OSF
HEALTHCARE SYSTEM

800 N.E. Glen Oak Avenue, Peoria, Illinois 61603-3200 Phone (309) 655-2850

ORIGINAL

E-020-13

RECEIVED

SEP 20 2013

HEALTH FACILITIES &
SERVICES REVIEW BOARD

September 17, 2013

Ms. Courtney R. Avery, Administrator
Illinois Health Facilities and Services Review Board
525 West Jefferson Street, 2nd Floor
Springfield, Illinois 62761

Re: COE Permit Application
Kewanee Hospital affiliation with
OSF Healthcare System

Dear Ms. Avery:

This COE Permit Application provides the majority of the information required by the Health Facilities and Services Review Board (HFSRB) to evaluate Kewanee Hospital's affiliation with the OSF Healthcare System. The proposed affiliation is consistent with the State Agency's underlying charter and the United States Healthcare System's transformation embodied in the Affordable Care Act.

This specific COE documentation is being submitted without the final transaction documents which are still being reviewed by the parties. This final material will be submitted 30 days prior to a scheduled Review Board meeting. In addition, letters of support will be forthcoming.

There is no cost to the transaction and we propose to close after approval by the HFSRB which is expected at your December 17, 2013 meeting. Based on this assumed approval date, the transaction is expected to close in late spring 2014 or before May 30, 2014.

Our check in the amount of $2,500.00 is enclosed as the COE processing fee.

We look forward to working with you and your staff on this important project for our respective communities and region.

Please contact Mark Hohulin at 309-624-2360 if additional information is required.

Sincerely,

On behalf of Kewanee Hospital
Lynn A. Fulton
Signature
Lynn A. Fulton
Printed Name
CEO
Title

On behalf of OSF Healthcare System
K. D. Schoeplein
Signature
KEVIN D. SCHOEPLEIN
Printed Name
CEO
Title

c: Mike Constantino

COE
for the
Change of Ownership
to Affiliate

Kewanee Hospital
Kewanee, Illinois

Into the

OSF Healthcare System
Peoria, Illinois

September 18, 2013

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Kewanee Hospital and OSF Healthcare

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ORIGINAL

E-020-13

ILLINOIS HEALTH FACILITIES AND SERVICES REVIEW BOARD
APPLICATION FOR EXEMPTION FOR THE
CHANGE OF OWNERSHIP FOR AN EXISTING HEALTH CARE FACILITY

RECEIVED
SEP 20 2013
HEALTH FACILITIES & SERVICES REVIEW BOARD

1. **INFORMATION FOR EXISTING FACILITY**

Current Facility Name Kewanee Hospital
Address 1051 West South Street
City Kewanee Zip Code 61443 County Henry
Name of current licensed entity for the facility Kewanee Hospital
Does the current licensee: own this facility X OR lease this facility____(if leased, check if sublease □)
Type of ownership of the current licensed entity (check one of the following) ____ Sole Proprietorship
X Not-for-Profit Corporation ____ For Profit Corporation ____ Partnership ____ Governmental
____ Limited Liability Company ____ Other, specify ____
Illinois State Senator for the district where the facility is located: Sen. Darin LaHood
State Senate District Number 37 Mailing address of the State Senator M103F Capitol Building, Springfield, Illinois 62706 / 5415 N. University, Suite 105 Peoria, Illinois 61614
Illinois State Representative for the district where the facility is located: Rep. Donald L. Moffitt
State Representative District Number 74 Mailing address of the State Representative 271-N Stratton Office Building, Springfield, Illinois 62706 / 64 S. Prairie Street, #5, Galesburg, Illinois 61401

2. **OUTSTANDING PERMITS**. Does the facility have any projects for which the State Board issued a permit that will not be completed (refer to 1130.140 "Completion or Project Completion" for a definition of project completion) by the time of the proposed ownership change? Yes □ No ☒. If yes, refer to Section 1130.520(f), and indicate the projects by Project # ____

3. **FACILITY'S OTHER CATEGORIES OF SERVICE AS DEFINED IN 77 IAC 1100** (Complete "APPENDIX A" attached to this application)

4. **NAME OF APPLICANT** (complete this information for each co-applicant and insert after this page).
Exact Legal Name of Applicant Kewanee Hospital
Address 1051 West South Street
City Kewanee Zip Code 61443 County Henry
Type of ownership of the current licensed entity (check one of the following) ____ Sole Proprietorship
X Not-for-Profit Corporation ____ For Profit Corporation ____ Partnership ____ Governmental
____ Limited Liability Company ____ Other, specify ____

5. **NAME OF LEGAL ENTITY THAT WILL BE THE LICENSEE/OPERATING ENTITY OF THE FACILITY NAMED IN THE APPLICATION AS A RESULT OF THIS TRANSACTION.** Exact Legal Name of Entity to be Licensed OSF Healthcare System (See Affiliation Agreement)
Address 800 NE Glen Oak Ave.
City, State & Zip Code Peoria, Illinois 61603
Type of ownership of the current licensed entity (check one of the following:) ____ Sole Proprietorship
X Not-for-Profit Corporation ____ For Profit Corporation ____ Partnership ____ Governmental
____ Limited Liability Company ____ Other, specify ____

6. **BUILDING/SITE OWNERSHIP. NAME OF LEGAL ENTITY THAT WILL OWN THE "BRICKS AND** MORTAR" (BUILDING) OF THE FACILITY NAMED IN THIS APPLICATION IF DIFFERENT FROM THE OPERATING/LICENSED ENTITY
Exact Legal Name of Entity That Will Own the Site OSF Healthcare System
Address 800 NE. Glen Oak Avenue
City, State & Zip Code Peoria, Illinois 61603
Type of ownership of the current licensed entity (check one of the following) ____ Sole Proprietorship
X Not-for-Profit Corporation ____ For Profit Corporation ____ Partnership ____ Governmental
____ Limited Liability Company ____ Other, specify ____

ILLINOIS HEALTH FACILITIES AND SERVICES REVIEW BOARD
APPLICATION FOR EXEMPTION FOR THE
CHANGE OF OWNERSHIP FOR AN EXISTING HEALTH CARE FACILITY

1. INFORMATION FOR EXISTING FACILITY

Current Facility Name Not Applicable – Co-Applicant Information
Address ______
City ______ Zip Code ______ County ______
Name of current licensed entity for the facility ______
Does the current licensee: own this facility ______OR lease this facility______(if leased, check if sublease □)
Type of ownership of the current licensed entity (check one of the following: ______ Sole Proprietorship
______ Not-for-Profit Corporation ______ For Profit Corporation ______ Partnership ______ Governmental
______ Limited Liability Company ______ Other, specify ______
Illinois State Senator for the district where the facility is located: Sen. ______
State Senate District Number ______ Mailing address of the State Senator ______
Illinois State Representative for the district where the facility is located: Rep. ______
State Representative District Number ____ Mailing address of the State Representative ______

2. OUTSTANDING PERMITS. Does the facility have any projects for which the State Board issued a permit that will not be completed (refer to 1130.140 "Completion or Project Completion" for a definition of project completion) by the time of the proposed ownership change? Yes □ No □. If yes, refer to Section 1130.520(f), and indicate the projects by Project # ______

3. FACILITY'S OTHER CATEGORIES OF SERVICE AS DEFINED IN 77 IAC 1100 (Complete "APPENDIX A" attached to this application)

4. NAME OF APPLICANT (complete this information for each co-applicant and insert after this page).
Exact Legal Name of Applicant OSF Healthcare System
Address 800 NE Glen Oak Avenue
City Peoria Zip Code 61603 County Peoria
Type of ownership of the current licensed entity (check one of the following) ______ Sole Proprietorship
X Not-for-Profit Corporation ______ For Profit Corporation ______ Partnership ______ Governmental
______ Limited Liability Company ______ Other, specify ______

5. NAME OF LEGAL ENTITY THAT WILL BE THE LICENSEE/OPERATING ENTITY OF THE FACILITY NAMED IN THE APPLICATION AS A RESULT OF THIS TRANSACTION.
Licensed OSF Healthcare System
Address 800 NE. Glen Oak Avenue
City, State & Zip Code Peoria, Illinois 61603
Type of ownership of the current licensed entity (check one of the following:) ______ Sole Proprietorship
X Not-for-Profit Corporation ______ For Profit Corporation ______ Partnership ______ Governmental
______ Limited Liability Company ______ Other, specify ______

6. BUILDING/SITE OWNERSHIP. NAME OF LEGAL ENTITY THAT WILL OWN THE "BRICKS AND MORTAR" (BUILDING) OF THE FACILITY NAMED IN THIS APPLICATION IF DIFFERENT FROM THE OPERATING/LICENSED ENTITY
Exact Legal Name of Entity That Will Own the Site OSF Healthcare System
Address 800 NE. Glen Oak Avenue
City, State & Zip Code Peoria, Illinois 61603
Type of ownership of the current licensed entity (check one of the following) ______ Sole Proprietorship
X Not-for-Profit Corporation ______ For Profit Corporation ______ Partnership ______ Governmental
______ Limited Liability Company ______ Other, specify ______

7. **TRANSACTION TYPE. CHECK THE FOLLOWING THAT APPLY TO THE TRANSACTION:**
   - o Purchase resulting in the issuance of a license to an entity different from current licensee;
   - o Lease resulting in the issuance of a license to an entity different from current licensee;
   - o Stock transfer resulting in the issuance of a license to a different entity from current licensee;
   - o Stock transfer resulting in no change from current licensee;
   - ☒ Assignment or transfer of assets resulting in the issuance of a license to an entity different from the current licensee;
   - o Assignment or transfer of assets not resulting in the issuance of a license to an entity different from the current licensee;
   - o Change in membership or sponsorship of a not-for-profit corporation that is the licensed entity;
   - o Change of 50% or more of the voting members of a not-for-profit corporation's board of directors that controls a health care facility's operations, license, certification or physical plant and assets;
   - o Change in the sponsorship or control of the person who is licensed, certified or owns the physical plant and assets of a governmental health care facility;
   - o Sale or transfer of the physical plant and related assets of a health care facility not resulting in a change of current licensee;
   - ☒ Any other transaction that results in a person obtaining control of a health care facility's operation or physical plant and assets, and explain in "Attachment 3 Narrative Description" **(The transaction is a statutory merger per the affiliation agreement ... Attachments 3 and 5)**

8. **APPLICATION FEE.** Submit the application fee in the form of a check or money order for $2,500 payable to the Illinois Department of Public Health and append as **ATTACHMENT #1.**

9. **FUNDING.** Indicate the type and source of funds which will be used to acquire the facility (e.g., mortgage through Health Facilities Authority; cash gift from parent company, etc.) and append as **ATTACHMENT #2.**

10. **ANTICIPATED ACQUISITION PRICE: $** -0-

11. **FAIR MARKET VALUE OF THE FACILITY: $** 54.846 mil (See Attachment 3)
(to determine fair market value, refer to 77 IAC 1130.140)

12. **DATE OF PROPOSED TRANSACTION:** Expected to be prior to May 30, 2014

13. **NARRATIVE DESCRIPTION.** Provide a narrative description explaining the transaction, and append it to the application as **ATTACHMENT #3.**

14. **BACKGROUND OF APPLICANT** (co-applicants must also provide this information). Corporations and Limited Liability Companies must provide a current Certificate of Good Standing from the Illinois Secretary of State. Limited Liability Companies and Partnerships must provide the name and address of each partner/ member and specify the percentage of ownership of each. Append this information to the application as **ATTACHMENT #4.**

15. **TRANSACTION DOCUMENTS.** Provide a copy of the complete transaction document(s) including schedules and exhibits which detail the terms and conditions of the proposed transaction (purchase, lease, stock transfer, etc). Applicants should note that the document(s) submitted should reflect the applicant's (and co-applicant's, if applicable) involvement in the transaction. The document must be signed by both parties and contain language stating that the transaction is contingent upon approval of the Illinois Health Facilities and Services Review Board. Append this document(s) to the application as **ATTACHMENT #5.**

17. **FINANCIAL STATEMENTS.** (Co-applicants must also provide this information) Provide a copy of the applicants latest audited financial statements, and append it to this application as ATTACHMENT #6 (Attached). If the applicant is a newly formed entity and financial statements are not available, please indicate by checking YES ____, and indicate the date the entity was formed ______ (Not Applicable; existing entity)

Information attached:

1. OSF Healthcare System is an A-rated organization
2. Kewanee Hospital financials attached

18. **PRIMARY CONTACT PERSON.** Individual representing the applicant to whom all correspondence and inquiries pertaining to this application are to be directed. (Note: other persons representing the applicant not named below will need written authorization from the applicant stating that such persons are also authorized to represent the applicant in relationship to this application).

OSF Healthcare System

Name: Mark Hohulin Decision Support Services

Address: 800 NE Glen Oak Ave.

City, State & Zip Code: Peoria, Illinois 61603

Telephone (309) 624-2360 Ext.

18. **PRIMARY CONTACT PERSON.** Individual representing the applicant to whom all correspondence and inquiries pertaining to this application are to be directed. (Note: other persons representing the applicant not named below will need written authorization from the applicant stating that such persons are also authorized to represent the applicant in relationship to this application).

Kewanee Hospital

Name: Lynn A. Fulton, CEO Kewanee Hospital

Address: 1051 West South Street, P.O. Box 747

City, State & Zip Code: Kewanee, Illinois 61443

Telephone (309) 852-7521 Ext.

19. **ADDITIONAL CONTACT PERSON.** Consultant, attorney, other individual who is also authorized to discuss this application and act on behalf of the applicant.

OSF Healthcare System

Name: Ajay Pathak Director of Strategic Business Development OSF Healthcare System

Address: 800 NE Glen Oak Avenue

City, State & Zip Code: Peoria, Illinois 61603

Telephone (309) 624-3743 Ext

19. **ADDITIONAL CONTACT PERSON.** Consultant, attorney, other individual who is also authorized to discuss this application and act on behalf of the applicant.

Kewanee Hospital

Name: Douglas B. Swill Drinker Biddle & Reath LLP

Address: 191 N. Wacker Drive Suite 3700

City, State & Zip Code: Chicago, Illinois 60606

Telephone (312) 569-1270 Ext.

19. **ADDITIONAL CONTACT PERSON.** Consultant, attorney, other individual who is also authorized to discuss this application and act on behalf of the applicant.

Name: Michael Henderson, Corporate Attorney, OSF Healthcare System

Address: 530 NE Glen Oak Avenue

City, State & Zip Code: Peoria, Illinois 61637

Telephone (309) 655-2402 Ext.

19. **ADDITIONAL CONTACT PERSON.** Consultant, attorney, other individual who is also authorized to discuss this application and act on behalf of the applicant.

OSF Healthcare System

Name: Edwin W. Parkhurst, Jr. Managing Principal PRISM Healthcare Consulting

Address: 800 Roosevelt Road, Bldg. E., Suite 110

City, State & Zip Code: Glen Ellyn, Illinois 60137

Telephone (630) 790-5089 Ext.

19. **ADDITIONAL CONTACT PERSON.** Consultant, attorney, other individual who is also authorized to discuss this application and act on behalf of the applicant.

OSF Healthcare System

Name Stephen Moore

Address Hinshaw & Culbertson LLP, 100 Park Avenue, P.O. Box 1389

City, State & Zip Code Rockford, Illinois 61602

Telephone (815) 490-4900 Ext.

20. CERTIFICATION Kewanee Hospital

I certify that the above information and all attached information are true and correct to the best of my knowledge and belief. I certify that the number of beds within the facility will not change as part of this transaction. I certify that no adverse action has been taken against the applicant(s) by the federal government, licensing or certifying bodies, or any other agency of the State of Illinois. I certify that I am fully aware that a change in ownership will void any permits for projects that have not been completed unless such projects will be completed or altered pursuant to the requirements in 77 IAC 1130.520(f) prior to the effective date of the proposed ownership change. I also certify that the applicant has not already acquired the facility named in this application or entered into an agreement to acquire the facility named in the application unless the contract contains a clause that the transaction is contingent upon approval by the State Board.

Lynn A. Fulton

Signature of Authorized Officer

Typed or Printed Name of Authorized Officer Lynn A. Fulton

Title of Authorized Officer: Chief Executive Officer, Kewanee Hospital

Address 1051 West South Street

City, State & Zip Code Kewanee, Illinois 61443

Date: 9/12/2013

NOTE: complete a separate signature page for each co-applicant and insert following this page.

20. CERTIFICATION OSF Healthcare System

I certify that the above information and all attached information are true and correct to the best of my knowledge and belief. I certify that the number of beds within the facility will not change as part of this transaction. I certify that no adverse action has been taken against the applicant(s) by the federal government, licensing or certifying bodies, or any other agency of the State of Illinois. I certify that I am fully aware that a change in ownership will void any permits for projects that have not been completed unless such projects will be completed or altered pursuant to the requirements in 77 IAC 1130.520(f) prior to the effective date of the proposed ownership change. I also certify that the applicant has not already acquired the facility named in this application or entered into an agreement to acquire the facility named in the application unless the contract contains a clause that the transaction is contingent upon approval by the State Board.

Signature of Authorized Officer

Typed or Printed Name of Authorized Officer Kevin Schoeplein

Title of Authorized Officer: Chief Executive Officer, OSF Healthcare System

Address 800 Glen Oak Avenue

City, State & Zip Code Peoria, Illinois 61603

Telephone (309) 655-4982 Date: 9/18/13

NOTE: complete a separate signature page for each co-applicant and insert following this page.

APPENDIX A

FACILITY BED AND DIALYSIS STATION CAPACITY AND CATEGORIES OF SERVICE

Complete the following for the facility for which the change of ownership is requested. The facility's bed and dialysis station capacity must be consistent with the State Board's Inventory of Health Care Facilities.

FACILITY NAME Kewanee Hospital CITY: Kewanee

Indicate (by placing an "X") the type of facility for which the change of ownership is requested:

☒ Hospital; ☐ Long-term Care Facility; ☐ Dialysis Facility; ☐ Ambulatory Surgical Treatment Center.

Provide the bed capacity by category of service: (Provided, but not required by new forms)

SERVICE	# of Beds	SERVICE	# of Beds
Medical/Surgical	22	Nursing Care	0
Obstetrics	0	Shelter Care	0
Pediatrics	0	DD Adults*	0
Intensive Care	3	DD Children**	0
Acute Mental Illness	0	Chronic Mental Illness	0
Rehabilitation	0	Children's Medical Care	0
Neonatal Intensive Care	0	Children's Respite Care	0

*Includes ICF/DD 16 and fewer bed facilities; **Includes skilled pediatric 22 years and under

Chronic Renal Dialysis: Enter the number of ESRD stations: ____________

Indicate (by placing an "X") those categories of service for which the facility is approved.

_____ Cardiac Catheterization
_____ Subacute Care Hospital Model
_____ Selected Organ Transplantation
_____ Open Heart Surgery
_____ Kidney Transplantation
_____ Postsurgical Recovery Care Center Model

Non-Hospital Based Ambulatory Surgery and Ambulatory Surgical Treatment Centers

Indicate (by placing an "X") if the facility is a ☐ limited or ☐ multi-specialty facility and indicate the surgical specialties provided.

_____ Cardiovascular
_____ Dermatology
_____ Gastroenterology
_____ General/Other (includes any procedure that is not included in the other specialties)
_____ Neurological
_____ Obstetrics/Gynecology
_____
_____ Ophthalmology
_____ Oral/Maxillofacial
_____ Orthopedic
_____ Otolaryngology
_____ Plastic Surgery
_____ Podiatry
_____ Thoracic
_____ Urology

APPENDIX A

FACILITY BED AND DIALYSIS STATION CAPACITY AND CATEGORIES OF SERVICE

Complete the following for the facility for which the change of ownership is requested. The facility's bed and dialysis station capacity must be consistent with the State Board's Inventory of Health Care Facilities.

FACILITY NAME OSF Healthcare System CITY: Peoria

Indicate (by placing an "X") the type of facility for which the change of ownership is requested:

☐ Hospital; ☐ Long-term Care Facility; ☐ Dialysis Facility; ☐ Ambulatory Surgical Treatment Center.

Provide the bed capacity by category of service:

SERVICE	# of Beds	SERVICE	# of Beds
Medical/Surgical		Nursing Care	
Obstetrics		Shelter Care	
Pediatrics		DD Adults*	
Intensive Care		DD Children**	
Acute Mental Illness		Chronic Mental Illness	
Rehabilitation		Children's Medical Care	
Neonatal Intensive Care		Children's Respite Care	

*Includes ICF/DD 16 and fewer bed facilities; **Includes skilled pediatric 22 years and under

Chronic Renal Dialysis: Enter the number of ESRD stations: ____________________

Indicate (by placing an "X") those categories of service for which the facility is approved.

_____ Cardiac Catheterization
_____ Subacute Care Hospital Model
_____ Selected Organ Transplantation
_____ Open Heart Surgery
_____ Kidney Transplantation
_____ Postsurgical Recovery Care Center Model

Non-Hospital Based Ambulatory Surgery and Ambulatory Surgical Treatment Centers

Indicate (by placing an "X") if the facility is a ☐ limited or ☐ multi-specialty facility and indicate the surgical specialties provided.

_____ Cardiovascular
_____ Dermatology
_____ Gastroenterology
_____ General/Other (includes any procedure that is not included in the other specialties)
_____ Neurological
_____ Obstetrics/Gynecology
_____ Ophthalmology
_____ Oral/Maxillofacial
_____ Orthopedic
_____ Otolaryngology
_____ Plastic Surgery
_____ Podiatry
_____ Thoracic
_____ Urology

Note: OSF Healthcare System is not a Hospital Facility by definition, but is the parent of several operating hospitals; thus, it does not, in and of itself, have beds or categories of services.

Attachment #1
Fee Information

Permit application fee in the amount of $2,500.00 payable to Illinois Department of Public Health

Attachment #2
Funding

Subject to underlying approvals as outlined in the Affiliation Agreement (which will be submitted under separate cover) between OSF Healthcare System and Kewanee Hospital, at closing, all obligations issued under the Kewanee Master Indenture and any related bond documents, that are outstanding on the Closing Date will be assumed by the OSF Obligated Group, and the covenants protecting the bondholders and the specific revenue sources and assets of Kewanee pledged for payment of the subject obligations issued under the Kewanee Master Indenture and any related bond documents will be replaced by the security for the obligations issued under the OSF Master Indenture in accordance with the underlying Plan of Finance. In the event that requisite bondholder approvals are not obtained for substitution of security described above, the Plan of Finance requires OSF Healthcare System to retire the bonds secured by the Kewanee Master Indenture.

OSF Healthcare System is an A-rated organization as evidenced by the attached rating statements dated September 12, 2013.

See also Attachment 6 for required financial statements.

MOODY'S
INVESTORS SERVICE

Rating Update: Moody's revises OSF Healthcare System's outlook to negative; A3 rating affirmed

Global Credit Research - 12 Sep 2013

Action affects $790 million of debt

ILLINOIS FINANCE AUTHORITY
Hospitals & Health Service Providers
IL

Opinion

NEW YORK, September 12, 2013 --Moody's Investors Service has affirmed OSF Healthcare System's (OSF) A3 rating and revised the outlook to negative from positive, affecting debt listed under the RATED DEBT section. The outlook reflects a significant decline in margins in nine months of fiscal year 2013 and economic and competitive challenges to hitting improvement targets.

SUMMARY RATINGS RATIONALE

The A3 rating is based on OSF's large, multi-site system and expanding presence in several distinct health care markets in northern and central Illinois, leading market positions in the largest markets, solid and liquid investment position, and manageable capital needs. OSF's challenges include a large decline in margins in the 9-months of 2013, higher-than-average direct leverage relative to the rating category and sizable indirect debt, and growing competition in most markets.

The outlook revision to negative from positive reflects a large decline in margins in 2013, following lower than expected performance at the end of fiscal year 2012. While total volumes are relatively stable in most markets, the system experienced an unfavorable change in service line mix with a loss of more profitable volumes. Margins have also been affected by strategies and increased investment in physician employment. While the system is implementing cost reductions to improve performance, we believe progress may be slower than projected given competitive and general industry-wide challenges. A rating downgrade will be considered in the absence of significant operating improvement as projected for fiscal year 2014.

STRENGTHS

*OSF is a large, multi-site system with nearly $2 billion in operating revenue and expanding presence in several distinct healthcare markets in northern and central Illinois. Physician alignment strategies and facilities investments are contributing to relatively stable admissions in most markets.

*The system has a distinctly leading market position in the primary service area (PSA) in and around the City of Peoria, the site of OSF's flagship, Saint Francis Medical Center.

*Unrestricted investments have grown to a solid 178 days cash on hand as of June 30, 2013 from 171 days at FYE 2012 and conservative asset allocation (70% cash and fixed income) provides good liquidity.

*Debt structure risks are manageable with 261% monthly cash-to-demand debt.

*Capital spending is moderating as the system has completed its Milestone patient tower project, installed the Epic information technology system, and completed other projects; management plans to limit future spending to slightly higher than depreciation until operating cashflow improves.

CHALLENGES

*The system reported a significant decline in operating performance (5.3% operating cashflow margin and -1.2% operating margin) through nine months of fiscal year 2013, following lower-than-expected performance in 2012.

*OSF faces strong competition in most of its markets, particularly for profitable services, contributing to large revenue shortfalls to budget in 2013.

*OSF's leverage is higher than average and debt measures weakened with the recent decline in performance. Based on annualized nine-month results for fiscal year 2013, debt-to-revenue and debt-to-cashflow are both high at 46% and 6.5 times, respectively, and peak debt service coverage is low at 2.8 times.

*Indirect debt obligations, including operating leases and an underfunded pension plan, result in a comparatively weak cash-to-comprehensive debt of 52% at fiscal yearend 2012. As a church plan, OSF's defined benefit pension plan is not subject to ERISA funding requirements and the plan was completely frozen in March 2011.

*A relatively high reliance on Medicaid (16% of gross revenues in FY 2012 compared to A3 median of 13%) heightens OSF's vulnerability to the State of Illinois's reimbursement delays.

DETAILED CREDIT DISCUSSION

LEGAL SECURITY: Debt service on the bonds is secured by a pledge of unrestricted receivables of the Obligated Group, the largest member of which is the OSF Healthcare System (OSF). OSF is the parent organization of eight acute care hospitals and several other organizations. Our analysis refers to the consolidated financial statements of OSF Healthcare System and Subsidiaries.

INTEREST RATE DERIVATIVES: OSF is a party to four interest rate swap agreements with a total notional amount of $240 million. The counterparty on each agreement is Bank of America, N.A. The swaps are floating to fixed rate agreements under which OSF pays fixed rates ranging from 3.65% to 3.97% to the counterparty in exchange for payments based on variable rate indices (SIFMA or LIBOR). As of June 30, 2013, the cumulative mark to market valuation of the swaps was a negative $44 million. The swaps are insured by Assured Guaranty. Collateral posting is not required unless Assured's rating falls below A3 or the equivalent by at least one rating agency; the system has not had to post collateral.

RECENT DEVELOPMENTS/RESULTS

The major development over the last year is a steep decline in OSF's operating performance through nine months of fiscal year 2013, following lower than expected performance at the end of fiscal year 2012. While the system is implementing a major improvement program, we believe competitive and industry-wide challenges will make it difficult to achieve projected targets for the next year.

Compared with nine months (ended June) of fiscal year 2012, the basis for the prior rating action and positive outlook, full year 2012 operating performance was lower than expected and fiscal year 2011. Operating income in fiscal year 2012 was $18 million (1.0%, adjusted for items noted below), compared with $36 million (1.9%) in fiscal year 2011; operating cashflow was $147 million (7.8%), compared with $172 million (9.2%) in 2011. Fiscal year 2012 was expected to be on par with 2011. The shortfall in the fourth quarter was related to the timing of end of year writeoffs related to receivables and charity care, the beginning on volume issues experienced in fiscal year 2013 and investments in care coordination and population management strategies.

Through nine months of fiscal year 2013, operating performance was significantly below budget and the prior year. OSF had an operating loss of $17 million (-1.2%) adjusted for the items below, compared with operating income of $16 million (1.1%) in the prior year period. Operating cashflow was $77 million (5.3%), compared with $124 million (8.9%) in the prior year. The decline was due to both revenue and expense challenges. Operating performance reported at each hospital reflects these issues, with Peoria declining from a large profit to a slightly better than breakeven performance, Rockford reporting a large operating loss, and Bloomington declining notably.

Admissions for the total system and most major markets were relatively stable in 2013 compared with the prior year; however, an unfavorable change in the mix of services and loss of more profitable cases to competitors drove low revenue growth of 2%. Volume issues were driven by both internal and external factors. In Peoria, volume issues related to capacity constraints in part due to equipment in several departments temporarily taken offline and volume going to competitors, and increased use of care coordinators which reduced use rates in certain areas (OSF is a Pioneer ACO organization). As one of the few Pioneer ACOs in the country, OSF has been investing in care coordinators and quality initiatives to better manage the population, which is reducing utilization. External factors, reflecting industry-wide challenges, include changes in employer coverage and higher deductible plans, resulting in less outpatient volume.

OSF's operating decline is also due to large investments in employing physicians, including acquiring several large groups over the last few years. The system has reorganized and consolidated the physician organization, which should allow improvements in productivity. The system is targeting to reduce referral leakage related to those practices, particularly as further population management strategies are implemented.

With the assistance of consultants, the system is implementing a large improvement program, primarily centered around cost reductions and expected to expected to result in operating cashflow margins better than fiscal year 2012. The system started its improvement program in 2011, but is now accelerating annual targets due to challenges in 2013. The program has a target of $80 million in fiscal year 2014, growing to $235 million by fiscal year 2017. Major initiatives include reimbursement opportunities, productivity improvement and supplies, among other areas. While this is a major program that should improve results, we believe increasing competition and issues specific to OSF will make it difficult to achieve targets. OSF's specific challenges relate to maintaining volumes in the face of capacity constraints and competition while cutting costs and increasing physician referrals.

OSF's capital spending has slowed since 2011 with the completion of a large patient tower and installation of Epic, as well as a number of other projects. Capital spending is anticipated to remain slightly higher than depreciation until operating cashflow improves; capital spending approvals are now tied to cashflow generation at the individual hospitals. Moderate capital spending should enable the system to preserve its good investment position, which has grown to 178 days cash on hand as of June 30, 2013 (from 171 days at FYE 2012). The system will be releasing close to $45 million of debt service funds as part of an upcoming restructuring of certain debt pieces. A conservative asset allocation limits risk to equities.

OSF's pension plan is a Church plan and, therefore, not subject to ERISA requirements. The system's philosophy is to fund at pension expense levels. However, compared with other health systems, the pension obligation is large and, combined with operating leases, results in a weak cash-comprehensive debt measure of 52% for fiscal year 2012. With an increase in the discount rate, management expects a fairly large decline in the obligation in fiscal year 2013.

OUTLOOK

The outlook revision to negative from positive reflects a large decline in margins in 2013, following lower than expected performance at the end of fiscal year 2012. While total volumes are relatively stable in most markets, the system experienced an unfavorable change in service line mix with a loss of more profitable volumes. Margins have also been affected by strategies and increased investment in physician employment. While the system is implementing cost reductions to improve performance, we believe progress may be slower than projected given competitive and general industry-wide challenges. A rating downgrade will be considered in the absence of significant operating improvement as projected for fiscal year 2014.

WHAT COULD MAKE THE RATING GO UP

With a negative outlook, a rating upgrade is not likely in the short term. Longer-term, a rating upgrade will be considered if operating cashflow margins improved and are sustained at higher levels for several years, the current investment position is maintained and no new debt is issued.

WHAT COULD MAKE THE RATING GO DOWN

A rating downgrade will be considered in the absence of significant operating improvement as projected for fiscal year 2014 or if the system has a material increase in debt.

KEY INDICATORS

Assumptions & Adjustments:

-Based on financial statements for OSF Healthcare System

-First number reflects audit year ended September 30, 2012

-Second number reflects unaudited nine-month results (ended June 30, 2013), annualized

-Investment returns normalized at 6% unless otherwise noted

-Comprehensive debt includes direct debt, operating leases, and pension obligation, if applicable

-Monthly liquidity to demand debt ratio is not included if demand debt is de minimis

-Non-recurring items or adjustments: fiscal year 2012 excludes $12 million Medicare rural floor settlement; FY12 and FY13 exclude gifts and investment income from operating revenue and reclassify net settlement of derivatives to operating expenses

*Inpatient admissions: 58,904; 60,228

*Observation stays: 13,841; N/A

*Medicare % of gross revenues: 44.6%; N/A

*Medicaid % of gross revenues: 15.9%; N/A

*Total operating revenues ($): $1.9 billion; $1.9 billion

*Revenue growth rate (%) (3 yr CAGR): 6.5%; N/A

*Operating margin (%): 1.0%; -1.2%

*Operating cash flow margin (%): 7.8%; 5.3%

*Debt to cash flow (x): 5.3 times; 6.5 times

*Days cash on hand: 171 days; 178 days

*Maximum annual debt service (MADS) ($): $59 million; $59 million

*MADS coverage with reported investment income (x): 3.3 times; 2.4 times

*Moody's-adjusted MADS Coverage with normalized investment income (x): 3.6 times; 2.8 times

*Direct debt ($): $888 million; $887 million

*Cash to direct debt (%): 94%; 101%

*Comprehensive debt: $1.6 billion; N/A

*Cash to comprehensive debt (%): 52%; N/A

*Monthly liquidity to demand debt (%): 261%; N/A

RATED DEBT (debt outstanding as of September 30, 2012)

-Series 2012A fixed rate bonds, $180 million, rated A3

-Series 2010A fixed rate bonds, $159 million, rated A3

-Series 2009A fixed rate bonds, $83 million, rated A3

-Series 2009B variable rate bonds, $50 million, A3 underlying rating, LOC from PNC (expires March 30, 2017)

-Series 2009C variable rate bonds, $50 million, A3 underlying rating, LOC from Wells Fargo Bank, NA (expires October 2, 2014)

-Series 2009D variable rate bonds, $25 million, A3 underlying rating, LOC from JP Morgan Chase, NA (expires October 2, 2016)

-Series 2007A fixed rate bonds, $117 million outstanding, rated A3

-Series 2007E variable rate bonds, $70 million, A3 underlying rating, insured by Assured Guaranty, SBPA from JP Morgan Chase Bank, NA (expires October 2, 2016)

-Series 2007F variable rate bonds, $55 million, A3 underlying rating, insured by Assured Guaranty, SBPA from PNC (expires August 28, 2017)

RATING METHODOLOGY

The principal methodology used in this rating was Not-for-Profit Healthcare Rating Methodology published in March 2012. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

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INVESTORS SERVICE

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Attachment #3
Narrative

Attachment 3 is organized as follows:

- Purpose
- National Trends / Patient Protection and Affordable Care Act
- Kewanee Hospital's Strategic Decision
- Health Facilities Planning Act Intent (P.A. 78-1156)
- Transaction Overview
- Charity Care
- Safety Net
- Attachments
    - Pre and Post Organizational Charts based on the proposed transaction
    - Support Letters (To be provided in separate mailings)
    - Fair Market Value Assessment

Purpose

OSF Healthcare System ("OSF") and Kewanee Hospital ("KH"), both Illinois not-for-profit corporations, seek approval of this Certification of Exemption ("COE") to continue their historical missions and build on their longstanding clinical relationship centered on providing access to sustainable high quality healthcare services through the affiliation described herein.

National Trends / Patient Protection and Affordable Care Act

Enacted in March of 2010, the Patient Protection and Affordable Care Act (ACA) is a seminal event in U.S. public policy. Its affirmation by the Supreme Court establishes the basis to transform the U.S. healthcare system. The ACA will have far-reaching effects, the details of which are not fully known at this time, but tend to focus on improving care quality, improving access, reducing over-utilization, and reducing and/or slowing the growth in healthcare expenditures.

Key components in the ACA are the concepts of population health management and Accountable Care Organizations (ACOs). The first concept was promulgated to encourage healthcare providers to shift their focus from treating acute episodes of care to managing health and wellness as well as chronic diseases so as to reduce inpatient admissions, encourage care delivery in less costly settings, and over-time, manage chronic conditions and improve the health of the population. OSF, one of 32 national organizations selected by the Centers for Medicare & Medicaid Services ("CMS") to participate in the Pioneer Accountable Care Organization Program ("Pioneer ACO"), has adopted the long-term strategy of population health management and is in the midst of transforming its charitable ministry to fit this new era of healthcare delivery.

A growing trend, fostered by ACA provisions, are various forms of affiliations wherein now independent hospitals can become more effective and efficient in providing needed healthcare services to their stakeholders and related communities, all while enhancing clinical outcomes with an emphasis on quality of care over quantity of care. The ACA is expected to increase the cost of doing business due to compliance requirements, all while revenue is being reduced through reimbursement reductions, making it increasingly difficult for independent / smaller hospitals, like KH, to remain financially viable in the long-term.

The new delivery models, brought on in large part by the ACA, are based on strategic affiliations between providers, including various specialists and sub-specialists that have not always been available to all populations. The strategic affiliations have the ability to bring operational efficiencies, improve quality, and manage / reduce the cost of delivering healthcare services. By way of summary, the ACA encourages hospitals to evaluate their relationships and affiliations with integrated health systems, in an effort to do more with less through effective and efficient operational and care delivery models. All critical factors in the proposed affiliation between KH and OSF, which aims to strengthen both parties and the patients and communities they have historically served.

Kewanee Hospital's Strategic Decision

KH is a small and rural Critical Access Hospital (CAH) located in northwestern Illinois. The community of Kewanee is rural with 50 miles travel to either Peoria or the Quad Cities. KH built a full replacement facility and moved into the hospital in May 2008 [CON Project 06-014/Completion Date 1/6/2009]. KH, like many rural communities, has an increased level of poverty and citizens over 65. The hospital not only provides vital health services for the community but also serves as a safety net to those who cannot afford care.

The KH Board of Trustees ("Board") began a strategic planning process in late 2010 to discuss the future for the hospital in light of the ACA. At that time, the Board had recently voted to close the obstetric service line [CON Permit 10-045/Completion Date 10/26/2010] as a measure to stabilize the hospital's financial status and was aware that further planning was needed in order to preserve local access to health care services for their community.

The Board's goal was to identify the path that would best carry the hospital through the changing landscape and preserve long-term access to care for the community. Like many independent, small-rural hospitals, KH faced a number of challenges including: ability to recruit physicians, develop an aligned medical staff and increase access to specialty care; coordination and utilization of information technology systems for improving quality of care across the care continuum; future financial uncertainty as a result of community economics and demographics and impact of changes in federal and state programs; and the depth of expertise required to address increasingly specialized skill sets to manage healthcare business (e.g. contracting, Information Technology support, staff training, compliance, Human Resources, etc.).

The Board recognized that the future of health care requires more extensive and formal collaboration (e.g., clinical care coordination, quality measurement, payment reform models, etc.) with physicians, tertiary care providers and others across the health care continuum. KH had moved into looking at the health of the population; however without a tertiary partner the Board determined it would be difficult, if not impossible to adequately address the needs of the community. After careful analysis and deliberation, the Board concluded that affiliating with a larger partner was the best mechanism to provide long-term viability, collaboration and enhancement of services for the community served.

KH carefully evaluated several options for collaboration as well as several health care systems in order to insure the right culture and fit for KH and the communities it serves. The Board identified several criteria for a future partner including:

- high quality as measured by public reporting,
- financial health and stability,
- aligned mission and vision,
- cultural consistency and synergy between organizations and
- human and capital resources including access to physicians and specialty services.

OSF was at the top of the list and proved to be the best fit for KH and the community. The Kewanee community and the medical staff were already familiar with OSF and generally utilized their services for tertiary care. The organizations jointly announced the Letter of Intent ("LOI") on November 5, 2012 and received a great deal of support from the community.

Health Facilities Planning Act Intent (P.A. 78-1156)

OSF and KH believe that the proposed affiliation is consistent with the tenants of the ACA and the purpose stated in the Health Facilities Planning Act. This affiliation will provide OSF and KH the opportunity to continue and expand their historical missions, and will benefit the Kewanee service area and its residents by:

a) Respecting community loyalty and values of the communities served.
b) Promoting greater access to healthcare services including the provision of specialty services in the local community.
c) Improving the coordination of healthcare services to the communities served by OSF and Kewanee.
d) Insuring local access to quality healthcare services for the Kewanee community.
e) Achieving excellence in clinical innovations, services, quality, cost, and outcomes.
f) Achieving maximum efficiencies in delivering healthcare services, thereby achieving cost savings wherever possible.

When approved and implemented, this COE and its underlying transactions are consistent with Federal legislation, State statutes, national trends and their respective intents, which are designed to restrain rising healthcare costs while improving care quality and population health.

Transaction Overview

OSF and KH, both Illinois not-for-profit corporations seek approval of this COE in order to allow for an affiliation among OSF and KH as described in the respective October 30, 2012 Letter of Intent and final transaction documents (definitive agreement) to be submitted under separate cover 30 days before the Health Facilities Services and Review Board ("Review Board") meeting date when this associated COE will be heard.

Upon closing, and assuming Review Board approval, KH will merge with and into OSF pursuant to a statutory merger. The OSF Board of Directors (OSF Board) will become the fiduciary governing body for KH. Additionally, a KH Community Board will be established to provide input, advice and guidance to the President of KH on specific matters such as management plans, strategic plans, annual capital and operating budgets, services, quality and safety. The President of KH will report to the Chief Executive Officer of OSF. (See Attachment 3 for pre- and post- organizational charts.)

KH will continue to be a licensed hospital and operated as a division of OSF and will, upon closing, begin operating under an assumed name approved by the OSF Board. The Fair Market Value (FMV) of the transaction has been determined to be $54.846 mil, based on the documentation included in this COE Permit Application Attachment 3 (Alvarez & Marsal Valuation Services, LLC letter dated September 17, 2013. The transaction acquisition price is $0.00.

OSF owns and operates healthcare facilities in Illinois and Michigan. OSF's Mission is to serve all persons with the greatest care and love. KH's anticipated affiliation with OSF will support a more coordinated patient-centric delivery of high quality clinical care, including disease-based population management focusing on the health and wellness of the KH communities. Additionally, OSF will fund, on an ongoing basis necessary capital requirements, in accordance with OSF's capital allocation policies and procedures in order to sustain and enhance the delivery of high quality health care services in the KH service area.

Charity Care

In order to further OSF's and KH's missions in Kewanee and surrounding communities, KH's existing charity care policies will be supplemented prior to the Closing Date by OSF's Charity Assistance Policy for Illinois Hospitals, which not only complies with, but exceeds the requirements of Illinois law, including the Illinois Hospital Uninsured Patient Discount Act. As certified in the verifications on Attachment # 4, OSF and KH will not adopt a more restrictive charity care policy than was in effect one year prior to the Closing Date of the proposed transaction, and KH's compliant charity care policy, modified with OSF's more generous Charity Assistance Policy for Illinois Hospitals, will remain in effect for at least a two (2)-year period following the Closing Date.

In general, the OSF Charity Assistance Policy for Illinois Hospitals is the same or more generous than the current KH Charity Care Program. For example, all OSF uninsured patients who are not otherwise eligible for free, discounted or catastrophic charity care receive a 20% discount on billed charges. After an account is sent to collections, if a patient wants to apply for OSF Charity Assistance, the entity billing the patient must give the patient 30 days after the account was placed in collections to apply for assistance. In addition, OSF utilizes a presumptive charity procedure for patients who fail to provide financial information normally considered in making charity eligibility determinations. When OSF is able to obtain comparable information from independent sources such as public records, OSF applies the same charity discount it would have provided, if the patient had completed a Charity Application and submitted the required financial documents.

Finally, a patient may appeal OSF Charity and Illinois Uninsured Patient Discount determinations. The appeal procedures are contained within the OSF Charity/Illinois Uninsured Discount Procedures.

Safety Net

KH and the Family Health Clinic ("FHC"), the hospital's Rural Health Clinic ("RHC"), provide care to everyone regardless of their ability to pay for services. The FHC serves as a safety net to Kewanee and surrounding community by providing needed primary care and general surgery services. The FHC also provides a great deal of outreach to the community in areas such as health and wellness education, preventative care, and sports physicals.

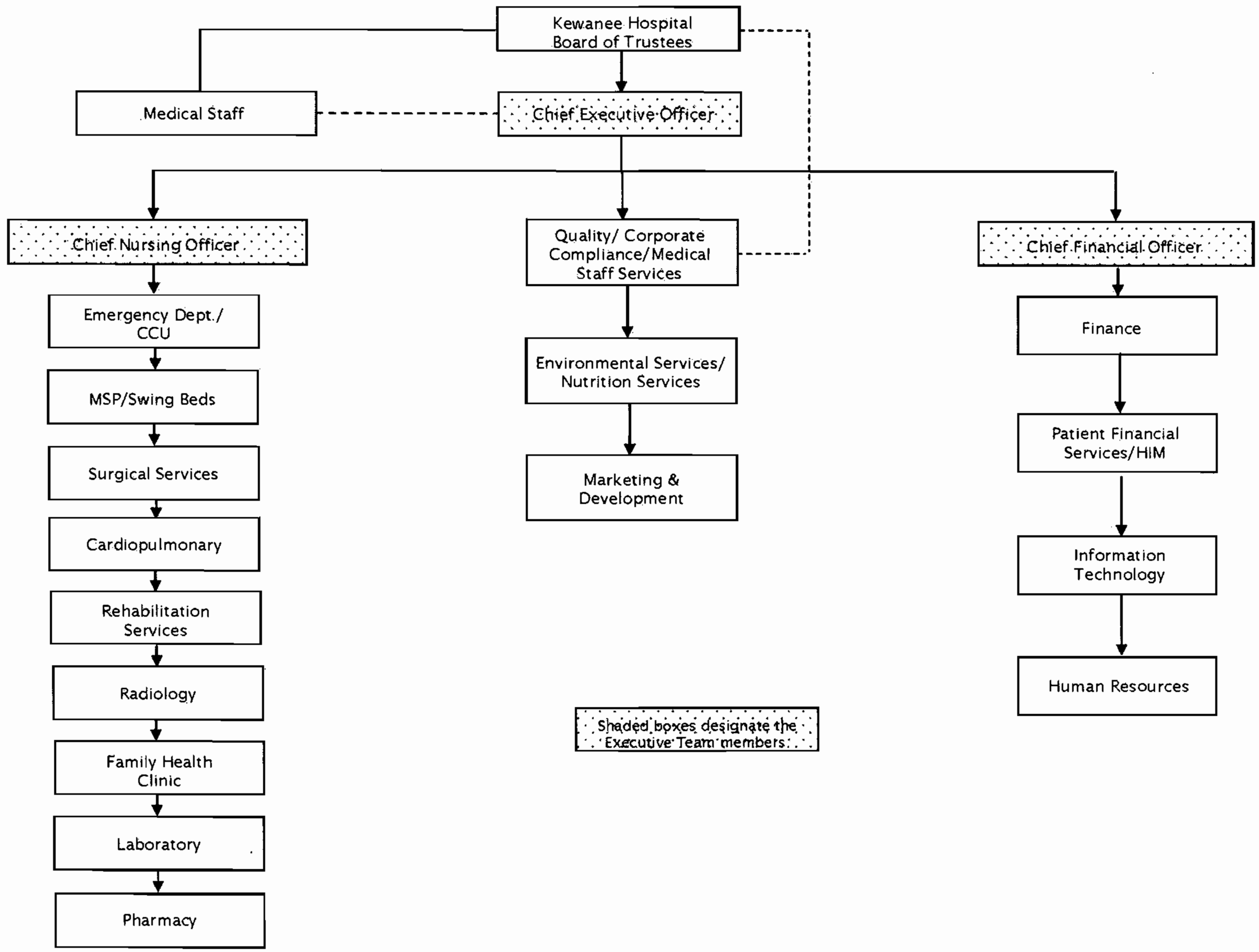
As mentioned previously, KH closed the obstetric service line in 2010, and does not have any obstetricians/gynecologists on the current medical staff. The KH services will not be adversely affected by affiliating with OSF and by adhering to the Ethical and Religions Directives for Catholic Health Care Services.

The affiliation with OSF will result in no change in services offered by KH and the FHC and the charity care policy of KH will be enhanced. Thus, there will be no impact on current safety net services within the community; in fact, they will be enhanced through the affiliation with OSF.

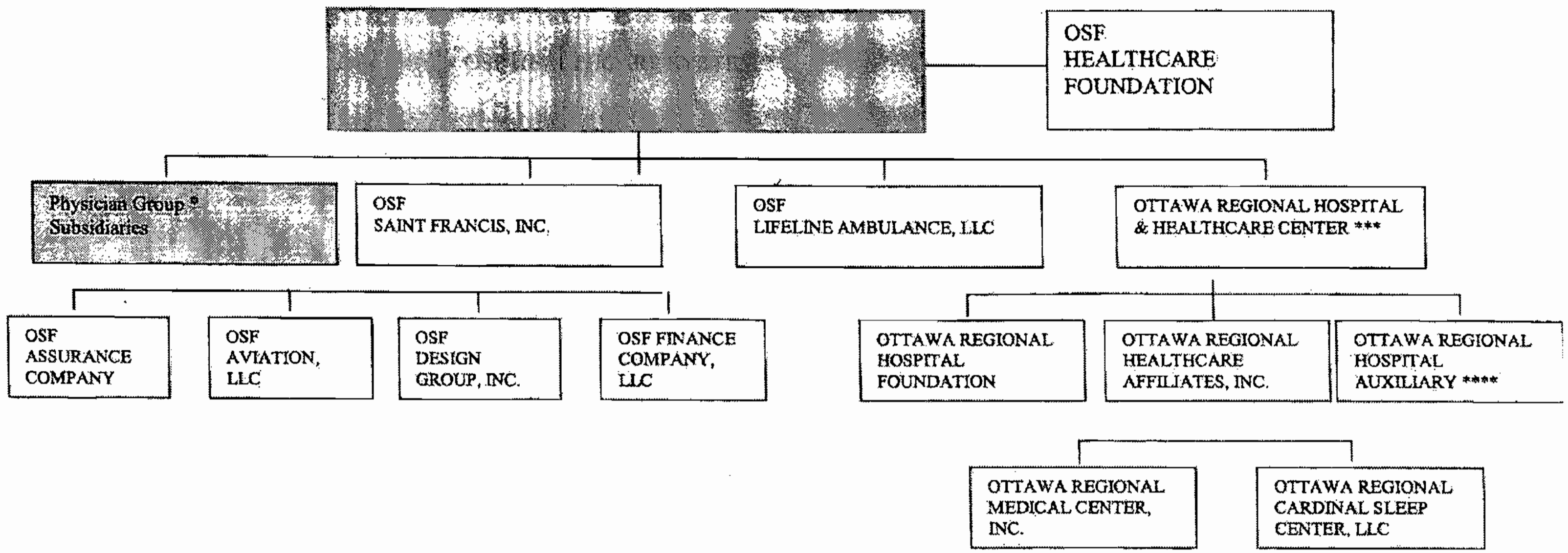
Attachments

Pre and Post Organizational Charts

Kewanee Hospital Organizational Chart—September 2013



PRE-AFFILIATION
OSF HEALTHCARE SYSTEM AND RELATED CORPORATIONS
CORPORATE STRUCTURE



***Physician Group Subsidiaries**

OSF Multi-Specialty Group
OSF Multispecialty Group – Peoria, LLC
OSF Multispecialty Group – Eastern Region, LLC
OSF Multispecialty Group – Western Region, LLC
OSF Heart & Vascular Institute
Cardiovascular Institute at OSF, LLC
HeartCare Midwest, Ltd.
Children's Hospital of Illinois Medical Group
OSF Children's Medical Group - Congenital Heart Center, LLC
OSF Perinatal Associates, LLC
Illinois Neuroscience Institute
Illinois Neurological Institute – Physicians, LLC
Illinois Pathologist Services, LLC
Illinois Specialty Physician Services at OSF, LLC

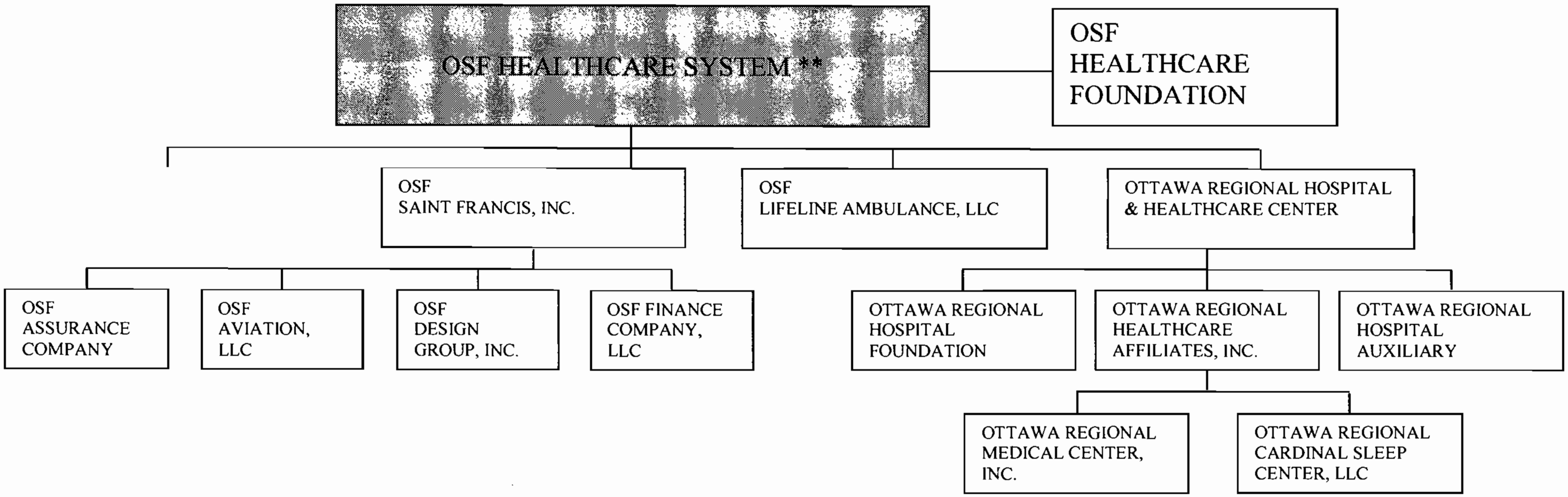
****OSF Healthcare System**

OSF Saint Francis Medical Center
OSF Saint Anthony Medical Center
OSF St. Joseph Medical Center
OSF Saint James-John W. Albrecht Medical Center
OSF St. Mary Medical Center
OSF Holy Family Medical Center
OSF St. Francis Hospital
OSF Saint Clare Home
OSF Home Care Services
OSF Medical Group
Cardiovascular Services
Neuroscience Services
Children's Services
Ambulatory Services

*** The Ottawa entities will have post-affiliation names that have not yet been determined.

**** The establishment of the Auxiliary as a post-affiliation subsidiary of ORHHC is dependent upon the adoption by the Auxiliary of proposed amended and restated articles and bylaws making ORHHC the sole corporate member of the Auxiliary.

POST-AFFILIATION
OSF HEALTHCARE SYSTEM AND RELATED CORPORATIONS
CORPORATE STRUCTURE



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OSF Heart & Vascular Institute
Cardiovascular Institute at OSF, LLC
HeartCare Midwest, Ltd.
Children's Hospital of Illinois Medical Group
OSF Children's Medical Group - Congenital Heart Center, LLC
OSF Perinatal Associates, LLC
Illinois Neuroscience Institute
Illinois Neurological Institute – Physicians, LLC
Illinois Pathologist Services, LLC
Illinois Specialty Physician Services at OSF, LLC

****OSF Healthcare System**

OSF Saint Francis Medical Center
OSF Saint Anthony Medical Center
OSF St. Joseph Medical Center
OSF Saint James-John W. Albrecht Medical Center
OSF St. Mary Medical Center
OSF Holy Family Medical Center
OSF St. Francis Hospital
TBD Currently Kewanee Hospital

OSF Home Care Services
OSF Medical Group
Cardiovascular Services
Neuroscience Services
Children's Services
Ambulatory Services

Alvarez & Marsal Valuation Services, LLC
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Chicago, IL 60603
Phone: +1 312 601 4220
Fax: +1 312 332 4599

September 17, 2013

Mr. Ajay Pathak
Director, Strategic Business Development
OSF HealthCare System
800 N.E. Glen Oak Avenue
Peoria, Illinois 61603

Dear Mr. Pathak,

As requested, Alvarez & Marsal Valuation Services, LLC ("A&M VS") has performed a valuation of Kewanee Hospital ("Kewanee") and certain assets (the "Subject Assets") associated with Kewanee as of May 31, 2013 (the "Valuation Date"). It is our understanding that OSF HealthCare System ("OSF") is contemplating a statutory merger with Kewanee (the "Transaction"). Management of OSF ("Management") has requested that A&M VS assist with an assessment of the fair market value[1] and fair value of (i) Kewanee, an Illinois not for profit corporation on a consolidated, going concern basis, (ii) the real and personal property owned by Kewanee at 1051 W. South Street, Kewanee, Illinois (iii) vacant land in Kewanee, Illinois that was the former site of the hospital and (iv) identified intangible assets associated with the operation of Kewanee Hospital, if any. It is our understanding that our work will be used for the purposes of i) evaluating and implementing the Transaction being considered and ii) reporting requirements with respect to financial and regulatory reporting regarding the Transaction. The scope of our work was limited to the analyses we deemed appropriate and necessary to prepare our assessment of the fair values ("Opinion") as stated herein.

Our analyses and report are intended solely for your use as described in our engagement letter dated May 16, 2013. The report may be used only for the purposes described above. Neither the report nor its contents may be referred to or quoted in any registration statement, prospectus, loan or other agreement or document without prior written consent of A&M VS.

Executive Summary

We have considered the prevailing economic and industry environments, the history and nature of Kewanee Hospital and the expected performance of Kewanee as reflected in the prospective financial information ("PFI") and described by Management.

[1] Fair Market Value is defined as: "The price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts." (Treas. Reg. 20.2031-1(b); Rev. Ruling 59-60, 1959 C.B. 237).

Scope of the Engagement

The scope of our work consisted of the identification, analysis and valuation of the Kewanee Hospital business enterprise and the Subject Assets which included the following:

- Real Property and Related Assets;
- Personal Property and Related Assets;
- Intangible Assets.

Assets and liabilities not identified above were excluded from the scope of our engagement.

Sources of Information

For the purpose of our analysis, the primary written documents and records provided by Management were as follows:

- Projected financial information;
- Audited and internally prepared historical financial information; and
- Other miscellaneous documents.

The information provided by Management has been assumed, without further independent verification, to correctly represent the results of the actual and/or estimated operations and the financial condition of Kewanee.

Public information and industry and statistical information have been obtained from sources we believe to be reliable. However, we make no representation as to the accuracy or completeness of such information and have performed no procedures to corroborate the information.

The PFI was provided by Management and prepared by Kewanee. Management utilized a third party healthcare industry consulting firm to assist them in identifying and making adjustments to the PFI provided by Kewanee. A&M VS had several discussions with Management regarding the PFI including discussions regarding the basis for expectations of future financial performance. The PFI was also compared to historical trends of Kewanee and the performance of selected publicly-traded guideline companies and private guideline transactions.

We have made certain adjustments to the historical information and PFI provided by Management considering the standard of value, the nature of the business and discussions with Management. In particular, we included the payment of corporate income taxes despite the tax exempt status of OSF and Kewanee as required by the standard of fair market value. Based on all of the above, we confirmed that the PFI reflects Management's best estimate of the assumptions a hypothetical buyer and seller would use in pricing Kewanee Hospital and was appropriate for use in our analysis. Our work does not constitute an examination, compilation or an agreed-upon procedures assignment as described in the American Institute of Certified Public Accountants ("AICPA") Professional Standards, Attestation Standards Section 200, Financial Forecasts and Projections.

Standard of Value

Fair value is defined in FASB ASC Section 820-10-35 as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

ASC 820 provides several key principles of fair value measurement:

- Fair value should reflect an exit price, the price that would be accepted to sell the asset.
- The hypothetical transaction is assumed to be an orderly transaction, not a forced sale.
- The asset (liability) is transferred in an exchange between market participants.
- Fair value should reflect the perspective of a market participant that holds the asset or owes the liability; thus, it would reflect its highest and best use.
- The hypothetical transaction is assumed to occur in the principal or most advantageous market.
- Fair value should not reflect any adjustment for transaction costs, but it may include transportation costs in certain circumstances.
- The highest and best use determines the premise of value, either in-use (in combination with other assets as installed or otherwise configured) or in-exchange (stand-alone).

Fair market value is defined by Internal Revenue Services as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under compulsion to buy or to sell and both having reasonable knowledge of relevant facts." Many of the underlying concepts and principles of fair market value are similar to those of fair value but there can be differences under certain circumstances. The differences are usually insignificant and unless otherwise noted, our conclusions are the same under both standards herein and are referred to as fair values.

Premise of Value

Fair value is established based on premise of value and underlying analytical approaches appropriate to the facts and circumstances pertaining to the various classes of assets valued. Our valuation assumes that, unless identified otherwise in this report, the highest and best use of the assets will continue to be as a group in the ongoing hospital business. Therefore, we recognized the highest and best use of the assets to be as installed and as used, and we valued the assets under an in-use premise. In the case of the personal property assets, the premise of value in-use includes the additional value related to the freight, tax, installation and other costs that were incurred when the personal property assets were placed into service.

Valuation Approaches

In developing our opinions, we considered three approaches to value for Kewanee and the Subject Assets and chose the most appropriate approach or approaches for each. Our conclusions rely on the approaches judged to be most appropriate for the purpose and scope of our analysis, as well as the nature and reliability of the available data. The three approaches to value are summarized as follows:

- **Income Approach**

  The income approach is a way of developing a value indication for a business, tangible or intangible asset or liability using one or more methods that convert anticipated economic benefits or obligations into a present single amount.[2] The discounted cash flow method is a method whereby the present value of future expected net cash flows is calculated using a discount rate.[3]

- **Market Approach**

  The market or sales comparison approach is a general way of estimating the value of a business, security, tangible, or intangible asset using one or more methods that compare the subject to similar investments or assets that have been sold or offered for sale.[4] Sales and offering prices for the comparable investments or assets are adjusted to reflect the difference between the investment or asset being valued and the comparable investments or assets, such as historical financial condition and performance, expected economic benefits, time and terms of sale, utility, and physical characteristics. The adjusted prices of the comparable assets provide an indication of value for the subject asset.

- **Cost Approach**

  The cost or asset approach may be viewed as a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capacity of that asset.[5]

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[2] AICPA Statement on Standards for Valuation Services No. 1, *Appendix B: International Glossary of Business Valuation Terms*, 45.
[3] Ibid. 43.
[4] *International Glossary of Business Valuation Terms*, 45.
[5] Ibid, 43.

Application and Methodology

Business Enterprise Value of Kewanee

Both income and market approaches were applied to determine the fair value of the Total Invested Capital ("TIC") of Kewanee. In particular, we used a discounted cash flow analysis ("DCF") and market-derived multiples of revenue, earnings before interest taxes depreciation and amortization ("EBITDA"). The discounted cash flow analysis was used to determine the enterprise value of Kewanee Hospital based on the PFI. In addition to the PFI, the discounted cash flow method relies upon a discount rate and a long term growth rate. The discount rate is the rate used to convert the annual cash flows as represented in the PFI into a present value. The appropriate discount rate to estimate enterprise value is the weighted average cost of capital ("WACC") that reflects the required rates of return on debt and equity by the investors in the business.

Our market approach included derivation of market multiples from publicly-traded guideline companies in the hospital management business as well as market multiples observed in private transactions where individual hospitals were acquired. We further defined the observations from private transactions to include only critical access hospitals.

By adding the value of liabilities not considered to be components of invested capital, typically the liabilities being included in Net Working Capital, to our estimate of the Total Invested Capital, we arrive at an estimated of the aggregate fair value of the cumulative Total Assets.

Real Property

In order to estimate the value of land, we used the sales comparison approach by gathering recent sales transactions of land sales with similar characteristics as the subject land parcels. We then used adjustment grids to make qualitative and quantitative adjustments to arrive to our land value.

The cost approach was used to calculate the fair value for building and site improvements. The replacement cost new less depreciation ("RCN-LD") was determined by subtracting accrued depreciation resulting from physical depreciation, functional and external obsolescence from the replacement cost new. Building and site improvement estimates were based on information provided by Management, information acquired during site inspections, discussions with Kewanee personnel, and estimates using GIS software. Our cost estimates are based on guidelines provided by *Marshall Valuation Service*. Due to the specialized nature of the subject property, the sales comparison and income approaches were not utilized in estimating the fair value of the subject buildings as vacant and site improvements.

Personal Property and Related Assets

We applied the cost and market approaches to value the personal property and related assets. The income approach was not considered due to the inefficiency of calculating an income stream to each individual personal property and related asset considered in the analysis. Within the cost approach analysis, several techniques are commonly used to facilitate the process of estimating the current replacement or reproduction cost new of the assets. The following methods of the cost approach have been applied within this analysis: trending and direct costing analysis. The historic costs were indexed (using trend factors) to determine the reproduction costs new of the assets. In some situations, additional procedures are appropriate to confirm or adjust the reproduction cost estimates to better reflect replacement costs. The direct replacement costs were researched and quantified by contacting Original Equipment Manufacturers ("OEM") and/or their representatives to determine the cost new today, and from standard pricing media and our data files.

Since the Subject Assets are currently in use and of various age, some deficiency, or loss in value, needs to be deducted in the form of accrued deprecation to arrive at their value. The elements of deprecation to be considered are Physical Deterioration, Functional Obsolescence, and Economic Obsolescence, when applicable. The three forms of deprecation are further described below:

- Physical is a form of depreciation where loss in value or usefulness of a property is due to the using up or expiration of its useful life caused by wear and tear, deterioration, exposure to various elements, physical stresses, and similar factors.

- Functional Obsolescence is a form of depreciation in which the loss in value or usefulness of a property is caused by inefficiencies or inadequacies of the property itself, when compared to a more efficient or less costly replacement property that new technology has developed. Symptoms suggesting the presence of functional obsolescence are excess operating cost, excess construction (excess capital cost), over-capacity, inadequacy, lack of utility, or similar conditions.

- Economic Obsolescence (sometimes called "external obsolescence") is a form of depreciation where the loss in value of a property is caused by factors external to the property. These may include such things as the economics of the industry; availability of financing; loss of material and/or labor sources; passage of new legislation; changes in ordinances; increased cost of raw materials, labor, or utilities (without an offsetting increase in product price); reduced demand for the product; increased competition; inflation or high interest rates; or similar factors.

Summary and Conclusions

Based upon the information provided, discussions with Management and our independent research, as well as the analyses performed and described herein, we have concluded that the fair market value and fair value of the Total Assets of Kewanee Hospital as of the Valuation Date is approximately $54.846 million.

The conclusions and opinions expressed herein are subject to the *Assumptions and Limiting Conditions* included in the full valuation report. Additional relevant information and analyses considered in our opinions will be retained in our work files and will be available for review upon request. The depth of discussion contained herein is specific to your needs as the client and for the intended use as stated.

If you have any questions regarding the results of the analysis, please contact me at (312) 288-4065.

Very truly yours,

Gary T. Frantzen

Gary T. Frantzen, CFA
Managing Director
Alvarez & Marsal Valuation Services, LLC

Attachment #4
Background of the Applicant

Kewanee Hospital

- **Certificate of Good Standing**
- **Kewanee Hospital License**
- **Kewanee CAH Certification**

OSF Healthcare System

- **Certificate of Good Standing**

File Number 0876-644-4

STATE OF ILLINOIS

OFFICE OF THE SECRETARY OF STATE

To all to whom these Presents Shall Come, Greeting:

I, Jesse White, Secretary of State of the State of Illinois, do hereby certify that

KEWANEE HOSPITAL, A DOMESTIC CORPORATION, INCORPORATED UNDER THE LAWS OF THIS STATE ON NOVEMBER 13, 1902, APPEARS TO HAVE COMPLIED WITH ALL THE PROVISIONS OF THE GENERAL NOT FOR PROFIT CORPORATION ACT OF THIS STATE, AND AS OF THIS DATE, IS IN GOOD STANDING AS A DOMESTIC CORPORATION IN THE STATE OF ILLINOIS.

In Testimony Whereof, *I hereto set my hand and cause to be affixed the Great Seal of the State of Illinois, this* 9TH *day of* JULY *A.D.* 2013 .

SEAL OF THE STATE OF ILLINOIS AUG. 26TH 1818

Authentication #: 1319002754

Authenticate at: http://www.cyberdriveillinois.com

Jesse White

SECRETARY OF STATE

State of Illinois 2127911
Department of Public Health

LICENSE, PERMIT, CERTIFICATION, REGISTRATION

The person, firm or corporation whose name appears on this certificate has complied with the provisions of the Illinois Statutes and/or rules and regulations and is hereby authorized to engage in the activity as indicated below.

LA MAR HASBROUCK, MD, MPH
DIRECTOR

Issued under the authority of The State of Illinois Department of Public Health

EXPIRATION DATE	CATEGORY	I.D. NUMBER
05/30/14	BGBD	0005538

FULL LICENSE
CRITICAL ACCESS HOSP
EFFECTIVE: 05/31/13

BUSINESS ADDRESS

KEWANEE HOSPITAL
1051 WEST SOUTH STREET
P.O. BOX 747
KEWANEE IL 61443 8354

The face of this license has a colored background. Printed by Authority of the State of Illinois • 4/97 •

DISPLAY THIS PART IN A CONSPICUOUS PLACE

REMOVE THIS CARD TO CARRY AS AN IDENTIFICATION

State of Illinois 2127911
Department of Public Health
LICENSE, PERMIT, CERTIFICATION, REGISTRATION

KEWANEE HOSPITAL

EXPIRATION DATE	CATEGORY	I.D. NUMBER
05/30/14	BGBD	0005538

FULL LICENSE
CRITICAL ACCESS HOSP
EFFECTIVE: 05/31/13

04/06/13

KEWANEE HOSPITAL
P.O. BOX 747
1051 WEST SOUTH STREET
KEWANEE IL 61443 8354

FEE RECEIPT NO.

Kewanee HOSPITAL

CAH Certification and Survey Process

Kewanee Hospital became a Critical Access Hospital (CAH) on February 1, 2003. The CAH program is a federal program that is administered through the Illinois Department of Public Health (IDPH). As part of their process IDPH surveys CAH's on behalf of the Centers for Medicare and Medicaid Services (CMS) for both nursing/patient care and for life safety codes to ensure that the hospital is in compliance with the Medicare Conditions of Participation for Critical Access Hospitals.

Kewanee Hospital's Joint Commission accreditation expired in March of 2005. When the hospital's option for renewal was evaluated it was found that many CAH's had elected to drop their accreditation since they were now regulated and surveyed through IDPH. After reviewing the survey process through IDPH with the Hospital's Board of Trustees, they elected not to renew The Joint Commission accreditation.

Survey Information:

Kewanee Hospital was surveyed as part of the CAH Recertification process resulting from the move to 1051 W. South Street.

Nursing/Patient Care: July 29, 2010
Life Safety: August 4, 2010
Recertification/Letter of Compliance from CMS: November 24, 2010

File Number 0107-414-8

STATE OF ILLINOIS
OFFICE OF THE SECRETARY OF STATE

To all to whom these Presents Shall Come, Greeting:

I, Jesse White, Secretary of State of the State of Illinois, do hereby certify that

OSF HEALTHCARE SYSTEM, A DOMESTIC CORPORATION, INCORPORATED UNDER THE LAWS OF THIS STATE ON JANUARY 02, 1880, APPEARS TO HAVE COMPLIED WITH ALL THE PROVISIONS OF THE GENERAL NOT FOR PROFIT CORPORATION ACT OF THIS STATE, AND AS OF THIS DATE, IS IN GOOD STANDING AS A DOMESTIC CORPORATION IN THE STATE OF ILLINOIS.

In Testimony Whereof, *I hereto set my hand and cause to be affixed the Great Seal of the State of Illinois, this* 9TH *day of* JULY *A.D.* 2013 .

Authentication #: 1319002786

Authenticate at: http://www.cyberdriveillinois.com

Jesse White

SECRETARY OF STATE

Attachment 5
Transaction Documents

- **Letter of Intent Attached**
- **The Final Transaction Documents will be submitted to the Illinois Health Facilities and Services Review Board 30 days prior to the scheduled Review Board meeting when this respective COE will be on the agenda.**

OSF
HEALTHCARE SYSTEM

800 N.E. Glen Oak Avenue, Peoria, Illinois 61603-3200 Phone (309) 655-2850

LETTER OF INTENT

October 30, 2012

Lynn A. Fulton, CEO
Kewanee Hospital
1051 West South St.
P.O. Box 747
Kewanee, Illinois 61443

Dear Ms. Fulton,

The purpose of this letter ("**Letter**") is to set forth certain nonbinding understandings and certain binding understandings between OSF Healthcare System, an Illinois not-for-profit corporation ("**OSF**"), and Kewanee Hospital, an Illinois not-for-profit corporation ("**Kewanee**"), with respect to the possible affiliation of Kewanee with OSF upon reaching a definitive agreement between the parties based upon the terms and objectives proposed below. Kewanee and OSF may be referred to herein individually as a "**Party**" and collectively as the "**Parties**."

NONBINDING PROVISIONS

The following numbered Sections of this Letter (collectively, the "**Nonbinding Provisions**") reflect the understanding of the matters described in them, but each Party acknowledges that the Nonbinding Provisions are not intended to constitute a complete statement of, or a legally binding or enforceable obligation on the part of, Kewanee or OSF, and neither Kewanee nor OSF shall have any liability to the other Party with respect to the Nonbinding Provisions until a definitive agreement ("**Definitive Agreement**") is prepared, authorized, executed and delivered by and between the Parties. If the Definitive Agreement is not prepared, authorized, executed and delivered for any reason, neither Party to this Letter shall have any liability to the other Party to this Letter based upon, arising from, or relating to the Nonbinding Provisions.

Section 1. **Basic Transaction**. On the terms and subject to the provisions to be set forth in the Definitive Agreement to be negotiated and entered into between Kewanee and OSF, Kewanee will become affiliated with OSF through a transaction in which either (a) OSF will acquire all or substantially all of the assets of Kewanee and OSF will assume certain of the liabilities of Kewanee, or (b) Kewanee will merge with and into OSF pursuant to a statutory merger (such transaction referred to herein as the "**Affiliation**").

Section 1.1 Purpose of Affiliation. The purpose of the Affiliation shall be:

(a) To carry out the historical missions of OSF and Kewanee more effectively by respecting the community loyalty and values of the communities served by OSF and Kewanee;

(b) To promote greater access to, and improve coordination of, healthcare services to the communities served by OSF and Kewanee; and

(c) To achieve excellence in clinical innovations, services, quality, cost and outcomes.

Section 1.2 Kewanee Hospital. As a condition of Closing:

(a) Name. The name of Kewanee will be changed to a name to be agreed upon by OSF and Kewanee and specified in the Definitive Agreement.

(b) Kewanee Community Board. Pursuant to bylaws approved by the OSF Board of Directors ("**OSF Board**"), a Community Board will be established to provide input, advice and guidance to the President/CEO of Kewanee Hospital on specific matters such as management plans, strategic plans, annual capital and operating budgets, services, quality and safety and medical staff credentialing decisions. All current members of the Board of Kewanee will be appointed to the Community Board. Future members of the Community Board will be nominated by the Community Board and appointed by the OSF Board. The Parties will agree to the bylaws of the Community Board and such bylaws will become an exhibit to the Definitive Agreement.

(c) OSF Board Education. In order to enhance strategic planning by OSF at the System level, the Community Board shall attend OSF's annual System board education sessions, from which come System-wide priorities and strategic initiatives.

(d) Management. The chief executive officer of Kewanee ("**Kewanee CEO**") shall report to the Chief Executive Officer of OSF, or his designee who is a system-level executive, and such reporting relationship will be consistent with the reporting relationship of chief executive officers of other hospitals in the system. The chief financial officer ("**Kewanee CFO**") and the chief nursing officer ("**Kewanee CNO**") shall report to the Kewanee CEO. The Kewanee CEO shall be Lynn Fulton. The Kewanee CFO shall be Preston Becker, and the CNO shall be Jennifer Junis.

Section 1.3 Kewanee Master Indenture. It is anticipated that all related debt issued under the Kewanee master trust indenture which is outstanding on the Closing will be redeemed, defeased and cancelled by OSF at Closing, that all obligations, loan agreements, tax agreements, credit agreements, and all other related loan documents of Kewanee under the Kewanee master trust indenture will be discharged and terminated at Closing, and that the Kewanee master trust indenture will be defeased at Closing, and any liens granted in the trust estate thereunder will be released and discharged; all in the manner to be specified in the Definitive Agreement or as otherwise agreed.

Section 2. **Use of Existing Funds; Future Gifts.** At Closing, the use of all funds and other assets held by Kewanee shall be restricted for the support of healthcare programs and services provided by Kewanee.

Section 3. **Catholic Teachings**. The moral teachings of the Roman Catholic Church, including the Ethical and Religious Directives for Catholic Health Care Services, as amended from time to time, promulgated by the United States Conference of Catholic Bishops, as interpreted and applied by OSF ("**Ethical and Religious Directives**"), and the Code of Canon Law of the Roman Catholic Church ("**Canon Law**") shall govern without exception the conduct by Kewanee of their businesses following Closing.

Section 4. **Physicians and Midlevel Providers.**

Section 4.1 Continued Employment. The employment agreements of all physicians and midlevel providers presently employed by Kewanee ("**Kewanee Providers**") will be honored by OSF and the OSF Affiliates following Closing, provided no employed physician or midlevel provider will be permitted to perform any procedure or provide any service in the scope of employment in violation of the Ethical and Religious Directives. The ultimate organizational structure for delivery of physician services by Kewanee has not yet been determined, but OSF and/or one of the OSF Affiliates will employ the Kewanee Providers following Closing. The Kewanee Providers shall participate in OSF quality programs and other OSF quality initiatives on the same basis as other physicians and midlevel providers aligned with OSF.

Section 4.2 Kewanee Provider Management. The Kewanee Providers will report to the Kewanee CEO and the chief executive officer of the OSF Medical Group.

Section 4.3 Provider-Based Rural Health Clinic. It is the intent of the Parties that Kewanee's Family Health Clinic will continue to qualify as a provider-based rural health clinic, provided that it remains financially advantageous to retain that status.

Section 4.4 Independent Physicians. All agreements for professional and administrative services between independent physicians and Kewanee will be honored by OSF and the OSF Affiliates after Closing, provided no services provided under any such agreement contravene the Ethical and Religious Directives.

Section 5. **Name**. Kewanee Hospital shall be renamed as agreed upon by OSF and Kewanee and specified in the Definitive Agreement. In addition, OSF shall consult with the Community Board before naming or renaming any other healthcare facility currently owned and operated by Kewanee. Notwithstanding the above, Kewanee may continue to use service line or branding names such as "Competitive Edge" and "Wellness Edge".

Section 6. **Employees; Key Personnel.**

Section 6.1 Employees. Employees of Kewanee as of the Closing will become employees of OSF or one of the OSF Affiliates immediately following Closing. Subject to due diligence and except as provided below, it is the intent of OSF that Employees of Kewanee will be subject to the benefits and human resource policies that are applicable to OSF employees and will be eligible to participate in OSF employee benefit arrangements to the same extent and in the same manner as similarly situated OSF employees, such as but not limited to 401(k) retirement plans and paid time off policies. OSF will recognize and provide credit for periods of service with Kewanee prior to the Closing for eligibility and vesting purposes under its employee benefit arrangements. Notwithstanding the foregoing, (i) employees of Kewanee will not become entitled to any benefits under the OSF frozen defined benefit pension plans, (ii) the service of employees of Kewanee prior to the Closing will not be counted in determining such employees' entitlement to share in the discretionary employer contribution made to OSF's defined contribution retirement plans, and (iii) the service of employees of Kewanee prior to the Closing will not be counted in determining such employees' entitlement to early retiree continuation coverage.

Section 6.2 Key Personnel. Kewanee and OSF recognize the importance of assuring continued employment of key management personnel following public announcement of the proposed Affiliation and the value of retention and employment agreements in assuring such employment. Accordingly, following execution of this Letter, Kewanee shall have the right to enter into (and amend existing) retention and employment agreements with its key management personnel, but Kewanee will first consult with OSF before executing such agreements. At Closing OSF will enter into retention agreements with those key management personnel of Kewanee agreed upon by the Parties, the form of which will be approved by the Parties prior to Closing.

Section 7. Post Closing Organizational, Operational and Capital Commitments.

Section 7.1 No Divestiture. During the ten (10) year period following Closing, ownership or control of substantially all the assets of Kewanee shall not be divested through sale of assets, change of control, merger, consolidation or otherwise, unless (i) such action is required by law, court order, or administrative order, or (ii) OSF determines in its sole and reasonable judgment that some or all of the assets of Kewanee need to be divested because OSF is legally compelled to provide abortion services or some other health care service which contravenes the moral teachings of the Roman Catholic Church, including the Ethical and Religious Directives and Canon Law, as interpreted by the appropriate ecclesiastical authority. Notwithstanding the foregoing, OSF shall not be prohibited from entering into a transaction involving a change of control of OSF or a merger or consolidation of OSF with or into any other entity.

Section 7.2 Clinical Service Line and Capital Commitments. Prior to Closing, the Parties will agree on developing and enhancing certain clinical service lines at

Kewanee and also agree on certain capital commitments for Kewanee, all of which will be set forth in a separate letter agreement between the Parties.

Section 7.3 Studer Group®. Post-Closing, OSF will support and fund Kewanee's ongoing commitment to the resources and methodology provided by the Studer Group®.

Section 8. Independent Entity. Kewanee and OSF agree that, prior to or at Closing, Kewanee Hospital may establish an independent entity to address the covenants of the Parties as of, and following Closing. It is intended that such independent entity will qualify for state nonprofit corporation status and federal tax-exempt status as a public charity; such entity may be funded with monetary assets of Kewanee Hospital.

BINDING PROVISIONS

Upon execution of this Letter or counterparts hereof by the Parties, the following numbered Sections (collectively, the "**Binding Provisions**") will constitute the legally binding and enforceable agreement of the Parties in recognition of the significant costs to be borne by the Parties in pursuing this proposed Affiliation and in further consideration of their mutual undertakings as to the matters described herein.

Section 9. Conditions.

Section 9.1 Nonbinding Provisions Not Enforceable. Except for Sections 11 - 18 of the Binding Provisions, which shall be binding on the Parties, it is understood that this Letter is intended to be a summary of the proposed Affiliation and the various discussions between the Parties to the date hereof and not as a binding agreement of all the terms and conditions of the Affiliation contemplated herein. A Party's signature below will indicate that it agrees in principle to the contents of this Letter and intends to proceed promptly and in good faith. Except as otherwise stated herein, any legal rights and obligations of a Party will result only upon: (i) successful completion of each Party's due diligence review; (ii) the execution of the Definitive Agreement, which agreement shall contain, among other things, such covenants, conditions, representations and warranties, indemnifications, ancillary agreements thereto and other provisions customarily found in such an affiliation agreement; (iii) each Party's obtaining all required approvals of the Definitive Agreement by its governing body and other third parties required to consummate the transactions described therein; and (iv) the Parties' obtaining any and all required regulatory approvals of the transactions, including but not limited to the issuance of a Certificate of Exemption by the Illinois Health Facilities and Services Review Board permitting a change of ownership of the Kewanee facilities and services to OSF. The definitive terms and conditions of the Affiliation will be as set forth in the Definitive Agreement, into which this Letter and all prior discussions shall merge. It is expressly understood that this Letter (except for those provisions that are intended to be binding on the Parties) is not a contract and that no Party shall be entitled to any recourse, in the form of damages, or otherwise, for expenses incurred or benefits conferred or lost before or after the date of this Letter in the event that there is a failure, for any reason, of the Parties to enter into the Definitive Agreement.

Section 9.2 Closing. The closing of the proposed Affiliation ("**Closing**") will be conditioned on each Party having complied with all covenants and agreements set forth in the Definitive Agreement to be performed by it at or prior to the Closing and all federal, state and local government approvals required by reason of the transactions set forth therein being obtained.

Section 10. Term; Termination of Letter. The term of this Letter will commence on the last date signed by authorized representatives of each Party ("**Execution Date**"), and shall continue until the Definitive Agreement is signed or the Letter is terminated by either Party in accordance with the terms hereof ("**Term**"). Either Party may terminate this Letter if the Definitive Agreement has not been entered into on or before January 1, 2014. However, the termination of this Letter shall not affect the liability of a Party for breach of any of the Binding Provisions prior to any such termination. Upon termination of this Letter, the Parties shall have no further obligations hereunder, except as stated in Sections 9.1, 13 and 15, which shall survive any such termination.

Section 11. Access to Information; Due Diligence. Upon execution of this Letter, each of the Parties will grant to the other Party and its representatives (attorneys, auditors, agents, consultants and bankers) full and complete access to, and the right to inspect and evaluate the business prospects of the same. Furthermore, each of the Parties will disclose or make available to the other Party and its representatives all books, agreements, papers and records reasonably requested by the other Party and its representatives, relation to that Party and the ownership and operation of its business. In this regard, each Party's right of access and inspection will be exercised in such a manner as not to interfere unreasonably with the operation of the business.

Section 12. Publicity and Public Relations.

Section 12.1 Publicity. Except as required by law, it is understood that all press releases or other public communications of any sort relating to this Letter, and the method of the release for publication thereof, will be subject to the approval of both Parties, which approval will not be unreasonably withheld by either Party, and shall not occur prior to the Execution Date, unless the Parties agree that they must respond to unsolicited inquiries from any third party. Kewanee and OSF shall agree on a mutual date for disclosure of the existence of this Letter to their respective medical staffs and employees at large following the Execution Date.

Section 12.2 Public Relations. OSF and Kewanee will cooperate with one another regarding public relations efforts in connection with the proposed Affiliation. Each OSF and Kewanee agree that its respective public relations teams shall work in a coordinated and cooperative fashion with the other in order to effectively present the proposed Affiliation to communities served by Kewanee, OSF, public interest groups and governmental bodies and officials.

Section 13. **Confidentiality; Exclusive Negotiations**. OSF and Kewanee previously entered into that certain Confidentiality Agreement attached hereto as Exhibit A (the "**Confidentiality Agreement**"). The Confidentiality Agreement remains in full force and effect, and applies to this Letter. Notwithstanding any provision to the contrary in the Confidentiality Agreement, either Party may release Confidential Information (as such term is defined therein) deemed necessary by such Party to comply with applicable securities laws and/or other legal requirements in connection with any offering of securities, such as the nature of the Affiliation and its potential impact on such Party, but such Party shall first notify the other Party in writing prior to making such disclosure. In the event the Parties do not sign the Definitive Agreement by January 1, 2014, or either of the Parties withdraw from the transactions contemplated by this Letter for any reason, each Party shall promptly destroy or return to the other Party any confidential and proprietary information received during the negotiations of the proposed Affiliation pursuant to the Confidentiality Agreement. Until the Definitive Agreement has been duly executed and delivered by the Parties or until this Letter has been terminated pursuant to Section 10 above, whichever occurs sooner, Kewanee agrees that it will not, nor will any of Kewanee's officers, directors, employees or agents, enter into any negotiations, discussions, agreements or understandings, or solicit, initiate, encourage, or entertain any proposals, for the Affiliation of Kewanee with any other person or entity or to issue or grant any options or rights to enter into an Affiliation.

Section 14. **Assignability**. This Letter is not assignable by either Party without the prior written consent of the other Party, nor shall either Party delegate any of its rights, obligations or duties under this Letter to another entity.

Section 15. **Legal Challenge/Costs**. Each Party shall be responsible for and bear all of its own respective costs and expenses, including without limitation expenses of its legal counsel, accountants and other representatives, incurred at any time in connection with pursuing or consummating the Definitive Agreement and the proposed Affiliation.

Section 16. **Governing Law**. This Letter will be governed by the laws of the State of Illinois without regard to its conflicts of laws principles. Any action or proceeding arising directly or indirectly in connection with, out of, or related to this Letter may be commenced and maintained only in courts located in Peoria County, Illinois. The Parties, by their execution of this Letter, consent and submit to the jurisdiction of any State or Federal court located within Peoria County, Illinois. Each Party waives any right that it may otherwise have to transfer or change the venue of any action or proceeding brought against it by the other Party and arising directly or indirectly in connection with, out of, or related to this Letter.

Section 17. **Notice**. Any notice, demand or communication required, permitted, or desired to be given hereunder will be deemed effectively given when personally delivered, when received by facsimile, email or overnight courier, or three days after being deposited in the United States mail, with postage prepaid thereon, certified or registered mail, return receipt required, addressed as follows:

Kewanee:	Lynn A. Fulton Chief Executive Officer Kewanee Hospital 1051 West South St. P.O. Box 747 Kewanee, IL 61443 lfulton@kewaneehospital.com
with a simultaneous copy to:	Douglas B. Swill Drinker Biddle & Reath LLP 191 N. Wacker Drive - Suite 3700 Chicago, IL 60606-1698 Douglas.Swill@dbr.com
OSF:	Kevin D. Schoeplein Chief Executive Officer OSF Healthcare System 800 N.E. Glen Oak Avenue Peoria, IL 61603 kevin.schoelplein@osfhealthcare.org
with a simultaneous copy to:	Stephen T. Moore, Esq. Hinshaw & Culbertson LLP 100 Park Avenue Rockford, IL 61101 smoore@hinshawlaw.com

Section 18. **<u>Counterparts; Facsimile Signatures</u>**. The Parties agree that this Letter may be executed in multiple counterparts, each of which will be considered an original for all purposes. The Parties further agree that facsimile signatures may be considered an original for all purposes, including, but not limited to, execution of this Letter and enforcement of the Letter.

70843328v13 0926813

Please indicate your agreement in principle to the terms and conditions of this Letter of Intent and your good faith intention to enter into the negotiations contemplated hereby by executing it in the space provided below and returning one executed copy to OSF. We look forward to a successful and mutually rewarding relationship in respect of the transactions set forth herein.

Very truly yours,

OSF HEALTHCARE SYSTEM, an Illinois not for profit corporation

By: K. D. Schoeplein
Kevin D. Schoeplein,
Chief Executive Officer

Agreed to and accepted this 31 day of October, 2012

KEWANEE HOSPITAL, an Illinois not for profit corporation

By: Lynn A. Fulton
Lynn A. Fulton,
Chief Executive Officer

70843328v13 0926813

Attachment 6
Financial Statements

Kewanee Hospital

Kewanee, Illinois

Financial Statements

Years Ended September 30, 2012 and 2011

Kewanee Hospital

Financial Statements

Years Ended September 30, 2012 and 2011

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WIPFLi LLP

Independent Auditor's Report

Board of Trustees
Kewanee Hospital
Kewanee, Illinois

We have audited the accompanying balance sheets of Kewanee Hospital (the "Hospital") as of September 30, 2012 and 2011, and the related statements of operations, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based upon our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kewanee Hospital as of September 30, 2012 and 2011, and the results of its operations, changes in its net assets, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

Wipfli LLP

Wipfli LLP

January 22, 2013
Green Bay, Wisconsin

Kewanee Hospital

Balance Sheets

September 30, 2012 and 2011

Assets	2012	2011
Current assets:		
Cash and cash equivalents	$ 3,262,371	$ 8,354,426
Investments	11,486,062	5,307,043
Current portion of assets limited as to use	1,108,611	1,063,611
Accounts receivable:		
Patients - Net	5,170,746	3,322,699
Other	2,645,793	438,157
Inventories	384,691	387,588
Prepaid expenses:		
Medicaid assessment program	0	107,388
Other	426,203	397,391
Total current assets	24,484,477	19,378,303
Assets limited as to use:		
Investments held by trustee	211,526	206,948
Restricted by loan agreement	2,358,270	2,360,852
Board designated	8,431,261	7,211,793
Donor restricted	729,623	729,276
Total assets limited as to use	11,730,680	10,508,869
Less portion required for current liabilities	1,108,611	1,063,611
Total assets limited as to use - Less current portion	10,622,069	9,445,258
Property and equipment - Net	27,368,617	29,280,107
Other assets:		
Unamortized debt issue costs	728,923	781,497
Pledges receivable	0	44,537
Other	20,298	20,298
Total other assets	749,221	846,332
TOTAL ASSETS	$ 63,224,384	$ 58,950,000

Liabilities and Net Assets	2012	2011
Current liabilities:		
Current maturities of long-term debt	$ 920,000	$ 875,000
Accounts payable	1,308,114	1,099,113
Accrued expenses:		
Salaries, wages, and payroll taxes	239,331	170,500
Paid leave	548,024	534,185
Health insurance	78,000	250,000
Interest	188,611	188,611
Other	459,591	447,581
Deferred revenue	322,163	786,616
Amounts payable to third-party reimbursement programs	1,721,241	50,000
Total current liabilities	5,785,075	4,401,606
Long-term liabilities:		
Deferred revenue	322,164	0
Long-term debt - Less current maturities	27,305,000	28,225,000
Total long-term liabilities	27,627,164	28,225,000
Total liabilities	33,412,239	32,626,606
Net assets:		
Unrestricted	29,082,522	25,594,118
Temporarily restricted	56,114	55,767
Permanently restricted	673,509	673,509
Total net assets	29,812,145	26,323,394
TOTAL LIABILITIES AND NET ASSETS	$ 63,224,384	$ 58,950,000

See accompanying notes to financial statements.

Kewanee Hospital

Statements of Operations

Years Ended September 30, 2012 and 2011

	2012	2011
Revenue:		
Net patient service revenue	$ 27,606,622	$ 27,021,910
Other operating revenue, including assets released from restrictions used for operations	1,224,868	391,501
Total revenue	28,831,490	27,413,411
Expenses:		
Salaries and wages	9,594,109	9,266,461
Employee benefits	1,744,793	1,901,435
Supplies and other	6,692,772	7,660,473
Professional fees	2,470,558	2,335,304
Depreciation	2,819,397	2,791,857
Rental	4,950	4,924
Insurance	387,300	319,238
Interest	1,526,474	1,568,291
Provision for bad debts	2,638,533	2,211,834
Total expenses	27,878,886	28,059,817
Income (loss) from operations	952,604	(646,406)
Other income (loss):		
Investment income	744,809	756,477
Grant revenue	301,230	16,055
Loss on sale of equipment	(2,823)	(179,446)
Excess (deficiency) of revenue over expenses	1,995,820	(53,320)
Other changes in unrestricted net assets:		
Change in net unrealized gains and losses on investments other than trading securities	1,492,584	(506,699)
Increase (decrease) in unrestricted net assets	$ 3,488,404	$ (560,019)

See accompanying notes to financial statements.

Kewanee Hospital

Statements of Changes in Net Assets

Years Ended September 30, 2012 and 2011

	2012	2011
Unrestricted net assets:		
Excess (deficiency) of revenue over expenses	$ 1,995,820	$ (53,320)
Change in net unrealized gains and losses on investments other than trading securities	1,492,584	(506,699)
Increase (decrease) in unrestricted net assets	3,488,404	(560,019)
Temporarily restricted net assets:		
Contributions and unrealized gains and losses	347	9,293
Net assets released from restrictions	0	(6,484)
Increase in temporarily restricted net assets	347	2,809
Increase (decrease) in net assets	3,488,751	(557,210)
Net assets at beginning	26,323,394	26,880,604
Net assets at end	$ 29,812,145	$ 26,323,394

See accompanying notes to financial statements.

Kewanee Hospital

Statements of Cash Flows

Years Ended September 30, 2012 and 2011

	2012	2011
Increase (decrease) in cash and cash equivalents:		
Cash flows from operating activities:		
Increase (decrease) in net assets	$ 3,488,751	$ (557,210)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	2,871,971	2,844,338
Provision for bad debts	2,638,533	2,211,834
Net realized gain on sale of marketable equity securities	0	(12,173)
Change in net unrealized gains and losses on investments other than trading securities	(1,492,584)	506,699
Loss on sale of equipment	2,823	179,446
Changes in operating assets and liabilities:		
Accounts receivable	(6,694,216)	(2,307,507)
Inventories	2,897	(95,881)
Prepaid expenses	123,113	(9,511)
Accounts payable	209,001	234,003
Accrued expenses	(77,320)	(507,714)
Amounts payable to third-party reimbursement programs	1,671,241	(553,302)
Deferred revenue	(142,289)	(65,357)
Total adjustments	(886,830)	2,424,875
Net cash provided by operating activities	2,601,921	1,867,665
Cash flows from investing activities:		
Purchase of property and equipment	(910,730)	(713,606)
Proceeds from sale of property and equipment	0	38,493
Purchases of assets limited as to use and investments	(5,908,246)	(1,634,946)
Proceeds from sale of assets limited as to use and investments	0	79,050
Net cash used in investing activities	(6,818,976)	(2,231,009)

Kewanee Hospital

Statements of Cash Flows (Continued)
Years Ended September 30, 2012 and 2011

		2012		2011
Net cash used in financing activities -				
Principal payments on long-term debt	$	(875,000)	$	(835,000)
Net decrease in cash and cash equivalents		(5,092,055)		(1,198,344)
Cash and cash equivalents at beginning		8,354,426		9,552,770
Cash and cash equivalents at end	$	3,262,371	$	8,354,426

Supplemental cash flow information:

Cash paid for interest	$	1,526,474	$	1,515,810

See accompanying notes to financial statements.

Note 1 Summary of Significant Accounting Policies

The Entity

Kewanee Hospital (the "Hospital") operates a 25-bed acute care facility and provides comprehensive medical, surgical, emergency, outpatient, and physician clinic services to the residents of Henry County and the surrounding area. The Hospital is designated as a critical access hospital (CAH) under Medicare regulations. The CAH designation limits the number of staffed beds the Hospital may operate to 25 beds.

Financial Statement Presentation

The Hospital follows accounting standards contained in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). The ASC is a single source of authoritative accounting principles generally accepted in the United States (GAAP) to be applied to nongovernmental entities in the preparation of financial statements in conformity with GAAP.

Use of Estimates in Preparation of Financial Statements

The preparation of the accompanying financial statements in conformity with GAAP requires management to make certain estimates and assumptions that directly affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results may differ from these estimates.

Cash Equivalents

The Hospital considers all highly liquid debt instruments with an original maturity of three months or less to be cash equivalents, excluding amounts whose use is limited or restricted.

Note 1 Summary of Significant Accounting Policies (Continued)

Patient Accounts Receivable and Credit Policy

Patient accounts receivable are uncollateralized patient obligations that are stated at the amount management expects to collect from outstanding balances. These obligations are primarily from local residents, most of whom are insured under third-party payor agreements. The Hospital bills third-party payors on the patients' behalf, or if a patient is uninsured, the patient is billed directly. Once claims are settled with the primary payor, any secondary insurance is billed, and patients are billed for copay and deductible amounts that are the patients' responsibility. Payments on patient accounts receivable are applied to the specific claim identified on the remittance advice or statement. The Hospital does not have a policy to charge interest on past due accounts.

The carrying amounts of patient accounts receivable are reduced by allowances that reflect management's best estimate of the amounts that will not be collected. Management provides for contractual adjustments under terms of third-party reimbursement agreements through a reduction of gross revenue and a credit to patient accounts receivable. In addition, management provides for probable uncollectible amounts, primarily uninsured patients and amounts patients are personally responsible for, through a charge to operations and a credit to a valuation allowance based on its assessment of historical collection likelihood and the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to patient accounts receivable.

Patient accounts receivable are recorded in the accompanying balance sheets net of contractual adjustments and an allowance for doubtful accounts.

Inventories

Inventories of supplies are valued at the lower of cost, determined on the first-in, first-out method, or market.

Note 1 Summary of Significant Accounting Policies (Continued)

Investments and Investment Income

Investments are measured at fair value in the balance sheets. Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in the excess (deficiency) of revenue over expenses unless the income is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess (deficiency) of revenue over expenses unless the investments are trading securities. Realized gains and losses are determined by specific identification and charged to operations.

The Hospital monitors the difference between the cost and fair value of its investments. A decline in market value of an individual investment security below cost that is deemed to be other than temporary results in an impairment, and the Hospital reduces the investment's carrying value to fair value. A new cost basis is established for the investment, and any impairment loss is recorded as a realized loss in investment income.

Assets Limited as to Use

Assets limited as to use include assets set aside by the Board of Trustees for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes, assets held by trustee, restricted by loan agreement, and donor-restricted funds. Included in assets limited as to use are investments, which consist primarily of cash and cash equivalents, equity securities, fixed income securities, and certificates of deposit.

Pledges Receivable

The Hospital has recorded pledges receivable for unconditional promises to be received from donors. The pledges which are expected to be collected within the next year are included in the current portion of other accounts receivable on the accompanying balance sheets. The pledges are recorded net of an estimated allowance for uncollectible receivables and have been discounted to their present value at a discount rate of 5%.

Note 1 Summary of Significant Accounting Policies (Continued)

Fair Value Measurements

The Hospital measures fair value of its financial instruments using a three-tier hierarchy, which prioritizes the inputs used in measuring 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 unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Hospital has the ability to access.

Level 2 Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets.
- Quoted prices for identical or similar assets or liabilities in inactive markets.
- Inputs other than quoted prices that are observable for the asset or liability.
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs.

Note 1 Summary of Significant Accounting Policies (Continued)

Property, Equipment, and Depreciation

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 using the straight-line method. Estimated useful lives range from 8 to 25 years for land improvements, 20 to 40 years for buildings and improvements, 3 to 20 years for major movable equipment, and 7 to 20 years for fixed equipment. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support and are excluded from the excess (deficiency) of revenue over expenses, 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, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Deferred Revenue

Funds received but not earned as of the date of the balance sheets have been classified as deferred revenue. Revenue will be recognized in future periods as the revenue is earned.

Electronic Health Record (EHR) Incentive Payments

The American Recovery and Reinvestment Act of 2009 (ARRA) provides for incentive payments under the Medicare and Medicaid programs for certain hospitals and physician practices that demonstrate meaningful use of certified EHR technology. These ARRA provisions, collectively referred to as the Health Information Technology for Economic and Clinical Health Act, are intended to promote the adoption and meaningful use of health information technology and qualified EHR technology.

Note 1 Summary of Significant Accounting Policies (Continued)

Electronic Health Record (EHR) Incentive Payments (Continued)

Qualifying critical access hospitals receive Medicare EHR incentive payments in one lump sum for the Medicare share, based on a statutory formula, of the reasonable costs incurred for the purchase of depreciable assets necessary to administer certified EHR technology.

The Hospital recognizes the Medicare EHR incentive payment as other operating revenue over three years, which is the period the software would have been depreciated and cost reimbursed through the Medicare cost report.

Amounts recognized under the Medicare EHR incentive program are based, in part, on cost report data that is subject to audit by fiscal intermediaries; accordingly, amounts recognized are subject to change. In addition, the Hospital's attestation of its compliance with the meaningful use criteria is subject to audit by the federal government or its designee.

The Hospital recognizes the Medicaid EHR incentive payment as other operating revenue in the year the funds are received.

Impairment

The Hospital reviews its property and equipment periodically to determine potential impairment by comparing the carrying value of the property and equipment with the estimated future undiscounted cash flows expected to result from the use of the assets, including cash flows from disposition. Should the sum of the expected future net cash flows be less than the carrying value, the Hospital would recognize an impairment loss at that time. The Hospital recognized no impairment losses for the years ended September 30, 2012 and 2011.

Note 1 Summary of Significant Accounting Policies (Continued)

Unamortized Debt Issue Costs

Debt issuance costs related to the issuance of long-term debt are amortized over the life of the related debt using the effective-interest method.

Net Assets

Unrestricted net assets consist of investments and otherwise unrestricted amounts that are available for use in carrying out the Hospital's mission and include those expendable resources which have been designated for special use by the Board of Trustees. Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. Permanently restricted net assets are those restricted by donors to be maintained in perpetuity.

Excess (Deficiency) of Revenue Over Expenses

The accompanying statements of operations include excess (deficiency) of revenue over expenses, which is considered the operating indicator. Changes in unrestricted net assets that are excluded from the operating indicator include unrealized gains and losses on investments other than trading securities, permanent transfer of assets to and from affiliates for other than goods and services, and contributions of long-lived assets, including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets.

Net Patient Service Revenue

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 are adjusted in future periods as final settlements are determined.

Note 1 Summary of Significant Accounting Policies (Continued)

Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. The Hospital maintains records to identify the amount of charges foregone for services and supplies furnished under the charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not included in net patient service revenue in the accompanying statements of operations.

The estimated cost of providing charity care to patients under the Hospital's charity care policy is calculated by multiplying the Hospital's ratio of cost to gross charges by the gross uncompensated charges associated with providing charity care.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Hospital 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 deemed unconditional. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying financial statements.

Advertising Costs

The Hospital expenses advertising costs as incurred.

Note 1 Summary of Significant Accounting Policies (Continued)

Income Taxes

The Hospital is an Illinois not-for-profit corporation as described in 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(a) of the Code. The Hospital is also exempt from state income taxes on related income.

In order to account for uncertain tax positions, the Hospital determines whether it is more likely than not that a tax position will be sustained upon examination of the technical merits of the position, assuming the taxing authority has full knowledge of all information. If the tax position does not meet the more-likely-than-not recognition threshold, the benefit of that position is not recognized in the financial statements.

The Hospital recorded no assets or liabilities for uncertain tax positions in 2012 or 2011. Federal and state tax returns for the years ended September 30, 2009, and beyond remain subject to examination by major tax jurisdictions. Tax returns for the year ended September 30, 2012, are not yet due and have not yet been filed as of the report date.

New Accounting Pronouncements

In August 2010, the FASB issued Accounting Standards Update (ASU) 2010-23, *Measuring Charity Care for Disclosure*. This ASU amends ASC Topic 954 and requires entities to use cost as the measurement basis for charity care disclosures, including both direct and indirect costs. Entities are also required to disclose the method used to determine these costs, such as directly from a costing system or through an estimation process. The Hospital adopted the guidance of this ASU for the year ended September 30, 2012. The amount of charity care for the year ended September 30, 2011, has been restated to reflect the estimated cost.

Note 1 **Summary of Significant Accounting Policies** (Continued)

New Accounting Pronouncements (Continued)

In July 2011, the FASB issued ASU 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and Allowance for Doubtful Accounts for Certain Health Care Entities.* This ASU amends ASC Topic 954 and requires health care entities to change the presentation of their statements of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue. Entities are also required to enhance disclosures about their policies for recognizing revenue and assessing bad debts. In addition, this guidance requires disclosure of qualitative and quantitative information about changes in the allowance for doubtful accounts. The guidance in this ASU is effective for the Hospital's year ending September 30, 2013.

Subsequent Events

Subsequent events have been evaluated through January 22, 2013, which is the date the financial statements were issued.

Note 2 **Reimbursement Arrangements With Third-Party Payors**

The Hospital has agreements with third-party payors that provide for reimbursement at amounts that vary from its established rates. A summary of the basis of reimbursement with major third-party payors follows:

- *Medicare* - The Hospital is certified as a CAH with reimbursement based on cost for inpatient and outpatient services. Professional services provided by physicians and other clinicians continue to be reimbursed based on prospectively determined fee schedules, with the exception of the rural health clinic, which is reimbursed on a cost basis subject to certain productivity limitations.

Note 2 Reimbursement Arrangements With Third-Party Payors (Continued)

- *Medicaid* - The Hospital renders inpatient and outpatient services to Illinois Medicaid patients at prospective rates determined by state of Illinois reimbursement formulas. These rates are not subject to retroactive adjustment. Effective January 1, 2011, the state of Illinois began reimbursing certain outpatient services provided by CAHs on a cost basis under state law enacted during fiscal 2010.

- *Blue Cross* - The majority of Blue Cross subscribers are paid under a Preferred Provider Organization (PPO) plan. The Blue Cross PPO plan reimburses the Hospital for inpatient services based on the lesser of net covered charges or the established per diem rate. Outpatient services are reimbursed based on a specified discount from charges. Blue Cross processes claims under a uniform payment plan or an interim basis subject to monthly reconciliation between actual payments received and the agreed-upon contractual amounts. The monthly reconciliation process results in the recognition of a liability that will be liquidated within 60 days.

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

Accounting for Contractual Arrangements

Medicare cost-based reimbursable items are reimbursed at tentative rates, and final settlements are determined after audit of the related annual cost reports. Estimated provisions to approximate the expected final settlements after review by the fiscal intermediary are included in the accompanying financial statements. The Hospital's cost reports have been audited by the Medicare fiscal intermediary through fiscal 2008.

Note 2 Reimbursement Arrangements With Third-Party Payors (Continued)

Compliance

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, particularly those relating to the Medicare and Medicaid programs, can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Recently, federal government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of regulations, which could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenue from patients' services. Management believes the Hospital is in substantial compliance with current laws and regulations.

The Centers for Medicare & Medicaid Services (CMS) uses recovery audit contractors (RACs) as part of its further efforts to ensure accurate payments under the Medicare program. RACs search for potentially inaccurate Medicare payments that may have been made to health care providers and not detected through existing CMS program integrity efforts. Once a RAC identifies a claim it believes is inaccurate, it makes a deduction from or addition to the provider's Medicare reimbursement in an amount estimated to equal the overpayment or underpayment. The provider will then have the opportunity to appeal the adjustment before final settlement of the claim is made. As of September 30, 2012, the Hospital has not been notified by the RAC of any potential significant reimbursement adjustments.

EHR Incentive Payment

For the year ended September 30, 2012, the Hospital recognized a Medicare EHR incentive payment of $966,490 as deferred revenue. The Hospital recognized $322,163 of the deferred revenue as other operating revenue during 2012. As of September 30, 2012, deferred revenue from the Medicare EHR incentive payment totaled $644,327.

Note 3 Patient Accounts Receivable

Patient accounts receivable consisted of the following at September 30:

	2012	2011
Patient accounts receivable	$ 14,621,847	$ 8,510,968
Less:		
Contractual adjustments	7,430,306	3,585,793
Allowance for doubtful accounts	2,020,795	1,602,476
Patient accounts receivable - Net	$ 5,170,746	$ 3,322,699

Note 4 Net Patient Service Revenue

Net patient service revenue consisted of the following:

	2012	2011
Gross patient service revenue	$ 51,451,067	$ 50,740,141
Less - Discounts, allowances, and estimated contractual adjustments under third-party reimbursement programs	23,844,445	23,718,231
Net patient service revenue	$ 27,606,622	$ 27,021,910

Note 5 Charity Care

The estimated cost of providing care to patients under the Hospital's charity care policy was approximately $908,000 and $736,000 in 2012 and 2011, respectively.

In addition to its charity care policy, the Hospital provided community benefits, including, but not limited to, the following:

- Operation of a full-time emergency room, providing emergency medical services to all patients accessing the Hospital, regardless of race, creed, sex, national origin, handicap, age, or ability to pay.
- Maintenance of provider agreements with Medicare and Illinois Public Aid programs.
- Health screenings, promotions, education, and prevention programs offered free or at a low cost to the community.
- Meeting facilities that are frequently used by community groups without charge.
- Language line and telephone line for the hearing impaired.
- Free pre-participation physicals for area athletes.

The Illinois legislature passed the Hospital Uninsured Patient Discount Act (the "Act"). The Act requires hospitals to provide certain mandated discounts from charges to the uninsured in Illinois. Charges are to be discounted to 135% of cost. Furthermore, a hospital may not collect more than 25% of an uninsured family's gross income in any one year. In addition, the Hospital must annually file a copy of Worksheet C, Part I of its Hospital's Medicare cost report with the Illinois Attorney General. The Hospital has developed procedures in order to implement and comply with the Act.

Note 6 Investments and Assets Limited as to Use

Investments and assets limited as to use are included in the accompanying balance sheets under the following captions as of September 30:

	2012	2011
Investments	$ 11,486,062	$ 5,307,043
Assets limited as to use:		
Held by trustee - Hoffman Memorial Trust	$ 211,526	$ 206,948
Restricted by loan agreement:		
Debt service reserve fund	2,352,650	2,352,650
Special interest fund	5,620	8,202
Total restricted by loan agreement	2,358,270	2,360,852
Board designated:		
Funded depreciation	3,212,311	2,575,521
Endowment purposes	5,161,446	4,342,822
Other	57,504	293,450
Total board designated	8,431,261	7,211,793
Donor restricted	729,623	729,276
Total assets limited as to use	11,730,680	10,508,869
Less - Current portion	1,108,611	1,063,611
Total assets limited as to use - Less current portion	$ 10,622,069	$ 9,445,258

Note 6 Investments and Assets Limited as to Use (Continued)

Investments and assets limited as to use, stated at fair value, consisted of the following at September 30:

	2012	2011
Cash, cash equivalents, and certificates of deposit	$ 3,123,877	$ 3,980,866
Corporate equity securities	4,405,291	2,988,367
Mutual funds	15,443,666	8,493,110
Bonds	145,304	254,965
Interest in split-value agreement	98,604	98,604
Total investments and assets limited as to use	$ 23,216,742	$ 15,815,912

Investments, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the value of certain investments will occur in the near term and such changes could materially affect the amounts reported in the financial statements.

The Hospital's Investment Committee evaluates the investment portfolio on a regular basis to determine if investments have suffered an other-than-temporary decline in value. In addition, the Investment Committee and an investment consulting firm monitor market trends and other circumstances that might impact the carrying value of securities. The Investment Committee considers factors affecting the investment, factors affecting the industry the issuer of the investment operates within, and general debt and equity market trends. The Investment Committee also considers the length of time an investment's fair value has been below carrying value, the near-term prospects for recovery, and the intent and ability to hold the investment until maturity or until market recovery is realized. When a determination is made that a decline in fair value below the cost basis is other than temporary, the loss on the investment is included as a realized loss in excess (deficiency) of revenue over expenses.

Management determined no investments were other than temporarily impaired for the years ended September 30, 2012 and 2011.

Note 6 Investments and Assets Limited as to Use (Continued)

Unrealized losses and fair value, aggregated by investment category and length of time individual securities have been in a continuous unrealized loss position, as of September 30, 2012 and 2011, are summarized as follows:

	Less than 12 Months		12 Months or More		Total	
2012	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate equity securities	$ 1,422,426	$ (8,791)	$ 0	$ 0	$ 1,422,426	$ (8,791)
Mutual funds	5,863,763	(246,173)	0	0	5,863,763	(246,173)
	$ 7,286,189	$ (254,964)	$ 0	$ 0	$ 7,286,189	$ (254,964)
2011						
Corporate equity securities	$ 1,422,426	$ (136,669)	$ 0	$ 0	$ 1,422,426	$ (136,669)
Mutual funds	5,863,763	(595,179)	0	0	5,863,763	(595,179)
	$ 7,286,189	$ (731,848)	$ 0	$ 0	$ 7,286,189	$ (731,848)

Note 7 Fair Value Measurements

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below:

- Investments in corporate equity securities, mutual funds, and certain fixed income securities traded on a national securities exchange are valued at the last reported sales price on the day of valuation. These financial instruments are classified as Level 1 in the fair value hierarchy.

- Investments in U.S. government obligations for which quotations are not readily available are valued using pricing models or the closing price reported on the active market in which the fund is traded. These financial instruments are classified as Level 2 in the fair value hierarchy.

Note 7 Fair Value Measurements (Continued)

The following tables set forth by level, within the fair value hierarchy, the Hospital's assets at fair value as of September 30:

	2012			
	Fair Value Measurements Using			Total Assets
	Level 1	Level 2	Level 3	at Fair Value
Investments and assets limited as to use:				
Corporate equity securities:				
U.S. government large/mid cap	$ 130,925	$ 0	$ 0	$ 130,925
Timber	559,441	0	0	559,441
Commodities	1,185,270	0	0	1,185,270
Other hard assets	1,885,813	0	0	1,885,813
Exchange traded	643,842	0	0	643,842
Mutual funds:				
U.S. large/mid cap	2,875,006	0	0	2,875,006
U.S. small/micro cap	268,419	0	0	268,419
Developed international large/mid cap	229,765	0	0	229,765
Emerging international	676,417	0	0	676,417
Real estate	656,558	0	0	656,558
Commodities	845,879	0	0	845,879
Government long/intermediate term	2,005,452	0	0	2,005,452
Other fixed income	3,807,241	0	0	3,807,241
Volatility reducers	2,312,246	0	0	2,312,246
Intermediate-term bond	1,641,581	0	0	1,641,581
Fixed income	90,048	0	0	90,048
Exchange traded	35,054	0	0	35,054
Bonds:				
Municipal short-term	0	50,026	0	50,026
General bond	95,278	0	0	95,278
Total	$ 19,944,235	$ 50,026	$ 0	$ 19,994,261

Kewanee Hospital

Notes to Financial Statements

Note 7 Fair Value Measurements (Continued)

	2011			
	Fair Value Measurements Using			Total Assets
	Level 1	Level 2	Level 3	at Fair Value
Investments and assets limited as to use:				
Corporate equity securities:				
U.S. government large/mid cap	$ 114,515	$ 0	$ 0	$ 114,515
Developed international large/mid cap	399,690	0	0	399,690
Timber	441,193	0	0	441,193
Commodities	1,052,380	0	0	1,052,380
Other hard assets	366,605	0	0	366,605
Volatility reducers	34,339	0	0	34,339
Exchange traded	579,645	0	0	579,645
Mutual funds:				
U.S. large/mid cap	1,696,707	0	0	1,696,707
U.S. small/micro cap	198,835	0	0	198,835
Developed international large/mid cap	211,332	0	0	211,332
Developed international small/micro cap	207,385	0	0	207,385
Emerging international	575,717	0	0	575,717
Real estate	497,519	0	0	497,519
Commodities	952,309	0	0	952,309
Other fixed income	1,905,810	0	0	1,905,810
Volatility reducers	657,074	0	0	657,074
Intermediate-term bond	1,465,519	0	0	1,465,519
Fixed income	92,823	0	0	92,823
Exchange traded	32,080	0	0	32,080
Bonds:				
Municipal short-term	0	52,483	0	52,483
General bond	202,482	0	0	202,482
Total	$ 11,683,959	$ 52,483	$ 0	$ 11,736,442

Note 8 Property and Equipment

Property and equipment consisted of the following at September 30:

	2012	2011
Land	$ 588,318	$ 588,318
Land improvements	854,467	854,467
Buildings and improvements	19,751,929	19,690,401
Major movable equipment	12,923,930	13,274,609
Fixed equipment	9,550,462	9,550,462
Total property and equipment	43,669,106	43,958,257
Less - Accumulated depreciation	16,649,780	14,719,172
Net depreciated value	27,019,326	29,239,085
Construction in progress	349,291	41,022
Property and equipment - Net	$ 27,368,617	$ 29,280,107

Note 9 Long-Term Debt

Long-term debt consisted of the following at September 30:

	2012	2011
Illinois Finance Authority Revenue Bonds, Series 2006, dated August 1, 2006, bearing interest at various rates ranging from 4.6% to 5.1%, maturing in varying amounts through August 15, 2031	$ 28,225,000	$ 29,100,000
Less - Current maturities	920,000	875,000
Long-term portion	$ 27,305,000	$ 28,225,000

Note 9 Long-Term Debt (Continued)

Scheduled payments of principal on long-term debt at September 30, 2012, including current maturities, are summarized as follows:

2013	$ 920,000
2014	965,000
2015	1,015,000
2016	1,065,000
2017	1,120,000
Thereafter	23,140,000
Total	$ 28,225,000

Note 10 Temporarily Restricted Net Assets

Temporarily restricted net assets were available for departmental use in the amount of $56,114 and $55,767 at September 30, 2012 and 2011, respectively.

Temporarily restricted net assets were released from donor restrictions by incurring expenditures satisfying their restricted purposes for property and equipment additions and reimbursement of operating expenses in the amount of $0 and $6,484 at September 30, 2012 and 2011, respectively.

Note 11 Permanently Restricted Net Assets

Permanently restricted net assets of $673,509 as of September 30, 2012 and 2011, are restricted to investment in perpetuity, the income from which is expendable to support health care services.

Note 12 Self-Funded Health Insurance

The Hospital is self-insured for employee group health insurance coverage. The Hospital reimburses employees through a third-party administrator based on received claims. The plan has a stop-loss coverage of $100,000. Excess claims over the limitation are reinsured. Claims expense approximated $778,000 and $1,105,000 for the years ended September 30, 2012 and 2011, respectively. Liabilities are reported when it is probable that a loss will occur, and the amount of loss can be reasonably estimated. Claims liabilities are calculated considering recent claims, settlement trends, including frequency and amount of payoffs, and other economic and social factors. The Hospital has recorded a current liability of approximately $78,000 and $250,000 as of September 30, 2012 and 2011, respectively, for open claims and claims incurred but not reported in the accompanying balance sheets.

Note 13 Malpractice Insurance

The Hospital participates in the Illinois Provider Trust (IPT), an organization sponsored by the Illinois Hospital Association (IHA) to provide professional liability coverage to Illinois hospitals that are members of IHA. The IPT is a multi-hospital, self-insurance trust formed pursuant to the provisions of the Illinois Religious and Charitable Risk Pooling Act. Member hospitals and affiliates make contributions to IPT, which provides mutual insurance protection for all members of IPT. The Hospital could also be required to make additional retroactive contributions based on actuarial calculations of trust loss experience. The provision for insurance is based on the Hospital's experience, and future premiums can be adjusted for favorable or unfavorable retrospective experience. Claims-made coverage is currently arranged through December 31, 2012. Coverage for claims made subsequent to December 31, 2012, is dependent upon the Hospital's ability to obtain claims-made insurance in the future.

The Hospital uses an actuary to calculate an estimate of incurred but not reported claims. The estimated accrual as of September 30, 2012 and 2011, is approximately $277,000 and $272,000, respectively. For the years ended September 30, 2012 and 2011, the Hospital incurred expenses for malpractice coverage of approximately $313,000 and $229,000, respectively.

Note 14 Workers' Compensation Insurance

The Hospital participates in the Illinois Compensation Trust (ICT), an organization sponsored by the IHA to provide workers' compensation coverage to Illinois hospitals that are members of IHA. The ICT is a multi-hospital, self-insurance trust formed pursuant to the provisions of the Illinois Religious and Charitable Risk Pooling Act. Member hospitals and affiliates make contributions to the ICT, which provides mutual insurance protection for all members of the ICT. According to the ICT agreement, a dividend may be made to participating hospitals if the ICT's loss experience is better than anticipated. If, however, the ICT's loss experience is worse than anticipated, IHA's board may vote to increase the hospitals' monthly premiums.

For the years ended September 30, 2012 and 2011, the Hospital incurred expenses for workers' compensation coverage of approximately $79,000 and $83,000, respectively, which primarily consisted of insurance premiums

Note 15 Retirement Plan

The Hospital sponsors a defined contribution retirement plan covering substantially all of its employees. The Hospital matches each participant's contribution up to a maximum of 3% of covered earnings. Total retirement expense for the years ended September 30, 2012 and 2011, was approximately $332,000 and $274,000, respectively.

Note 16 Functional Expenses

The Hospital provides general health care services to residents within its geographic location. The Hospital receives, raises, and administers gifts for the sole benefit of the Hospital. Expenses related to providing these services consisted of the following:

	2012	2011
Health care services	$ 20,705,710	$ 20,236,730
General and administrative	7,123,416	7,753,898
Fund-raising	49,760	69,189
Total expenses	$ 27,878,886	$ 28,059,817

Note 17 Concentration of Credit Risk

Financial instruments that potentially subject the Hospital to credit risk consist principally of accounts receivable, investments, and cash deposits in excess of insured limits in financial institutions.

Patient accounts receivable consist of amounts due from patients, their insurers, or governmental agencies (primarily Medicare and Medicaid) for health care provided to patients. The majority of the Hospital's patients are from Henry County, Illinois, and the surrounding area. The mix of receivables from patients and third-party payors was as follows at September 30:

	2012	2011
Medicare	18%	26%
Medicaid	35%	16%
Other third-party payors	17%	19%
Patients	30%	39%
Totals	100%	100%

The Hospital maintains depository relationships with area financial institutions, including banks that are participating in the Federal Deposit Insurance Corporation (FDIC). On November 9, 2010, the FDIC issued a final rule implementing Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act that provides for unlimited insurance coverage of non-interest-bearing transaction accounts through December 31, 2012. The Hospital maintains interest-bearing accounts at these institutions that are guaranteed by the FDIC up to $250,000. Other investments and assets limited as to use held by financial institutions are uninsured. At September 30, 2012, the Hospital exceeded FDIC-insured limits by approximately $3,075,000.

Note 18 Property Tax Exemption

During May 2012, legislation was passed setting criteria for Illinois hospitals to meet in order to be deemed exempt from property taxes. The new application will be developed by the Illinois Department of Revenue and distributed to hospitals in late 2012. These applications will be due to each hospital's respective county by January 31 every year. The Hospital has paid property taxes while awaiting a ruling on the filed application for property tax exemption. The tax years that have been paid are 2009, 2010, and 2011. The Hospital has internally evaluated the new exemption criteria and believes that the exemptions will be granted and anticipates a full refund for the three years of taxes that have been paid, totaling approximately $1,400,000. As there is uncertainty surrounding the exemptions, the Hospital has recorded a $413,798 receivable as of September 30, 2012, for refund of the property taxes previously paid by the Hospital.

Note 19 Endowments

The Hospital's endowments consist of different funds established to benefit the Hospital for a variety of purposes. The Hospital's endowments include both donor-restricted endowments and funds designated by the Board of Trustees to function as an endowment. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Donor-Restricted Endowments

The Board has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the Hospital to preserve the fair value of the donor's original gift, as of the date of the gift, absent any explicit donor stipulations to the contrary. As a result of this interpretation, the Hospital classifies as permanently restricted net assets (a) the original value of a donor's gifts to the permanent endowment, (b) the original value of a donor's subsequent gifts to the permanently restricted endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Hospital in a manner consistent with the standard of prudence prescribed by UPMIFA.

Note 19 Endowments (Continued)

Donor-Restricted Endowments (Continued)

In accordance with UPMIFA, the Hospital considers the following factors in making a determination to appropriate or accumulate donor-restricted endowments funds: (1) the duration and preservation of the various funds, (2) the purposes of the donor-restricted endowment funds, (3) general economic conditions, (4) the possible effect of inflation and deflation, (5) the expected total return from income and the appreciation of investments, (6) other resources of the Hospital, and (7) the Hospital's investment policies.

Board-Designated Endowment

The Board has set aside certain unrestricted net assets for endowment purposes. Since these amounts are not restricted by the donor but are restricted only by Board policy, the amounts have been classified as unrestricted net assets. The Board may designate additional amounts from time to time to be added to the endowment fund.

Investment Return Objectives, Risk Parameters, and Strategies

The Hospital has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowments while seeking to preserve the fair value of the endowment assets. Under the Hospital 's investment policy, as approved by the Board, the endowment assets are invested in a manner to protect principal, grow the aggregate portfolio value in excess of the rate of inflation and achieve an effective annual rate of return that is equal to or greater than the designated benchmarks for the various types of investment vehicles, and ensure that any risk assumed is commensurate with the given investment vehicle and the Hospital 's objectives.

To achieve its investment goals, the Hospital targets an asset allocation that will achieve a balanced return of current income and long-term growth of principal while exercising risk control. The Hospital's asset allocations include a blend of equity and debt securities and cash equivalents.

Note 19 Endowments (Continued)

Investment Return Objectives, Risk Parameters, and Strategies (Continued)

Endowment net assets consisted of the following at September 30:

2012	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted funds	$ 0	$ 10,298	$ 673,509	$ 683,807
Board-designated (quasi) endowment funds	5,161,446	0	0	5,161,446
	$ 5,161,446	$ 10,298	$ 673,509	$ 5,845,253
2011				
Donor-restricted funds	$ 0	$ 10,298	$ 673,509	$ 683,807
Board-designated (quasi) endowment funds	4,342,822	0	0	4,342,822
	$ 4,342,822	$ 10,298	$ 673,509	$ 5,026,629

Changes in endowment net assets were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at October 1, 2011	$ 5,751,739	$ 10,298	$ 673,509	$ 6,435,546
Investment return:				
Investment income	231,843	0	0	231,843
Change in net unrealized gains and losses	(1,216,060)	0	0	(1,216,060)
Total investment return	(984,217)	0	0	(984,217)
Appropriation of endowment assets for expenditures	(424,700)	0	0	(424,700)
Endowment net assets at September 30, 2011	4,342,822	10,298	673,509	5,026,629
Investment return:				
Investment income	142,883	0	0	142,883
Change in net unrealized gains and losses	731,915	0	0	731,915
Total investment return	874,798	0	0	874,798
Appropriation of endowment assets for expenditures	(56,174)	0	0	(56,174)
Endowment net assets at September 30, 2012	$ 5,161,446	$ 10,298	$ 673,509	$ 5,845,253

Note 20 Illinois Medicaid Program

During fiscal 2010, the state of Illinois enacted a law under which eligible outpatient hospital services provided by CAHs, including the Hospital, would be reimbursed on a cost-reimbursement methodology. Effective January 1, 2011, the state of Illinois is reimbursing CAHs for outpatient services on a cost basis. The Hospital began receiving payments under the new system in May 2011 applicable retroactively to dates of services on or after January 1, 2011.

In December 2008, CMS approved the State of Illinois Medicaid Hospital Assessment Program (the "Program"). Under the Program, which was retroactive to July 1, 2008, a hospital receives additional Medicaid reimbursement from the state and pays a related assessment. Total reimbursement revenue recognized by the Hospital related to the Program amounted to approximately $2,239,000 and $1,220,000 for the years ended September 30, 2012 and 2011, respectively, which is recorded as an increase in net patient service revenue. During the state fiscal year 2012 (year ended June 30, 2012), assessment payments were accelerated so that two months were paid and reimbursed at a time. Beginning July 2012 (state fiscal year 2013), assessment payments are being made and reimbursed on a month-to-month basis. The amount of deferred revenue related to the Program as of September 30, 2012 and 2011, was approximately $0 and $787,000, respectively. Total annual assessments incurred by the Hospital related to the Program amounted to approximately $430,000 for the years ended September 30, 2012 and 2011, which is recorded as other expenses. The prepaid expenses related to the Program as of September 30, 2012 and 2011, were approximately $0 and $107,000, respectively. The Program is effective through June 2013.

In November 2010, CMS approved the state of Illinois' one-time Medicaid stimulus payment plan to Illinois hospitals which provide Medicaid services. Under this stimulus payment plan, the Hospital was awarded approximately $711,000, all of which was received and recognized in November 2010.

Note 21 Related-Party Transactions

From time to time, the Hospital may enter into various business transactions with members of the Board of Trustees, members of various board committees, or organizations that employ board and/or committee members. Transactions are provided at fair value and follow the Hospital's conflict of interest policies.

Note 22 Reclassifications

Certain reclassifications have been made to the 2011 financial statements to conform to 2012 classifications.

- Not Applicable
- A-Rated organization