amount of $308 and $3,244 for the years ended September 30, 2018 and 2017, respectively.

## (8) Other Assets

Included in other assets at September 30 are the following:

- Escrow deposits of $5,476 in 2018 and $4,665 in 2017 for the self-insured workers' compensation program and are comprised of cash and cash equivalents.
- Deferred tax assets of $7,050 and $12,298 at September 30, 2018 and 2017, respectively (note 15).
- Other miscellaneous assets of $3,168 and $3,603 at September 30, 2018 and 2017, respectively.
- Venture capital investments of $30,129 and $15,842 at cost at September 30, 2018 and 2017, respectively.
- OSF sponsors deferred compensation programs to supplement the income of participating individuals during retirement or following separation from the organization. Eligibility for the plans is restricted to specified executives or as defined by the Internal Revenue Service (IRS) for certain "highly paid" employees. The deferred compensation plans are not qualified retirement plans under Section 401 of the Code. Contributions to the plans are stipulated in the plan documents and involve various methodologies depending on the plan. Plan assets were $60,943 at September 30, 2018 and have been included with other assets with a corresponding liability in other liabilities in the accompanying consolidated balance sheet at September 30, 2018.
- The investments in joint ventures accounted for using the equity method of accounting totaled $30,468 and $15,026 at September 30, 2018 and 2017, respectively. The most significant of these investments at September 30, 2018 include:
  - Community Cancer, LLC – 50.0% ownership interest
  - Eastland Medical Plaza Surgicenter, LLC (EMPS) – 50.0% ownership
  - Renal Intervention Center, LLC – 34.0% ownership interest
  - SimNext, LLC – 50.0% ownership interest
  - River Plex Fitness Center, LLC – 50.0% ownership interest (in operating results only)
  - McLean Imaging Properties, LLC – 49.9% ownership interest
  - Rockford Orthopedic Surgery Center, LLC (ROSC) – 25.0% ownership interest
  - Gladstone MOB – 50.0% ownership interest
  - Central Illinois Imaging, LLC – 47.0% ownership interest
  - The tekMill, Inc. – 50.0% ownership interest
  - Physician Immediate Care, LLC – 40.0% ownership interest

(In thousands)

For the years ended September 30, 2018 and 2017, OSF recognized income of $338 and losses of $(117) in investments in joint ventures, respectively, as a component of other revenue.

The following table summarizes the aggregated unaudited financial information of unconsolidated joint ventures of OSF as of September 30, 2018 and 2017:

| | | 2018 | 2017 |
|---|---|---|---|
| Total assets | $ | 49,638 | 44,369 |
| Total liabilities | | 19,072 | 16,094 |
| Total net assets | $ | 30,566 | 28,275 |
| Total revenues | $ | 26,665 | 32,058 |
| Operating expenses | | 24,352 | 28,487 |
| Net income | $ | 2,313 | 3,571 |

## (9) Long-Term Debt

A summary of long-term debt at September 30, 2018 and 2017 is as follows:

| | | 2018 | 2017 |
|---|---|---|---|
| OSF Master Trust Indenture Obligations: | | | |
| Revenue Bonds (Illinois Finance Authority Bonds, Series 2017A, Series 2017B, and Series 2017C), payable in annual installments of varying amounts, commencing May 15, 2019 through May 15, 2047. Interest is determined monthly based on private placement floating rate using LIBOR (2.19% on all issues as of September 30, 2018) | $ | 235,000 | — |
| Revenue Bonds (Illinois Finance Authority Bonds, Series 2016), payable in annual installments of varying amounts, commencing on May 15, 2021 at fixed interest rates between 3.125% and 5.00% depending on the date of maturity through May 15, 2039 | | 114,375 | 114,375 |
| Revenue Bonds (Illinois Finance Authority Bonds, Series 2015A), payable in annual installments of varying amounts, commencing on November 15, 2017 at fixed interest rates between 3.00% and 5.00% depending on the date of maturity through November 15, 2045 | | 367,360 | 368,150 |

(In thousands)

| | | 2018 | 2017 |
|---|---|---|---|
| Taxable Revenue Bonds (Illinois Finance Authority Bonds, Series 2015B), payable in annual installments of varying amounts, commencing on November 1, 2024 through November 1, 2045. Interest is determined monthly based on current market conditions (3.03% at September 30, 2018 and 2.16% at September 30, 2017) | $ | 94,270 | 94,270 |
| Revenue Refunding Bonds (Illinois Finance Authority Bonds, Series 2012A), payable in annual installments of varying amounts, commencing on May 15, 2013 at fixed interest rates between 4.00% and 5.00% depending on the date of maturity through May 15, 2041 | | 169,200 | 171,845 |
| Revenue Refunding Bonds (Illinois Finance Authority Bonds, Series 2010A), payable in annual installments of varying amounts, commencing on May 15, 2011 at a fixed interest rate of 6.00%. The bonds mature on May 15, 2039. Debt with maturities after May 15, 2020 was defeased in the amount of $100,710 on September 29, 2016 | | 31,420 | 45,765 |
| Revenue Bonds (Illinois Finance Authority Bonds, Series 2009B, Series 2009C, and Series 2009D), payable in annual installments of varying amounts, commencing November 15, 2021 through November 15, 2037. Interest is determined weekly based on current market conditions (1.55%, 1.54%, and 1.57%, respectively, as of September 30, 2018 and 0.95%, 0.92%, and 0.95%, respectively, as of September 30, 2017) | | 125,000 | 125,000 |
| Revenue Bonds (Illinois Finance Authority Bonds, Series 2009G), was payable in annual installments of varying amounts, commencing August 1, 2010 through August 1, 2029. Interest was determined monthly based on the current market conditions (1.43% as of September 30, 2017) Series 2009G was paid in full with proceeds of the 2017ABC Series. | | — | 16,500 |



(Continued)

(In thousands)

| | | 2018 | 2017 |
|---|---|---|---|
| Revenue Bonds (Illinois Finance Authority Bonds, Series 2007E and Series 2007F) payable in annual installments of varying amounts commencing November 15, 2024 through November 15, 2037. Interest is determined weekly based on current market conditions (1.57% and 1.57%, respectively, as of September 30, 2018 and 0.95% and 0.95%, respectively, as of September 30, 2017) | $ | 125,000 | 125,000 |
| Other debt: | | | |
| Mortgage note payable to Byron Bank, secured by an EMS training facility. Interest was at a rate of 2.91%. Principal and interest of $3 were payable monthly through October 30, 2017. Balloon payment of $469 was paid on November 30, 2017 | | — | 469 |
| HUD insured mortgage under Section 242 of the National Housing Act. Interest was at a rate of 4.425%. Principal and interest of $190 was due monthly through December 2036. Mortgage was paid in full with proceeds of 2017ABC Series Bonds. | | — | 29,550 |
| Revenue Bonds (OSF Finance Company, LLC, Adjustable Rate Taxable Securities, Series 2007-A) payable in annual installments of varying amounts commencing on December 1, 2009 through December 1, 2037. Interest rate varies weekly based on current market conditions (2.25% as of September 30, 2018 and 1.18% as of September 30, 2017) | | 22,955 | 23,590 |
| Mortgage note payable to Rockford Bank and Trust, secured by medical office building. The note bears an interest rate of 3.80% payable monthly. Principal and interest of $22 is payable monthly with a balloon payment of $2,906 on June 20, 2020 | | 3,143 | 3,278 |
| Mortgage note payable to Busey Bank, secured by a medical office building. The note bears an interest rate of 3.25% payable monthly. Principal and interest of $16 are due monthly through May 2024 | | 940 | 1,089 |

(In thousands)

| | | 2018 | 2017 |
|---|---|---|---|
| Mortgage note payable to JP Morgan Chase Bank, N.A., secured by a medical office building. The interest rate varies monthly based on current market conditions (3.58% and 2.99% as of September 30, 2018 and 2017, respectively). Principal payment of $47 plus accrued interest is due monthly through January 2024 | $ | 2,997 | 3,556 |
| Mortgage note payable to Commerce Bank, secured by a medical office building. The note bears an interest rate of 3.32% payable monthly. Principal and interest of $31 are payable monthly through June 30, 2022 with a balloon payment of $1,087 due July 31, 2022 | | 2,259 | 2,548 |
| Mortgage note payable to Busey Bank, secured by an office building. The note bears an interest rate of 4.36% payable monthly. Principal and interest of $68 is payable monthly through March 2024 with a balloon payment of $6,641 due April 1, 2024 | | 9,161 | 9,561 |
| Mortgage note payable to Byron Bank, secured by a medical office building. The note bears an interest rate of 4.42% payable monthly. Principal and interest of $10 is payable monthly through August 2029 | | 985 | 1,053 |
| Mortgage note payable to Commerce Bank, secured by a medical office building. The note bears an interest rate of 3.32% payable monthly. Principal and interest of $15 are payable monthly through June 30, 2022 with a balloon payment of $513 due July 30, 2022 | | 1,067 | 1,204 |
| Note payable to Commerce Bank, secured by an aviation hangar. The note bears an interest rate of 3.57%. Principal and interest of $14 are payable monthly through May 1, 2024. | | 891 | 1,028 |
| Mortgage note payable to Commerce Bank, secured by a medical office building. The note bears an interest rate of 2.96% payable monthly. Principal and interest payments of $42 are payable monthly through October 1, 2022 with a balloon payment of $1,485 due November 1, 2022 | | 3,245 | 3,644 |

(In thousands)

| | | 2018 | 2017 |
|---|---|---|---|
| Mortgage note payable to Busey Bank, secured by a medical office building. Interest was at a rate of 3.08%. Principal and interest of $6 was payable monthly through April 1, 2018. Balloon payment of $804 was made in May 2018 | $ | — | 826 |
| Mortgage note payable to Commerce Bank secured by a medical office building. The interest rate varies monthly based upon current market conditions (3.56% and 2.73% as of September 30 2018 and September 30, 2017, respectively.) Principal payment of $26.5 plus accrued interest is due monthly through May 15, 2024 with a balloon payment of $985 due June 15, 2024, plus interest | | 2,787 | 3,105 |
| Other miscellaneous notes payable and capital leases | | 2,098 | 2,207 |
| | | 1,314,153 | 1,147,613 |
| Plus original issue premium, net | | 35,461 | 37,240 |
| Total debt | | 1,349,614 | 1,184,853 |
| Less: | | | |
| Current installments | | 25,856 | 24,419 |
| Debt issuance costs, net | | 7,871 | 7,689 |
| Total long-term debt, excluding current installments | $ | 1,315,887 | 1,152,745 |

OSF's average interest rates for variable rate debt for the years ended September 30, 2018 and 2017 are as follows:

| | 2018 | 2017 |
|---|---|---|
| Variable interest rate issues: | | |
| 2007E | 1.28% | 0.76% |
| 2007F | 1.28 | 0.76 |
| 2009B | 1.27 | 0.75 |
| 2009C | 1.26 | 0.73 |
| 2009D | 1.28 | 0.76 |
| 2009G | 1.55 | 1.27 |
| 2015B | 2.68 | 1.84 |
| 2017ABC | 1.78 | — |

On September 29, 2015, OSF entered into a Second Amended and Restated Master Trust Indenture (MTI) dated September 1, 2015. The purpose of the MTI is to provide a mechanism for the efficient and economical advancement of funds to various operating divisions of OSF using the collective borrowing capacity and credit rating of OSF. OSF has pledged letters of credit as collateral on certain borrowings under the MTI. Under the terms of the MTI, OSF is also required to maintain certain deposits with a trustee. Such deposits are included with assets limited as to use. The MTI also places limits on the incurrence of additional borrowings and requires that OSF satisfy certain measures of financial performance as long as the notes are outstanding. As of September 30, 2018 and 2017, amounts outstanding under the MTI totaled $1,261,625 and $1,060,905, respectively.

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

In December 2017, OSF issued Series 2017ABC bonds. In addition to new funds provided by the issue, proceeds of the Series 2017ABC issue paid off the Series 2009G and the HUD insured mortgage. This resulted in a loss on early extinguishment of debt of $1,500.

At September 30, 2018, OSF had variable rate demand notes that had a put option available to the creditor. If the put option is exercised, the bonds are presented to the bank, which in turn draws on the underlying letter of credit or liquidity facility.

On October 17, 2018, OSF issued Illinois Finance Authority Bonds, Series 2018A, Series 2018B, and Series 2018C. With the issuance of those bonds, the Series 2007E, Series 2007F, Series 2009B, Series 2009C, Series 2009D, and Series 2017ABC were fully repaid (note 17). Thereby, on October 17, 2018, the underlying letters of credit for the Series 2007E, 2007F, 2009B, 2009C, and 2009D were terminated. The series and the underlying credit facility terms that were outstanding at September 30, 2018 are described as follows. Since there will be no triggering event related to those issues retired or the related terminated letters of credit, the only issue reflected in the schedule of principal payments subject to remarketing at September 30 2018 is the Series 2007A.

(In thousands)

| | Term |
|---|---|
| OSF Master Trust Indenture Obligations: | |
| 2007E | Quarterly beginning 367 days after bank purchase date and ending on the fifth anniversary of the bank purchase date. The letter of credit expires September 25, 2019 and was terminated on October 17, 2018. |
| 2007F | Quarterly beginning 367 days after bank purchase date and ending on the fifth anniversary of the bank purchase date. The letter of credit expires September 25, 2019 and was terminated on October 17, 2018. |
| 2009B | Quarterly over three years beginning three months after 366 days elapsed since liquidity advance. The letter of credit expires September 15, 2021 and terminated was on October 17, 2018. |
| 2009C | Quarterly over three years beginning on the first day of the calendar quarter after 366 days elapsed since liquidity advance. The letter of credit expires January 2, 2019 and was terminated on October 17, 2018. |
| 2009D | Quarterly over two years beginning after 367 days elapsed since liquidity advance. The letter of credit expires October 2, 2019 and was terminated on October 17, 2018. |
| Other debt: 2007A | Quarterly over three years beginning after 366 days elapsed since liquidity advance. The letter of credit expires December 20, 2020 |

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

| | | |
|---|---|---|
| Year ending September 30: | | |
| 2019 | $ | 25,856 |
| 2020 | | 30,059 |
| 2021 | | 28,773 |
| 2022 | | 31,249 |
| 2023 | | 31,587 |
| Thereafter | | 1,202,090 |

(In thousands)

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

| | | |
|---|---|---|
| Year ending September 30: | | |
| 2019 | $ | 25,856 |
| 2020 | | 36,771 |
| 2021 | | 35,439 |
| 2022 | | 37,945 |
| 2023 | | 30,813 |
| Thereafter | | 1,182,790 |

A summary of interest cost on borrowed funds held by the trustee under the MTI during the years ended September 30, 2018 and 2017 is as follows:

| | | 2018 | 2017 |
|---|---|---|---|
| Interest cost – charged to operations | $ | 38,376 | 32,776 |

### (10) Derivative Instruments and Hedging Activities

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

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

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

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

OSF is exposed to credit loss in the event of nonperformance by the counterparty to the interest rate swap agreements; however, this is not anticipated. During the years ended September 30, 2018 and 2017, neither OSF nor any counterparty to the interest rate swap agreements were required to post collateral.

(In thousands)

A summary of outstanding positions under OSF's interest rate swap program at September 30, 2018 is as follows:

| | Notional amount | Maturity date | Rate received | Rate paid |
|---|---|---|---|---|
| $ | 13,084 | November 2,2029 | BMA Index | 3.969% |
| | 2,787 | October 19, 2029 | BMA Index | 3.969 |
| | 7,775 | November 15, 2024 | BMA Index | 3.794 |
| | 130,000 | November 15, 2037 | 67% 1 Mo. Libor | 3.651 |
| | 123,510 | May 15, 2041 | 79% 3 Mo. Libor | SIFMA |

Net payments equal to the differential to be paid under all interest rate swap agreements are recognized within nonoperating gains (losses) as net settlement of derivative instruments and amounted to approximately $(5,375) and $(7,048) in 2018 and 2017, respectively.

The fair value of the swap agreements under ASC Subtopic 820-10 was $(30,071) and $(46,258) and is recorded as a component of other liabilities in the accompanying consolidated balance sheets at September 30, 2018 and 2017, respectively. For the years ended September 30, 2018 and 2017, OSF recognized an unrealized gain of $16,187 and $21,680, respectively, as its change in the fair value of the interest rate swaps as a component of nonoperating gains (losses) – change in fair value of derivative instruments.

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

| Type of interest swap | | Notional amount | | Mark to market | Fair value |
|---|---|---|---|---|---|
| Floating-to-fixed | $ | 42,500 | | (4,630) | (4,516) |
| Floating-to-fixed | | 42,750 | | (4,618) | (4,505) |
| Floating-to-fixed | | 7,775 | | (403) | (398) |
| Floating-to-fixed | | 130,000 | | (22,245) | (21,180) |
| Floating-to-fixed | | 123,510 | | 585 | 528 |
| | | | $ | (31,311) | (30,071) |

(In thousands)

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

| Type of interest swap | | Notional amount | | Mark to market | Fair value |
|---|---|---|---|---|---|
| Floating-to-fixed | $ | 43,875 | | (7,147) | (6,890) |
| Floating-to-fixed | | 44,150 | | (7,160) | (6,904) |
| Floating-to-fixed | | 8,725 | | (738) | (722) |
| Floating-to-fixed | | 130,000 | | (32,618) | (30,712) |
| Floating-to-fixed | | 125,440 | | (1,275) | (1,030) |
| | | | $ | (48,938) | (46,258) |

A summary of outstanding positions under SFI's interest rate swap program at September 30, 2018 is as follows:

| | Notional amount | Maturity date | Rate received | Rate paid |
|---|---|---|---|---|
| $ | 13,084 | December 1, 2037 | USD – LIBOR-BBA | 2.877 |
| | 2,787 | June 25, 2024 | USD – LIBOR-BBA | 2.150 |

Net payments equal to the differential to be received under the interest rate swap program are recognized as a component of interest expense and amounted to approximately $220 and $661 in 2018 and 2017, respectively.

The fair value of the SFI swap agreements was $704 and $(101) and is recorded as a component of other liabilities in the accompanying consolidated balance sheets as of September 30, 2018 and 2017, respectively. For the years ended September 30, 2018 and 2017, SFI recognized an unrealized gain of $805 and $700, respectively, as its change in the fair value of the interest rate swaps as a component of nonoperating gains (losses) – change in fair value of derivative instruments.

The following is a summary of SFI's swaps as of September 30, 2018:

| Type of interest swap | | Notional amount | | Mark to market | Fair value |
|---|---|---|---|---|---|
| Floating rate payor | $ | 13,084 | | 660 | 631 |
| Floating rate payor | | 2,787 | | 75 | 73 |
| | | | $ | 735 | 704 |

(In thousands)

The following is a summary of SFI's swaps as of September 30, 2017:

| Type of interest swap | | Notional amount | | Mark to market | Fair value |
|---|---|---|---|---|---|
| Floating rate payor | $ | 13,000 | | (70) | (70) |
| Floating rate payor | | 3,158 | | (31) | (31) |
| | | | $ | (101) | (101) |

## (11) Investment Composition and Fair Value Measurements

### *(a) Overall Investment Objective*

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

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

OSF maintains a percentage of assets in domestic and international stocks. To manage its risk exposure, the investment allocation of the portfolio is balanced with investments in fixed income and equity securities. Because of the inherent uncertainties for valuation of some holdings, the estimated fair values may differ from values that would have been used had a ready market existed.

### *(c) Basis of Reporting*

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

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

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

- The carrying amount reported in the consolidated balance sheets for the following approximates fair value because of the short maturities of these instruments: cash and cash equivalents, other assets, accounts payable and accrued expenses, and estimated third-party payor settlements.
- Fair values of OSF's investments held as investments, assets limited as to use, and restricted assets are estimated based on prices provided by its investment managers and its custodian bank. Fair value for cash and cash equivalents, equities, and foreign equities are measured using quoted market prices at the reporting date multiplied by the quantity held. U.S. Treasury obligations,

U.S. government agencies, municipal securities, corporate obligations, mutual funds, and foreign securities are measured using other observable inputs. The carrying value equals fair value.

- Commingled funds and mutual funds that do not have a readily determinable fair value are valued using NAV as a practical expedient to measure fair value as allowed by ASU No. 2009-12.
- Fair value of interest rate swaps is determined using pricing models developed based on the LIBOR swap rate and other observable market data. The value was determined after considering the potential impact of collateralization and netting agreements, adjusted to reflect nonperformance risk of both the counterparty and OSF.

### *(e) Fair Value Hierarchy*

OSF adopted ASC Subtopic 820-10 for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. OSF did not elect to fair value any of its nonfinancial assets or liabilities as of September 30, 2018 and 2017. ASC Subtopic 820-10 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that OSF has the ability to access at the measurement date.
- Level 2 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.

(In thousands)

The following tables present OSF's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2018:

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets: | | | | |
| Cash and cash equivalents | $ 233,445 | 233,445 | — | — |
| Investments: | | | | |
| Cash and cash equivalents | $ 7,828 | 4,103 | 3,725 | — |
| Domestic equities | 330,151 | 330,151 | — | — |
| U.S. Treasury obligations | 132,539 | 132,539 | — | — |
| U.S. government agencies | 81,948 | — | 81,948 | — |
| Municipal securities | 2,388 | — | 2,388 | — |
| Domestic corporate obligations | 213,852 | — | 213,852 | — |
| Domestic mutual funds – equities | 29,594 | 29,594 | — | — |
| Domestic mutual funds – bonds | 92,496 | 92,496 | — | — |
| Domestic commingled funds | 127,008 | 116,971 | 10,037 | — |
| Foreign equities | 144,612 | 144,612 | — | — |
| Foreign bonds | 28,975 | — | 28,975 | — |
| Foreign mutual funds – equities | 4,781 | 4,781 | — | — |
| Foreign mutual funds – bonds | 46 | 46 | — | — |
| Subtotal | 1,196,218 | $ 855,293 | 340,925 | — |
| Foreign securities – commingled | 53,294 | | | |
| Other | 5 | | | |
| Total investments | $ 1,249,517 | | | |
| Restricted assets – excluding pledges and other of $15,920: | | | | |
| Cash and cash equivalents | $ 900 | 900 | — | — |
| U.S. Treasury Obligations | 5 | 5 | — | — |
| Domestic equities | 4,946 | 4,946 | — | — |
| Domestic corporate obligations | 78 | — | 78 | — |
| Domestic mutual funds – equities | 2,060 | 2,060 | — | — |
| Domestic mutual funds – bonds | 1,915 | 1,915 | — | — |
| Foreign mutual funds – equities | 1,110 | 1,110 | — | — |
| Foreign mutual funds – bonds | 368 | 368 | — | — |
| Foreign equities | 211 | 211 | — | — |
| Foreign bonds | 50 | — | 50 | — |
| Other | 92 | — | 92 | — |

# OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

(In thousands)

| | | Fair value | | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|---|---|
| Investments held at foundation: | | | | | | |
| Cash and cash equivalents | $ | 1,675 | | 1,304 | 371 | — |
| U.S. government agencies | | 48 | | — | 48 | — |
| Domestic equities | | 16,964 | | 16,964 | — | — |
| Domestic corporate obligations | | 186 | | — | 186 | — |
| Domestic mutual funds – equities | | 34,437 | | 34,437 | — | — |
| Domestic mutual funds – bonds | | 31,029 | | 31,029 | — | — |
| Foreign mutual funds – equities | | 8,679 | | 8,679 | — | — |
| Foreign mutual funds – bonds | | 166 | | 166 | — | — |
| Foreign equities | | 42 | | 42 | — | — |
| Subtotal | | 104,961 | $ | 104,136 | 825 | — |
| Other – farmland / commodities | | 960 | | | | |
| Total restricted assets | $ | 105,921 | | | | |
| Assets limited as to use: | | | | | | |
| Cash and cash equivalents | $ | 49,797 | | 49,797 | — | — |
| Domestic equities | | 11,222 | | 11,222 | — | — |
| U.S. Treasury obligations | | 42,199 | | 42,199 | — | — |
| U.S. government agencies | | 7,382 | | — | 7,382 | — |
| Domestic corporate obligations | | 52,610 | | — | 52,610 | — |
| Domestic mutual funds – equities | | 259 | | 259 | — | — |
| Domestic commingled funds | | 39,133 | | 39,133 | — | — |
| Foreign equities | | 902 | | 902 | — | — |
| Foreign bonds | | 9,488 | | — | 9,488 | — |
| Subtotal | | 212,992 | | 143,512 | 69,480 | — |
| Foreign commingled funds | | 15,427 | | | | |
| Total assets limited as to use | $ | 228,419 | | | | |
| Other assets – retirement plan assets: | | | | | | |
| Cash and cash equivalents | $ | 4,483 | | 4,483 | — | — |
| Domestic mutual funds – bonds | | 56,460 | | 56,460 | — | — |
| Other assets – retirement plan assets: | $ | 60,943 | | 60,943 | — | — |



(Continued)

(In thousands)

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial liabilities: | | | | |
| Fair value of swap agreements | $ (29,367) | — | (29,367) | — |
| Total financial liabilities | $ (29,367) | — | (29,367) | — |

The following tables present OSF's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2017:

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets: | | | | |
| Cash and cash equivalents | $ 195,990 | 195,990 | — | — |
| Investments: | | | | |
| Cash and cash equivalents | $ 8,887 | 5,489 | 3,398 | — |
| Domestic equities | 196,640 | 196,640 | — | — |
| U.S. Treasury obligations | 131,775 | 131,775 | — | — |
| U.S. government agencies | 81,376 | — | 81,376 | — |
| Municipal securities | 2,551 | — | 2,551 | — |
| Domestic corporate obligations | 235,121 | — | 235,121 | — |
| Domestic mutual funds – equities | 27,566 | 27,566 | — | — |
| Domestic mutual funds – bonds | 145,556 | 145,556 | — | — |
| Domestic commingled funds | 57,011 | 57,011 | — | — |
| Foreign equities | 91,768 | 91,768 | — | — |
| Foreign bonds | 27,261 | — | 27,261 | — |
| Foreign mutual funds – equities | 524 | 524 | — | — |
| Foreign mutual funds – bonds | 164 | 164 | — | — |
| Subtotal | 1,006,200 | $ 656,493 | 349,707 | — |
| Foreign securities – commingled | 43,166 | | | |
| Other | 189 | | | |
| Total investments | $ 1,049,555 | | | |
| Restricted assets – excluding pledges and other of $26,787: | | | | |
| Cash and cash equivalents | $ 730 | 730 | — | — |
| Domestic equities | 4,328 | 4,328 | — | — |
| Domestic corporate obligations | 74 | — | 74 | — |
| Domestic mutual funds – equities | 2,066 | 2,066 | — | — |
| Domestic mutual funds – bonds | 1,856 | 1,856 | — | — |



(Continued)

(In thousands)

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Foreign mutual funds – equities | $ 1,072 | 1,072 | — | — |
| Foreign mutual funds – bonds | 342 | 342 | — | — |
| Foreign equities | 189 | 189 | — | — |
| Foreign bonds | 101 | — | 101 | — |
| Other | 99 | — | 99 | — |
| Investments held at foundation: | | | | |
| Cash and cash equivalents | 2,562 | 2,191 | 371 | — |
| U.S. government agencies | 30 | — | 30 | — |
| Domestic equities | 10,547 | 10,547 | — | — |
| Domestic corporate obligations | 128 | — | 128 | — |
| Domestic mutual funds – equities | 26,024 | 26,024 | — | — |
| Domestic mutual funds – bonds | 23,049 | 23,049 | — | — |
| Foreign bonds | 524 | 524 | — | — |
| Foreign mutual funds – equities | 6,558 | 6,558 | — | — |
| Foreign mutual funds – bonds | 171 | 171 | — | — |
| Subtotal | 80,450 | $ 79,647 | 803 | — |
| Other – farmland / commodities | 960 | | | |
| Total restricted assets | $ 81,410 | | | |
| Assets limited as to use: | | | | |
| Cash and cash equivalents | $ 59,263 | 59,263 | — | — |
| Domestic equities | 9,573 | 9,573 | — | — |
| U.S. Treasury obligations | 42,399 | 42,399 | — | — |
| U.S. government agencies | 8,808 | — | 8,808 | — |
| Municipal securities | 3,058 | — | 3,058 | — |
| Domestic corporate obligations | 77,573 | — | 77,573 | — |
| Domestic mutual funds – equities | 1,000 | 1,000 | — | — |
| Domestic mutual funds – bonds | 1,011 | 1,011 | — | — |
| Domestic commingled funds | 42,750 | 42,750 | — | — |
| Foreign equities | 369 | 369 | — | — |
| Foreign bonds | 9,804 | — | 9,804 | — |
| Foreign mutual funds – equities | 200 | 200 | — | — |
| Subtotal | 255,808 | $ 156,565 | 99,243 | — |
| Foreign commingled funds | 14,390 | | | |
| Total assets limited as to use | $ 270,198 | | | |



(Continued)

(In thousands)

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial liabilities: | | | | |
| Fair value of swap agreements | $ (46,359) | — | (46,359) | — |
| Total financial liabilities | $ (46,359) | — | (46,359) | — |

OSF's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no transfers into or out of Level 1, Level 2, or Level 3 for the years ended September 30, 2018 and 2017.

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

| | 2018 | 2017 | Redemption frequency | Days notice |
|---|---|---|---|---|
| Investments: | | | | |
| Foreign securities – commingled | $ 53,294 | 43,166 | Monthly | 10 |
| Domestic commingled funds | 127,008 | 57,011 | Daily | 2 |
| Global hedge fund | — | 181 | Monthly | Specific date each month |
| Assets limited as to use: | | | | |
| Foreign securities – commingled | $ 15,427 | 14,390 | Monthly | 10 |
| Domestic commingled funds | 39,133 | 42,750 | Daily | 2 |

## (12) Temporarily and Permanently Restricted Net Assets

OSF's temporarily restricted net assets of $69,992 and $64,684 at September 30, 2018 and 2017, respectively, are restricted for nursing education and various programs related to the provision of healthcare.

OSF's permanently restricted net assets of $51,849 and $43,513 at September 30, 2018 and 2017, respectively, consist of investments to be held in perpetuity, the majority of income of which is expendable to support healthcare services.

During 2018 and 2017, net assets were released from donor restrictions by purchasing equipment and incurring operating expenses, which satisfied the restricted purpose of healthcare and nursing education in the amount of $11,069 and $4,557, respectively.



(Continued)

(In thousands)

## (13) Self-Insurance

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

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

OSF is also self-insured for unemployment compensation benefits and health and dental claims. OSF has developed internal techniques for estimating the ultimate costs of these claims. Accrued losses are recorded on an undiscounted basis. In management's opinion, accrued losses provide an adequate reserve for loss contingencies. Due to the short-term nature of health and dental claims, estimated liabilities of $16,818 and $13,305 as of September 30, 2018 and 2017, respectively, have been reported as accrued expenses. The associated expense of $176,867 and $156,345 as of September 30, 2018 and 2017, respectively, is included in salaries and benefits in the accompanying consolidated statements of operations and changes in unrestricted net assets.

As of September 30, 2018 and 2017, estimated self-insurance liabilities are comprised of the following:

| | | 2018 | 2017 |
|---|---|---|---|
| Professional and general liability | $ | 162,092 | 179,548 |
| Workers' compensation | | 13,512 | 14,968 |
| Other | | 1,893 | 2,220 |
| Total estimated self-insurance liabilities | | 177,497 | 196,736 |
| Less current portion | | 31,330 | 32,860 |
| Total estimated self-insurance liabilities, less current portion | $ | 146,167 | 163,876 |

OSF shares certain insurance risks it has underwritten through the use of reinsurance contracts. Amounts that can be claimed from OSF's reinsurers are valued by an independent actuary. Should OSF's reinsurers be unable to reimburse OSF for recoverable claims, OSF would still be liable to pay the claims; however, OSF contracts with various highly rated insurance carriers to mitigate this risk. As of September 30, 2018 and 2017, OSF has recorded no insurance receivables in the accompanying consolidated balance sheets.



(Continued)

(In thousands)

Self-insurance expense is included in supplies and other expenses in the accompanying consolidated statements of operations and changes in unrestricted net assets. The amount recognized for the year ended September 30, 2018 includes a favorable reduction in the liability as a result of changes in underlying estimates and assumptions inherent in the liability reserving process from recent claims' experience. As of September 30, 2018 and 2017, self-insurance expense is comprised of the following:

| | | 2018 | 2017 |
|---|---|---|---|
| Professional and general liability | $ | (14,475) | 16,725 |
| Workers' compensation | | 5,162 | 1,745 |
| Total self-insurance expense | $ | (9,313) | 18,470 |

## (14) Retirement Benefits

OSF has a noncontributory defined benefit pension plan (the Plan) covering substantially all employees of the Providers and OSF Corporate Office. The Plan was changed to eliminate benefit accruals after March 5, 2011. Prior to the Plan's change, the benefit was based on a career average benefit based on both pay and service earned at OSF. Contributions are made on a monthly basis to improve the Plan's funded status. The Plan is a "Church" plan and is not subject to Employee Retirement Income Security Act (ERISA).

The actuarial funding method used in the actuarial valuation for 2018 and 2017 is the projected unit credit cost method. The measurement date for plan liabilities and assets is September 30 for the years ended September 30, 2018 and 2017. The following tables set forth the Plan's funded status and amounts recognized in OSF's consolidated financial statements at September 30, 2018 and 2017:

| | | 2018 | 2017 |
|---|---|---|---|
| Change in benefit obligation: | | | |
| Benefit obligation at beginning of year | $ | 1,000,517 | 1,012,596 |
| Interest cost | | 38,391 | 37,491 |
| Actuarial gain | | (66,500) | (22,875) |
| Benefits paid | | (29,414) | (26,695) |
| Benefit obligation at end of year | $ | 942,994 | 1,000,517 |
| Change in plan assets: | | | |
| Fair value of plan assets at beginning of year | $ | 615,322 | 565,904 |
| Actual return on plan assets | | 58,573 | 71,015 |
| Employer contributions | | 5,193 | 5,098 |
| Benefits paid | | (29,414) | (26,695) |
| Fair value of plan assets at end of year | $ | 649,674 | 615,322 |



(Continued)

(In thousands)

| | | 2018 | 2017 |
|---|---|---|---|
| Reconciliation of funded status: | | | |
| Funded status | $ | (293,320) | (385,195) |
| Net amount recognized at year-end | $ | (293,320) | (385,195) |
| Amounts recognized in the accompanying consolidated balance sheets: | | | |
| Accrued benefit liability | $ | (293,320) | (385,195) |
| Amounts not yet reflected in net periodic benefit cost and included as an accumulated credit to unrestricted net assets: | | | |
| Net actuarial loss | $ | (329,372) | (421,013) |
| Prior service cost | | (6,617) | (6,851) |
| Net amounts recognized in the accompanying consolidated balance sheets | $ | (335,989) | (427,864) |

| | | 2018 | 2017 |
|---|---|---|---|
| Weighted average assumptions: | | | |
| Discount rate: | | | |
| Benefit obligation | | 4.40 % | 3.90 % |
| Net periodic benefit cost | | 3.90 | 3.75 |
| Rate of compensation increase: | | | |
| Benefit obligation | | N/A | N/A |
| Net periodic benefit cost | | N/A | N/A |
| Expected return on plan assets | | 7.50 | 7.50 |
| Components of net periodic benefit cost: | | | |
| Interest cost | $ | 38,391 | 37,491 |
| Expected return on plan assets | | (44,175) | (42,979) |
| Amortization of prior service cost | | 234 | 234 |
| Amortization of actuarial loss | | 10,743 | 11,357 |
| Net periodic benefit cost | $ | 5,193 | 6,103 |

The accumulated benefit obligation for the Plan was $942,994 and $1,000,517 at September 30, 2018 and 2017, respectively. As of September 30, 2018, OSF adopted the RP-2014 Mortality Table with generational improvements using a modified projection scale MP-2018. As of September 30, 2017, OSF adopted the RP-2014 Mortality Table with generational improvements using a modified projection scale MP-2017.

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



(Continued)

(In thousands)

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

OSF is expected to contribute approximately $4,181 to the Plan in 2019.

The benefits expected to be paid in each year 2019 through 2023 are approximately $35,434, $39,209, $42,489, $45,598, and $48,326, respectively. The aggregate benefits expected to be paid in the five years from 2024 through 2028 are approximately $271,011. The expected benefits are based on the same assumptions used to measure OSF's benefit obligation at September 30, 2018.

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

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

| Asset | Target allocation | Acceptable range | Actual allocation at September 30 2018 | Actual allocation at September 30 2017 |
|---|---|---|---|---|
| Large cap equity | 39 % | 34% to 44% | 42.3 % | 41.3 % |
| Small cap equity | 6 | 1 to 11 | 7.4 | 6.9 |
| International equity | 20 | 15 to 25 | 19.2 | 20.8 |
| Fixed income | 35 | 30 to 40 | 30.0 | 30.1 |
| Cash | — | — | 1.1 | 0.9 |

*Fair Value of Financial Instruments*

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at September 30, 2018 and 2017.

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

(In thousands)

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

*Fair Value Hierarchy*

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

The following table presents the Plan's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2018:

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets: | | | | |
| Investments: | | | | |
| Cash and cash equivalents | $ 16,471 | 16,471 | — | — |
| Domestic equities | 201,274 | 201,274 | — | — |
| U.S. Treasury obligations | 31,102 | 31,102 | — | — |
| U.S. government agencies | 30,597 | — | 30,597 | — |
| Municipal securities | 1,092 | | 1,092 | — |
| Domestic corporate obligations | 82,797 | — | — | — |
| | | — | 82,797 | — |
| Domestic mutual funds – equities | 1,091 | 1,091 | — | — |
| Domestic mutual funds – bonds | 12,753 | 12,753 | — | — |
| Domestic commingled funds | 114,569 | 96,429 | 18,140 | — |
| Foreign equities | 72,613 | 72,613 | — | — |
| Foreign bonds | 16,513 | — | 16,513 | — |
| Subtotal | 580,872 | $ 431,733 | 149,139 | — |
| Foreign commingled funds | 68,802 | | | |
| Total financial assets | $ 649,674 | | | |

(In thousands)

The following table presents the Plan's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2017:

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets: | | | | |
| Investments: | | | | |
| Cash and cash equivalents | $ 22,226 | 22,226 | — | — |
| Domestic equities | 184,984 | 184,984 | — | — |
| U.S. Treasury obligations | 38,293 | 38,293 | — | — |
| U.S. government agencies | 18,837 | — | 18,837 | — |
| Municipal securities | 1,504 | — | 1,504 | — |
| Domestic corporate obligations | 61,478 | — | 61,478 | — |
| Domestic mutual funds – equities | 853 | 853 | — | — |
| Domestic mutual funds – bonds | 48,085 | 48,085 | — | — |
| Domestic commingled funds | 88,870 | 87,940 | 930 | — |
| Foreign equities | 66,990 | 66,990 | — | — |
| Foreign bonds | 9,581 | — | 9,581 | — |
| Subtotal | 541,701 | $ 449,371 | 92,330 | — |
| Foreign commingled funds | 73,580 | | | |
| Partnership | 41 | | | |
| Total financial assets | $ 615,322 | | | |

The Plan's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no transfers into or out of Level 1, Level 2, or Level 3 for the years ended September 30, 2018 and 2017.

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

| | 2018 | 2017 | Redemption frequency | Days notice |
|---|---|---|---|---|
| Foreign commingled funds | $ 68,802 | 73,580 | Monthly | 10 |
| Domestic commingled funds | 96,429 | 87,940 | Daily | 2 |
| Partnership | — | 41 | At GP discretion | N/A |



(Continued)

(In thousands)

In addition, OSF sponsors a retirement savings plan that includes a 401(k) feature. In conjunction with the change in the pension plan on March 5, 2011, OSF enhanced the retirement savings plan by increasing the match and adding an annual discretionary contribution. In 2017 and 2018, participants may deposit an amount from 1% to 90% of their eligible compensation up to the IRS limit. OSF contributes 100% of the employee contribution up to 5% of eligible compensation. OSF may also make annual discretionary contributions based on a participant's age and years of service. OSF contributed $67,669 in 2018 and $62,825 in 2017 to the retirement savings plan, which has been expensed as salaries and benefits expense. OSF also accrued for an anticipated discretionary contribution of $11,236 in 2018 and $17,681 in 2017, which has been expensed as salaries and benefits expense.

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

The actuarial funding method used in the actuarial valuation for 2018 and 2017 for the SFI Plan is the projected unit credit cost method. The measurement date for plan liabilities and assets is September 30. The following tables set forth the SFI Plan's funded status and amounts recognized in the consolidated financial statements at September 30, 2018:

| | | 2018 | 2017 |
|---|---|---|---|
| Change in benefit obligation: | | | |
| Benefit obligation at beginning of year | $ | 71,682 | 74,763 |
| Interest cost | | 2,792 | 2,774 |
| Actuarial gain | | (2,817) | (4,193) |
| Benefits paid | | (1,841) | (1,662) |
| Benefit obligation at end of year | $ | 69,816 | 71,682 |
| Change in plan assets: | | | |
| Fair value of plan assets at beginning of year | $ | 55,136 | 49,969 |
| Actual return on plan assets | | 4,630 | 6,829 |
| Employer contributions | | 315 | — |
| Benefits paid | | (1,841) | (1,662) |
| Fair value of plan assets at end of year | $ | 58,240 | 55,136 |
| Reconciliation of funded status: | | | |
| Funded status | $ | (11,576) | (16,546) |
| Net amount recognized at year-end | $ | (11,576) | (16,546) |

(In thousands)

| | | 2018 | 2017 |
|---|---|---|---|
| Amounts recognized in the accompanying consolidated balance sheets: | | | |
| Accrued benefit liability | $ | (11,576) | (16,546) |
| Amounts not yet reflected in net periodic benefit cost and included as an accumulated credit to stockholder's equity: | | | |
| Net actuarial loss | $ | (20,325) | (24,463) |
| Prior service cost | | (271) | (280) |
| Net amounts recognized in the accompanying consolidated balance sheets | $ | (20,596) | (24,743) |

| | | 2018 | 2017 |
|---|---|---|---|
| Weighted average assumptions: | | | |
| Discount rate: | | | |
| Benefit obligation | | 4.40 % | 3.95 % |
| Net periodic benefit cost | | 3.95 | 3.75 |
| Rate of compensation increase: | | | |
| Benefit obligation | | N/A | N/A |
| Net periodic benefit cost | | N/A | N/A |
| Expected return on plan assets | | 7.50 | 7.50 |
| Components of net periodic benefit cost: | | | |
| Interest cost | $ | 2,792 | 2,774 |
| Expected return on plan assets | | (3,912) | (3,751) |
| Amortization of actuarial loss | | 602 | 730 |
| Amortization of prior service cost | | 10 | 9 |
| Net periodic benefit cost | $ | (508) | (238) |

The accumulated benefit obligation for the SFI Plan was $69,816 and $71,682 at September 30, 2018 and 2017, respectively. As of September 30, 2018, OSF adopted the RP-2014 Mortality Table with generational improvements using a modified projection scale MP-2018. As of September 30, 2017, OSF adopted the RP-2014 Mortality Table with generational improvements using a modified projection scale MP-2017.

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

SFI is expected to contribute approximately $689 to the SFI Plan in 2019.

(In thousands)

The benefits expected to be paid in each year 2019 through 2023 for the SFI Plan are approximately $2,237, $2,517, $2,773, $3,019, and $3,284, respectively. The aggregate benefits expected to be paid in the five years from 2024 through 2028 are approximately $19,258.

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

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

| Asset | Target allocation | Acceptable range | Actual allocation at September 30 2018 | Actual allocation at September 30 2017 |
|---|---|---|---|---|
| Large cap equity | 39 % | 34% to 44% | 42.7 % | 42.7 % |
| Small cap equity | 6 | 0 to 11 | 5.8 | 5.7 |
| International equity | 20 | 15 to 25 | 17.9 | 18.6 |
| Fixed income | 35 | 30 to 40 | 32.8 | 32.1 |
| Cash | — | — | 0.8 | 0.9 |

The following table presents the SFI Plan's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2018:

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets: | | | | |
| Investments: | | | | |
| Cash and cash equivalents | $ 477 | 477 | — | — |
| Domestic mutual funds – equities | 3,366 | 3,366 | — | — |
| Domestic mutual funds – bonds | 19,086 | 19,086 | — | — |
| Domestic commingled funds | 24,863 | 24,863 | — | — |
| Foreign securities | 10,448 | 10,448 | — | — |
| Total financial assets | $ 58,240 | 58,240 | — | — |



(Continued)

(In thousands)

The following table presents the SFI Plan's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2017:

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets: | | | | |
| Investments: | | | | |
| Cash and cash equivalents | $ 519 | 519 | — | — |
| Domestic mutual funds – equities | 3,160 | 3,160 | — | — |
| Domestic mutual funds – bonds | 17,673 | 17,673 | — | — |
| Domestic commingled funds | 23,520 | 23,520 | — | — |
| Foreign securities | 10,264 | 10,264 | — | — |
| Total financial assets | $ 55,136 | 55,136 | — | — |

The SFI Plan's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no transfers into or out of Level 1, Level 2, or Level 3 for the years ended September 30, 2018 and 2017.

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

| | 2018 | 2017 | Redemption frequency | Days notice |
|---|---|---|---|---|
| Domestic commingled funds | $ 24,863 | 23,520 | Daily | 2 |

In addition, SFI sponsors a retirement savings plan that includes a 401(k) feature. In 2017 and 2018, participants may deposit an amount from 1% to 90% of their eligible compensation up to the IRS limit. SFI may make matching contributions equal to a discretionary percentage of the participant's contributions. SFI may also make annual discretionary contributions based on a participant's age and years of service. SFI contributed $820 in 2018 and $754 in 2017 to the retirement savings plan, which has been expensed as salaries and benefits expense. SFI also accrued for an anticipated discretionary contribution of $136 in 2018 and $211 in 2017, which has been expensed as salaries and benefits expense.

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

(In thousands)

The actuarial funding method used in the actuarial valuation for 2018 and 2017 for the SAHC Plan is the projected unit credit cost method. The measurement date for plan liabilities and assets is September 30 for the years ended September 30, 2018 and 2017. The following tables set forth the SAHC Plan's funded status and amounts recognized in OSF's consolidated financial statements at September 30, 2018 and 2017:

| | | 2018 | 2017 |
|---|---|---|---|
| Change in benefit obligation: | | | |
| Benefit obligation at beginning of year | $ | 75,085 | 76,596 |
| Interest cost | | 2,869 | 2,824 |
| Actuarial gain | | (3,880) | (1,684) |
| Benefits paid | | (3,075) | (2,651) |
| Benefit obligation at end of year | $ | 70,999 | 75,085 |
| Change in plan assets: | | | |
| Fair value of plan assets at beginning of year | $ | 40,099 | 38,710 |
| Actual return on plan assets | | 2,816 | 3,434 |
| Employer contributions | | 573 | 606 |
| Benefits paid | | (3,075) | (2,651) |
| Fair value of plan assets at end of year | $ | 40,413 | 40,099 |
| Reconciliation of funded status: | | | |
| Funded status | $ | (30,586) | (34,986) |
| Net amount recognized at year-end | $ | (30,586) | (34,986) |
| Amounts recognized in the accompanying consolidated balance sheets: | | | |
| Accrued benefit liability | $ | (30,586) | (34,986) |
| Amounts not yet reflected in net periodic benefit cost and included as an accumulated credit to unrestricted net assets: | | | |
| Net actuarial loss | $ | (24,224) | (28,625) |
| Net amounts recognized in the accompanying consolidated balance sheets | $ | (24,224) | (28,625) |

(In thousands)

| | | 2018 | 2017 |
|---|---|---|---|
| Weighted average assumptions: | | | |
| Discount rate: | | | |
| Benefit obligation | | 4.40 % | 3.90 % |
| Net periodic benefit cost | | 3.90 | 3.75 |
| Rate of compensation increase: | | | |
| Benefit obligation | | N/A | N/A |
| Net periodic benefit cost | | N/A | N/A |
| Expected return on plan assets | | 7.50 | 7.50 |
| Components of net periodic benefit cost: | | | |
| Interest cost | $ | 2,869 | 2,824 |
| Expected return on plan assets | | (3,031) | (2,998) |
| Amortization of net loss | | 736 | 780 |
| Net periodic benefit cost | $ | 574 | 606 |

The accumulated benefit obligation for the SAHC Plan was $70,999 and $75,085 at September 30, 2018 and 2017, respectively. As of September 30, 2018, OSF adopted the RP-2014 Mortality Table with generational improvements using a modified projection scale MP-2018. As of September 30, 2017, OSF adopted the RP-2014 Mortality Table with generational improvements using a modified projection scale MP-2017.

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

SAHC expects to contribute $669 to the SAHC Plan in 2019.

The benefits expected to be paid in each year 2019 through 2023 for the SAHC Plan are approximately $3,298, $3,483, $3,660, $3,827, and $3,972, respectively. The aggregate benefits expected to be paid in the five years from 2024 through 2028 are approximately $22,003. The expected benefits are based on the same assumptions used to measure the SAHC Plan's benefit obligation at September 30, 2018.

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

(In thousands)

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

| Asset | Target allocation | Acceptable range | September 30 2018 | September 30 2017 |
|---|---|---|---|---|
| Large cap equity | 30 % | 20% to 40% | 24.0 % | 26.8 % |
| Small cap equity | 15 | 10 to 30 | 15.9 | 17.2 |
| International equity | 20 | 0 to 15 | 13.2 | 17.1 |
| Real estate securities | 5 | 0 to 10 | — | 4.9 |
| Fixed income | 30 | 20 to 35 | 19.5 | 20.3 |
| Cash | — | 0 to 10 | 0.2 | 5.0 |
| Alternative investments | — | 0 to 10 | — | 8.7 |

The following table presents the SAHC Plan's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2018:

| | Fair value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets: | | | | |
| Investments: | | | | |
| Cash and cash equivalents | $ 1,830 | 1,830 | — | — |
| Domestic equities | 14,676 | 14,676 | — | — |
| U. S. Treasury obligations | 3,422 | 3,422 | — | — |
| U. S. government agencies | 193 | — | 193 | — |
| Domestic corporate obligations | 3,441 | — | 3,441 | — |
| Domestic mutual funds – equities | 7,054 | 7,054 | — | — |
| Domestic mutual funds – bonds | 863 | 863 | — | — |
| Foreign equities | 2,573 | 2,573 | — | — |
| Foreign bonds | 479 | — | 479 | — |
| Foreign mutual funds – equities | 5,728 | 5,728 | — | — |
| Foreign mutual funds – bonds | 154 | 154 | — | — |
| Total financial assets | $ 40,413 | $ 36,300 | 4,113 | — |

(In thousands)

The following table presents the SAHC Plan's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2017:

| | | Fair value | | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|---|---|
| Financial assets: | | | | | | |
| Investments: | | | | | | |
| Cash and cash equivalents | $ | 2,397 | | 2,397 | — | — |
| Domestic equities | | 14,898 | | 14,898 | — | — |
| U. S. Treasury obligations | | 3,596 | | 3,596 | — | — |
| U. S. government agencies | | 281 | | — | 281 | — |
| Domestic corporate obligations | | 3,131 | | — | 3,131 | — |
| Domestic mutual funds – equities | | 4,306 | | 4,306 | — | — |
| Domestic mutual funds – bonds | | 486 | | 486 | — | — |
| Foreign equities | | 2,672 | | 2,672 | — | — |
| Foreign bonds | | 566 | | — | 566 | — |
| Foreign mutual funds – equities | | 4,333 | | 4,333 | — | — |
| Subtotal | | 36,666 | $ | 32,688 | 3,978 | — |
| Other – Global investment hedge fund | | 3,433 | | | | |
| Total financial assets | $ | 40,099 | | | | |

The SAHC Plan's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no transfers into or out of Level 1, Level 2, or Level 3 for the years ended September 30, 2018 and 2017.

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

| | | 2018 | 2017 | Redemption frequency | Days notice |
|---|---|---|---|---|---|
| Global investment hedge fund | $ | — | 3,433 | Monthly | Specific date each month |

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

(In thousands)

The actuarial funding method used in the actuarial valuation for 2018 and 2017 for the IPMR Plan is the projected unit credit cost method. The measurement date for plan liabilities and assets is September 30 for the years ended September 30, 2018 and 2017. The following table sets forth the IPMR Plan's funded status and amounts recognized in OSF's consolidated financial statements at September 30, 2018 and 2017:

| | | 2018 | 2017 |
|---|---|---|---|
| Benefit obligation at end of year | $ | 2,750 | 2,735 |
| Fair value of plan assets at end of year – Level 1 investments | | 2,301 | 2,266 |
| Funded status – Accrued benefit liability | $ | (449) | (469) |
| Amounts not yet reflected in net periodic benefit cost and included as an accumulated credit to unrestricted net assets: | | | |
| Net actuarial loss | $ | 910 | 832 |
| Weighted average assumptions: | | | |
| Discount rate: | | | |
| Benefit obligation | | 4.35 % | 3.75 % |
| Net periodic benefit cost | | 3.75 | 3.50 |
| Rate of compensation increase: | | | |
| Benefit obligation | | N/A | N/A |
| Net periodic benefit cost | | N/A | N/A |
| Expected return on plan assets | | 7.50 | 7.50 |

The accumulated benefit obligation for the IPMR Plan was $2,750 and $2,735 at September 30, 2018 and 2017, respectively. Settlement accounting occurred September 30, 2017 due to the amount of lump sums paid from the plan during the year ended September 30, 2017. As of September 30, 2018, OSF adopted the RP-2014 Mortality Table with generational improvements using a modified projection scale MP-2018. As of September 30, 2017, OSF adopted the RP-2014 Mortality Table with generational improvements using a modified projection scale MP-2017.

## (15) Income Taxes

Income tax (benefit) expense attributable from revenues, gains, and other support over expenses was $(259) and $1,903 for the years ended September 30, 2018 and 2017, respectively.

Deferred income taxes on taxable entities are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future tax years to differences between the consolidated financial statement carrying amounts and the tax basis of existing assets and liabilities. As of September 30, 2018 and 2017, SFI has a deferred tax asset related to these timing differences of $7,050 and $12,298, respectively, which is recorded within other assets in the consolidated balance sheets. As of September 30, 2018 and 2017, no valuation allowance against the SFI deferred tax assets was considered necessary as management believed it was more likely than not that the results of future operations would generate sufficient taxable income to realize these deferred tax assets.

(In thousands)

OSF generates "unrelated business" income subject to federal and state income taxes (UBIT). OSF recorded a UBIT receivable of $165 and $710 for the years ended September 30, 2018 and 2017, respectively. UBIT expense (benefit) of $681 and $(94) was recorded for the years ended September 30, 2018 and 2017, respectively, and is included in income tax within the consolidated statements of operations and unrestricted changes in net assets.

## (16) Commitments and Contingencies

### *(a) Operating Leases*

OSF occupies space in certain facilities under long-term noncancelable operating lease arrangements. Total equipment rental, asset lease, and facility rental expenses in 2018 and 2017 were $58,360 and $63,351, respectively.

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

| | | Amount |
|---|---|---|
| Year ending September 30: | | |
| 2019 | $ | 40,904 |
| 2020 | | 31,013 |
| 2021 | | 20,732 |
| 2022 | | 14,842 |
| 2023 | | 12,219 |
| Thereafter | | 50,637 |

### *(b) Litigation*

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

As disclosed in note 14, Retirement Benefits, OSF sponsors various types of employee benefit plans. On May 3, 2016, a lawsuit was filed in the U.S. District Court for the Central District of Illinois against OSF Healthcare System, on behalf of the participants of the Plan. On May 6, 2016, a similar lawsuit was filed in the U.S. District Court for the Southern District of Illinois against SAHC, on behalf of the participants of the SAHC Plan. The lawsuits challenge the eligibility of the Plan and the SAHC Plan to be treated as "Church Plans" because Church Plans are exempt from ERISA. OSF has vigorously defended the Plan and the SAHC Plan statuses as eligible Church Plans, consistent with long-standing positions of the U.S. Department of Treasury, including the IRS, the Department of Justice, the Pension Benefit Guaranty Corporation, and the U.S. Department of Labor.

On June 5, 2017, in a similar case against a Catholic healthcare system, the U.S. Supreme Court ruled unanimously that pension plans of church affiliated organizations qualify for Church Plan status and are exempt from ERISA requirements. Thereafter, the Plaintiffs in the Central District filed a motion to dismiss their case, and on September 28, 2017, the Central District Court granted Plaintiffs motion to dismiss. However, Plaintiffs in that case were added to the case pending in the Southern District.

Thereafter, the Plaintiffs in the Southern District filed an Amended Complaint alleging new state law causes of action. OSF filed a motion to dismiss Plaintiffs' new claims and intends to file dispositive motions asking the Southern District to dismiss the entire case based on the U.S. Supreme Court ruling. On September 28, 2018, a judge in the Southern District of Illinois granted summary judgment to OSF and dismissed the lawsuit filed by participants in its pension plans.

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

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

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

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

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

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

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

Effective June 14, 2012, Public Act 97-688 created a new method for granting state sales tax and property tax exemptions to not-for-profit hospitals in Illinois. The law established standards for the issuance of exemptions, such that a nonprofit hospital must certify annually that in the prior year it provided to low-income and underserved individuals qualified services with a value at least equal to the estimated tax liability of the hospital's tax-exempt property. This law applies only to those OSF properties for which OSF applied for new property tax exemption after the law's enactment. The primary facilities exempt under this law are HFMC, SAHC, SEMC, SLMC, and SPMC, along with numerous ancillary properties

The law has been the subject of litigation challenging its constitutionality under the Illinois Constitution. On September 20, 2018, the Illinois Supreme Court upheld the law as constitutional. It clarified that a not-for-profit hospital seeking an exemption under Section 15-86 of the Property Tax Code must show that it meets the requirements of the statute and that it meets the requirement of the Illinois Constitution that the property that is the subject of the application is used exclusively for charitable purposes.

Due to the Court's ruling, OSF's property tax exemptions granted under Section 15-86 remain in effect. It has sought or will seek exemption under Section 15-86 for HMMC and SHMC. OSF's other primary Illinois facilities, being SAMC, SFMC, SJJWAMC, SJMC, and SMMC, are exempt under a separate section of the property tax code that has not been the subject of constitutional challenge. However, OSF plans to seek exemption for SAMC under Section 15-86 in 2018, thereby relinquishing its current exemption, due to the construction of a new bed tower on the hospital's campus, which constitutes a change of use of the exempt property, necessitating a new application for exemption. OSF has not accrued any liability for property taxes and maintains the position that all of the facilities listed above are exempt for property taxes.

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

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

## (17) Subsequent Events

In connection with the preparation of the consolidated financial statements and in accordance with ASC Topic 855, *Subsequent Events*, OSF evaluated subsequent events after the consolidated balance sheet date of September 30, 2018 through January 21, 2019, which was the date the consolidated financial statements were issued.

On October 17, 2018, OSF issued $472,460 of debt consisting of $341,640 of Series 2018A bonds, $65,435 of Series 2018B bonds, and $65,385 of Series 2018C bonds. The debt was utilized for the extinguishment of the Series 2007E, Series 2007F, Series 2009B, Series 2009C, Series 2009D, and Series 2017ABC bonds totaling $485,000.