



CDH/DELNOR HEALTH SYSTEM
d/b/a Cadence Health, and Affiliates

Consolidated Financial Statements and
Supplementary Information

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)



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

Independent Auditors' Report

The Board of Directors
CDH/Delnor Health System (d/b/a Cadence Health):

We have audited the accompanying consolidated balance sheets of CDH/Delnor Health System, d/b/a Cadence Health, and Affiliates (the Corporations) as of June 30, 2012 and 2011, and the related consolidated statements of operations, changes in net assets, and cash flows for the year ended June 30, 2012 and the three-month period ended June 30, 2011. These consolidated financial statements are the responsibility of the Corporations' management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporations' internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of CDH/Delnor Health System, d/b/a Cadence Health, and Affiliates as of June 30, 2012 and 2011, and the results of their operations, changes in their net assets, and their cash flows for the year ended June 30, 2012 and the three-month period ended June 30, 2011, in conformity with U.S. generally accepted accounting principles.



Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included in schedules 1 through 3 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the 2012 consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

September 19, 2012

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CDH/DELNOR HEALTH SYSTEM
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Consolidated Balance Sheets

June 30, 2012 and 2011

(In thousands)

Assets	2012	2011
Current assets:		
Cash and cash equivalents	\$ 5,914	40,899
Current portion of assets limited or restricted as to use	54	100
Receivables:		
Patient and resident accounts, less allowance for doubtful accounts of approximately \$70,531 and \$47,132	142,082	111,341
Estimated receivables under third-party reimbursement programs and other	59,583	32,058
Inventories	4,463	5,480
Prepaid expenses	19,857	20,524
Total current assets	231,953	210,402
Assets whose use is limited or restricted, net of current portion:		
By board for investment	1,195,413	1,111,783
Self-insurance trust	34,341	27,629
Held by trustee under debt agreements	10,445	49,135
Donor restricted	18,494	13,520
Total assets whose use is limited or restricted, net of current portion	1,258,693	1,202,067
Land, buildings, and equipment, net of accumulated depreciation and amortization	860,216	818,279
Other assets:		
Notes and advances receivable	67,917	57,985
Retirement plan assets	4,408	4,372
Investments in joint ventures and other assets	50,630	49,332
Total other assets	122,955	111,689
Total assets	\$ 2,473,817	2,342,437

See accompanying notes to consolidated financial statements

Liabilities and Net Assets	2012	2011
Current liabilities:		
Current installments of long-term debt	\$ 4,005	4,658
Accounts payable	41,448	36,319
Accrued liabilities:		
Salaries and wages	56,401	60,525
Pension	2,687	3,367
Interest	4,014	3,997
Other	37,798	25,542
Estimated payables under third-party reimbursement programs	103,120	87,075
Total current liabilities	<u>249,473</u>	<u>221,483</u>
Long-term debt, net of unamortized bond premiums and current installments	579,424	595,402
Construction payables	—	10,091
Retirement plan liabilities	4,408	4,372
Deferred revenue and other liabilities	112,999	87,141
Total liabilities	<u>946,304</u>	<u>918,489</u>
Net assets:		
Unrestricted	1,509,019	1,410,428
Temporarily restricted	13,011	8,255
Permanently restricted	5,483	5,265
Total net assets	<u>1,527,513</u>	<u>1,423,948</u>
Total liabilities and net assets	<u>\$ 2,473,817</u>	<u>2,342,437</u>

CDH/DELNOR HEALTH SYSTEM

d/b/a Cadence Health, and Affiliates

Consolidated Statements of Operations

Year ended June 30, 2012 and three-month period ended June 30, 2011

(In thousands)

	<u>2012</u>	<u>2011</u>
Net patient and resident service revenue	\$ 1,021,735	229,151
Other revenue	50,505	13,374
Total revenue	<u>1,072,240</u>	<u>242,525</u>
Expenses:		
Salaries and wages	362,025	84,585
Employee benefits	79,549	22,713
Professional fees and purchased services	113,623	32,154
Supplies	156,287	36,859
Interest	29,214	3,203
Depreciation and amortization	77,646	18,177
Provision for uncollectible accounts	65,373	15,128
Other	80,321	20,946
Total expenses	<u>964,038</u>	<u>233,765</u>
Revenue in excess of expenses	108,202	8,760
Nonoperating gains and losses:		
Investment return, unrestricted contributions, and other, net	(4,911)	3,016
Revenue and gains in excess of expenses and losses	103,291	11,776
Other changes in unrestricted net assets:		
Change in net unrealized gains and losses on other-than-trading securities	(5,100)	1,371
Joint venture equity transactions	—	36
Net assets released from restriction for the purchase of land, buildings, and equipment	400	209
Increase in unrestricted net assets	<u>\$ 98,591</u>	<u>13,392</u>

See accompanying notes to consolidated financial statements.

CDH/DELNOR HEALTH SYSTEM

d/b/a Cadence Health, and Affiliates

Consolidated Statements of Changes in Net Assets

Year ended June 30, 2012 and three-month period ended June 30, 2011

(In thousands)

	<u>2012</u>	<u>2011</u>
Increase in unrestricted net assets	\$ 98,591	13,392
Temporarily restricted net assets:		
Contributions for specific purposes	6,749	1,223
Investment return	2	12
Net assets released from restriction and used for operations	(1,595)	(388)
Net assets released from restriction for the purchase of land, buildings, and equipment	(400)	(209)
Increase in temporarily restricted net assets	<u>4,756</u>	<u>638</u>
Permanently restricted net assets:		
Contributions to be held in perpetuity	13	3
Investment return	205	7
Increase in permanently restricted net assets	<u>218</u>	<u>10</u>
Change in net assets	103,565	14,040
Net assets at beginning of period	<u>1,423,948</u>	<u>1,409,908</u>
Net assets at end of period	<u>\$ 1,527,513</u>	<u>1,423,948</u>

See accompanying notes to consolidated financial statements.

CDH/DELNOR HEALTH SYSTEM
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Consolidated Statements of Cash Flows

Year ended June 30, 2012 and three-month period ended June 30, 2011

(In thousands)

	2012	2011
Cash flows from operating activities and gains and losses:		
Change in net assets	\$ 103,565	14,040
Adjustments to reconcile change in net assets to net cash provided by operating activities and gains and losses:		
Depreciation and amortization	77,646	18,177
Amortization of net bond premiums	(148)	(12)
Provision for uncollectible accounts	65,373	15,128
Loss on write-off of deferred finance charges	263	254
Realized gains (losses) and change in unrealized gains (losses) on investments, net	15,457	(561)
Change in fair value of derivative instruments	27,255	4,063
Amortization of entrance fees	(504)	(131)
Net refunds of entrance fees	(223)	—
Joint venture equity transactions	—	(36)
Permanently restricted contributions and investment return	(218)	(10)
Equity earnings in joint ventures, net of cash distributions received	(1,589)	(251)
Joint venture impairment	—	668
Changes in assets and liabilities:		
Receivables, net	(123,639)	8,375
Inventories and prepaid expenses	1,684	713
Accounts payable, accrued liabilities, and other liabilities	11,964	11,017
Estimated payables under third-party reimbursement programs	16,045	(398)
Net cash provided by operating activities	192,931	71,036
Cash flows from investing activities:		
Purchases of assets whose use is limited or restricted	(1,293,135)	(300,655)
Proceeds from sales or maturities of assets whose use is limited or restricted	1,221,062	279,264
Acquisition of land, buildings, and equipment	(119,583)	(38,703)
Change in construction payables	(10,091)	(961)
Net change in other assets	(9,904)	(2,120)
Net cash used in investing activities	(211,651)	(63,175)
Cash flows from financing activities:		
Principal payments and defeasance of long-term debt	(202,048)	(8,713)
Proceeds from issuance of long-term debt	185,565	—
Permanently restricted contributions and investment return	218	10
Net cash used in financing activities	(16,265)	(8,703)
Net change in cash and cash equivalents	(34,985)	(842)
Cash and cash equivalents at beginning of period	40,899	41,741
Cash and cash equivalents at end of period	\$ 5,914	40,899
Supplemental disclosure of cash flow information:		
Cash paid for interest, net of amounts capitalized	\$ 29,197	10,723

See accompanying notes to consolidated financial statements.

CDH/DELNOR HEALTH SYSTEM
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Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(In thousands)

(1) CDH-Delnor Health System and Affiliates

Effective April 1, 2011, Delnor-Community Health System (Delnor) and Central DuPage Health (CDHealth) merged to form CDH/Delnor Health System, d/b/a Cadence Health (Cadence Health). The merger was effectuated by CDHealth becoming the sole corporate member of Delnor and its affiliated entities. Concurrent with the merger, the board of directors of CDHealth was reconstituted to include equal representation from Delnor and CDHealth. The reconstituted CDHealth board of directors exercises control over CDHealth, Delnor, and all of their respective affiliates through ownership, sole voting membership, the authority to approve board membership, or the holding of certain reserve powers. The merger of Delnor and CDHealth was approved by the boards of directors of both organizations to make available the resources and specialties of both health systems to the communities they serve. The combination of CDHealth and Delnor has been accounted for as a merger given the ceding of control by both organizations to the reconstituted CDHealth board of directors. The accompanying consolidated financial statements of Cadence Health present the financial position and results of operations of the merged entity as of and subsequent to the merger date.

The accompanying consolidated financial statements include the accounts of Cadence Health, which was incorporated to promote and encourage health and human services in the communities it serves, and the following affiliates (collectively referred to as the Corporations):

- Central DuPage Hospital Association (CDH), a not-for-profit acute care hospital. CDH provides inpatient, outpatient, and emergency care for residents in the Wheaton, Winfield, West Chicago, Glen Ellyn, and surrounding areas.
- Cadence Physician Group (CPG), a not-for-profit corporation that contracts with licensed physicians to provide medical services to patients, hospitals, affiliated group practices, or other medical care facilities.
- Community Nursing Service of DuPage County, Inc. d/b/a CNS Home Health (CNS), a not-for-profit corporation that provides home healthcare and hospice services.
- DuPage Health Services, Inc. (DHSI), a wholly owned for-profit subsidiary of Cadence Health. DHSI provides various physician support as well as other business activities in furtherance of the interests of DHSI and the Cadence Health healthcare delivery system.
- PAHCS II, d/b/a Central DuPage Business Health, a not-for-profit corporation that operates a business dedicated to the advancement and promotion of health for employees of companies within the communities served by Cadence Health and its affiliates.
- Central DuPage Special Health Association (Special Health), a not-for-profit corporation that operates a pharmaceutical distribution center serving the Corporations and their patients.
- Central DuPage Health Foundation (Foundation), a not-for-profit corporation that promotes and supports patient-centered services and programs of Cadence Health and its affiliates.

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(In thousands)

- Delnor-Community Hospital (Delnor Hospital), a charitable not-for-profit organization providing acute healthcare services primarily to the St. Charles, Geneva, Batavia, and Elburn, Illinois communities.
- Delnor-Community Health Care Foundation (Delnor Foundation), a not-for-profit organization that exists principally to solicit, receive, and grant gifts and contributions for and on behalf of charitable service organizations.
- Delnor-Community Residential Living, Inc. (Residential Living), d/b/a Delnor Glen, a not-for-profit organization that owns and operates a residential supportive living facility that includes 78 residential supportive living units and related facilities.
- Living Well Cancer Resource Center (Living Well), a not-for-profit organization established in 2006 for the purpose of providing cancer support and wellness.
- DelCom Corporation (DelCom), an Illinois taxable for-profit organization that engages in for-profit healthcare and related ventures.
- Unified Professionals Insurance Company, Ltd. (UPIC) was incorporated as an Exempted Company under the Companies Law of the Cayman Islands on September 12, 2011. UPIC is licensed as an Unrestricted Class 'B' Insurer under Section 4(2) of the Cayman Islands' Insurance Law and is a wholly owned subsidiary of Cadence Health.

At the April 1, 2011 merger date, neither Delnor nor CDHealth had significant assets or liabilities that do not require recognition under U.S. generally accepted accounting principles. The application of merger accounting to the combination as of April 1, 2011 required Delnor to conform certain accounting policies for consistency with CDHealth, including expensing certain supplies inventory and the estimation of self-insured workers' compensation liabilities.

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(In thousands)

The amounts recognized as of the April 1, 2011 merger date for each major class of assets, liabilities, and net assets for CDHealth and Delnor, inclusive of opening balance adjustments, are provided in the following table:

	CDH and affiliates	Delnor and affiliates	Adjustments		Total
			Debit	Credit	
Current assets:					
Cash and cash equivalents	\$ 30,600	11,139	—	—	41,739
Receivables, net of allowances	136,331	30,433	—	—	166,764
Other current assets	21,344	5,970	—	601	26,713
Total current assets	188,275	47,542	—	601	235,216
Assets whose use is limited or restricted					
Land, buildings, and equipment, net	952,908	232,185	—	—	1,185,093
Other assets	624,880	172,876	—	—	797,756
	95,037	10,931	—	—	105,968
Total assets	\$ 1,861,100	463,534	—	601	2,324,033
Current liabilities:					
Current installments of long-term debt	\$ 2,575	2,495	—	—	5,070
Accounts payable and accrued liabilities	162,607	47,874	—	643	211,124
Total current liabilities	165,182	50,369	—	643	216,194
Long-term debt, excluding current installments					
Other liabilities	466,847	136,857	—	—	603,704
	71,141	23,086	—	—	94,227
Total liabilities	703,170	210,312	—	643	914,125
Net assets:					
Unrestricted	1,149,286	249,071	1,244	—	1,397,113
Temporarily restricted	3,389	4,151	—	—	7,540
Permanently restricted	5,255	—	—	—	5,255
Total net assets	1,157,930	253,222	1,244	—	1,409,908
Total liabilities and net assets	\$ 1,861,100	463,534	1,244	643	2,324,033

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Notes to Consolidated Financial Statements

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(In thousands)

(2) Summary of Significant Accounting Policies

The following accounting policies, all of which conform to general practice within the healthcare industry, are utilized in presenting the consolidated financial statements:

- The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.
- The consolidated statements of operations include revenue and gains in excess of expenses and losses. Transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as revenue and expenses. Transactions incidental to the provision of patient and residential care services are reported as gains and losses. Changes in unrestricted net assets, which are excluded from revenue and gains in excess of expenses and losses, consistent with industry practice, include unrealized gains and losses on other-than-trading investment securities, equity transactions of unconsolidated joint ventures, and contributions of long-lived assets (including assets acquired using contributions that by donor restriction were to be used for the purposes of acquiring such assets).
- Net patient and resident service revenue is reported at the estimated net realizable amounts from patients, residents, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors and policy discounts. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.
- In August 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-23, *Measuring Charity Care for Disclosure* (ASU No. 2010-23). ASU No. 2010-23 requires that cost be used as the measurement basis for charity care disclosure purposes and that cost can be identified as direct and indirect costs of providing charity care. The Corporations implemented ASU No. 2010-23 for the year ended June 30, 2012 (note 4).
- Cash and cash equivalents include demand deposits, interest-bearing accounts at banks, overnight sweep investments, certain money market fund investments, and certain fixed income securities with maturities at date of purchase of three months or less.
- Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated balance sheets. Investments in a private equity real estate fund and a hedge fund of funds are reported at cost. Investment return (including realized gains and losses on investments, interest, and dividends) is included in revenue and gains in excess of expenses and losses unless the income or loss is temporarily or permanently restricted by donors, in which case the investment return is recorded directly to temporarily or permanently restricted net assets. Changes in net unrealized gains and losses on investments are excluded from revenue and gains in excess of expenses and losses unless the investments are classified as trading securities. A decline in the market value of any other-than-trading security below cost that is deemed

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(In thousands)

to be other-than-temporary results in a reduction in carrying amount to fair value. The impairment is included in nonoperating losses and a new cost basis for the security is established. To determine whether an impairment is other than temporary, the Corporations consider whether they have the ability and intent to hold the investment until a market price recovery and consider whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to year-end, and forecasted performance of the investee.

- The Corporations apply the provisions of Accounting Standards Codification (ASC) Subtopic 820-10, *Fair Value Measurements – Overall*, for fair value measurements of financial assets and liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. ASC Subtopic 820-10 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Subtopic 820-10 also establishes a framework for measuring fair value and expands disclosures about fair value measurements (note 7).
- In conjunction with the adoption of ASC Subtopic 820-10, the Corporations adopted the measurement provisions of ASU No. 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, to certain investments in money market funds that do not have readily determinable fair values. This guidance amends ASC Subtopic 820-10 and allows for the estimation of the fair value of investment companies for which the investment does not have a readily determinable fair value using net asset value per share or its equivalent.
- In January 2010, the FASB issued ASU No. 2010-06, *Improving Disclosures about Fair Value Measurements* (ASU No. 2010-06). ASU No. 2010-06 amends ASC Subtopic 820-10 to provide additional disclosure requirements for transfers into and out of Levels 1 and 2 and for activity in Level 3 and to clarify other existing disclosure requirements. The Corporations implemented ASU No. 2010-06 for the period ended June 30, 2011.
- The Corporations have adopted the provisions of ASC Topic 820, *Fair Value Measurements*, related to fair value measurements of nonfinancial assets and nonfinancial liabilities that are recognized or disclosed in the consolidated financial statements on a nonrecurring basis.
- The Corporations have adopted the provisions of ASC Subtopic 825-10, *The Fair Value Option for Financial Assets and Financial Liabilities*. ASC Subtopic 825-10 gives the Corporations the irrevocable option to report most financial assets and financial liabilities at fair value on an instrument-by-instrument basis, with changes in fair value reported in earnings. Since adoption and through June 30, 2012, the Corporations' management has not elected to measure any additional eligible financial assets or financial liabilities at fair value.

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(In thousands)

- Assets whose use is limited or restricted include: assets set aside by the boards of directors (the Boards) for investment purposes and future capital improvements, over which the Boards retain control and may at their discretion subsequently use for any other purpose; assets held by a trustee under the self-insured professional and general liability program; assets held by trustees under the terms of bond indentures; and all donor-restricted investments. Assets limited or restricted as current liabilities in the accompanying consolidated balance sheet are classified as current assets to the extent they are expected to satisfy obligations classified as current liabilities in the accompanying consolidated balance sheets.
- The Corporations account for derivatives and hedging activities in accordance with ASC Topic 815, *Accounting for Derivative Instruments and Certain Hedging Activities*, as amended, which requires that all derivative instruments be recorded on the consolidated balance sheet at their respective fair values.
- Land, buildings, and equipment are recorded at cost. Depreciation is provided over the estimated useful lives of depreciable assets using the straight-line method. Amortization of leasehold improvements is over the shorter of the useful lives of the assets or the respective lease terms. Interest cost is capitalized as a component of the cost of acquiring or constructing significant capital assets, including net interest cost incurred on borrowed funds during the period of construction.
- Inventories consist primarily of supplies and are stated at the lower of cost (first-in, first-out) or market.
- In August 2010, the FASB issued ASU No. 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries* (ASU No. 2010-24). ASU No. 2010-24 clarifies that healthcare entities should not net insurance recoveries against the related claim liability and that the claim liability amount should be determined without consideration of insurance recoveries. The Corporations implemented ASU No. 2010-24 for the year ended June 30, 2012. Adoption of ASU No. 2010-24 had no impact on the accompanying 2012 consolidated balance sheet.
- Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity. Temporarily restricted net assets at June 30, 2012 principally represent amounts restricted for the purpose of acquiring long-lived assets or for operations.
- Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Unrestricted contributions are reported as nonoperating gains. Contributions are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations as net assets released from restriction. Net assets released from restriction for operating purposes are included with other revenue. Gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

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(In thousands)

- The Corporations' permanently restricted net assets represent endowment funds for which the investments are to be held in perpetuity and the related investment income is expendable to support healthcare or other donor-designated services. The Corporations have adopted the provisions of ASC Subtopic 958, *Endowments for Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA)*, and *Enhanced Disclosures for All Endowment Funds*. ASC Subtopic 958 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of UPMIFA. ASC Subtopic 958 also enhances disclosures related to both donor-restricted and board-designated endowment funds, whether or not the organization is subject to UPMIFA (note 15).
- The Corporations incur expenses for the provision of healthcare services and related general and administrative activities.
- Cadence Health, CDH, CPG, CNS, PAHCS II, Special Health, Foundation, Delnor Hospital, Delnor Foundation, Residential Living, and Living Well are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code (the Code) are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. UPIC is exempt from all local income, profit, and capital gains taxes under Cayman Islands tax concession law.
- DelCom is an Illinois for-profit corporation that recognizes deferred income taxes under the asset-and-liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.
- DelCom's tax effects of temporary differences that give rise to significant portions of the deferred tax assets at June 30, 2012 are primarily the result of net operating loss carryforwards. At June 30, 2012, DelCom had net operating loss carryforwards for federal and state income tax purposes of approximately \$5,406, which expire at various future dates through 2020. These net operating loss carryforwards give rise to a deferred tax asset before valuation allowance of approximately \$1,826.
- In assessing the realizability of deferred tax assets, management considered whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers projected future taxable income and tax planning strategies in making this assessment. Based upon the level of historical losses and future projections over the period in which the deferred tax assets are deductible, management believes it more likely than not that DelCom will not realize the majority of the benefits of these deductible differences. Accordingly, the deferred tax assets attributable to these net operating loss carryforwards not realized at June 30, 2012 have been fully reserved in the accompanying consolidated financial statements due to the uncertainty of realization.

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(In thousands)

- The Corporations apply ASC Subtopic 740-10, *Income Taxes – Overall*, which addresses the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the consolidated financial statements. Under ASC Subtopic 740-10, the Corporations must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the consolidated financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. ASC Subtopic 740-10 also provides guidance on derecognition, classification, interest, and penalties on income taxes and accounting in interim periods and requires increased disclosures. As of June 30, 2012, the Corporations do not have any liabilities for unrecognized tax benefits.
- Provisions for unrelated business income federal and state taxes of \$8,710 and \$806 for the year ended June 30, 2012 and the three-month period ended June 30, 2011, respectively, are included within nonoperating losses in the consolidated statements of operations. There are no significant deferred income taxes, deferred tax assets, or deferred tax liabilities attributable to unrelated business activities as of June 30, 2012 or 2011.

(3) Net Patient and Resident Service Revenue

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

Medicare – Inpatient acute care, outpatient, and home health services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. The prospectively determined rates are not subject to retroactive adjustment. The Corporations' classification of patients under the prospective payment systems and the appropriateness of the patients' admissions are subject to validation reviews.

The Corporations are reimbursed for certain other services and costs based upon fee schedules and other reimbursement methodologies. The Corporations are reimbursed for certain services at a tentative rate with final settlement determined after submission of annual reimbursement reports by the Corporations and audits thereof by the Medicare fiscal intermediary. The Corporations' Medicare reimbursement reports through June 30, 2007 have been audited by the Medicare fiscal intermediary.

Medicaid – Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under prospectively determined rates and fee schedules, respectively. Medicaid payment methodologies and rates for services are based on the amount of funding available to the State of Illinois Medicaid program.

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The State of Illinois (the State) has enacted an assessment program to assist in the financing of its Medicaid program, which expires on June 30, 2013. Pursuant to this program, hospitals within the State are required to remit payment to the State of Illinois Medicaid program under an assessment formula approved by the Centers for Medicare & Medicaid Services (CMS). The Corporations have included their assessment of \$15,405 and \$3,851 for the year ended June 30, 2012 and three-month period ended June 30, 2011, respectively, within professional fees and purchased services expense in the accompanying consolidated statements of operations. The assessment program also provides hospitals within the State with additional Medicaid reimbursement based on funding formulas also approved by CMS. The Corporations have included their additional reimbursement of \$15,338 and \$3,834 for the year ended June 30, 2012 and the three-month period ended June 30, 2011, respectively, within net patient and resident service revenue in the accompanying consolidated statements of operations.

The Corporations have also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements includes prospectively determined rates per discharge, discounts from established charges, prospectively determined per diem rates, and cost-based formulas.

Accruals for settlements with third-party payors are made based on estimates of amounts to be received or paid under the terms of the respective contracts and related settlement principles and regulations of the federal Medicare program, the Illinois Medicaid program, and the Blue Cross Plan of Illinois. For the year ended June 30, 2012, the consolidated statement of operations includes \$6,432 of net favorably determined retroactive settlements and changes in prior estimates for third-party settlements and allowances, which includes \$4,214 related to a retroactive settlement from Medicare for fiscal years 2007 – 2011 related to the settlement of the Rural Floor Budget Neutrality Adjustment Appeal. For the three-month period ended June 30, 2011, there were no significant adjustments to the consolidated statement of operations related to retroactive settlements and changes in prior year third-party reimbursement estimates.

(4) Charity Care

The Corporations maintain records to identify and monitor the level of charity care they provide. These records include the amount of charges forgone for services and supplies furnished under their charity care policies, the estimated cost of these services and supplies, and equivalent service statistics. CDH, Delnor Hospital, and CNS also consider the difference between the cost of providing services to Medicaid and Medicare patients and residents and the amounts reimbursed by Medicaid and Medicare as charity care. Since these entities do not expect payment for charity care services, charges related to charity care services are not recorded as revenue.

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In addition, these entities also report the cost associated with services provided to the community and other uncompensated costs as charity care. The following information presents the level of charity care at cost and other uncompensated costs provided during the year ended June 30, 2012 and the three-month period ended June 30, 2011:

	<u>2012</u>	<u>2011</u>
Costs of free care provided to non-Medicaid and non-Medicare patients	\$ 20,649	4,830
Excess of cost over reimbursement for services provided to Medicaid patients	30,715	5,388
Excess of cost over reimbursement for services provided to Medicare patients	59,453	15,790
Community services provided, at cost	6,209	1,389
	<u>\$ 117,026</u>	<u>27,397</u>

(5) Concentrations of Credit Risk

The Corporations grant credit without collateral to their patients and residents, most of whom reside locally and are generally insured under third-party payor agreements. The mix of receivables from patients, residents, and third-party payors at June 30, 2012 and 2011 is as follows:

	<u>2012</u>	<u>2011</u>
Medicare	17%	20%
Medicaid	22	10
Managed care/commercial	41	45
Other	20	25
	<u>100%</u>	<u>100%</u>

A summary of the Corporations' Medicare, Medicaid, and managed care/contracted payor utilization percentages based upon gross patient service revenue for the year ended June 30, 2012 and three-month period ended June 30, 2011 is as follows:

	<u>2012</u>	<u>2011</u>
Medicare	37%	36%
Medicaid	9	10
Managed care/commercial	50	49
Other	4	5
	<u>100%</u>	<u>100%</u>

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(6) Investments

Investments are reported in the accompanying consolidated balance sheets as assets whose use is limited or restricted and retirement plan assets. A summary of the composition of the Corporations' investment portfolio at June 30, 2012 and 2011 is as follows:

	<u>2012</u>	<u>2011</u>
Corporate bonds and notes	\$ 620,806	685,277
Government and agency securities	37,006	60,307
Mutual funds and common stocks	537,784	345,165
Alternative limited partnership investments, at cost	16,480	16,480
Short-term securities and money market funds	<u>51,079</u>	<u>99,310</u>
Total assets whose use is limited or restricted and retirement plan assets	<u>\$ 1,263,155</u>	<u>1,206,539</u>

The composition of investment return on the Corporations' investment portfolios for the year ended June 30, 2012 and the three-month period ended June 30, 2011 is as follows:

	<u>2012</u>	<u>2011</u>
Interest and dividend income	\$ 26,490	7,937
Net realized gains on sale of investments	8,620	751
Net change in unrealized gains and losses during the holding period	<u>(24,077)</u>	<u>(190)</u>
Investment return	<u>\$ 11,033</u>	<u>8,498</u>

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Changes in unrealized gains and losses during the holding period are included with nonoperating gains and losses for that portion of the investment portfolios that management has designated as trading securities. All other changes in unrealized gains and losses during the holding period are attributable to other-than-trading securities and, accordingly, are excluded from the determination of revenue and gains in excess of expenses and losses. Investment returns are included in the accompanying consolidated statements of operations and changes in net assets for the year ended June 30, 2012 and three-month period ended June 30, 2011 as follows:

	<u>2012</u>	<u>2011</u>
Investment return, unrestricted contributions, and other, net	\$ 15,926	7,108
Change in net unrealized gains (losses) on other-than-trading securities	(5,100)	1,371
Temporarily restricted net assets:		
Investment return	2	12
Permanently restricted net assets:		
Investment return	205	7
Total investment return	<u>\$ 11,033</u>	<u>8,498</u>

Gross unrealized losses on other-than-trading investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2012 and 2011 were as follows:

		<u>2012</u>					
		<u>Less than 12 months</u>		<u>12 Months or longer</u>		<u>Total</u>	
		<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>
Corporate bonds and notes	\$	105,034	(190)	5,307	(5)	110,341	(195)
Government and agency securities		14,153	(7)	—	—	14,153	(7)
Total	\$	<u>119,187</u>	<u>(197)</u>	<u>5,307</u>	<u>(5)</u>	<u>124,494</u>	<u>(202)</u>

		<u>2011</u>					
		<u>Less than 12 months</u>		<u>12 Months or longer</u>		<u>Total</u>	
		<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>
Corporate bonds and notes	\$	102,078	(225)	—	—	102,078	(225)
Government and agency securities		3,041	(1)	—	—	3,041	(1)
Total	\$	<u>105,119</u>	<u>(226)</u>	<u>—</u>	<u>—</u>	<u>105,119</u>	<u>(226)</u>

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The decline in fair value of corporate bonds and notes is primarily attributable to changes in interest rates and the market's perception of credit quality. The Corporations have the intent and ability to hold these investments until a market price recovery or maturity, and therefore, these investments are not considered other-than-temporarily impaired.

(7) Fair Value Measurements

(a) Fair Value of Financial Instruments

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

- The carrying amount reported in the consolidated balance sheets for the following approximates fair value because of the short maturities of these instruments: cash and cash equivalents, accounts receivable, inventories, prepaid expenses, accounts payable and accrued liabilities, construction payables, and estimated third-party payor settlements.
- Assets whose use is limited or restricted: Fair values are estimated based on prices provided by its investment managers, custodian banks, and valuations provided by an independent investment reporting service. Common stocks, quoted mutual funds, and direct U.S. government obligations are measured using quoted market prices at the reporting date multiplied by the quantity held. Corporate bonds, notes, certain American Depository Receipts, and U.S. agency securities are measured using other observable inputs. The carrying value equals fair value.
- Interest rate swap agreements: The fair value of interest rate swaps is determined using pricing models developed based on the LIBOR swap rate and other observable market data. The value was determined after considering the potential impact of netting agreements, adjusted to reflect nonperformance risk of both the counterparty and the Corporations. The carrying value equals fair value.
- Fair value of fixed rate long-term debt is estimated based on market indications for the same or similar debt issues.

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(b) Fair Value Hierarchy

The Corporations apply ASC Subtopic 820-10 for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. ASC Subtopic 820-10 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Corporations have the ability to access at the measurement date. Level 1 assets include cash and cash equivalents, common stock, quoted mutual funds, and direct U.S. government obligations.
- Level 2 inputs are observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets include corporate bonds, notes, American Depository Receipts and U.S. agency securities, and nonquoted mutual funds.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

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The following table presents assets and liabilities that are measured at fair value on a recurring basis at June 30, 2012:

	<u>Total</u>	<u>Quoted prices in active markets for identical assets (Level 1)</u>	<u>Significant other observable inputs (Level 2)</u>	<u>Significant unobservable inputs (Level 3)</u>
Assets:				
Cash and cash equivalents	\$ 5,914	5,914	—	—
Assets whose use is limited or restricted:				
Corporate bonds and notes	620,806	—	620,806	—
Government and agency securities	36,006	18,337	17,669	—
Mutual funds and common stocks	534,640	534,640	—	—
Short-term securities and money market funds	50,815	50,815	—	—
Retirement plan assets:				
Government and agency securities	1,000	1,000	—	—
Mutual funds and common stocks	3,144	3,131	—	13
Short-term securities and money market funds	264	264	—	—
Total	\$ <u>1,252,589</u>	<u>614,101</u>	<u>638,475</u>	<u>13</u>
Liabilities:				
Interest rate derivatives	\$ 57,318	—	57,318	—

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The following table presents assets and liabilities that are measured at fair value on a recurring basis at June 30, 2011:

	<u>Total</u>	<u>Quoted prices in active markets for identical assets (Level 1)</u>	<u>Significant other observable inputs (Level 2)</u>	<u>Significant unobservable inputs (Level 3)</u>
Assets:				
Cash and cash equivalents	\$ 40,899	40,899	—	—
Assets whose use is limited or restricted:				
Corporate bonds and notes	685,277	88,978	596,299	—
Government and agency securities	59,090	27,094	31,996	—
Mutual funds and common stocks	342,088	342,088	—	—
Short-term securities and money market funds	99,232	99,232	—	—
Retirement plan assets:				
Government and agency securities	1,217	1,217	—	—
Mutual funds and common stocks	3,077	3,072	—	5
Short-term securities and money market funds	78	78	—	—
Total	<u>\$ 1,230,958</u>	<u>602,658</u>	<u>628,295</u>	<u>5</u>
Liabilities:				
Interest rate derivatives	\$ 30,063	—	30,063	—

(c) ***Alternative Investments***

The Corporations evaluate investments carried under the cost method of accounting for impairment on an annual basis. These investments are considered to be impaired whenever events or changes in circumstances indicate the carrying amount of an investment may not be recoverable from future cash flows. Recoverability of these investments is measured by a comparison of the carrying amount of an investment to future cash flows expected to be generated by the investment. When such investments are considered to be impaired, the impairment loss recognized is measured by the amount by which the carrying value of the investment exceeds the fair value of the investment. The Corporations did not recognize any impairment charges during the year ended June 30, 2012 or the three-month period ended June 30, 2011 related to cost basis investments. The carrying and estimated fair value of cost basis investments at June 30, 2012 were \$16,480 and \$16,887,

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respectively. The carrying and estimated fair value of cost basis investments at June 30, 2011 were \$16,480 and \$16,987, respectively. Fair value of alternative investments is based on the Corporations' proportionate interest in the net asset value of the respective investment.

(8) Derivative Instruments

The Corporations have interest rate related derivative instruments to manage exposure on debt instruments. By using derivative financial instruments to hedge exposures to changes in interest rates, the Corporations are exposed to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of a derivative contract is positive, the counterparty owes the Corporations, which creates credit risk for the Corporations. When the fair value of a derivative contract is negative, the Corporations owe the counterparty, and therefore, it does not possess credit risk. The Corporations minimize the credit risk in derivative instruments by entering into transactions with high-quality counterparties. Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. The Corporations' management also mitigates risk through periodic reviews of its derivative positions in the context of their total blended cost of capital.

In an effort to lower its overall cost of capital on long-term debt, the Corporations maintain four interest rate swap agreements, which have the effect of changing the variable rate on a portion of the long-term debt to a fixed rate. The notional amounts under the interest rate swap agreements are reduced over the term of the agreements. Under the first agreement, the Corporations receive 67% of three-month USD-LIBOR-BBA on a notional amount of \$64,088 every month, and make payments at an annual fixed rate of 3.518% through November 1, 2038. This agreement gives the swap counterparty a one-time option to cancel the swap at fair value on November 1, 2017, after which, if unexercised, the swap will remain outstanding through its stated expiration. Under the second agreement, the Corporations receive 67% of three-month USD-LIBOR-BBA on a notional amount of \$64,088 every month, and make payments at an annual fixed rate of 3.818% through November 1, 2038. Under the third agreement, the Corporations receive 67% of LIBOR on a notional amount of \$35,000 every month, and make payments at an annual fixed rate of 4.180% through May 1, 2032. Under the fourth agreement, the Corporations receive 67% of LIBOR on a notional amount of \$31,225 every month, and make payments at an annual fixed rate of 2.890% through May 4, 2033. Under all four swap agreements, the Corporations retain the right to cancel either or both in whole or in part at any time for cash at settlement value.

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The interest rate swap agreements were not designated as cash flow hedge instruments by the Corporations, and therefore, changes in the fair value of the interest rate swap agreements of \$(27,255) and \$(4,063) for the year ended June 30, 2012 and three-month period ended June 30, 2011, respectively, were recognized as losses within nonoperating gains and losses: investment return, unrestricted contributions, and other, net in the accompanying consolidated statements of operations. The fair value of the interest rate swap liability of \$57,318 and \$30,063 at June 30, 2012 and 2011, respectively, is included with deferred revenue and other long-term liabilities in the accompanying consolidated balance sheets. Total net payments made by the Corporations under the swap agreements totaled \$6,743 and \$1,799 for the year ended June 30, 2012 and the three-month period ended June 30, 2011 and are reported within interest expense in the accompanying consolidated statements of operations.

(9) Investment in Joint Ventures

The Corporations have joint venture and operating partnership investment interests in ambulatory surgical facilities, fitness centers, and other health-related businesses that are accounted for using the equity method. The following is a summary of financial information as of and for the year June 30, 2012 and the three-month period ended June 30, 2011 relating to equity method joint ventures:

	<u>2012</u>	<u>2011</u>
Current assets	\$ 20,492	17,466
Current liabilities	<u>13,018</u>	<u>8,556</u>
Working capital	7,474	8,910
Property and equipment, net	40,660	40,557
Other long-term assets	331	293
Long-term liabilities	<u>6,094</u>	<u>12,174</u>
Net assets	<u>\$ 42,371</u>	<u>37,586</u>
Revenues	\$ 48,688	11,539
Expenses	<u>36,130</u>	<u>9,591</u>
Excess of revenues over expenses	<u>\$ 12,558</u>	<u>1,948</u>

The carrying value of equity method joint venture investments of \$15,550 and \$13,961 at June 30, 2012 and 2011, respectively, is included with investments in joint ventures and other assets in the accompanying consolidated balance sheets. Net equity earnings from these investments amounted to \$5,053 and \$1,534 during the year ended June 30, 2012 and three-month period ended June 30, 2011, respectively, and is included with net nonoperating gains in the accompanying consolidated statements of operations. The Corporations received cash distributions from such joint ventures of \$3,464 and \$1,283, respectively, for the year ended June 30, 2012 and the three-month period ended June 30, 2011. During the three-month period ended June 30, 2011, the Corporations recognized a \$668 impairment of a joint venture for that portion of the joint venture's carrying value considered permanently impaired. There were no such impairments for the year ended June 30, 2012.

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In 2009, Cadence Health entered into a joint venture with ProCure Treatment Centers, Inc. and certain radiation oncologists that sought to build, equip, and operate a proton beam therapy center (the Proton Beam Venture). Cadence Health provided initial capital contributions of \$10,000 to the Proton Beam Venture during 2009. Cadence Health has an approximate 12.2% effective equity interest in the Proton Beam Venture, which is accounted for under the cost method. The \$10,000 carrying value of the Proton Beam Venture is included with investments in joint ventures and other assets. The proton beam venture became operational during 2011.

Simultaneously with its investment, Cadence Health also provided a \$40,000 loan to ProCure Treatment Centers, Inc. to support the development and construction of the proton beam therapy center. The loan is evidenced by an unsecured note receivable and accrues interest at a rate per annum of 14% over the term, which is approximately 12 years. Interest on the note is accrued and added to the outstanding note receivable balance for the first four years. Interest is due and payable semiannually after the fourth year. Principal and accrued interest payments are due at the maturity of the note receivable. Cadence Health recognized approximately \$8,278 and \$1,869 in accrued interest income on the note receivable for the year ended June 30, 2012 and the three-month period ended June 30, 2011, respectively, which is included in nonoperating gains in the accompanying consolidated statements of operations. Included in notes and advances receivable at June 30, 2012 and 2011 are \$65,405 and \$57,127, respectively, of total outstanding principal and accrued interest amounts related to the note receivable.

In support of its efforts to develop a broader oncology presence, Cadence Health purchased a parcel of land for \$8,215 on which the proton beam therapy center and a cancer treatment center were constructed. Cadence Health entered into a ground lease agreement with ProCure Management, LLC to lease the land on which the proton beam therapy center operates. The initial term of the ground lease is 50 years with the option to renew for two 20-year periods. For the year ended June 30, 2012 and the three-month period ended June 30, 2011, Cadence Health recognized \$432 and \$108, respectively, of rental income under the land lease, which is included in other revenue in the accompanying consolidated statements of operations.

(10) Other Revenue – Entrance Fees and Revenue Recognition

Residential Living recognizes revenue from residents through service fees, monthly assessments, and amortization of entrance fees. Service fees and monthly assessments are recognized as revenue in the period in which they relate. Residents also pay entrance fees, which can be all or partially refundable as determined by the resident's length of occupancy. Resident refunds limited to the extent of reoccupancy proceeds are included in deferred revenue. Refundable entrance fees are amortized to revenue using the straight-line method over the estimated useful life of the residents' townhomes. Nonrefundable portions of entrance fees are included in deferred revenue from entrance fees and are amortized to revenue using the straight-line method over the actuarially determined remaining life expectancies of the residents. Amortization of entrance fees amounted to \$504 and \$131 for the year ended June 30, 2012 and the three-month period ended June 30, 2011, respectively, which is included in other revenue in the accompanying consolidated statements of operations. Gross refundable entrance fees at June 30, 2012 and 2011 amounted to \$5,969 and \$6,696, respectively.

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(11) Land, Buildings, and Equipment

A summary of land, buildings, and equipment as of June 30, 2012 and 2011 is as follows:

	2012		2011	
	Cost	Accumulated depreciation and amortization	Cost	Accumulated depreciation and amortization
Land	\$ 35,520	—	34,919	—
Land improvements	46,373	(24,952)	43,120	(21,888)
Leasehold improvements	13,318	(8,143)	12,193	(6,492)
Buildings and building service equipment	898,198	(275,585)	715,081	(241,517)
Major movable equipment	419,596	(273,377)	329,029	(236,776)
Construction in progress	29,268	—	190,610	—
	<u>\$ 1,442,273</u>	<u>(582,057)</u>	<u>1,324,952</u>	<u>(506,673)</u>

Construction in progress at June 30, 2012 consists primarily of costs for various construction and renovation projects. Significant contractual commitments outstanding at June 30, 2012 on construction projects approximate \$17,099.

Interest cost is capitalized as a component cost of significant capital projects, net of any interest income earned on unexpended project-specific borrowed funds. During the year ended June 30, 2012 and the three-month period ended June 30, 2011, the Corporations capitalized \$1,246 and \$2,486, respectively, of interest cost. Gross interest costs capitalized during the year ended June 30, 2012 and the three-month period ended June 30, 2011 were \$1,302 and \$2,500, respectively, which were offset by \$56 and \$14, respectively, of investment income on borrowed funds held by the bond trustee.

The Corporations evaluate long-lived assets for impairment on an annual basis. Long-lived assets are considered to be impaired whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable from future cash flows. No impairments of long-lived assets were recognized during the year ended June 30, 2012 or the three-month period ended June 30, 2011.

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The Corporations lease medical office buildings to physicians and other healthcare providers under various operating lease arrangements. Rental income recognized under the terms of operating leases amounted to \$9,017 and \$2,603 for the year ended June 30, 2012 and the three-month period ended June 30, 2011, respectively, and is included with other revenue in the accompanying consolidated statements of operations. Future minimum rental payments receivable under noncancelable operating leases as of June 30, 2012 are as follows:

2013	\$	7,963
2014		6,925
2015		6,444
2016		4,598
2017		2,829
Thereafter		<u>3,715</u>
	\$	<u><u>32,474</u></u>

The Corporations lease office space and equipment under various operating lease agreements. Rental expense recognized under the terms of operating leases amounted to \$6,568 and \$1,733 for the year ended June 30, 2012 and the three-month period ended June 30, 2011, respectively, and is included with other expense in the accompanying consolidated statements of operations. Future minimum rental commitments under noncancelable office space operating leases as of June 30, 2012 are as follows:

2013	\$	5,732
2014		4,723
2015		4,229
2016		3,430
2017		2,818
Thereafter		<u>7,526</u>
	\$	<u><u>28,458</u></u>

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(12) Long-Term Debt

A summary of long-term debt at June 30, 2012 and 2011 is as follows.

	2012	2011
CDH Master Trust Indenture obligations:		
Revenue bonds, Series 2011A with interest at a variable rate determined monthly, due by annual mandatory redemption through November 1, 2038, effective interest rate of 3.94% as of June 30, 2012	\$ 62,735	—
Revenue bonds, Series 2011B with interest at a variable rate determined monthly, due by annual mandatory redemption through November 1, 2038, effective interest rate of 3.94% in 2012	62,740	—
Revenue bonds, Series 2009 with interest at various fixed rates averaging 5.25% and maturing on various dates beginning November 1, 2014 through November 1, 2039	90,000	90,000
Revenue bonds, Series 2009B with interest at various fixed rates averaging 5.36% and maturing on various dates beginning November 1, 2013 through November 1, 2039	240,000	240,000
Variable rate demand revenue bonds, Series 2004A, interest at a variable rate determined daily, redeemed in August 2011, effective interest rate of 0.07% and 0.20% in 2012 and 2011, respectively	—	127,150
Periodic auction rate revenue bonds, Series 2000A-1, interest at a variable rate determined daily, redeemed in December 2011, effective interest rate of 0.13% and 0.32% in 2012 and 2011, respectively	—	150
Periodic auction rate revenue bonds, Series 2000A-2, interest at a variable rate determined weekly, redeemed in December 2011, effective interest rate of 1.48% and 0.31% in 2012 and 2011, respectively	—	12,575
Delnor Master Trust Indenture obligations:		
Revenue bonds, Series 2011C with interest at a variable rate determined monthly, due by annual mandatory redemption through November 1, 2038, effective interest rate of 1.09% in 2012	58,415	—
Variable rate demand revenue refunding bonds, Series 2008A, redeemed in August 2011, interest rate of 0.25% in 2011	—	58,415

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(In thousands)

	<u>2012</u>	<u>2011</u>
Fixed rate revenue bonds, Series 2003A, maturing on various dates between 2009 and 2023, in principal amounts ranging from \$625 to \$2,525; interest rate of 5.00%	\$ 19,875	21,925
Fixed rate revenue bonds, Series 2003B, maturing on various dates between 2024 and 2032, in principal amounts ranging from \$25 to \$900; interest rate of 5.25%	6,150	6,150
Fixed rate revenue bonds, Series 2003C, maturing on various dates between 2032 and 2033, in principal amounts ranging from \$625 to \$4,575; interest rate of 5.25%	5,200	5,200
Fixed rate revenue bonds, Series 2002A, maturing on various dates between 2020 and 2022, in principal amounts ranging from \$1,850 to \$2,200; interest rate of 5.25%	6,000	6,000
Fixed rate revenue bonds, Series 2002B, maturing on various dates between 2022 and 2025, in principal amounts ranging from \$400 to \$2,450; interest rate of 5.25%	6,000	6,000
Fixed rate revenue bonds, Series 2002C, maturing on various dates between 2025 and 2027, in principal amounts ranging from \$1,600 to \$2,700; interest rate of 5.25%	6,000	6,000
Fixed rate revenue bonds, Series 2002D, maturing on various dates between 2027 and 2032, in principal amounts ranging from \$1,050 to \$3,450; interest rate of 5.25%	17,000	17,000
Delnor Foundation – South Elgin Holding Mortgage, interest at 5.75%, matures October 1, 2014	1,867	1,900
Total long-term debt	<u>581,982</u>	<u>598,465</u>
Less current installments of long-term debt	4,005	4,658
Plus unamortized net bond premiums	<u>1,447</u>	<u>1,595</u>
Long-term debt, net of unamortized bond premiums and current installments	<u>\$ 579,424</u>	<u>595,402</u>

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(In thousands)

Cadence Health and CDH, collectively referred to as the CDH Obligated Group, entered into a Master Trust Indenture (CDH Master Trust Indenture) dated as of May 1, 2000. The purpose of the CDH Master Trust Indenture is to provide a mechanism to be able to issue promissory notes and other evidences of indebtedness in order to secure the financing or refinancing of facilities and for other lawful proper corporate purposes. The CDH Master Trust Indenture provides for other legal entities in the future to participate with Cadence Health and CDH in a Credit Group for the payment of obligations and the performance of all covenants contained therein. The Credit Group consists of the CDH Obligated Group and any affiliate Cadence Health designates as a Credit Group member. All notes issued under the CDH Master Trust Indenture are the joint and several obligations of each member of the CDH Obligated Group. The CDH Master Trust Indenture requires CDH Obligated Group members to cause Credit Group members to make payments on notes issued by other members of the CDH Obligated Group if such other members are unable to satisfy their obligations under the CDH Master Trust Indenture. No other Cadence Health affiliates are currently designated as Credit Group members.

In December 2011, Cadence Health paid off the remaining outstanding Series 2000A-1 and Series 2000A-2 Bonds.

On August 5, 2011, the Illinois Finance Authority issued \$63,575 of Series 2011A Bonds and \$63,575 of Series 2011B Bonds on behalf of Cadence Health. In connection with the issuance of the Series 2011A Bonds and 2011B Bonds, Cadence Health redeemed the then-outstanding Series 2004A Bonds. The Series 2011A and Series 2011B bonds are secured by direct note obligations issued under the CDH Master Trust Indenture. The Series 2011A Bonds are subject to a mandatory tender on August 1, 2016. The Series 2011B Bonds are subject to a mandatory tender on August 2, 2021. The Series 2011A and Series 2011B Bonds bear interest at variable rates.

On November 18, 2009, the Illinois Finance Authority issued \$240,000 of Series 2009B Bonds on behalf of Cadence Health. The Series 2009B Bonds are secured by a direct note obligation issued under the CDH Master Trust Indenture. The Series 2009B Bonds bear interest at effective rates ranging from 2.94% to 5.63% depending on the date of maturity. These fixed rate bonds were issued at an overall premium from face value totaling \$1,070, which is being amortized ratably using the effective-interest method over the life of the bonds.

On May 6, 2009, the Illinois Finance Authority issued \$90,000 of Series 2009 Bonds on behalf of Cadence Health. The Series 2009 bonds are secured by a direct note obligation issued under the CDH Master Trust Indenture. The Series 2009 Bonds bear interest at effective rates ranging from 3.18% to 5.50% depending on the date of maturity. These fixed rate bonds were issued at an overall discount from face value totaling \$1,605, which is being amortized ratably using the effective-interest method over the life of the bonds.

Delnor Hospital entered into a Master Trust Indenture (Delnor Master Trust Indenture) dated as of May 15, 1989. The purpose of the Delnor Master Trust Indenture is to provide a mechanism to be able to issue promissory notes and other evidences of indebtedness in order to secure the financing or refinancing of facilities and for other lawful proper corporate purposes.

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On August 24, 2011, the Illinois Finance Authority issued \$58,415 of Series 2011C Bonds on behalf of Delnor Hospital. In connection with the issuance of the Series 2011C Bonds, Delnor Hospital redeemed the then-outstanding Series 2008A Bonds. The Series 2011C Bonds are secured by direct note obligations issued under the Delnor Master Trust Indenture. The Series 2011C Bonds are subject to a mandatory tender on August 24, 2018. The Series 2011C Bonds bear interest at a variable rate.

On May 23, 2008, the Illinois Health Facilities Authority remarketed the Series 2002 Bonds as Fixed Rate Revenue Bonds (Series 2002 Remarketed Bonds) in the aggregate amount of \$35,000 on behalf of Delnor Hospital. Principal and interest payments on the Series 2002 Remarketed Bonds are guaranteed by a bond insurance policy. The bonds are secured by Delnor Hospital's unrestricted receivables.

On May 23, 2008, the Illinois Health Facilities Authority remarketed the Series 2003 Bonds as Fixed Rate Revenue Bonds (Series 2003 Remarketed Bonds) in the aggregate amount of \$39,050 on behalf of the Hospital. Principal and interest payments on the Series 2003 Remarketed Bonds are guaranteed by a bond insurance policy. The bonds are secured by Delnor Hospital's unrestricted receivables.

Deferred finance charges consist of underwriter fees and other issuance costs. Deferred finance charges are amortized using the bonds outstanding method over the periods in which the related obligations are expected to be outstanding.

At June 30, 2012, the fair value of the Series 2009 and Series 2009B fixed rate bonds was \$98,153 and \$266,386, respectively. The recorded carrying amount of the Series 2009 and Series 2009B fixed rate bonds was \$88,662 (net of unamortized discount) and \$240,921 (net of unamortized premium), respectively.

At June 30, 2011, the fair value of the Series 2009 and Series 2009 B fixed rate bonds was approximately \$89,748 and \$246,802, respectively. The recorded carrying amount of the Series 2009 and Series 2009B fixed rate bonds was \$88,578 (net of unamortized discount) and \$240,977 (net of unamortized premium), respectively.

At June 30, 2012, the fair values of the Series 2002 A-D and Series 2003 A-C fixed rate bonds were \$37,956 and \$34,360, respectively. The recorded carrying amount of the Series 2002A-D and Series 2003A-C fixed rate bonds was \$35,702 (including amortized premium) and \$32,388 (including amortized premium), respectively.

At June 30, 2011, the fair values of the Series 2002 A-D and Series 2003 A-C fixed rate bonds were \$34,066 and \$33,889, respectively. The recorded carrying amount of the Series 2002A-D and Series 2003A-C fixed rate bonds was \$35,753 (including amortized premium) and \$34,562 (including unamortized premium), respectively.

At June 30, 2012 and 2011, the fair value of the Corporations' variable rate long-term debt approximated recorded amounts.

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(In thousands)

Scheduled principal repayments of long-term debt are as follows:

Year ending June 30:	
2013	\$ 4,005
2014	11,907
2015	13,537
2016	12,300
2017	12,850
Thereafter	<u>527,383</u>
	<u>\$ 581,982</u>

Cadence Health is a limited partner in HealthTrack Sports & Wellness, LP, an Illinois limited partnership that owns and operates a sports and fitness facility located in Glen Ellyn, Illinois (HealthTrack). Cadence Health's affiliate DuPage Health Services, Inc. (DHSI) is a member of the limited liability company that serves as general partner of the limited partnership. Cadence Health guarantees one-half of the debt and interest rate swaps of HealthTrack. As of June 30, 2012 and 2011, there was \$3,650 and \$4,000, respectively, of debt outstanding at HealthTrack, of which Cadence Health has guaranteed \$1,825 and \$2,000, respectively. HealthTrack has a fixed payor interest rate swap to hedge its exposure to fluctuations in interest rates. The swap had a liability of \$657 and \$575 at June 30, 2012 and 2011, respectively, \$329 and \$288 of which was subject to the Cadence Health guaranty. There is no collateral posting requirement on the swap. Cadence Health has not been required to make any payment pursuant to this bank guaranty.

Cadence Health is a member with a one-third ownership interest in Bloomingdale Life Time Fitness, LLC, an Illinois limited liability company that owns a sports and fitness facility located in Bloomingdale, Illinois (Lifetime). Cadence Health guarantees one-third of the debt and interest rate swaps of Lifetime. As of June 30, 2012 and 2011, there was \$6,475 and \$7,300 of debt outstanding at Lifetime, of which Cadence Health has guaranteed \$2,158 and \$2,433, respectively. Cadence Health has not been required to make any payment pursuant to its guaranty.

During 2010, Cadence Health sold its senior care and living facilities. Pursuant to the terms of the sale agreement, Cadence Health agreed to provide certain liquidity and guarantees of buyer acquisition debt and obligations subsequent to the date of sale. Cadence Health also guaranteed certain long-term debt of the senior care facilities assumed by the buyer. Pursuant to these terms, Cadence Health deposited \$6,400 in escrow accounts for the benefit of the senior lender in the event the buyer does not make scheduled debt service payments or comply with specified debt covenants. Such escrow amounts are included with assets whose use is limited – funds held by trustees. In addition, Cadence Health has provided the senior lender a put option for a five-year period subsequent to the transaction date that allows the senior lender to put the buyer debt to Cadence Health in the event the buyer fails to satisfy occupancy, debt service coverage, or days cash on hand ratios for any quarter. The put option extends to the earlier of the maturity date on the debt or the achievement of the aforementioned ratios for four consecutive quarters. In the event the senior lender puts the debt to Cadence Health, Cadence Health will assume the debt under the same terms and conditions as the buyer. Total debt outstanding at June 30, 2012 and 2011 subject to the guarantees

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(In thousands)

approximated \$36,162 and \$36,915, respectively. As of June 30, 2012, no escrowed funds have been drawn upon nor have the Corporations been required to assume the buyer acquisition debt or make any payments pursuant to the guarantee arrangements. Any payments made under the guarantees will be secured by the assets of the senior care and living facilities.

(13) Employee Retirement Plans

Cadence Health sponsors a defined contribution retirement plan (the Plan) that covers substantially all employees of CDH, Cadence Physician Group, CNS, PAHCS II, Special Health, and CDFoundation. The Plan was amended June 1, 2012 to also cover substantially all employees of Delnor Hospital and Residential Living. The Plan is a money purchase defined-contribution plan qualified under Section 401 of the Code. Other significant provisions of the Plan are as follows:

- **Contributions** – For calendar year 2011, the Corporations contributed 4% of qualified employees' gross annual earnings into each participant's plan account. Employee contributions to the Plan are not permitted. For calendar year 2012, the contributions are based on each employee's length of service as follows: 1 to 9 years – 2% contribution; and 10 or more years – 3% contribution. The Corporations fund the Plan annually for the plan year ended December 31.
- **Qualification** – To qualify for the Plan, employees must complete one year of employment, be at least 21 years of age, and provide a minimum of 1,000 hours of annual service.
- **Vesting** – Prior to January 1, 2002, employees vested in the Plan over a seven-year period. From January 1, 2002 to May 31, 2012, the vesting period was reduced to a six-year period. Effective June 1, 2012 the vesting period was reduced to a three-year cliff vesting schedule. Forfeited employer contributions revert back to the Corporations.

Effective July 1, 1999, Cadence Health and participating affiliates adopted a matched savings plan under Section 403(b) of the Code (the 403(b) Plan). The 403(b) Plan was updated June 1, 2012 to cover substantially all employees of Delnor Hospital and Residential Living. The 403(b) Plan is a defined-contribution plan and significant provisions of the 403(b) Plan are as follows:

- **Contributions** – Employees contribute to the 403(b) Plan through salary reductions specified in the participant's salary reduction agreement. Cadence Health and affiliates, at their sole discretion, may make matching contributions to the 403(b) Plan equal to a defined percentage of the participant's contributions for participants who have earned one year of service.
- **Qualification** – Employees are immediately eligible to participate in the 403(b) Plan upon employment and after submitting a signed salary reduction agreement. Effective January 1, 2010, all eligible new employees are auto-enrolled in the 403(b) Plan at a 4% contribution level.
- **Vesting** – Employees are fully vested in their participant contributions to the 403(b) Plan. Prior to January 1, 2002, employer contributions vested over a seven-year period. From January 1, 2002 to May 31, 2012, the vesting period was reduced to a six-year period. Effective June 1, 2012, the vesting period was reduced to a three-year cliff vesting schedule. Forfeited employer contributions revert back to Cadence Health and its affiliates.

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The Corporations make contributions to the Plan and the 403(b) Plan equal to amounts accrued for pension expense. Pension expense of \$10,732 and \$2,456 for the year ended June 30, 2012 and the three-month period ended June 30, 2011, respectively, has been recognized under the terms of the Plan and the 403(b) Plan and is included with employee benefits expense in the accompanying consolidated statements of operations.

Cadence Health also sponsors deferred compensation programs to supplement the income of participating individuals during retirement or following separation from the organization. Eligibility for the plans is restricted to specified executives or as defined by the Internal Revenue Service for certain “highly paid” employees. The deferred compensation plans are not qualified retirement plans under Section 401 of the Code. Contributions to the plans are stipulated in the plan documents and involve various methodologies depending on the plan. These range from use of an actuarial analysis based on compensation, an annual sum approved at the Board’s discretion or salary deferrals as elected by the participants. Cadence Health has recorded \$179 and \$75 of pension expense during the year ended June 30, 2012 and the three-month period ended June 30, 2011, respectively, under provisions of the deferred compensation plans. Amounts accrued for the benefit of the specified participants under the plans are reflected as retirement plan liabilities in the noncurrent liabilities section of the accompanying consolidated balance sheets.

Prior to June 1, 2012, Delnor Hospital and Residential Living maintained defined-contribution plans covering substantially all full-time employees of Delnor Hospital and Residential Living. Contributions were 2% of each covered employee’s salary and a matching portion of 50% of the employee’s contribution up to a maximum of 4% of individual earnings. The total cost of these plans was \$1,906 and \$560 for the eleven-month period ended May 31, 2012 and the three-month period ended June 30, 2011 and is included in employee benefits expense in the accompanying consolidated statements of operations. These plans were funded on a current basis.

DelCom maintains a 401(k) plan for the employees of DelCom. DelCom matches contributions up to 4% of the employee’s contribution. The total cost of this plan was \$34 and \$10 for the year ended June 30, 2012 and the three-month period ended June 30, 2011, respectively, and is included in employee benefits expense in the accompanying consolidated statements of operations. This plan is funded on a current basis.

(14) Self-insurance

(a) Professional and General Liability

Effective April 16, 1979, CDH had entered into a contractual agreement with the Illinois Provider Trust (IPT), a self-insurance administrator that, through its risk-sharing provisions, provided CDH with insurance coverage for medical, professional, and comprehensive general liability exposure. CDH ceased participation in IPT effective July 1, 1999. CDH obtained various levels of primary and excess insurance coverage from IPT on an occurrence basis while a participant in the program prior to July 1, 1999. IPT is a multihospital trust formed pursuant to the provisions of the Illinois Religious and Charitable Risk Pooling Act. Hospitals participating in IPT are obligated to make additional

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(In thousands)

contributions necessary for maintaining trust assets at a level adequate to support anticipated disbursements as defined in the trust agreement. This obligation continues beyond the period of participation in the trust.

For the period July 1, 1999 through August 12, 2002, CDH obtained coverage from commercial insurance carriers for all professional and general liability claims. For the period July 1, 1999 through August 12, 2001, coverage was occurrence-based; and for the period August 13, 2001 through August 12, 2002, such coverage was on a claims-made basis. The commercial carrier, which provided coverage for the period July 1, 1999 through June 30, 2000, is insolvent and CDH does not expect the carrier to be able to pay claims for contracted coverage limits. Effective August 13, 2002, CDH elected to again participate in the IPT. Professional liability coverage, as well as excess coverage obtained from the IPT, was on a claims-made basis whereas general liability continued on an occurrence basis.

As of January 1, 2006, CDH terminated its participation in IPT and became self-insured for all its professional and general liability claims made on or subsequent to that date. CDH had procured excess liability coverage from commercial carriers on a claims-made basis to insure those claims that may exceed the stated self-insured retention amount. A self-insurance trust fund was maintained for anticipated claims that may be payable from the retained amount based on an actuarial review of historical and industry claims patterns. CDH utilizes the services of a professional consultant for actuarial evaluations of self-insured funding requirements. CDH has designated attorneys to handle legal matters relating to medical, professional, and comprehensive general liability matters. The CDH professional and general liability insurance program also provides coverage to other Cadence Health affiliates, excluding affiliates that merged with CDHealth on April 1, 2011. The Corporations recognize a provision for the ultimate cost of claims reported that fall within the self-insured retention, cost of claims not insured, and estimates of claims incurred but not reported as of the respective consolidated balance sheet dates for uninsured exposures.

Delnor Hospital was under a contractual agreement with IPT for its medical, professional, and comprehensive general liability exposures. Coverage obtained from IPT was provided on an occurrence basis through December 31, 2004. Effective January 1, 2005, IPT began providing primary insurance coverage on a claims-made basis. Excess coverage was provided through IPT on a claims-made basis. General liability coverage was on an occurrence basis. As of July 1, 2011, Delnor Hospital terminated its participation in IPT and coverages were merged into the CDH-Delnor Self-Insured Trust for all its medical, professional, and comprehensive general liability claims made on or subsequent to that date.

On September 12, 2011, UPIC was created. UPIC is a wholly owned subsidiary of Cadence Health and is licensed as an Unrestricted Class "B" Insurer under Section 4(2) of the Cayman Islands' Insurance Law.

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(In thousands)

Effective October 1, 2011, UPIC issued a retrospectively rated prior acts liability policy providing medical professional liability coverage to specified physicians employed by Cadence Health and its affiliates with each insured having limits of liability of \$1,000 per claim and \$3,000 in the annual aggregate. The policy has no expiration date because the coverage remains in effect until the limits are exhausted or until all claims have closed.

Effective January 1, 2012, UPIC issued a retrospectively rated claims made primary hospital professional and general liability policy (Primary Policy) with limits of \$2,000 per incident with no aggregate for professional and patient general liability. Coverage for nonpatient general liability and employee benefits liability is provided at limits of \$1,000 per claim and \$3,000 in the annual aggregate.

Effective January 1, 2012, UPIC issued a direct buffer policy with limits of \$3,000 per claim and \$3,000 in the annual aggregate excess of the Primary Policy for professional and patient general liability claims only.

Effective January 1, 2012, under a loss portfolio transfer agreement UPIC assumed the outstanding liabilities related to the hospital professional and general liability policies previously included under CDH-Delnor Self Insured Trust for incidents occurring between August 13, 2010 and December 31, 2011 that were reported prior to December 31, 2011. As consideration for the assumption, CDH-Delnor Self Insured Trust assets of an actuarially determined amount, representing loss reserves on December 31, 2011 were transferred to UPIC.

The provision for claims incurred but not reported at June 30, 2012 is actuarially determined using factors including Cadence Health's and specific industry experience. The estimated outstanding professional and general claims liability of \$42,962 and \$38,393 at June 30, 2012 and 2011, respectively, is included with deferred revenue and other long-term liabilities in the accompanying consolidated balance sheets. Included in other expense are provisions of \$12,831 and \$3,145 for professional and general liability program expenses for the year ended June 30, 2012 and the three-month period ended June 30, 2011, respectively. No portion of the professional and general claims liability is reported within current liabilities, as the amount expected to be paid within one year of the consolidated balance sheet is not determinable.

(b) Workers' Compensation

The Corporations maintain self-insurance programs for workers' compensation coverage. Accrued workers' compensation claims of \$6,570 and \$6,401 at June 30, 2012 and 2011, respectively, are included with deferred revenue and other long-term liabilities in the accompanying consolidated balance sheets. The provision for claims incurred but not reported at June 30, 2012 and 2011 is actuarially determined using factors including the Corporations' historical and industry-specific experience. Provisions for the self-insured workers' compensation claims of \$3,431 and \$1,836 for the year ended June 30, 2012 and the three-month period ended June 30, 2011, respectively, are included in employee benefits expense as the best estimate of workers' compensation insurance costs. Coverage from commercial insurance carriers is maintained for claims in excess of

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(In thousands)

self-insured retention levels. No portion of the workers' compensation claims liability is reported within current liabilities, as the amount expected to be paid within one year of the consolidated balance sheet is not determinable.

(c) Healthcare

The Corporations also participate in a program of self-insurance for employee healthcare coverage. Accrued health claims of \$3,959 and \$3,387 at June 30, 2012 and 2011, respectively, are included with other accrued liabilities in the accompanying consolidated balance sheets. Provisions for self-insured employee healthcare claims amounted to \$34,603 and \$9,314 for the year ended June 30, 2012 and the three-month period ended June 30, 2011, respectively, are included in employee benefits expense in the accompanying consolidated statements of operations. Stop-loss reinsurance coverage is maintained for claims in excess of stop-loss limits.

The Corporations are self-insured for employee dental coverage. Accrued dental claims of approximately \$246 and \$143 at June 30, 2012 and 2011, respectively, are included with other accrued liabilities in the accompanying consolidated balance sheets. Provisions for self-insured employee dental claims amounted to \$1,879 and \$275 for the year ended June 30, 2012 and three-month period ended June 30, 2011, respectively, and are included in employee benefits expense in the accompanying consolidated statements of operations.

(15) Endowments

The Corporations comply with the provisions of ASC Topic 958. ASC Topic 958 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) and also required disclosures about endowments funds, both donor-restricted endowment funds and board-designated endowment funds.

The Foundation established two donor-restricted endowment funds (collectively referred to as the Funds), the principal of which may not be expended. The interest and dividend income and realized gains from the fund established in 1973 and the fund established in 2001 are utilized for CDH operations and a physician services program, respectively. The Funds are classified in permanently restricted net assets in the consolidated balance sheets at June 30, 2012 and 2011.

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(In thousands)

The Funds' activity for the year ended June 30, 2012 and the three-month period ended June 30, 2011 is as follows:

	<u>2012</u>	<u>2011</u>
Beginning fair value	\$ 5,265	5,255
Current year contributions	13	3
Income:		
Interest and dividends	210	15
Disbursements:		
Assets released from restriction	—	(12)
Unrealized gains (losses), net	<u>(5)</u>	<u>4</u>
Ending fair value	<u>\$ 5,483</u>	<u>5,265</u>

The fair value of assets associated with individual donor-restricted endowment funds may fall below the amount of the original donation as a result of unfavorable market conditions. There were no such deficiencies as of June 30, 2012 and 2011.

(16) Physician Loans

Delnor Hospital has line-of-credit agreements with physicians under guidelines approved by the board of directors. The agreements are extended to physicians where a community need is identified. The agreements have a maximum term of two years. Under the terms of the loan agreements, Delnor Hospital will provide partial forgiveness of the principal and interest owed for every year the physician serves the community up to four years after the initial term of the agreement. At June 30, 2012 and 2011, approximately \$707 and \$1,819, respectively, of physician loans due within one year were recorded as other current assets in the accompanying consolidated balance sheets. At June 30, 2012 and 2011, approximately \$726 and \$1,227, respectively, of physician loans due after one year were recorded as other assets in the accompanying consolidated balance sheets.

(17) Commitments and Contingencies

(a) Litigation

The Corporations are involved in litigation arising in the normal course of business. In consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Corporations' financial position or results from operations.

(b) Regulatory Investigations

The U.S. Department of Justice and other federal agencies routinely conduct regulatory investigations and compliance audits of healthcare providers. The Corporations are subject to these regulatory efforts. Management is currently unaware of any regulatory matters that will result in a material adverse effect on the Corporations' financial position or results from operations.

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June 30, 2012 and 2011

(In thousands)

(c) *Investment Risks and Uncertainties*

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

(d) *Charity Care Legislation*

Effective June 14, 2012, the Governor of Illinois signed into law *Public Act 97-0688* which creates new standards for state income tax and property tax exemptions in Illinois. The law establishes new standards for the issuance of charitable exemptions including requirements for a nonprofit hospital to certify annually that in the prior year, it provided an amount of qualified services and activities to low-income and underserved individuals with a value at least equal to the hospital's estimated property tax liability. The Corporations will begin certifying in 2013, and have not recorded a liability for related property taxes based upon management's current determination of qualified services provided.

(18) *Subsequent Events*

In connection with the preparation of the consolidated financial statements and in accordance with ASC Topic 855, *Subsequent Events*, the Corporations evaluated subsequent events after the balance sheet date of June 30, 2012 through September 19, 2012, which was the date the consolidated financial statements were issued.

In August 2012, Cadence Health entered into an agreement to acquire Orthopaedic Associates of DuPage (OAD), a multispecialty orthopaedic practice. Subject to the terms of the purchase agreements, Cadence Health will acquire OAD, an ambulatory surgery center, and related real estate. The acquisition is subject to approval by the Illinois Health Facilities and Services Review Board and is expected to close in fiscal year 2013.

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Required Supplementary Information (Unaudited)

Year ended June 30, 2012

(In thousands)

Unaudited Supplementary Information

The following information is not audited, but is required supplemental pro forma information. The Corporations' revenue, excess of revenues and gains over expenses and losses, and changes in each component of net assets for the year ended June 30, 2011, as if the merger had occurred as of July 1, 2010, are as follows:

Revenue	\$	951,516
Revenues and gains in excess of expenses and losses	\$	173,420
Changes in net assets:		
Unrestricted	\$	176,791
Temporarily restricted		(2,047)
Permanently restricted		642
Total changes in net assets	\$	<u>175,386</u>

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Consolidating Balance Sheet Information

June 30, 2012

(In thousands)

Assets	Cadence Health	Central DuPage Hospital Association	CDH Obligated Group eliminations	CDH Obligated Group subtotal	Delnor- Community Hospital	Cadence Physician Group	Community Nursing Service of DuPage County, Inc.
Current assets:							
Cash and cash equivalents	\$ (10,595)	8,984	—	(1,611)	302	17	266
Current portion of assets limited or restricted as to use	—	—	—	—	54	—	—
Receivables:							
Patient and resident accounts, less allowance for doubtful accounts of \$70,531	221	105,754	—	105,975	23,644	9,101	1,932
Estimated receivables under third-party reimbursement programs and other	6,782	49,795	—	56,577	7,122	991	214
Inventories	—	1,825	—	1,825	2,538	—	—
Prepaid expenses	10,653	8,587	—	19,240	603	7	16
Total current assets	<u>7,061</u>	<u>174,945</u>	<u>—</u>	<u>182,006</u>	<u>34,263</u>	<u>10,116</u>	<u>2,428</u>
Assets whose use is limited or restricted:							
By board for investment	682,204	298,327	—	980,531	186,511	—	8,251
Self-insurance trust	—	—	—	—	—	—	—
Held by trustee under debt agreements	10,445	—	—	10,445	—	—	—
Donor restricted	—	—	—	—	210	—	—
Total assets whose use is limited or restricted, net of current portion	<u>692,649</u>	<u>298,327</u>	<u>—</u>	<u>990,976</u>	<u>186,721</u>	<u>—</u>	<u>8,251</u>
Land, buildings, and equipment, net of accumulated depreciation and amortization	143,981	553,869	—	697,850	128,686	4,189	275
Other assets:							
Notes and advances receivable	67,191	—	—	67,191	726	—	—
Retirement plan assets	4,408	—	—	4,408	—	—	—
Investments in joint ventures and other assets	42,940	1,036	—	43,976	4,882	6,525	454
Total other assets	<u>114,539</u>	<u>1,036</u>	<u>—</u>	<u>115,575</u>	<u>5,608</u>	<u>6,525</u>	<u>454</u>
Total assets	\$ <u><u>958,230</u></u>	<u><u>1,028,177</u></u>	<u><u>—</u></u>	<u><u>1,986,407</u></u>	<u><u>355,278</u></u>	<u><u>20,830</u></u>	<u><u>11,408</u></u>

See accompanying independent auditors' report.

Schedule 1

DuPage Health Services, Inc.	PAHCS II	Central DuPage Special Health Association	Central DuPage Health Foundation	Delnor-Community Health Care Foundation	DelCom Corporation	Delnor-Community Residential Living, Inc.	Living Well Cancer Resource Center	United Professional Insurance Corporation	Eliminations	Consolidated
5	6	660	216	907	2,883	1,323	737	203	—	5,914
—	—	—	—	—	—	—	—	—	—	54
—	829	601	—	—	—	—	—	—	—	142,082
1,158	22	—	1,750	2,673	695	585	138	5,222	(17,564)	59,583
—	—	61	—	39	—	—	—	—	—	4,463
—	—	—	—	(17)	8	—	—	677	(677)	19,857
<u>1,163</u>	<u>857</u>	<u>1,322</u>	<u>1,966</u>	<u>3,602</u>	<u>3,586</u>	<u>1,908</u>	<u>875</u>	<u>6,102</u>	<u>(18,241)</u>	<u>231,953</u>
—	—	1,629	4,476	13,034	—	845	136	—	—	1,195,413
—	—	—	—	—	—	—	—	34,341	—	34,341
—	—	—	—	—	—	—	—	—	—	10,445
—	—	—	12,400	4,393	—	—	1,491	—	—	18,494
—	—	1,629	16,876	17,427	—	845	1,627	34,341	—	1,258,693
727	303	2	53	8,170	36	14,693	5,232	—	—	860,216
—	—	—	—	—	—	—	—	—	—	67,917
—	—	—	—	—	—	—	—	—	—	4,408
211	—	—	7	2,751	4,976	1,020	168	—	(14,340)	50,630
211	—	—	7	2,751	4,976	1,020	168	—	(14,340)	122,955
<u>2,101</u>	<u>1,160</u>	<u>2,953</u>	<u>18,902</u>	<u>31,950</u>	<u>8,598</u>	<u>18,466</u>	<u>7,902</u>	<u>40,443</u>	<u>(32,581)</u>	<u>2,473,817</u>

CDH/DELNOR HEALTH SYSTEM
d/b/a Cadence Health, and Affiliates
Consolidating Balance Sheet Information
June 30, 2012
(In thousands)

Liabilities and Net Assets	Cadence Health	Central DuPage Hospital Association	CDH Obligated Group eliminations	CDH Obligated Group subtotal	Delnor- Community Hospital	Cadence Physician Group	Community Nursing Service of DuPage County, Inc.
Current liabilities:							
Current installments of long-term debt	\$ 1,625	—	—	1,625	2,380	—	—
Accounts payable	23,141	16,975	—	40,116	5,203	208	25
Accrued liabilities:							
Salaries and wages	53,438	—	—	53,438	—	2,920	—
Pension	2,687	—	—	2,687	—	—	—
Interest	3,367	—	—	3,367	647	—	—
Other	21,058	15,340	—	36,398	—	474	95
Estimated payables under third-party reimbursement programs	—	81,404	—	81,404	21,716	—	—
Total current liabilities	105,316	113,719	—	219,035	29,946	3,602	120
Long-term debt, net of unamortized bond premiums and current installments	453,432	—	—	453,432	124,125	—	—
Retirement plan liabilities	4,408	—	—	4,408	—	—	—
Deferred revenue and other liabilities	59,602	—	—	59,602	16,620	—	—
Total liabilities	622,758	113,719	—	736,477	170,691	3,602	120
Net assets:							
Unrestricted	335,472	914,458	—	1,249,930	181,419	17,228	11,288
Temporarily restricted	—	—	—	—	3,168	—	—
Permanently restricted	—	—	—	—	—	—	—
Total net assets	335,472	914,458	—	1,249,930	184,587	17,228	11,288
Total liabilities and net assets	\$ 958,230	1,028,177	—	1,986,407	355,278	20,830	11,408

See accompanying independent auditors' report.

DuPage Health Services, Inc.	PAHCS II	Central DuPage Special Health Association	Central DuPage Health Foundation	Delnor-Community Health Care Foundation	DelCom Corporation	Delnor-Community Residential Living, Inc.	Living Well Cancer Resource Center	United Professional Insurance Corporation	Eliminations	Consolidated
—	—	—	—	—	—	—	—	—	—	4,005
506	489	(43)	177	533	776	1,051	70	4,679	(12,342)	41,448
—	12	—	31	—	—	—	—	—	—	56,401
—	—	—	—	—	—	—	—	—	—	2,687
—	—	—	—	—	—	—	—	—	—	4,014
26	—	—	—	268	9	519	9	—	—	37,798
—	—	—	—	—	—	—	—	—	—	103,120
532	501	(43)	208	801	785	1,570	79	4,679	(12,342)	249,473
—	—	—	—	1,867	—	—	—	—	—	579,424
—	—	—	—	—	—	—	—	—	—	4,408
—	—	—	138	605	—	6,289	—	35,644	(5,899)	112,999
532	501	(43)	346	3,273	785	7,859	79	40,323	(18,241)	946,304
1,569	659	2,996	6,155	24,285	7,813	9,587	6,165	120	(10,195)	1,509,019
—	—	—	6,918	4,392	—	1,020	1,658	—	(4,145)	13,011
—	—	—	5,483	—	—	—	—	—	—	5,483
1,569	659	2,996	18,556	28,677	7,813	10,607	7,823	120	(14,340)	1,527,513
2,101	1,160	2,953	18,902	31,950	8,598	18,466	7,902	40,443	(32,581)	2,473,817

CDH/DELNOR HEALTH SYSTEM

d/b/a Cadence Health

Consolidating Statement of Operations Information

Year ended June 30, 2012

(In thousands)

	Cadence Health	Central DuPage Hospital Association	CDH Obligated Group eliminations	CDH Obligated Group subtotal	Delnor- Community Hospital	Cadence Physician Group	Community Nursing Service of DuPage County, Inc.
Net patient and resident service revenue	\$ 1,621	744,887	(1)	746,507	197,799	52,987	17,242
Other revenue	78,208	19,393	(54,460)	43,141	2,877	3,103	450
Total revenue	79,829	764,280	(54,461)	789,648	200,676	56,090	17,692
Expenses:							
Salaries and wages	31,151	190,487	—	221,638	64,621	52,682	9,532
Employee benefits	4,045	45,847	—	49,892	17,738	7,583	2,123
Professional fees and purchased services	39,583	67,513	(1)	107,095	8,769	(1,197)	928
Supplies	2,454	111,146	—	113,600	29,611	9,504	1,099
Interest	22,319	—	—	22,319	6,895	—	—
Depreciation and amortization	13,148	47,133	—	60,281	12,867	2,751	186
Provision for uncollectible accounts	320	50,021	—	50,341	12,884	1,641	116
Other	20,558	77,234	(54,460)	43,332	31,801	13,406	2,085
Total expenses	133,578	589,381	(54,461)	668,498	185,186	86,370	16,069
Revenue in excess (deficient) of expenses	(53,749)	174,899	—	121,150	15,490	(30,280)	1,623
Nonoperating gains and losses:							
Investment return, unrestricted contributions and other, net	6,199	12	—	6,211	(9,624)	10	363
Revenue and gains in excess (deficient) of expenses and losses	(47,550)	174,911	—	127,361	5,866	(30,270)	1,986
Other changes in unrestricted net assets:							
Change in net unrealized gains and losses on other-than-trading securities	(3,453)	(1,518)	—	(4,971)	(98)	(144)	94
Joint venture equity transactions	—	—	—	—	—	—	—
Net assets released from restriction for the purchase of land, buildings, and equipment	—	—	—	—	400	—	—
Equity transfers among affiliates	40,717	(62,995)	—	(22,278)	(4,708)	43,185	—
Increase (decrease) in unrestricted net assets	\$ (10,286)	110,398	—	100,112	1,460	12,771	2,080

See accompanying independent auditors' report.

Schedule 2

DuPage Health Services, Inc.	PAHCS II	Central DuPage Special Health Association	Central DuPage Health Foundation	Delnor-Community Health Care Foundation	DelCom Corporation	Delnor-Community Residential Living, Inc.	Living Well Cancer Resource Center	United Professional Insurance Corporation	Eliminations	Consolidated
119	5,927	4,306	—	—	—	—	—	—	(3,152)	1,021,735
—	338	—	—	4,668	7,657	4,640	1,010	8,261	(25,640)	50,505
119	6,265	4,306	—	4,668	7,657	4,640	1,010	8,261	(28,792)	1,072,240
338	2,615	834	—	2,085	5,937	1,585	488	—	(330)	362,025
26	506	145	—	—	1,415	425	89	—	(393)	79,549
24	1,632	342	—	117	610	437	72	111	(5,317)	113,623
23	315	1,689	—	—	80	277	62	40	(13)	156,287
—	—	—	—	—	—	—	—	—	—	29,214
61	44	—	—	513	18	779	146	—	—	77,646
—	225	126	—	—	—	40	—	—	—	65,373
73	786	386	—	1,670	273	731	299	8,082	(22,603)	80,321
545	6,123	3,522	—	4,385	8,333	4,274	1,156	8,233	(28,656)	964,038
(426)	142	784	—	283	(676)	366	(146)	28	(136)	108,202
(38)	—	41	(1,119)	(710)	2,650	24	(30)	(28)	(2,661)	(4,911)
(464)	142	825	(1,119)	(427)	1,974	390	(176)	—	(2,797)	103,291
—	—	5	14	—	—	—	—	—	—	(5,100)
—	—	—	—	—	(512)	—	—	120	392	—
—	—	—	—	—	—	—	—	—	—	400
—	(1,000)	—	1,103	(16,941)	—	—	48	—	591	—
(464)	(858)	830	(2)	(17,368)	1,462	390	(128)	120	(1,814)	98,591

CDH/DELNOR HEALTH SYSTEM
d/b/a Cadence Health, and Affiliates
Consolidating Statement of Changes in Net Assets Information
Year ended June 30, 2012
(In thousands)

	Cadence Health	Central DuPage Hospital Association	CDH Obligated Group eliminations	CDH Obligated Group subtotal	Delnor- Community Hospital	Cadence Physician Group	Community Nursing Service of DuPage County, Inc.	DuPage Health Services, Inc.
Increase (decrease) in unrestricted net assets	\$ (10,286)	110,398	—	100,112	1,460	12,771	2,080	(464)
Temporarily restricted net assets:								
Contributions for specific purposes	—	—	—	—	—	—	—	—
Investment return	—	—	—	—	—	—	—	—
Net assets released from restriction and used for operations	—	—	—	—	—	—	—	—
Change in net interest of DCHCF	—	—	—	—	1,675	—	—	—
Transfer of restricted net assets	—	—	—	—	—	—	—	—
Net assets released from restriction used for the purchase of land, buildings, and equipment	—	—	—	—	—	—	—	—
Increase (decrease) in temporarily restricted net assets	—	—	—	—	1,675	—	—	—
Permanently restricted net assets:								
Contributions to be held in perpetuity	—	—	—	—	—	—	—	—
Investment return	—	—	—	—	—	—	—	—
Increase in permanently restricted net assets	—	—	—	—	—	—	—	—
Change in net assets	(10,286)	110,398	—	100,112	3,135	12,771	2,080	(464)
Net assets at beginning of period	345,758	804,060	—	1,149,818	181,452	4,457	9,208	2,033
Net assets at end of period	\$ 335,472	914,458	—	1,249,930	184,587	17,228	11,288	1,569

See accompanying independent auditors' report.

Schedule 3

PAHCS II	Central DuPage Special Health Association	Central DuPage Health Foundation	Delnor- Community Health Care Foundation	DelCom Corporation	Delnor- Community Residential Living, Inc.	Living Well Cancer Resource Center	United Professional Insurance Corporation	Eliminations	Consolidated
(858)	830	(2)	(17,368)	1,462	390	(128)	120	(1,814)	98,591
—	—	3,601	2,155	—	—	993	—	—	6,749
—	—	(1)	3	—	—	—	—	—	2
—	—	(424)	(161)	—	—	(1,010)	—	—	(1,595)
—	—	—	—	—	(88)	(40)	—	(1,547)	—
—	—	—	(100)	—	—	100	—	—	—
—	—	—	(400)	—	—	—	—	—	(400)
—	—	3,176	1,497	—	(88)	43	—	(1,547)	4,756
—	—	13	—	—	—	—	—	—	13
—	—	205	—	—	—	—	—	—	205
—	—	218	—	—	—	—	—	—	218
(858)	830	3,392	(15,871)	1,462	302	(85)	120	(3,361)	103,565
1,517	2,166	15,164	44,548	6,351	10,305	7,908	—	(10,979)	1,423,948
659	2,996	18,556	28,677	7,813	10,607	7,823	120	(14,340)	1,527,513