



**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Consolidated Financial Statements

September 30, 2019 and 2018

(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, 2019 and 2018, and the related consolidated statements of operations and changes in net assets without donor restrictions, 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, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.



*Emphasis of Matter*

As discussed in note 2(u) to the consolidated financial statements, in 2019 OSF adopted new accounting guidance for Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, and ASU No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. Our opinion is not modified with respect to these matters.

KPMG LLP

Chicago, Illinois  
January 29, 2020

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Consolidated Balance Sheets

September 30, 2019 and 2018

(In thousands)

<b>Assets</b>	<b>2019</b>	<b>2018</b>
Current assets:		
Cash and cash equivalents	\$ 203,114	233,445
Receivables:		
Patient and resident accounts receivable	473,807	515,247
Due from third party reimbursement programs	20,572	16,919
Other	21,908	14,610
Total receivables	516,287	546,776
Assets limited as to use	27,270	31,330
Inventory	57,353	52,521
Prepaid expense	19,521	17,646
Total current assets	823,545	881,718
Investments	1,349,277	1,249,517
Assets limited as to use, net of current portion	159,884	197,089
Property and equipment, net	1,465,743	1,380,172
Assets with donor restrictions	152,442	121,841
Goodwill	62,790	46,394
Other assets	137,146	137,234
Total assets	\$ 4,150,827	4,013,965
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Current portion of long-term debt	\$ 29,648	25,856
Accounts payable and accrued expenses	361,233	350,943
Estimated third-party payor settlements	106,561	137,966
Estimated self-insurance liabilities	27,270	31,330
Total current liabilities	524,712	546,095
Long-term debt, net of current portion	1,295,118	1,315,887
Accrued benefit liability	559,384	335,931
Estimated self-insurance liabilities, net of current portion	135,244	146,167
Other liabilities	131,336	105,015
Total liabilities	2,645,794	2,449,095
Net assets:		
Net assets without donor restrictions:		
Net assets without donor restrictions of OSF	1,340,288	1,438,153
Noncontrolling interests in subsidiaries	12,303	4,876
Total net assets without donor restrictions	1,352,591	1,443,029
Net assets with donor restrictions	152,442	121,841
Total net assets	1,505,033	1,564,870
Total liabilities and net assets	\$ 4,150,827	4,013,965

See accompanying notes to consolidated financial statements.

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Consolidated Statements of Operations and Changes in Net Assets Without Donor Restrictions

Years ended September 30, 2019 and 2018

(In thousands)

	<u>2019</u>	<u>2018</u>
Net patient service revenues	\$ 2,906,574	2,696,397
Other revenues:		
Contributions	3,171	3,190
Other	145,886	121,974
Net assets released from restrictions used for operations	<u>5,325</u>	<u>4,508</u>
Total revenues	<u>3,060,956</u>	<u>2,826,069</u>
Expenses:		
Salaries and benefits	1,714,343	1,576,297
Sisters' evaluated services	1,340	2,159
Supplies and other expenses	1,098,050	1,002,248
Depreciation and amortization	101,552	123,684
Interest	<u>52,633</u>	<u>43,463</u>
Total expenses	<u>2,967,918</u>	<u>2,747,851</u>
Income from operations	<u>93,038</u>	<u>78,218</u>
Nonoperating gains (losses):		
Investment return	73,478	71,746
Income taxes	(2,235)	(940)
Net settlement of derivative instruments	(3,636)	(5,375)
Loss on early extinguishment of debt	(695)	(1,500)
Change in fair value of derivative instruments	(21,954)	16,992
Other	<u>(10,816)</u>	<u>(3,771)</u>
Total nonoperating gains, net	<u>34,142</u>	<u>77,152</u>
Net income	127,180	155,370
Other changes in net assets without donor restrictions:		
Net assets released from restrictions used for the purchase of property and equipment	2,034	6,561
Recognition of change in pension funded status	(221,269)	96,088
Net contributions from (distributions to) noncontrolling shareholders and other	<u>1,617</u>	<u>(8,560)</u>
Change in net assets without donor restrictions	\$ <u><u>(90,438)</u></u>	<u><u>249,459</u></u>

See accompanying notes to consolidated financial statements.

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

### Consolidated Statements of Changes in Net Assets

Years ended September 30, 2019 and 2018

(In thousands)

	<u>2019</u>	<u>2018</u>
Net assets without donor restrictions:		
Net income	\$ 127,180	155,370
Other changes in net assets without donor restrictions:		
Net assets released from restrictions used for the purchase of property and equipment	2,034	6,561
Recognition of change in pension funded status	(221,269)	96,088
Net contributions from (distributions to) noncontrolling shareholders and other	1,617	(8,560)
Change in net assets without donor restrictions	<u>(90,438)</u>	<u>249,459</u>
Net assets with donor restrictions:		
Contributions	35,078	20,713
Investment return	2,882	4,000
Net assets released from restrictions	<u>(7,359)</u>	<u>(11,069)</u>
Change in net assets with donor restrictions	<u>30,601</u>	<u>13,644</u>
Change in net assets	(59,837)	263,103
Net assets, beginning of year	<u>1,564,870</u>	<u>1,301,767</u>
Net assets, end of year	<u>\$ 1,505,033</u>	<u>1,564,870</u>

See accompanying notes to consolidated financial statements.

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years ended September 30, 2019 and 2018

(In thousands)

	<u>2019</u>	<u>2018</u>
Cash flows from operating activities:		
Change in net assets	\$ (59,837)	263,103
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Gain from equity basis investments	(3,802)	(338)
Other	—	(1,535)
Distributions from equity basis investments	4,698	2,225
Loss on early extinguishment of debt	695	1,500
Amortization of bond issue costs and premiums/discounts included in interest expense	(1,882)	(965)
Change in fair value of derivative instruments	21,954	(16,992)
Change in fair value of trading securities	(15,610)	(28,341)
Net realized gains on investments	(20,750)	(19,940)
Net (contributions from) distributions to noncontrolling shareholders and other	(1,617)	8,560
Depreciation and amortization	101,552	123,684
Donor restricted contributions and investment return	(37,960)	(24,713)
Net assets with donor restrictions released from restrictions used for operations	5,325	4,508
Recognition of change in pension funded status	221,269	(96,088)
Changes in assets and liabilities:		
Patient and resident accounts receivable	43,009	48,080
Due from third party reimbursement programs	(3,653)	19,734
Other receivables	(7,298)	3,150
Inventory	(4,527)	(8,126)
Prepaid expense	(1,692)	(966)
Other assets	(2,572)	(11,748)
Other liabilities	4,164	6,055
Accounts payable and accrued expenses	9,557	37,922
Estimated third-party payor settlements	(31,405)	38,999
Estimated self-insurance liabilities	(14,983)	(19,239)
Net cash provided by operating activities	<u>204,635</u>	<u>328,529</u>
Cash flows from investing activities:		
Acquisition of property and equipment	(186,478)	(177,068)
Asset/stock purchase of affiliates	(3,460)	(12,817)
Change in assets with donor restrictions	(30,601)	(13,912)
Gross purchases of retirement plan assets	(22,031)	(28,823)
Gross sales of retirement plan assets	17,994	20,772
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 received from (contributed to) acquisitions	914	(660)
Gross purchases of investments	(1,462,939)	(2,291,932)
Gross proceeds from the sale of investments	<u>1,440,804</u>	<u>2,182,030</u>
Net cash used in investing activities	<u>(245,797)</u>	<u>(476,949)</u>
Cash flows from financing activities:		
Donor restricted contributions and investment return	37,960	24,713
Net assets with donor restrictions released from restrictions used for operations	(5,325)	(4,508)
Net distributions paid to noncontrolling interests	(5,575)	(243)
Proceeds from issuance of long-term debt, including premium	494,513	235,068
Extinguishment of long-term debt, including redemption premium	(484,305)	(46,050)
Repayment of long-term debt	<u>(26,437)</u>	<u>(23,105)</u>
Net cash provided by financing activities	<u>10,831</u>	<u>185,875</u>
Net change in cash and cash equivalents	(30,331)	37,455
Cash and cash equivalents:		
Beginning of year	<u>233,445</u>	<u>195,990</u>
End of year	\$ <u>203,114</u>	\$ <u>233,445</u>
Supplemental disclosures of cash flow information:		
Cash paid for interest, net of amounts capitalized	\$ 46,907	43,322
Cash paid for income taxes	695	233

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years ended September 30, 2019 and 2018

(In thousands)

	<u>2019</u>	<u>2018</u>
Noncash transactions associated with the consolidated and deconsolidated joint venture entities:		
Patient accounts receivable	\$ 1,569	(2,602)
Property and equipment	645	454
Net assets with donor restrictions	—	(268)
Goodwill	15,378	(15,378)
Inventory	305	(322)
Prepaid expense	183	(18)
Other current assets	—	(12)
Other long-term assets	(7,548)	7,428
Accounts payable and accrued expenses	(733)	211
Long-term debt	(1,134)	369
Other liabilities	(2,387)	2,837

See accompanying notes to consolidated financial statements.

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

(In thousands)

### (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 OSF Ministry Services and OSF's wholly owned subsidiaries: Ottawa Regional Hospital & Healthcare Center and Subsidiaries, Mendota Community Hospital, POINTcore, Inc., OSF Lifeline Ambulance, LLC, Illinois Pathologists Services, LLC, 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 is the sole member of Ottawa Regional Hospital Foundation and Radiation Oncology of Northern Illinois, LLC (RONI). RONI was dissolved on September 24, 2018.

On April 1, 2015, OSF became the sole corporate member of Mendota Community Hospital d/b/a OSF Saint Paul Medical Center, an Illinois not-for-profit corporation (SPMC).

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. Pointcore, LLC ownership was transferred from OSF to OSF Saint Francis, Inc (SFI) effective October 1, 2018. Pointcore, LLC was statutorily merged into SFI effective June 1, 2019. SFI changed its name to POINTcore, Inc. (PCI) effective June 1, 2019.

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

(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:

	<b>SHMC</b>	<b>HMMC</b>	<b>Total</b>
<b>Assets</b>			
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
<b>Liabilities and Net Assets</b>			
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 2019. 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. In 2019, management adjusted goodwill and other long-term liabilities within the consolidated balance sheets by \$1,018 to record the adjustment for an asset retirement obligation for HMMC.

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

(In thousands)

Operating expenses for the year ended September 30, 2019 and 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.

The unaudited supplemental pro forma operating results of OSF as if the SHMC and HMMC acquisition had occurred on October 1, 2017 are as follows:

	<u>2018</u>
	(Unaudited)
Total operating revenue	\$ 2,898,328
Income from operations	72,981
Net income	155,419

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

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.

PCI (formerly known as 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. PCI 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.

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

(In thousands)

PCI 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.

PCI entered into a 50% joint venture agreement with a large construction company to form POINTCORE Construction, LLC, on May 6, 2019. The sole purpose is to align OSF's construction needs with a single partner, which will allow OSF to assure consistent adherence to quality standards and better control costs. OSF Design Group, Inc. was transferred to POINTCORE Construction, LLC effective May 5, 2019.

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 wholly owned physician group subsidiaries, which were formed or acquired to provide physician services and function as physician groups. As of September 30, 2019 the only remaining physician group subsidiary is Illinois Pathologists Services, LLC. Saint Anthony Physician Group was dissolved on September 30, 2018.

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% controlling interest in CHASC as of September 30, 2019 and 2018. On April 18, 2018, CHASC purchased Musculoskeletal Surgery Center, LLC for \$3,950, which created \$3,764 of goodwill.

Fort Jesse Imaging Center, LLC (FJIC) was formed in 2002 to establish and operate a medical imaging center in Bloomington, Illinois. SJMC has a 50.16% and 50.20% controlling interest in FJIC as of September 30, 2019 and 2018, respectively.

Eastland Medical Plaza SurgiCenter, LLC (EMPS) was formed in 2000 to establish and operate an ambulatory surgery treatment center in Bloomington, Illinois. As of September 30, 2018, SJMC had a 50% interest and did not have management control in EMPS; therefore, EMPS was deconsolidated and the joint venture activity was recorded as an investment using the equity method of accounting. During 2019, 85.7 Class A shares were repurchased by EMPS; therefore, as of September 30, 2019, SJMC has a 52.57% interest and regained management control in EMPS. These transactions resulted in reconsolidation of the joint venture activity in 2019 and added \$15,378 of EMPS goodwill in the accompanying consolidated financial statements.

Fox River Cancer Center (FRCC) was formed in 2007 to establish and operate a cancer treatment center in Ottawa, Illinois. SEMC had 69.68% controlling ownership as of September 30, 2018. During 2019, SEMC contributed capital for \$2,433 to FRCC, which resulted in controlling ownership of 82.00% as of September 30, 2019.

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

(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, 2019 and 2018:

	<b>Unrestricted net assets</b>		
	<b>Total</b>	<b>Controlling interest</b>	<b>Noncontrolling interest</b>
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 to noncontrolling shareholders and other	(8,560)	—	(8,560)
Balance at September 30, 2018	1,443,029	1,438,153	4,876
Net income	127,180	121,786	5,394
Net assets released from restrictions used for the purchase of property and equipment	2,034	2,034	—
Recognition of change in pension funded status	(221,269)	(221,269)	—
Net contributions from noncontrolling shareholders and other	1,617	(416)	2,033
Balance at September 30, 2019	\$ 1,352,591	1,340,288	12,303

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.

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

(In thousands)

Summarized financial information of the Foundation for the years ended September 30, 2019 and 2018 is as follows:

	<u>2019</u>	<u>2018</u>
Cash, investments, pledges, and other	\$ 199,893	161,887
Accounts payable and due to affiliates	2,772	2,538
Net assets without donor restrictions	60,870	53,664
Net assets with donor restrictions	136,251	105,685
Cash transfers to OSF during the year	7,389	19,743

Amounts due from the Foundation recognized at September 30, 2019 and 2018 consists of \$1,224 and \$862, respectively, in other receivables, \$60,614 and \$53,456, respectively, in investments, and \$136,251 and \$105,685, respectively, in restricted assets in the accompanying consolidated balance sheets.

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.

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.

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

(In thousands)

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 non-operating gains or losses in the accompanying consolidated statements of operations and changes in net assets without donor restrictions, 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 net assets without donor restrictions.

### **(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 non-operating 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.

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### **(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 loss would be recorded in the period such determination is made based on the fair value of the related entity. No impairments were recorded for the years ended September 30, 2019 and 2018.

### **(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 unit 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, 2019 and 2018, 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 2019 and 2018.

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The composition of goodwill at September 30, 2019 and 2018 is set forth in the following table:

	<u>2019</u>	<u>2018</u>
OSF	\$ 43,648	42,630
Joint ventures	<u>19,142</u>	<u>3,764</u>
	<u>\$ 62,790</u>	<u>46,394</u>

**(j) Net Assets with Donor Restrictions**

Net assets with donor restrictions are those whose use has been limited by the donors to a specific time period or purpose or restricted by donors to be maintained by OSF in perpetuity.

**(k) 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. Gifts are reported as restricted if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, net assets with donor restrictions are reclassified to net assets without donor restrictions in the consolidated statements of operations and changes in net assets. In the absence of a donor specification that restricts income and gains on restricted gifts, such income and gains are reported as income of net assets without donor restrictions. In order to protect permanently restricted gifts from a loss of purchasing power, OSF uses a spending rate policy to determine the portion of investment return that can be used to support operations of the current period.

OSF reports gifts of equipment or other long-lived assets as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, OSF reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

**(l) Net Income**

The consolidated statements of operations and changes in net assets without donor restrictions include a performance indicator, net income. Changes in net assets without donor restrictions, 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 contributions from (distributions to) noncontrolling shareholders and other.

**(m) 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

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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.

### **(n) Other Operating Revenue**

Other operating revenue includes income from investment return on trustee funds, rental income, grant revenue, joint venture activity, risk contract revenue, and other miscellaneous revenue.

### **(o) 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.

### **(p) 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.

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

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

### **(r) 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 PCI 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.

### **(s) 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.

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PCI 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 PCI 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, 2019 and 2018, OSF and PCI 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 OSF.

### (t) **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.

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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.

### **(u) New Accounting Pronouncements**

OSF adopted ASC Topic 606, *Revenue from Contracts with Customers*, effective October 1, 2018 using a full retrospective approach. The standard requires an entity to recognize revenue when the entity transfers control of promised goods and services to the customer. Revenue is recognized in an amount that reflects the consideration an entity expects to receive in exchange for those goods and services. An entity is also required to disclose sufficient quantitative and qualitative information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The adoption of ASC Topic 606 resulted in changes to the presentation and disclosure of revenue related to uninsured or underinsured patients. Prior to the adoption of ASC Topic 606, OSF presented a separate provision for bad debts related to self-pay patients, as well as co-pays and deductibles owed by patients with insurance. Under ASC Topic 606, the estimated uncollectible amounts due from these patients are generally considered a direct reduction to net operating revenues and, correspondingly, result in a material reduction in the amounts presented separately as provision for bad debts. As such the 2018 provision for bad debts of \$125,887 has been reclassified and presented as a reduction to net patient services revenue for 2018 presentation. OSF also assessed the impact of the new standard on various reimbursement programs that represent variable consideration and concluded that accounting for these programs under the new standard is substantially consistent with the historical accounting practices. ASC Topic 606 did not materially impact the financial position, results of operations, or cash flows of OSF and there was no cumulative effect of a change in accounting principle recorded related to the adoption.

ASU No. 2016-14, *Not-for-Profit Entities (ASC 958)*, was adopted by OSF effective October 1, 2018 with retroactive application. ASC 958 changed the way a not-for-profit entity (NFP) classifies and presents net assets on the face of the financial statements and presents information in the financial statements and notes about the NFP's liquidity, financial performance, and cash flows. The amendment changed the way OSF reports classes of net assets, from the previously required three classes to two. As a result of this adoption 2018 temporarily restricted net assets of \$69,992 and permanently restricted net assets of \$51,849 have been combined for presentation in 2018 as net assets with donor restrictions. The standard did not have any other material effect on the consolidated financial statements, other than the additional disclosure required by the standard.

Effective September 30, 2019, OSF adopted FASB ASU, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost* (ASU No. 2017-07). This new guidance requires that the service cost component be reported in the same line items as compensation costs arising from services rendered by the pertinent employees during the period. The other components of net pension benefit costs are required to be presented separately from the service cost component and outside a subtotal of income from operations. This new guidance was early adopted by OSF on October 1, 2018, which resulted in \$4,331 of net periodic pension benefit cost to be reported as a

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component of other in nonoperating gains (losses) within the 2019 consolidated statements of operations and changes in net assets without donor restrictions. This guidance was retrospectively applied to the 2018 consolidated statements of operations and changes in net assets without donor restrictions and \$5,306 was reclassified from salaries and benefits to other in for the year ended September 30, 2018.

ASU No. 2016-02 *Leases*, (ASC Topic 842), was adopted by OSF effective October 1, 2019, ASC Topic 842 requires lessees to recognize leases on balance sheet and disclose key information about leasing arrangements. The new standard establishes a right-of-use (ROU) model that requires a lessee to recognize an ROU asset and lease liability on the balance sheet for all leases with a term longer than 12 months. Leases are classified as finance or operating, with classification affecting the pattern and classification of the expense recognition in the statement of operations. As of October 1, 2019, OSF recorded a ROU asset of approximately \$187,000 and a corresponding leasing obligation of the same amount as part of the adoption.

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.

### **(v) Reclassifications**

Certain reclassifications have been made to the 2018 consolidated financial statements to conform to the 2019 presentation. Reclassifications relate to the adoption of new accounting standards as discussed in note 2(u) above.

### **(3) Net Patient and Resident Service Revenue**

Net patient service revenue is reported at the amount that reflects the consideration to which OSF expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (managed care and government programs), and others and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total charges. Performance obligations satisfied over time relate to inpatient acute care services. Revenue for performance obligations satisfied at a point in time is recognized when goods or services are provided and OSF does not believe it is required to provide additional goods or services to the patient. Performance obligations for patients that are in house at period end generally complete within days or possibly weeks of period end, therefore, are estimated on a pro-rata basis.

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OSF determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payers, discounts provided to uninsured patients in accordance with OSF's policy, and/or implicit price concessions provided to uninsured patients. Estimates of contractual adjustments and discounts are based on contractual agreements, its discount policy (or policies), and historical experience. Estimate of implicit price concessions are based on its historical collection experience with this class of patients.

Agreements with third-party payers typically provide for payments at amounts less than established charges. A summary of the payment arrangements with major third-party payers follows:

### **(a) Medicare**

Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge based on clinical, diagnostic, and other factors. Inpatient non-acute 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, 2019, Medicare cost reports have been audited and final-settled through September 30, 2015 for all hospitals except SAMC. Medicare cost reports have been audited and final settled through September 30, 2016 for SFH, SJH, SJMC, SFMC, SMMC, SLMC, HFMC, and SEMC. Medicare cost reports have been audited and final settled through September 30, 2017 for 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 2018 and 2019. 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.

As of September 30, 2019 and 2018, OSF has recorded a receivable of \$13,854 and \$8,515, respectively, for outstanding risk contracts.

### **(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, 2019 and 2018 of \$151,953 and \$134,257, respectively, within net patient service revenue in the accompanying consolidated statements of operations and changes in net assets without donor restrictions.

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OSF included its related assessment tax payments of \$86,973 and \$77,549 for the years ended September 30, 2019 and 2018, respectively, within supplies and other expense in the accompanying consolidated statements of operations and changes in net assets without donor restrictions.

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.

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to interpretation. Compliance with such laws and regulations may also be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge OSF's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon OSF. In addition, contracts with commercial payers also provide for retroactive audit and review of claims.

Settlements with third-party payers for retroactive adjustments due to audits, reviews, or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payer, correspondence from the payer and historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available), or as years are settled or are no longer subject to such audits, reviews, and investigations. During 2019 and 2018, changes to prior year variable consideration resulted in a decrease of net patient service revenue of \$(2,030) and \$(2,532), respectively, due to appeals, cost report settlements, and other adjustments to prior year, exclusive of the amounts related to the aforementioned Medicaid program.

Generally patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. OSF also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. OSF estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change,

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OSF provides care to patients regardless of their ability to pay. Therefore, OSF has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances (for example, copays and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts OSF expects to collect based on its collection history with those patients.

Patients who meet OSF's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue.

Net patient service revenue net of explicit allowances and discounts (but before implicit price concessions) recognized in the period by major payer is as follows:

	<u>2019</u>	<u>2018</u>
Medicare	29 %	30 %
Medicaid	15	15
Managed care	51	49
Commercial and other	2	3
Self-pay	<u>3</u>	<u>3</u>
Net patient service revenues	<u>100 %</u>	<u>100 %</u>

Patient service revenue recognized in the period by type of service is as follows:

	<u>2019</u>	<u>2018</u>
Inpatient	\$ 1,119,514	1,134,429
Outpatient/ambulatory care	1,286,165	1,095,041
Clinic and other	<u>500,895</u>	<u>466,927</u>
	<u>\$ 2,906,574</u>	<u>2,696,397</u>

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OSF grants credit without collateral to its patients and residents, most of whom are local residents and are insured under third-party payor arrangements. OSF values these receivables using historical collection on enacted rates at the time of the estimate. The mix of net patient accounts receivables by major payor at September 30 consists of the following:

	<u>2019</u>	<u>2018</u>
Medicare	18 %	19 %
Medicaid	32	34
Blue Cross	10	9
Other third-party payors	29	29
Patients	11	9
	<u>100 %</u>	<u>100 %</u>

#### (4) 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 \$39,845 and \$34,440 in 2019 and 2018, 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.

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**(5) Investments**

**(a) Investments**

The composition of investments, at fair value, at September 30, 2019 and 2018 is set forth in the following table:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 13,700	7,828
Domestic equities	346,576	330,151
U.S. Treasury obligations	159,497	132,539
U.S. government agencies	102,098	81,948
Municipal securities	1,978	2,388
Domestic corporate obligations	229,635	213,852
Domestic mutual funds – equities	18,087	29,594
Domestic mutual funds – bonds	98,637	92,496
Domestic commingled funds	142,401	127,008
Foreign equities	122,795	144,612
Foreign bonds	42,299	28,975
Foreign mutual funds – equities	7,849	4,781
Foreign mutual funds – bonds	21	46
Foreign securities – commingled	62,572	53,294
Other	1,132	5
	<u>\$ 1,349,277</u>	<u>1,249,517</u>

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**(b) Assets with Donor Restrictions**

The composition of restricted assets, at fair value, except other – farmland/commodities, at September 30, 2019 and 2018 is set forth in the following table:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 917	900
U.S. Treasury obligations	34	5
Municipal securities	14	—
Domestic equities	4,825	4,946
Domestic corporate obligations	77	78
Domestic mutual funds – equities	2,035	2,060
Domestic mutual funds – bonds	2,073	1,915
Foreign mutual funds – equities	1,040	1,110
Foreign mutual funds – bonds	146	368
Foreign equities	244	211
Foreign bonds	—	50
Other	61	92
Pledges receivable and other	34,056	15,920
Investments held at Foundation on behalf of OSF:		
Cash and cash equivalents	3,452	1,675
U.S. government agencies	85	48
Domestic equities	35,226	16,964
Domestic corporate obligations	323	186
Domestic mutual funds – equities	19,647	34,437
Domestic mutual funds – bonds	36,183	31,029
Foreign equities	—	42
Foreign mutual funds – equities	8,868	8,679
Foreign mutual funds – bonds	348	166
Other – farmland/commodities	2,788	960
	<u>\$ 152,442</u>	<u>121,841</u>

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

The composition of assets limited as to use at fair value at September 30, 2019 and 2018 is set forth in the following table:

	<u>2019</u>	<u>2018</u>
Held by trustee under indenture agreement:		
Cash and cash equivalents	\$ 1,596	24,004
Board-designated for self-insurance, including \$27,270 and \$31,330 designated as current portion as of September 30, 2019 and 2018, respectively:		
Cash and cash equivalents	10,221	25,793
Domestic equities	10,970	11,222
U.S. Treasury obligations	40,984	42,199
U.S. government agencies	11,998	7,382
Domestic corporate obligations	53,266	52,610
Domestic mutual funds – equities	269	259
Domestic commingled funds	35,441	39,133
Foreign bonds	6,519	9,488
Foreign equities	893	902
Foreign commingled funds	14,997	15,427
	<u>185,558</u>	<u>204,415</u>
	187,154	228,419
Less current portion	<u>(27,270)</u>	<u>(31,330)</u>
	<u>\$ 159,884</u>	<u>197,089</u>

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

The composition of other assets – retirement plan assets (note 8) at fair value as of September 30 is set forth in the following table:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 5,206	4,483
Domestic mutual funds – equities	31,558	29,877
Domestic mutual funds – bonds	25,912	24,402
Foreign mutual funds – equities	2,304	2,181
	<u>\$ 64,980</u>	<u>60,943</u>

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

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(In thousands)

The composition of OSF's investment return for the years ended September 30, 2019 and 2018 is as follows:

	<u>2019</u>	<u>2018</u>
Investment return:		
Interest and dividend income	\$ 41,961	26,417
Net realized gains	24,477	21,235
Change in net unrealized gains on trading securities	<u>13,565</u>	<u>30,220</u>
Total investment return	\$ <u>80,003</u>	<u>77,872</u>

Investment returns included in the accompanying consolidated statements of operations and changes in net assets without donor restrictions for the years ended September 30, 2019 and 2018 are as follows:

	<u>2019</u>	<u>2018</u>
Unrestricted revenue, gains, and other support:		
Other	\$ 3,643	2,126
Nonoperating gains:		
Investment return	73,478	71,746
Other changes in net assets:		
Net assets with donor restrictions:		
Interest and dividend income	1,200	826
Net realized gains	3,727	1,295
Change in net unrealized gains on trading securities	<u>(2,045)</u>	<u>1,879</u>
Total investment return	\$ <u>80,003</u>	<u>77,872</u>

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

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**(6) Cash and Cash Equivalents, Assets Limited as to Use, Investments, and Assets with Donor Restrictions**

As of September 30, cash and cash equivalents, assets limited as to use, investments, and assets with donor restrictions, consist of the following:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 233,000	293,645
Fixed income	648,807	571,748
Mutual funds – bonds	137,408	126,020
Equity securities	521,529	509,050
Mutual funds – equities	57,795	80,920
Commingled funds	255,411	234,862
Other	38,037	16,977
	<u>\$ 1,891,987</u>	<u>1,833,222</u>

OSF holds cash balances that are optimized around large and predictable cash flows. To efficiently manage liquidity and capital, OSF continually determines the necessary amount of cash and cash equivalents to hold in cash and money market funds to meet operational needs, and allocates the excess to a separate investment account that is expected to generate higher yielding returns while still maintaining a high degree of liquidity and a focus on capital preservation. As added insurance, a line of credit is also maintained in the unlikely event there is an unexpected immediate cash need. In relation to the long-term investments of OSF, approximately 99.93% of the funds can be liquidated within one month and approximately 0.07% may be liquid between one to two years, although access to these funds can be attained in less than one year depending on pricing of liquidation of the asset (farmland).

As of September 30, unrestricted financial assets, reduced by amounts that are considered to be illiquid within one year, consist of the following:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 203,114	233,445
Patient accounts receivable, net	473,807	515,247
Due from third party reimbursement programs	20,572	16,919
Other	21,908	14,610
Investments	1,349,277	1,249,517
Less: assets with liquidity over one year	<u>(1,132)</u>	<u>(5)</u>
	<u>\$ 2,067,546</u>	<u>2,029,733</u>

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

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(In thousands)

**(7) Property and Equipment**

A summary of property and equipment at September 30 2019 and 2018, is as follows:

	<u>2019</u>	<u>2018</u>
Land	\$ 59,340	58,716
Land improvements	33,922	34,103
Buildings	1,699,076	1,712,085
Equipment	<u>1,042,104</u>	<u>1,010,042</u>
	2,834,442	2,814,946
Less accumulated depreciation	<u>1,515,490</u>	<u>1,509,010</u>
	1,318,952	1,305,936
Construction in progress	<u>146,791</u>	<u>74,236</u>
Property and equipment, net	<u>\$ 1,465,743</u>	<u>1,380,172</u>

During 2019, management relived the remaining service life of certain buildings and equipment based upon their anticipated use. The reliving has been accounted for prospectively as a change in estimate. The impact of the reliving was a reduction in depreciation expense of \$32,892 in 2019.

At September 30, 2019, the remaining contractual commitment on construction in progress approximated \$85,540 for various construction and renovation projects, and will be financed through operations and existing funds. OSF capitalized interest, net of interest income on project funds in the amount of \$983 and \$308 for the years ended September 30, 2019 and 2018, respectively.

**(8) Other Assets**

Included in other assets at September 30 2019 and 2018, are the following:

- Venture capital investments of \$36,768 and \$30,129 at cost at September 30, 2019 and 2018, respectively.
- Deferred tax assets of \$8,935 and \$7,050 at September 30, 2019 and 2018, respectively (note 16).
- Escrow deposits of \$0 in 2019 and \$5,476 in 2018 for the self-insured workers' compensation program and are comprised of cash and cash equivalents. During 2019, surety bonds were purchased to replace the escrow deposits.
- Other miscellaneous assets of \$2,596 and \$3,168 at September 30, 2019 and 2018, 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

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

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methodologies depending on the plan. Plan assets were \$64,980 and \$60,943 at September 30, 2019 and 2018, respectively. The plan assets have been included with other assets with a corresponding liability in other liabilities in the accompanying consolidated balance sheet at September 30, 2019 and 2018, respectively.

- The investments in joint ventures accounted for using the equity method of accounting totaled \$23,867 and \$30,468 at September 30, 2019 and 2018, respectively. The most significant of these investments at September 30, 2019 include:
  - Community Cancer – 50.0% ownership interest
  - Renal Intervention Center, LLC – 34.0% ownership interest
  - SimNext, LLC – 50.0% ownership interest
  - River Plex Fitness Center, LLC – 50.0% ownership interest
  - 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
  - Pointcore Construction, LLC – 50.0% ownership interest
  - Pointcore Network Services – 50.0% ownership interest

For the years ended September 30, 2019 and 2018, OSF recognized income of \$3,802 and \$338 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, 2019 and 2018:

	<b>2019</b>	<b>2018</b>
Total assets	\$ 27,810	49,638
Total liabilities	11,323	19,072
Total net assets	\$ 16,487	30,566
Total revenues	\$ 11,552	26,665
Operating expenses	10,340	24,352
Net income	\$ 1,212	2,313

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

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(In thousands)

**(9) Long-Term Debt**

A summary of long-term debt at September 30, 2019 and 2018 is as follows:

	<u>2019</u>	<u>2018</u>
OSF Master Trust Indenture Obligations:		
Revenue Refunding Bonds (Illinois Finance Authority Bonds, Series 2018A), payable in annual installments of varying amounts, commencing on May 15, 2019 through May 15, 2047 at fixed interest rates between 4.00% and 5.00% depending on the date of maturity.	\$ 338,350	—
Revenue Refunding Bonds (Illinois Finance Authority Bonds, Series 2018B), payable in annual installments of varying amounts, commencing on November 15, 2032 through November 15, 2037. Interest is determined daily based on market conditions. (1.77% at September 30, 2019).	65,435	—
Revenue Refunding Bonds (Illinois Finance Authority Bonds, Series 2018C), payable in annual installments of varying amounts, commencing on November 15, 2032 through November 15, 2037. Interest is determined daily based on market conditions. (1.75% at September 30, 2019).	65,385	—
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) This bond was fully paid on October 17, 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 4.00% and 5.00% depending on the date of maturity through November 15, 2045	366,515	367,360

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	<u>2019</u>	<u>2018</u>
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 (3.01% at September 30, 2019 and 3.03% at September 30, 2018)	\$ 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	166,225	169,200
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	16,425	31,420
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 was determined weekly based on current market conditions (1.55%, 1.54%, and 1.57% as of September 30, 2018). The bonds were fully paid on October 17, 2018.	—	125,000
Revenue Bonds (Illinois Finance Authority Bonds, 2007E and Series 2007F) payable in annual installments of varying amounts commencing November 15, 2024 through November 15, 2037. Interest was determined weekly based on current market conditions ( 1.57% and 1.57% as of September 30, 2018). The bonds were fully paid on October 17, 2018.	—	125,000
Other debt:		
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 (2.03% as of September 30, 2019 and 2.25% as of September 30, 2018)	22,280	22,955

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

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	<u>2019</u>	<u>2018</u>
Mortgage note payable to Rockford Bank and Trust, secured by medical office building. The note bears an interest rate of 4.25% payable monthly. Principal and interest of \$22 is payable monthly with a balloon payment of \$2,906 on June 20, 2020	\$ 3,002	3,143
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	787	940
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 (3.61% and 3.58% as of September 30, 2019 and 2018, respectively). Principal payment of \$47 plus accrued interest is due monthly through January 2024	2,438	2,997
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	1,960	2,259
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	8,743	9,161
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	913	985
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	926	1,067
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.	749	891

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	<u>2019</u>	<u>2018</u>
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	\$ 2,833	3,245
Mortgage note payable to Commerce Bank secured by a medical office building. The interest rate varies monthly based upon current market conditions (3.68% and 3.56% as of September 30 2019 and September 30, 2018, 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.	2,469	2,787
Direct Note Obligation, Series 2019A to PNC Bank, as administrative agent, dated April 25, 2019 providing for issuance not to exceed \$100,000, multiple draw construction loan, with maturity on April 25, 2022. The interest rate varies monthly based on current market conditions (2.45% as of September 30, 2019). There is an additional commitment fee during any period in which the balance is less than 60% of the aggregate term loan (0.075% as of September 30, 2019).	8,523	—
Other miscellaneous notes payable and capital leases	<u>2,875</u>	<u>2,098</u>
	1,285,478	1,314,153
Plus original issue premium, net	<u>49,038</u>	<u>35,461</u>
Total debt	1,334,516	1,349,614
Less:		
Current installments	29,648	25,856
Debt issuance costs, net	<u>9,750</u>	<u>7,871</u>
Total long-term debt, excluding current installments	\$ <u><u>1,295,118</u></u>	\$ <u><u>1,315,887</u></u>

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

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OSF's average interest rates for variable rate debt for the years ended September 30, 2019 and 2018 are as follows:

	2019	2018
Variable interest rate issues:		
2007E-retired October 17, 2018	1.55%	1.28%
2007F-retired October 17, 2018	1.55	1.28
2009B-retired October 17, 2018	1.53	1.27
2009C-retired October 17, 2018	1.53	1.26
2009D-retired October 17, 2018	1.54	1.28
2009G-retired December 20, 2017	—	1.55
2015B	3.35	2.68
2017ABC-retired October 17, 2018	2.32	1.78
2018B	1.54	—
2018C	1.52	—
2019A	2.46	—

On October 17, 2018, OSF entered into a Third Amended and Restated Master Trust Indenture (MTI) dated October 1, 2018. 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, 2019 and 2018, amounts outstanding under the MTI totaled \$1,226,980 and \$1,261,625, respectively.

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

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, Series 2017A, Series 2017B, and Series 2017C were fully repaid. This resulted in a loss on early extinguishment of debt of \$695.

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

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At September 30, 2019, 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.

	<b>Term</b>
OSF Master Trust Indenture Obligations:	
2018B	Due in full 367 days after bank purchase date. The letter of credit expires on October 17, 2023.
2018C	Eight equal installments beginning 367 days after bank purchase date The letter of credit expires on October 17, 2023.
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:			
2020	\$	29,648	
2021		28,816	
2022		38,235	
2023		30,020	
2024		36,296	
Thereafter		1,171,501	

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 PCI debt is not refinanced in the ordinary course is as follows:

Year ending September 30:			
2020	\$	29,648	
2021		133,372	
2022		77,386	
2023		36,433	
2024		35,476	
Thereafter		1,022,201	

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A summary of interest cost on borrowed funds held by the trustee under the MTI during the years ended September 30, 2019 and 2018 is as follows:

	<u>2019</u>	<u>2018</u>
Interest cost – charged to operations	\$ 48,928	38,376

**(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, 2019 and 2018, neither OSF nor any counterparty to the interest rate swap agreements were required to post collateral.

A summary of outstanding positions under OSF’s interest rate swap program at September 30, 2019 is as follows:

	<u>Notional amount</u>	<u>Maturity date</u>	<u>Rate received</u>	<u>Rate paid</u>
\$	41,050	November 2, 2029	BMA Index	3.969%
	41,300	October 19, 2029	BMA Index	3.969
	6,800	November 15, 2024	BMA Index	3.794
	130,000	November 15, 2037	67% 1 Mo. Libor	3.651

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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 \$(4,337) and \$(5,375) in 2019 and 2018, respectively.

Additionally in June 2019, OSF terminated a swap with a maturity of May 15, 2041 and original notional amount of \$130,000 for a settlement of \$701 and is recognized within nonoperating gains (losses) as net settlement of derivative instruments.

The fair value of the swap agreements under ASC Subtopic 820-10 was \$(51,154) and \$(30,071) and is recorded as a component of other liabilities in the accompanying consolidated balance sheets at September 30, 2019 and 2018, respectively. For the years ended September 30, 2019 and 2018, OSF recognized an unrealized gain (loss) of \$(21,083) and \$16,187, 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, 2019:

<u>Type of interest swap</u>	<u>Notional amount</u>	<u>Mark to market</u>	<u>Fair value</u>
Floating-to-fixed	\$ 41,050	(7,439)	(7,298)
Floating-to-fixed	41,300	(7,390)	(7,252)
Floating-to-fixed	6,800	(498)	(495)
Floating-to-fixed	130,000	(37,970)	(36,109)
		<u>\$ (53,297)</u>	<u>(51,154)</u>

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

<u>Type of interest swap</u>	<u>Notional amount</u>	<u>Mark to market</u>	<u>Fair value</u>
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
		<u>\$ (31,311)</u>	<u>(30,071)</u>

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A summary of outstanding positions under PCI's interest rate swap program at September 30, 2019 is as follows:

	<u>Notional amount</u>	<u>Maturity date</u>	<u>Rate received</u>	<u>Rate paid</u>
\$	12,700	December 1, 2037	USD – LIBOR-BBA	2.877
	2,469	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 \$58 and \$220 in 2019 and 2018, respectively.

The fair value of the PCI swap agreements was \$(167) and \$704 and is recorded as a component of other liabilities in the accompanying consolidated balance sheets as of September 30, 2019 and 2018, respectively. For the years ended September 30, 2019 and 2018, PCI recognized an unrealized gain (loss) of \$(871) and \$805, 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 PCI's swaps as of September 30, 2019:

<u>Type of interest swap</u>	<u>Notional amount</u>	<u>Mark to market</u>	<u>Fair value</u>
Fixed rate payor	\$ 12,700	(109)	(106)
Fixed rate payor	2,469	(60)	(61)
		\$ (169)	(167)

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

<u>Type of interest swap</u>	<u>Notional amount</u>	<u>Mark to market</u>	<u>Fair value</u>
Fixed rate payor	\$ 13,084	660	631
Fixed rate payor	2,787	75	73
		\$ 735	704

**(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

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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, 2019 and 2018. ASC Subtopic 820-10

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(In thousands)

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.

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, 2019:

	<u>Fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Financial assets:				
Cash and cash equivalents	\$ 203,114	203,114	—	—
Investments:				
Cash and cash equivalents	\$ 13,700	12,665	1,035	—
Domestic equities	346,576	346,576	—	—
U.S. Treasury obligations	159,497	159,497	—	—
U.S. government agencies	102,098	—	102,098	—
	1,978	—	1,978	—
Domestic corporate obligations	229,635	—	229,635	—
Domestic mutual funds – equities	18,087	18,087	—	—
Domestic mutual funds – bonds	98,637	98,637	—	—
Domestic commingled funds	142,401	131,501	10,900	—
Foreign equities	122,795	122,795	—	—
Foreign bonds	42,299	—	42,299	—
Foreign mutual funds – equities	7,849	7,849	—	—
Foreign mutual funds – bonds	21	21	—	—
Subtotal	1,285,573	\$ 897,628	387,945	—
Other 1 of 4 Foreign securities – commingled	62,572			
Other 2 of 4 Other	1,132			
Total investments	\$ 1,349,277			

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

(In thousands)

	<u>Fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Restricted assets – excluding pledges and other of \$34,056:				
Cash and cash equivalents	\$ 917	917	—	—
U.S. Treasury obligations	34	34	—	—
Municipal securities	14	—	14	—
Domestic equities	4,825	4,825	—	—
Domestic corporate obligations	77	—	77	—
Domestic mutual funds – equities	2,035	2,035	—	—
Domestic mutual funds – bonds	2,073	2,073	—	—
Foreign mutual funds – equities	1,040	1,040	—	—
Foreign mutual funds – bonds	146	146	—	—
Foreign equities	244	244	—	—
Other	61	—	61	—
Investments held at foundation:				
Cash and cash equivalents	3,452	3,087	365	—
U.S. government agencies	85	—	85	—
Domestic equities	35,226	35,226	—	—
Domestic corporate obligations	323	—	323	—
Domestic mutual funds – equities	19,647	19,647	—	—
Domestic mutual funds – bonds	36,183	36,183	—	—
Foreign mutual funds – equities	8,868	8,868	—	—
Foreign mutual funds – bonds	348	348	—	—
Subtotal	115,598	\$ <u>114,673</u>	<u>925</u>	<u>—</u>
Other 3 of 4 Other – farmland / commodities	<u>2,788</u>			
Total restricted assets	\$ <u>118,386</u>			

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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(In thousands)

	<u>Fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets limited as to use:				
Cash and cash equivalents	\$ 11,817	11,817	—	—
Domestic equities	10,970	10,970	—	—
U.S. Treasury obligations	40,984	40,984	—	—
U.S. government agencies	11,998	—	11,998	—
Domestic corporate obligations	53,266	—	53,266	—
Domestic mutual funds – equities	269	269	—	—
Domestic commingled funds	35,441	35,441	—	—
Foreign equities	893	893	—	—
Foreign bonds	6,519	—	6,519	—
Subtotal	172,157	\$ <u>100,374</u>	<u>71,783</u>	<u>—</u>
Other 4 of 4 Foreign commingled funds	<u>14,997</u>			
Total assets limited as to use	\$ <u>187,154</u>			
Other assets – retirement plan assets:				
Cash and cash equivalents	\$ 5,206	5,206	—	—
Domestic mutual funds – equities	31,558	31,558	—	—
Domestic mutual funds – bonds	25,912	25,912	—	—
Foreign mutual funds – equities	2,304	2,304	—	—
Other assets – retirement plan assets:	\$ <u>64,980</u>	<u>64,980</u>	<u>—</u>	<u>—</u>
Financial liabilities:				
Fair value of swap agreements	\$ <u>(51,321)</u>	<u>—</u>	<u>(51,321)</u>	<u>—</u>
Total financial liabilities	\$ <u>(51,321)</u>	<u>—</u>	<u>(51,321)</u>	<u>—</u>

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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(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:

	<u>Fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
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, 2019 and 2018

(In thousands)

	<b>Fair value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
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 – equities	29,877	29,877	—	—
Domestic mutual funds – bonds	24,402	24,402	—	—
Foreign equities	2,181	2,181	—	—
Other assets – retirement plan assets:	\$ 60,943	60,943	—	—

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

(In thousands)

	<u>Fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Financial liabilities:				
Fair value of swap agreements	\$ (29,367)	—	(29,367)	—
Total financial liabilities	\$ (29,367)	—	(29,367)	—

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, 2019 and 2018.

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:

	<u>2019</u>	<u>2018</u>	<u>Redemption frequency</u>	<u>Days notice</u>
Investments:				
Foreign securities – commingled	\$ 62,572	53,294	Monthly	10
Domestic commingled funds	142,401	127,008	Daily	2
Assets limited as to use:				
Foreign securities – commingled	\$ 14,997	15,427	Monthly	10
Domestic commingled funds	35,441	39,133	Daily	2

**(12) Net Assets with Donor Restrictions**

Net assets with donor restrictions have been restricted by donors for the following purposes as of September 30:

	<u>2019</u>	<u>2018</u>
Capital	\$ 6,572	5,158
Colleges of nursing	10,749	10,311
Healthcare services	113,011	104,519
Education and research	20,034	174
Patient care	1,551	1,152
Other	525	527
	\$ <u>152,442</u>	<u>121,841</u>

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

(In thousands)

OSF holds net assets with donor restrictions that are permanently endowed and only the income is available for designated purposes. Income on the following endowments is restricted for the following purposes as of September 30:

	<u>2019</u>	<u>2018</u>
Capital	\$ 861	856
Colleges of nursing	5,600	5,486
Healthcare services	49,920	43,746
Education and research	20,034	174
Patient care	1,551	1,152
Other	436	435
	<u>\$ 78,402</u>	<u>51,849</u>

### (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 engaged 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 \$16,144 and \$16,818 as of September 30, 2019 and 2018, respectively, have been reported as accrued expenses. The associated expense of \$183,545 and \$176,867 as of September 30, 2019 and 2018, respectively, is included in salaries and benefits in the accompanying consolidated statements of operations and changes in net assets without donor restrictions.

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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(In thousands)

As of September 30, 2019 and 2018, estimated self-insurance liabilities, excluding health and dental claims, are comprised of the following:

	<u>2019</u>	<u>2018</u>
Professional and general liability	\$ 148,288	162,092
Workers' compensation	12,704	13,512
Other	<u>1,522</u>	<u>1,893</u>
Total estimated self-insurance liabilities	162,514	177,497
Less current portion	<u>27,270</u>	<u>31,330</u>
Total estimated self-insurance liabilities, less current portion	<u>\$ 135,244</u>	<u>146,167</u>

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, 2019 and 2018, OSF has recorded no insurance receivables in the accompanying consolidated balance sheets.

Self-insurance expense is included in supplies and other expenses in the accompanying consolidated statements of operations and changes in net assets without donor restrictions. The amounts recognized for the year ended September 30, 2019 and 2018 include 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, 2019 and 2018, self-insurance expense is comprised of the following:

	<u>2019</u>	<u>2018</u>
Professional and general liability	\$ (2,825)	(14,475)
Workers' compensation	<u>6,157</u>	<u>5,162</u>
Total self-insurance expense	<u>\$ 3,332</u>	<u>(9,313)</u>

**(14) Retirement Benefits**

OSF has a noncontributory defined benefit pension plan (the Plan) covering all employees who met the eligibility requirements. 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).

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

(In thousands)

The actuarial funding method used in the actuarial valuation for 2019 and 2018 is the projected unit credit cost method. The measurement date for plan liabilities and assets is September 30 for the years ended September 30, 2019 and 2018. The following tables set forth the Plan's funded status and amounts recognized in OSF's consolidated financial statements at September 30, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 942,994	1,000,517
Interest cost	40,721	38,391
Actuarial loss (gain)	188,607	(66,500)
Benefits paid	<u>(32,439)</u>	<u>(29,414)</u>
Benefit obligation at end of year	\$ <u>1,139,883</u>	<u>942,994</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 649,674	615,322
Actual return on plan assets	25,284	58,573
Employer contributions	4,217	5,193
Benefits paid	<u>(32,439)</u>	<u>(29,414)</u>
Fair value of plan assets at end of year	\$ <u>646,736</u>	<u>649,674</u>
Reconciliation of funded status:		
Funded status	\$ <u>(493,147)</u>	<u>(293,320)</u>
Net amount recognized at year-end	\$ <u>(493,147)</u>	<u>(293,320)</u>
Amounts recognized in the accompanying consolidated balance sheets:		
Accrued benefit liability	\$ (493,147)	(293,320)
Amounts not yet reflected in net periodic benefit cost and included as an accumulated credit to unrestricted net assets:		
Net actuarial loss	\$ (529,469)	(329,372)
Prior service cost	<u>(6,383)</u>	<u>(6,617)</u>
Net amounts recognized in the accompanying consolidated balance sheets	\$ <u>(535,852)</u>	<u>(335,989)</u>

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

(In thousands)

	<u>2019</u>	<u>2018</u>
Weighted average assumptions:		
Discount rate:		
Benefit obligation	3.30%	4.40%
Net periodic benefit cost	4.40	3.90
Rate of compensation increase:		
Benefit obligation	N/A	N/A
Net periodic benefit cost	N/A	N/A
Expected return on plan assets	7.25	7.50
Components of net periodic benefit cost:		
Interest cost	\$ 40,721	38,391
Expected return on plan assets	(45,455)	(44,175)
Amortization of prior service cost	234	234
Amortization of actuarial loss	<u>8,681</u>	<u>10,743</u>
Net periodic benefit cost	<u>\$ 4,181</u>	<u>5,193</u>

The accumulated benefit obligation for the Plan was \$1,139,883 and \$942,994 at September 30, 2019 and 2018, respectively. As of September 30, 2019, OSF adopted the PRI-2012 mortality tables with generational improvements using a modified projection scale MP-2019. As of September 30, 2018, OSF adopted the RP-2014 Mortality Table with generational improvements using a modified projection scale MP-2018.

Benefit costs are included in other in the accompanying consolidated statements of operations and changes in net assets without donor restrictions.

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.

OSF is expected to contribute approximately \$6,356 to the Plan in 2020.

The benefits expected to be paid in each year 2020 through 2024 are approximately \$39,285, \$43,209, \$46,593, \$49,568, and \$52,171, respectively. The aggregate benefits expected to be paid in the five years from 2025 through 2029 are approximately \$289,975. The expected benefits are based on the same assumptions used to measure OSF's benefit obligation at September 30, 2019.

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.

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

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(In thousands)

The table below lists the target asset allocation and acceptable ranges and actual asset allocations as of September 30, 2019 and 2018:

<u>Asset</u>	<u>Target allocation</u>	<u>Acceptable range</u>	<u>Actual allocation at September 30</u>	
			<u>2019</u>	<u>2018</u>
Large cap equity	39%	34% to 44%	41.0%	42.3%
Small cap equity	6	1 to 11	5.7	7.4
International equity	20	15 to 25	18.2	19.2
Fixed income	35	30 to 40	34.5	30.0
Cash	—	—	0.6	1.1

### *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, 2019 and 2018.

- 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.

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.

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

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(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, 2019:

	<u>Fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Financial assets:				
Investments:				
Cash and cash equivalents	\$ 10,122	10,122	—	—
Domestic equities	185,056	185,056	—	—
U.S. Treasury obligations	52,015	52,015	—	—
U.S. government agencies	36,946		36,946	—
Municipal securities	925	—	925	—
Domestic corporate obligations	82,619	—	82,619	—
Domestic mutual funds – equities	967	967	—	—
Domestic mutual funds – bonds	13,663	13,663	—	—
Domestic commingled funds	113,636	93,920	19,716	—
Foreign equities	67,757	67,757	—	—
Foreign bonds	16,119	—	16,119	—
Subtotal	579,825	\$ 423,500	156,325	—
Foreign commingled funds	66,911			
Total financial assets	\$ 646,736			

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(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, 2018:

	<u>Fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
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			

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, 2019 and 2018.

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.

	<u>2019</u>	<u>2018</u>	<u>Redemption frequency</u>	<u>Days notice</u>
Foreign commingled funds	\$ 66,911	68,802	Monthly	10
Domestic commingled funds	113,636	114,569	Daily	2

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

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(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 2019 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 \$61,464 in 2019 and \$67,669 in 2018 to the retirement savings plan, which has been expensed as salaries and benefits expense. OSF also accrued for an anticipated discretionary contribution of \$10,038 in 2019 and \$11,236 in 2018, which has been expensed as salaries and benefits expense.

PCI sponsors a defined benefit pension plan, OSF Saint Francis, Inc. Employee Pension Plan, (PCI Plan) covering all employees who met the eligibility requirements. The plan was changed to eliminate benefit accruals after March 5, 2011. Prior to the plan change, PCI Plan benefits were based on years of service and the employee's compensation during those years of service. PCI'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 2019 and 2018 for the PCI 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 PCI Plan's funded status and amounts recognized in the consolidated financial statements at September 30, 2019:

	<b>2019</b>	<b>2018</b>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 69,816	71,682
Interest cost	3,023	2,792
Actuarial loss (gain)	12,042	(2,817)
Benefits paid	(2,027)	(1,841)
Benefit obligation at end of year	\$ 82,854	69,816
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 58,240	55,136
Actual return on plan assets	3,432	4,630
Employer contributions	710	315
Benefits paid	(2,027)	(1,841)
Fair value of plan assets at end of year	\$ 60,355	58,240
Reconciliation of funded status:		
Funded status	\$ (22,499)	(11,576)
Net amount recognized at year-end	\$ (22,499)	(11,576)

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

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(In thousands)

	<u>2019</u>	<u>2018</u>
Amounts recognized in the accompanying consolidated balance sheets:		
Accrued benefit liability	\$ (22,499)	(11,576)
Amounts not yet reflected in net periodic benefit cost and included as an accumulated credit to stockholder's equity:		
Net actuarial loss	\$ (32,556)	(20,325)
Prior service cost	<u>(261)</u>	<u>(271)</u>
Net amounts recognized in the accompanying consolidated balance sheets	\$ <u>(32,817)</u>	<u>(20,596)</u>
	<u>2019</u>	<u>2018</u>
Weighted average assumptions:		
Discount rate:		
Benefit obligation	3.30%	4.40%
Net periodic benefit cost	4.40	3.95
Rate of compensation increase:		
Benefit obligation	N/A	N/A
Net periodic benefit cost	N/A	N/A
Expected return on plan assets	7.25	7.50
Components of net periodic benefit cost:		
Interest cost	\$ 3,023	2,792
Expected return on plan assets	(4,124)	(3,912)
Amortization of actuarial loss	503	602
Amortization of prior service cost	<u>10</u>	<u>10</u>
Net periodic benefit cost	\$ <u>(588)</u>	<u>(508)</u>

The accumulated benefit obligation for the PCI Plan was \$82,854 and \$69,816 at September 30, 2019 and 2018, respectively. As of September 30, 2019, the PCI Plan adopted the PRI-2012 mortality tables with generational improvements using a modified projection scale MP-2019. As of September 30, 2018, the PCI Plan adopted the RP-2014 Mortality Table with generational improvements using a modified projection scale MP-2018.

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.

PCI is expected to contribute approximately \$1,285 to the PCI Plan in 2020.

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

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(In thousands)

The benefits expected to be paid in each year 2020 through 2024 for the PCI Plan are approximately \$2,487, \$2,769, \$3,017, \$3,289, and \$3,549, respectively. The aggregate benefits expected to be paid in the five years from 2025 through 2029 are approximately \$20,179.

The PCI Plan has a statement of investment policy, which is reviewed and approved by the PCI 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 PCI Plan as of September 30, 2019 and 2018:

<u>Asset</u>	<u>Target allocation</u>	<u>Acceptable range</u>	<u>Actual allocation at September 30</u>	
			<u>2019</u>	<u>2018</u>
Large cap equity	39%	34% to 44%	42.1%	42.7%
Small cap equity	6	0 to 11	5.0	5.8
International equity	20	15 to 25	17.6	17.9
Fixed income	35	30 to 40	34.0	32.8
Cash	—	—	1.3	0.8

The following table presents the PCI Plan's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2019:

	<u>Fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Financial assets:				
Investments:				
Cash and cash equivalents	\$ 764	764	—	—
Domestic mutual funds – equities	3,017	3,017	—	—
Domestic mutual funds – bonds	20,520	20,520	—	—
Domestic commingled funds	25,430	25,430	—	—
Foreign securities	10,624	10,624	—	—
Total financial assets	<u>\$ 60,355</u>	<u>60,355</u>	<u>—</u>	<u>—</u>

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(In thousands)

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

	<u>Fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
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	<u>\$ 58,240</u>	<u>58,240</u>	<u>—</u>	<u>—</u>

The PCI 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, 2019 and 2018.

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:

	<u>2019</u>	<u>2018</u>	<u>Redemption frequency</u>	<u>Days notice</u>
Domestic commingled funds	\$ 25,430	24,863	Daily	2

In addition, PCI participants in the OSF retirement savings plan that includes a 401(k) feature. In 2018 and 2019, participants may deposit an amount from 1% to 90% of their eligible compensation up to the IRS limit. PCI may make matching contributions equal to a discretionary percentage of the participant's contributions. PCI may also make annual discretionary contributions based on a participant's age and years of service. PCI contributed \$755 in 2019 and \$820 in 2018 to the retirement savings plan, which has been expensed as salaries and benefits expense. PCI also accrued for an anticipated discretionary contribution of \$125 in 2019 and \$136 in 2018, 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. OSF assumed SAHC's pension plan in 2015 in connection with the merger of SAHC.

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

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(In thousands)

The actuarial funding method used in the actuarial valuation for 2019 and 2018 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, 2019 and 2018. The following tables set forth the SAHC Plan's funded status and amounts recognized in OSF's consolidated financial statements at September 30, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 70,999	75,085
Interest cost	3,052	2,869
Actuarial loss (gain)	9,706	(3,880)
Benefits paid	(3,379)	(3,075)
Plan amendments	835	—
Benefit obligation at end of year	\$ <u>81,213</u>	<u>70,999</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 40,413	40,099
Actual return on plan assets	483	2,816
Employer contributions	669	573
Benefits paid	(3,379)	(3,075)
Fair value of plan assets at end of year	\$ <u>38,186</u>	<u>40,413</u>
Reconciliation of funded status:		
Funded status	\$ <u>(43,027)</u>	<u>(30,586)</u>
Net amount recognized at year-end	\$ <u>(43,027)</u>	<u>(30,586)</u>
Amounts recognized in the accompanying consolidated balance sheets:		
Accrued benefit liability	\$ (43,027)	(30,586)
Amounts not yet reflected in net periodic benefit cost and included as an accumulated credit to unrestricted net assets:		
Net actuarial loss	(35,831)	(24,224)
Prior service cost	(835)	—
Net amounts recognized in the accompanying consolidated balance sheets	\$ <u>(36,666)</u>	<u>(24,224)</u>

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

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(In thousands)

	<u>2019</u>	<u>2018</u>
Weighted average assumptions:		
Discount rate:		
Benefit obligation	3.30%	4.40%
Net periodic benefit cost	4.40	3.90
Rate of compensation increase:		
Benefit obligation	N/A	N/A
Net periodic benefit cost	N/A	N/A
Expected return on plan assets	7.25	7.50
Components of net periodic benefit cost:		
Interest cost	\$ 3,052	2,869
Expected return on plan assets	(3,008)	(3,031)
Amortization of net loss	<u>624</u>	<u>736</u>
Net periodic benefit cost	<u>\$ 668</u>	<u>574</u>

The accumulated benefit obligation for the SAHC Plan was \$81,213 and \$70,999 at September 30, 2019 and 2018, respectively. As of September 30, 2019, SAHC adopted the Pri-2012 mortality tables with generational improvements using a modified projection scale MP-2019. As of September 30, 2018, SAHC adopted the RP-2014 Mortality Table with generational improvements using a modified projection scale MP-2018.

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.

SAHC expects to contribute \$851 to the SAHC Plan in 2020.

The benefits expected to be paid in each year 2020 through 2024 for the SAHC Plan are approximately \$3,628, \$3,789, \$3,931, \$4,053, and \$4,175, respectively. The aggregate benefits expected to be paid in the five years from 2025 through 2029 are approximately \$22,485. The expected benefits are based on the same assumptions used to measure the SAHC Plan's benefit obligation at September 30, 2019.

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.

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(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, 2019 and 2018:

Asset	Target allocation	Acceptable range	September 30	
			2019	2018
Large cap equity	30%	20% to 40%	25.2%	24.0%
Small cap equity	15	10 to 30	15.0	15.9
International equity	20	0 to 15	11.0	13.2
Real estate securities	5	0 to 10	—	—
Fixed income	30	20 to 35	22.0	19.5
Cash	—	0 to 10	0.3	0.2
Balanced	—	—	26.5	—

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, 2019:

	Fair value	Level 1	Level 2	Level 3
Financial assets:				
Investments:				
Cash and cash equivalents	\$ 1,892	1,892	—	—
Domestic equities	13,844	13,844	—	—
U. S. Treasury obligations	4,006	4,006	—	—
U. S. government agencies	96	—	96	—
Domestic corporate obligations	3,534	—	3,534	—
Domestic mutual funds – equities	5,729	5,729	—	—
Domestic mutual funds – bonds	667	667	—	—
Foreign equities	2,528	2,528	—	—
Foreign bonds	427	—	427	—
Foreign mutual funds – equities	214	214	—	—
Foreign mutual funds – bonds	5,249	5,249	—	—
Total financial assets	\$ 38,186	34,129	4,057	—

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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(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, 2018:

	<u>Fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
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	<u>\$ 40,413</u>	<u>36,300</u>	<u>4,113</u>	<u>—</u>

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, 2019 and 2018.

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

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.

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(In thousands)

The actuarial funding method used in the actuarial valuation for 2019 and 2018 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, 2019 and 2018. The following table sets forth the IPMR Plan's funded status and amounts recognized in OSF's consolidated financial statements at September 30, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Benefit obligation at end of year	\$ 2,952	2,750
Fair value of plan assets at end of year – Level 1 investments	<u>2,241</u>	<u>2,301</u>
Funded status – Accrued benefit liability	\$ <u>(711)</u>	<u>(449)</u>
Amounts not yet reflected in net periodic benefit cost and included as an accumulated credit to unrestricted net assets:		
Net actuarial loss	\$ (1,288)	(910)
Prior service costs	<u>(52)</u>	<u>—</u>
Net amounts recognized in the accompanying consolidated balance sheets	\$ <u>(1,340)</u>	<u>(910)</u>
Weighted average assumptions:		
Discount rate:		
Benefit obligation	3.15%	4.35%
Net periodic benefit cost	4.35	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	7.25	7.50

The accumulated benefit obligation for the IPMR Plan was \$2,952 and \$2,750 at September 30, 2019 and 2018, respectively. As of September 30, 2019, the IPMR Plan adopted the Pri-2012 mortality tables with generational improvements using a modified projection scale MP-2019. As of September 30, 2018, the IPMR Plan adopted the RP-2014 Mortality Table with generational improvements using a modified projection scale MP-2018.

**OSF HEALTHCARE SYSTEM AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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(In thousands)

**(15) Functional Expenses**

OSF provides general healthcare services to residents within its respective geographic regions. Expenses related to providing these services for the years end September 30, 2019 and 2018 are as follows:

	<u>Healthcare Services</u>	<u>General and administration</u>	<u>Total</u>
2019:			
Salaries and benefits	\$ 1,301,067	413,276	1,714,343
Sisters' evaluated services	27	1,313	1,340
Supplies and other expenses	702,611	395,439	1,098,050
Depreciation and amortization	14,740	86,812	101,552
Interest	138	52,495	52,633
	<u>\$ 2,018,583</u>	<u>949,335</u>	<u>2,967,918</u>
2018:			
Total	\$ 1,868,539	879,312	2,747,851

**(16) Income Taxes**

Income tax expense attributable from revenues, gains, and other support over expenses was \$1,550 and \$259 for the years ended September 30, 2019 and 2018, 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, 2019 and 2018, PCI has a deferred tax asset related to these timing differences of \$8,935 and \$7,050, respectively, which is recorded within other assets in the consolidated balance sheets. As of September 30, 2019 and 2018, no valuation allowance against the PCI 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.

OSF generates “unrelated business” income subject to federal and state income taxes (UBIT). OSF recorded a UBIT receivable of \$178 and \$165 for the years ended September 30, 2019 and 2018, respectively. UBIT expense of \$685 and \$681 was recorded for the years ended September 30, 2019 and 2018, respectively, and is included in income tax within the consolidated statements of operations and changes in net assets without donor restrictions.

**(17) 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 2019 and 2018 were \$50,982 and \$58,360, respectively.

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(In thousands)

The following table is a schedule by year of future minimum lease payments to be made under operating leases as of September 30, 2019 that have initial or remaining lease terms in excess of one year:

	<u>Amount</u>
Year ending September 30:	
2020	\$ 46,631
2021	35,865
2022	27,464
2023	20,415
2024	14,048
Thereafter	63,042

### **(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 two frozen defined benefit pension plans (the Plans). The Plans have historically been funded based on the actuarially determined pension expense because the Plans qualify as "church plans" and are exempt from the funding requirements of the Employee Retirement Income Security Act (ERISA) of 1974. OSF has re-examined the status of its Plans and has determined the Plans continue to meet the criteria to qualify as "church plans" and are appropriately funded.

On May 6, 2016, plan participants filed a lawsuit in the U.S. District Court for the Southern District of Illinois challenging the Plans' eligibility to be treated as "church plans." OSF is vigorously defending the lawsuit consistent with long-standing positions of the U.S. Department of Treasury, the Internal Revenue Service, the U.S. Department of Justice, the Pension Benefit Guaranty Corporation, and the U.S. Department of Labor. Additionally, on June 5, 2017, the U.S. Supreme Court unanimously decided in *Advocate Health Care Network et al. v. Stapleton* that certain faith-based organizations' pension plans were "church plans."

The U.S. District Court for the Southern District granted OSF's motion for summary judgment on September 28, 2018 and dismissed the Plaintiffs' case. The Plaintiffs appealed the decision to the Seventh Circuit. The Seventh Circuit heard oral arguments on May 15, 2019 and issued an opinion on August 13, 2019. The Seventh Circuit rejected Plaintiffs' argument that OSF's internal administrative committees could not be entities that maintained and administered the Church Plans, but concluded there was a fact issue as to whether the committees were maintaining and administering the plans. Therefore, the court remanded the case for further discovery.

After the case was remanded, the parties participated in mediation on October 23, 2019, but were unable to come to an agreement. The parties will proceed with discovery in the case.

## OSF HEALTHCARE SYSTEM AND SUBSIDIARIES

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(In thousands)

### **(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**

Under Illinois law, not-for-profit hospitals are eligible for property tax exemptions under two provisions of the Property Tax Code. In general, facilities owned prior to June 2012 that are recognized by the Illinois Department of Revenue as exempt, such as SAMC, SFMC, SJJWAMC, SJMC, SMMC, and various ancillary facilities, hold such exemptions as institutions of public charity that use their properties exclusively for charitable purposes. Facilities built or acquired after that date that are recognized as exempt, such as HFMC, HMMC, SAHC, SEMC, SHMC, SLMC, SPMC, and various ancillary facilities, hold their exemptions under a section of the Property Tax Code applicable only to not-for-profit hospitals, which among other things requires such hospitals to certify annually that in the prior year they provided to low income and underserved individuals qualified services with a value at least equal to the estimated tax liability of their tax exempt property. This latter provision of the law was the subject of a constitutional challenge, but was found to be constitutional by the Illinois Supreme Court, so long as the not-for-profit hospital shows that it uses the applicable property exclusively for charitable purposes. OSF has not accrued any liability for property taxes and maintains the position that all of the facilities listed above are exempt from property taxes. Under Illinois law, sales tax exemptions are granted to not-for-profit hospitals in the same manner as described above.

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OSF applied for and was granted in 2019, retroactive to February 1, 2018, a property tax exemption for the HMMC campus. The Champaign County Board of Review, which recommended against granting the exemption, has, along with two taxing bodies, challenged in an administrative proceeding the Illinois Department of Revenue's decision to grant the exemption. OSF is vigorously defending the exempt status of this property and has filed a motion to dismiss the challenges. Concurrently, the Champaign County taxing authorities issued 2018 tax bills, payable in 2019, for the parcels comprising the HMMC campus. OSF brought suit in circuit court to require the Champaign County Board of Review to correct its books to recognize the Department of Revenue's grant of the exemption effective February 1, 2018, and to require the Champaign County Treasurer to rescind the tax bills. The court granted OSF's requested relief through a summary judgment order. The taxing authorities' window for appeal of this order will close on January 20, 2020. Finally, the Champaign County Board of Review issued notices of assessment, applicable to the 2019 tax year, for the parcels comprising the HMMC campus. OSF has challenged the Board of Review's proposed assessments, on the grounds that the parcels are exempt from taxation; these challenges remain outstanding.

In a separate action, the Peoria Public Schools District 150 has challenged in an administrative proceeding the Illinois Department of Revenue's grant of a property tax exemption to the Jump Trading Education and Simulation Center, a facility located on its own parcel on the SFMC campus. The proceeding is in the initial stages of discovery and OSF is vigorously defending the exempt status of the property.

### **(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.

### **(18) 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, 2019 through January 29, 2020, which was the date the consolidated financial statements were issued.

In October 2019, OSF signed a merger agreement with Little Company of Mary Medical Center, a not-for-profit health system located in Evergreen Park, Illinois. The merger effective date is planned for February 1, 2020. The new name for the facility will be OSF HealthCare Little Company of Mary Medical Center.