



CONSOLIDATED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION

Northwestern Memorial HealthCare and Subsidiaries
Years Ended August 31, 2011 and 2010
With Reports of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

Northwestern Memorial HealthCare and Subsidiaries

Consolidated Financial Statements and
Other Financial Information

Years Ended August 31, 2011 and 2010

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Report of Independent Auditors

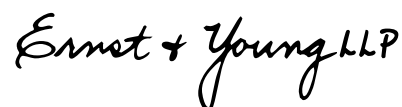
The Board of Directors
Northwestern Memorial HealthCare

We have audited the accompanying consolidated balance sheets of Northwestern Memorial HealthCare (an Illinois not-for-profit corporation) and Subsidiaries (Northwestern Memorial) as of August 31, 2011 and 2010, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of Northwestern Memorial's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of Northwestern Memorial's internal control over financial reporting. Our audits included 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 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Northwestern Memorial HealthCare and Subsidiaries as of August 31, 2011 and 2010, and the consolidated results of their operations and changes in net assets and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, during 2011, Northwestern Memorial changed its method of accounting for its ownership interest in alternative investments from the cost method to the equity method.

A handwritten signature in black ink that reads 'Ernst & Young LLP'.

November 18, 2011

Northwestern Memorial HealthCare and Subsidiaries

Consolidated Balance Sheets

(In Thousands)

| | August 31 | |
|--|-------------------------|---------------------|
| | 2011 | 2010 |
| | As Adjusted (Note 1) | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 131,311 | \$ 72,345 |
| Short-term investments | 85,188 | 84,886 |
| Current portion of investments, including assets limited as to use | 91,138 | 82,540 |
| Current portion of pledges and grants receivable, net | 16,250 | 12,238 |
| Patient accounts receivable, net of estimated uncollectibles of \$32,338 and \$28,622 in 2011 and 2010, respectively | 232,460 | 218,146 |
| Current portion of insurance recoverable | 14,433 | 19,419 |
| Inventories | 31,715 | 32,509 |
| Other current assets | 28,239 | 41,776 |
| Total current assets | <u>630,734</u> | <u>563,859</u> |
| Investments, including assets limited as to use, less current portion | 2,247,163 | 1,990,709 |
| Property and equipment, at cost: | | |
| Land | 227,820 | 206,549 |
| Buildings | 1,613,399 | 1,572,932 |
| Equipment and furniture | 509,021 | 482,845 |
| Construction-in-progress | 90,101 | 54,141 |
| | <u>2,440,341</u> | <u>2,316,467</u> |
| Less accumulated depreciation | 1,100,060 | 1,016,823 |
| | <u>1,340,281</u> | <u>1,299,644</u> |
| Prepaid pension cost | 53,216 | 28,128 |
| Insurance recoverable, less current portion | 71,249 | 70,537 |
| Other assets, net | 98,495 | 68,561 |
| Total assets | <u>\$ 4,441,138</u> | <u>\$ 4,021,438</u> |

| | August 31 | |
|--|---------------------|---------------------|
| | 2011 | 2010 |
| | As Adjusted | |
| | <i>(Note 1)</i> | |
| Liabilities and net assets | | |
| Current liabilities: | | |
| Accounts payable | \$ 87,535 | \$ 67,689 |
| Accrued salaries and benefits | 85,044 | 74,217 |
| Grants and academic support payable, current portion | 28,250 | 43,053 |
| Accrued expenses and other current liabilities | 42,575 | 55,191 |
| Due to third-party payors | 177,399 | 153,221 |
| Current accrued liabilities under self-insurance programs | 72,462 | 57,789 |
| Current maturities of long-term debt | 13,710 | 13,140 |
| Total current liabilities | <u>506,975</u> | 464,300 |
| Long-term debt, less current maturities | 821,354 | 836,039 |
| Accrued liabilities under self-insurance programs, less current portion | 414,173 | 405,758 |
| Grants and academic support payable, less current portion | 36,068 | 26,237 |
| Due to insureds | 45,303 | 29,702 |
| Interest rate swaps | 73,845 | 78,247 |
| Other liabilities | 70,372 | 72,715 |
| Total liabilities | <u>1,968,090</u> | 1,912,998 |
| Net assets: | | |
| Unrestricted: | | |
| General | 2,075,713 | 1,763,387 |
| Board-designated | 130,618 | 114,650 |
| Total unrestricted | <u>2,206,331</u> | 1,878,037 |
| Temporarily restricted | 140,388 | 124,500 |
| Permanently restricted | 126,329 | 105,903 |
| Total net assets | <u>2,473,048</u> | 2,108,440 |
| | | |
| Total liabilities and net assets | <u>\$ 4,441,138</u> | <u>\$ 4,021,438</u> |

See accompanying notes to consolidated financial statements.

Northwestern Memorial HealthCare and Subsidiaries

Consolidated Statements of Operations
and Changes in Net Assets
(In Thousands)

| | Year Ended August 31 | |
|---|-----------------------------|------------------|
| | 2011 | 2010 |
| | As Adjusted | |
| | <i>(Note 1)</i> | |
| Revenue | | |
| Net patient service revenue | \$ 1,593,596 | \$ 1,474,243 |
| Rental and other revenue | 101,792 | 93,896 |
| Net assets released from donor restrictions and federal and state grants | <u>21,466</u> | <u>22,037</u> |
| Total revenue | <u>1,716,854</u> | <u>1,590,176</u> |
| Expenses | | |
| Salaries and professional fees | 563,583 | 510,372 |
| Employee benefits | 188,614 | 171,170 |
| Supplies | 263,831 | 245,744 |
| Purchased services | 170,876 | 139,400 |
| Depreciation | 138,249 | 140,419 |
| Insurance | 75,766 | 68,817 |
| Provision for uncollectible accounts | 33,296 | 31,174 |
| Rent and utilities | 40,978 | 41,703 |
| Repairs and maintenance | 44,327 | 38,440 |
| Interest | 28,824 | 29,843 |
| Illinois Hospital Assessment | 41,395 | 39,330 |
| Other | 34,712 | 31,869 |
| Total expenses | <u>1,624,451</u> | <u>1,488,281</u> |
| Operating income | <u>92,403</u> | <u>101,895</u> |
| Nonoperating gains (losses) | | |
| Investment return | 237,074 | 137,770 |
| Change in fair value of interest rate swaps | 4,527 | (31,806) |
| Grants and academic support | (55,560) | (55,923) |
| Other | 9,432 | 7,046 |
| Total nonoperating gains, net | <u>195,473</u> | <u>57,087</u> |
| Excess of revenue over expenses | <u>287,876</u> | <u>158,982</u> |

Continued on next page.

Northwestern Memorial HealthCare and Subsidiaries

Consolidated Statements of Operations
and Changes in Net Assets (continued)

(In Thousands)

| | Year Ended August 31 | |
|--|-----------------------------|---------------------|
| | 2011 | 2010 |
| | As Adjusted | |
| | <i>(Note 1)</i> | |
| Unrestricted net assets | | |
| Excess of revenue over expenses | \$ 287,876 | \$ 158,982 |
| Net assets released from restrictions used for property and equipment additions | 380 | 4,088 |
| Postretirement-benefit-related changes other than net periodic pension cost | 40,165 | (40,760) |
| Contribution of Northwestern Lake Forest Hospital net assets | – | 208,951 |
| Other | (127) | (123) |
| Increase in unrestricted net assets | 328,294 | 331,138 |
| Temporarily restricted net assets | | |
| Contributions | 22,578 | 25,269 |
| Investment return | 16,146 | 10,663 |
| Net assets released from restrictions used for: | | |
| Operating expenses, charity care, and research and education | (22,118) | (21,473) |
| Property and equipment additions | (380) | (4,088) |
| Change in fair value of split-interest agreements | (192) | (136) |
| Contribution of Northwestern Lake Forest Hospital net assets | – | 3,830 |
| Other | (146) | 111 |
| Increase in temporarily restricted net assets | 15,888 | 14,176 |
| Permanently restricted net assets | | |
| Contributions | 19,683 | 5,187 |
| Change in fair value of split-interest agreements | 993 | 667 |
| Contribution of Northwestern Lake Forest Hospital net assets | – | 20,982 |
| Other | (250) | (428) |
| Increase in permanently restricted net assets | 20,426 | 26,408 |
| Change in total net assets | 364,608 | 371,722 |
| Net assets, beginning of year, as originally reported | | 1,642,453 |
| Change in accounting for alternative investments | | 94,265 |
| Net assets, beginning of year, as adjusted | 2,108,440 | 1,736,718 |
| Net assets, end of year | \$ 2,473,048 | \$ 2,108,440 |

See accompanying notes to consolidated financial statements.

Northwestern Memorial HealthCare and Subsidiaries

Consolidated Statements of Cash Flows

(In Thousands)

| | Year Ended August 31 | |
|---|-----------------------------|------------------|
| | 2011 | 2010 |
| Operating activities | | |
| Change in net assets | \$ 364,608 | \$ 371,722 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | |
| Postretirement-benefit-related changes other than net periodic pension cost | (40,165) | 40,760 |
| Change in fair value of interest rate swaps | (4,402) | 31,931 |
| Net investment return and net change in unrealized investment gains/losses | (246,873) | (144,960) |
| Restricted contributions and realized investment return | (49,409) | (34,461) |
| Contribution of Northwestern Lake Forest Hospital net assets | – | (233,763) |
| Depreciation and amortization | 137,639 | 139,556 |
| Provision for uncollectible accounts | 33,296 | 31,174 |
| Change in operating assets and liabilities: | | |
| Patient accounts receivable | (47,610) | (29,930) |
| Due to third-party payors | 22,255 | 15,619 |
| Grants and academic support payable | (4,972) | (10,192) |
| Other operating assets and liabilities | 55,697 | (22,058) |
| Net cash provided by operating activities | 220,064 | 155,398 |
| Investing activities | | |
| Purchases of trading securities | (410,539) | (616,530) |
| Sales of trading securities | 296,581 | 499,315 |
| Unrestricted realized investment return | 95,477 | 44,975 |
| Cash received from contribution of Northwestern Lake Forest Hospital | – | 19,213 |
| Capital expenditures, net | (178,886) | (117,107) |
| Net cash used in investing activities | (197,367) | (170,134) |
| Financing activities | | |
| Payments of long-term debt | (13,140) | (15,420) |
| Restricted contributions and realized investment return | 49,409 | 34,461 |
| Net cash provided by financing activities | 36,269 | 19,041 |
| Net increase in cash and cash equivalents | 58,966 | 4,305 |
| Cash and cash equivalents, beginning of year | 72,345 | 68,040 |
| Cash and cash equivalents, end of year | \$ 131,311 | \$ 72,345 |

See accompanying notes to consolidated financial statements.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (In Thousands)

Years Ended August 31, 2011 and 2010

1. Organization and Summary of Significant Accounting Policies

Northwestern Memorial HealthCare (NMHC) serves as the sole corporate member of Northwestern Memorial Hospital (NMH), Northwestern Lake Forest Hospital (NLFH) (see Note 2), and Northwestern Memorial Foundation (the Foundation). NMH's subsidiary corporations are Northwestern HealthCare Corporation (NHC), Northwestern Memorial Physicians Group (NMPG), and Northwestern Memorial Insurance Company (NMIC). NLFH's subsidiary corporation is Lake Forest Health and Fitness Institute (HFI). NMH and NLFH are both members of the obligated group (Obligated Group) for all of the outstanding bonds of NMH and NLFH.

NMH is a major academic medical center located in the Streeterville neighborhood of Chicago, providing a complete range of adult inpatient and outpatient services, primarily to residents of Chicago and surrounding areas, in an educational and research environment. It is licensed for 894 beds. NMH, whose origins date back to 1849, is the primary teaching center for Northwestern University's Feinberg School of Medicine (FSM).

NLFH is a community hospital located in Lake Forest, Illinois, providing a complete range of adult inpatient and outpatient services, as well as skilled nursing care, primarily to residents of Lake Forest and the surrounding area. It is licensed for 117 acute care beds and 88 skilled nursing care beds.

The Foundation carries out fund-raising and other related development activities to promote and support the tax-exempt interests and purposes of NMH and NLFH.

Basis of Presentation

The accompanying consolidated financial statements include the accounts of NMHC, the Foundation, NMH and its subsidiaries, and NLFH and its subsidiary (collectively referred to herein as Northwestern Memorial). All significant intercompany transactions and balances have been eliminated in consolidation.

Community Benefit

Northwestern Memorial provides care to patients regardless of their ability to pay. Northwestern Memorial developed a Free and Discounted Care Policy (the Policy) for both the uninsured and the underinsured. Under the Policy, patients are offered discounts of up to 100% of charges on a

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

sliding scale, which is based on income as a percentage of the Federal Poverty Level guidelines (up to 600%). The Policy also contains provisions that are responsive to those patients subject to catastrophic healthcare expenses and uninsured patients not covered by the provisions above. Since Northwestern Memorial does not pursue collection of these amounts, they are not reported as net patient service revenue. Charges forgone under the Policy were \$207,497 and \$162,502 in 2011 and 2010, respectively. Northwestern Memorial's unreimbursed cost of providing care to the uninsured and the underinsured; provision for uncollectible accounts (excluding non-patient related provisions); unreimbursed cost of government-sponsored indigent healthcare programs; cost of providing other community services, grants, or awards; and unreimbursed cost to support education and clinical research for the years ended August 31, 2011 and 2010, are reported on the schedule of community benefits in the accompanying other financial information section.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid short-term investments with maturities of 90 days or less from the date of purchase.

Patient Accounts Receivable

Patient accounts receivable are stated at net realizable value. Northwestern Memorial maintains allowances for uncollectible accounts and for estimated losses resulting from a payor's inability to make payments on accounts. Northwestern Memorial estimates the allowance for uncollectible accounts based on management's assessment of historical and expected net collections considering historical and current business and economic conditions, trends in healthcare coverage, and other collection indicators. Accounts receivable are charged to the allowance for uncollectible accounts when they are deemed uncollectible.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

Assets Limited as to Use

Assets limited as to use consist primarily of investments designated by the appropriate board of directors (the Board) for certain medical education and healthcare programs. The appropriate Board retains control of these investments and may, at its discretion, subsequently use them for other purposes. In addition, assets limited as to use include investments held by trustees under debt agreements and for self-insurance.

Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are reported at fair value based on quoted market prices. Alternative investments, primarily hedge funds and limited partnership interests in private equity, venture capital, and real estate funds, are reported using the equity method.

Derivative Instruments

Derivative instruments, specifically interest rate swaps, are recorded on the consolidated balance sheets at fair value. The change in the fair value of those derivative instruments, less any ineffective portion thereof, that meet the criteria of an effective hedge, is reflected as a change in unrestricted net assets. The change in the fair value of derivative instruments that do not meet hedge accounting criteria and any ineffective portion of the derivative instruments that do meet hedge accounting criteria are reflected in nonoperating gains (losses).

Inventories

Inventories, consisting primarily of pharmaceuticals and supplies, are stated at the lower of cost on the first-in, first-out method or fair value.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. Typical useful lives are 5 to 40 years for buildings and building service equipment and 3 to 20 years for equipment and furniture. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Asset Impairment

Northwestern Memorial considers whether indicators of impairment are present and performs the necessary tests to determine if the carrying value of an asset is appropriate. Impairment write-downs are recognized in operating income at the time the impairment is identified. There was no impairment of long-lived assets in 2011 and 2010.

Deferred Charges

Deferred finance charges and bond discount or premium are amortized using the effective interest method or the bonds outstanding method, which approximates the effective interest method, over the life of the related debt.

Net Assets

Resources are classified for reporting purposes into four net asset categories as general unrestricted, board-designated unrestricted, temporarily restricted, and permanently restricted, according to the absence or existence of board designations or donor-imposed restrictions. Board-designated net assets are unrestricted net assets that have been set aside by the Board for specific purposes. Temporarily restricted net assets are those assets, including contributions and accumulated investment returns, whose use has been limited by donors for a specific purpose or time period. Permanently restricted net assets are those for which donors require the principal of the gifts to be maintained in perpetuity to provide a permanent source of income.

Changes in donor restrictions that change the net asset category of previously recorded contributions are recorded as other transfers in the accompanying consolidated statements of operations and changes in net assets in the period communicated by the donor.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

Net Patient Service Revenue

Northwestern Memorial has agreements with third-party payors that provide for payments to Northwestern Memorial at amounts different from its established rates. Payment arrangements include prospectively determined rates per admission or visit, reimbursed costs, discounted charges, and per diem rates. Net patient service revenue is reported at the estimated net amount due from patients and third-party payors for services rendered, including estimated adjustments under reimbursement agreements with third-party payors, certain of which are subject to audit by administering agencies. These adjustments are accrued on an estimated basis and are adjusted, as needed, in future periods.

Contributions

Unrestricted gifts, other than long-lived assets, are recorded as a component of other nonoperating gains in the accompanying consolidated statements of operations and changes in net assets. Unrestricted gifts of long-lived assets such as land, buildings, or equipment are recorded at fair value as an increase in unrestricted net assets. Contributions are reported as either temporarily or permanently restricted net assets if they are received with donor restrictions. 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 accompanying consolidated statements of operations and changes in net assets as net assets released from restrictions.

Unconditional promises to give cash or other assets are reported as pledges receivable and contributions within the appropriate net asset category. An allowance for uncollectible pledges receivable is estimated based on historical experience and other collection indicators. Pledges receivable with payment terms extending beyond one year are discounted using a risk-free rate of return.

Northwestern Memorial is a beneficiary of several split-interest agreements, primarily perpetual trusts held by others. The Foundation recognizes its initial interest in these trusts as temporarily or permanently restricted net assets based on either the present value of expected future cash flows to be received from the trusts (discounted using a risk-free rate of return) or for the Foundation's percentage of the fair value of the trusts' assets, as appropriate, based on each trust arrangement.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

Nonoperating Gains (Losses)

Nonoperating gains (losses) consist primarily of investment returns (including realized gains and losses; net change in unrealized investment gains and losses; changes in Northwestern Memorial's proportionate share of its equity interest in alternative investments, interest, and dividends), unrestricted contributions received, grants and academic support provided to external organizations, net assets released from restriction and used for grants and academic support, and changes in fair value of interest rate swaps not qualifying for hedge accounting treatment.

Excess of Revenue Over Expenses

The accompanying consolidated statements of operations and changes in net assets include the excess of revenue over expenses. Changes in unrestricted net assets, which are excluded from the excess of revenue over expenses, primarily include contributions of long-lived assets (including assets acquired using contributions, which, by donor restriction, are to be used for the purposes of acquiring such assets), transfers between net asset categories based on changes in donor restrictions, and postretirement-benefit-related changes other than net periodic pension cost.

Reclassifications

Certain reclassifications have been made to the 2010 consolidated financial statements to conform with classifications used in 2011. The reclassifications had no effect on the changes in net assets or on net assets previously reported.

Change in Accounting Principle

Northwestern Memorial previously recorded alternative investments for its non-pension plan assets at cost, less other than temporary impairments. In 2011, Northwestern Memorial elected to change its method of recording these alternative investments to the equity method of accounting. The equity method was adopted as it is a preferred method of accounting for alternative investments. Comparative financial statements of prior years have been adjusted to apply the equity method retrospectively.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

The following consolidated financial statement line items at August 31, 2010, and for the year then ended, were affected by the change in accounting principle:

| | <u>Adjusted</u> | <u>Originally Reported</u> | <u>Effect of Change</u> |
|---|-----------------|--------------------------------|-----------------------------|
| Balance Sheet | | | |
| Investments, including limited as to use, less current portion | \$ 1,990,709 | \$ 1,830,827 | \$ 159,882 |
| Total assets | 4,021,438 | 3,861,556 | 159,882 |
| Net assets: | | | |
| Unrestricted: | | | |
| General | 1,763,387 | 1,633,317 | 130,070 |
| Board-designated | 114,650 | 102,019 | 12,631 |
| Total unrestricted | 1,878,037 | 1,735,336 | 142,701 |
| Temporarily restricted | 124,500 | 107,319 | 17,181 |
| Total net assets | 2,108,440 | 1,948,558 | 159,882 |
| Total liabilities and net assets | 4,021,438 | 3,861,556 | 159,882 |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

| | Adjusted | Originally Reported | Effect of Change |
|---|-----------------|--------------------------------|-----------------------------|
| Statement of Operations and Changes in Net Assets | | | |
| Nonoperating: | | | |
| Investment return | \$ 137,770 | \$ 103,917 | \$ 33,853 |
| Investment loss – impairments | – | (25,858) | 25,858 |
| Total nonoperating gains, net | 57,087 | (2,624) | 59,711 |
| Excess of revenue over expenses | 158,982 | 99,271 | 59,711 |
| Increase in unrestricted net assets | 331,138 | 271,427 | 59,711 |
| Temporarily restricted net assets: | | | |
| Investment return | 10,663 | 7,217 | 3,446 |
| Investment loss – impairments | – | (2,460) | 2,460 |
| Increase in temporarily restricted net assets | 14,176 | 8,270 | 5,906 |
| Change in total net assets | 371,722 | 306,105 | 65,617 |
| Statement of Cash Flows | | | |
| Unrestricted realized investment return and net change in unrealized gains/losses and impairments | (144,960) | (79,599) | (65,361) |
| Restricted contributions and realized investment return | (34,461) | (34,204) | (257) |
| Net cash provided by operating activities | 155,398 | 171,205 | (15,807) |
| Purchases of alternative investments | – | (232,785) | 232,785 |
| Sales of alternative investments | – | 144,995 | (144,995) |
| Purchase of trading securities | (616,530) | – | (616,530) |
| Sale of trading securities | 499,315 | – | 499,315 |
| Unrestricted realized investment return | 44,975 | – | 44,975 |
| Net cash used in investing activities | (170,134) | (185,684) | 15,550 |
| Restricted contributions and realized investment return | 34,461 | 34,204 | 257 |
| Net cash provided by financing activities | 19,041 | 18,784 | 257 |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-06, *Improving Disclosures about Fair Value Measurements* (ASU 2010-06). ASU 2010-06 amends Accounting Standards Codification (ASC) 820, *Fair Value Measurement*, to require a number of additional disclosures regarding fair value measurements. These disclosures include the amounts of significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for these transfers; the reasons for any transfer in or out of Level 3; and information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances, and settlements on a gross basis, as well as clarification on previous reporting requirements. This new guidance is effective for the first reporting period, including interim periods, beginning after December 15, 2009, for all disclosures except the requirement to separately disclose purchases, sales, issuances, and settlements of recurring Level 3 measurements, which will be effective for Northwestern Memorial in fiscal year 2012. Northwestern Memorial adopted this guidance in fiscal year 2010, with the exception of the additional Level 3 disclosures, which it will adopt in fiscal year 2012.

In August 2010, the FASB issued ASU 2010-23, *Measuring Charity Care for Disclosure* (ASU 2010-23). The provisions of ASU 2010-23 are intended to reduce the diversity in how charity care is calculated and disclosed across healthcare entities that provide it. Charity care is required to be measured at cost, defined as the direct and indirect costs of providing the charity care. Funds received to offset or subsidize the cost of charity care provided, for example from gifts or grants restricted for charity care, should be separately disclosed. As a healthcare entity does not recognize revenue when charity care is provided, this update will only require enhanced disclosures and will have no effect on the consolidated statements of operations and changes in net assets. This new guidance is effective for fiscal years beginning after December 15, 2010, with retrospective application required and with early application permitted. Northwestern Memorial will adopt this guidance in fiscal year 2012.

In August 2010, the FASB issued ASU 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries* (ASU 2010-24). ASU 2010-24 prohibits the netting of insurance recoveries against a related claim liability and requires the claim liability to be reported without consideration of insurance recoveries unless a right of setoff exists. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010, with early application permitted. Northwestern Memorial will adopt this guidance in fiscal year 2012. Northwestern Memorial is evaluating the effect this guidance will have on its consolidated financial statements.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

In December 2010, the FASB issued ASU 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations* (ASU 2010-29). ASU 2010-29 clarifies the disclosure requirement for pro forma revenue and earnings for comparative current and prior reporting periods. Pro forma information should be disclosed as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior fiscal year only. ASU 2010-29 also expands the disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination(s). This guidance is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010, with early adoption permitted. This guidance will be effective for and adopted by Northwestern Memorial in fiscal year 2012.

In May 2011, the FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04). ASU 2011-04 changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. This update was issued to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and International Financial Reporting Standards (IFRS). ASU 2011-04 includes amendments that clarify the FASB's intent about the application of existing measurement and disclosure and changes certain principles and requirements for measuring fair value and for disclosing information about fair value measurements. This new guidance is effective for interim and annual periods beginning after December 15, 2011. Early application is not permitted. This guidance will be effective for Northwestern Memorial in the third quarter of fiscal year 2012. Northwestern Memorial is evaluating the effect this guidance will have on its consolidated financial statements.

In July 2011, the FASB issued ASU 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities* (ASU 2011-07). ASU 2011-07 requires healthcare entities that recognize significant amounts of patient service revenue at the time of service even though they do not assess the patient's ability to pay to present the provision for bad debts related to patient service revenue as a deduction from patient service revenue on the statement of operations. In addition, enhanced disclosure about the entity's policies for recognizing revenue and assessing bad debts, including disclosures of patient service revenue (net of contractual allowances and discounts) as well as qualitative and quantitative information about changes in the allowance for doubtful accounts, is required. This new guidance is effective for fiscal years and interim periods within

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

those fiscal years beginning after December 15, 2011, with early adoption permitted. This guidance will be effective for Northwestern Memorial in fiscal year 2013. Northwestern Memorial is evaluating the effect this guidance will have on its consolidated financial statements.

2. Affiliation Agreement with Lake Forest Hospital

On February 1, 2010, Lake Forest Hospital (now known as NLFH) became a wholly owned subsidiary of NMHC pursuant to an affiliation agreement by and among NMHC, NMH, Lake Forest Hospital Foundation, and Lake Forest Hospital. Lake Forest Hospital was engaged in providing healthcare and related lines of business, including a 205-bed hospital located in Lake Forest, Illinois. This affiliation is expected to enable better access to care, clinical trials, new and expanded services, and the latest technologies for patients in Lake and Cook Counties and the surrounding regions.

The affiliation was affected through a membership substitution, and no monetary consideration was paid by NMHC or NMH. For accounting purposes, this transaction was accounted for under purchase accounting rules, and a contribution was recorded for the fair value of assets net of liabilities of NLFH in the accompanying consolidated statements of operations and changes in net assets for the year ended August 31, 2010. No goodwill was recorded as a result of this transaction.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

2. Affiliation Agreement with Lake Forest Hospital (continued)

The fair value of assets and liabilities of NLFH contributed at February 1, 2010, consists of the following:

| | |
|-----------------------------------|-------------------|
| Cash and cash equivalents | \$ 19,213 |
| Other current assets | 46,483 |
| Property and equipment | 180,814 |
| Other long-term assets | 157,091 |
| Total assets | <u>\$ 403,601</u> |
| Current liabilities | \$ 43,799 |
| Long-term debt | 74,810 |
| Pension liability | 27,806 |
| Other long-term liabilities | 23,423 |
| Total liabilities | <u>\$ 169,838</u> |
| Increase in net assets: | |
| Unrestricted net assets | \$ 208,951 |
| Temporarily restricted net assets | 3,830 |
| Permanently restricted net assets | 20,982 |
| Total net assets | <u>\$ 233,763</u> |

Total operating revenue and operating income from the date of affiliation for NLFH and subsidiary of \$137,078 and \$5,470, respectively, have been included in the accompanying consolidated statements of operations and changes in net assets for the year ended August 31, 2010. Following are the unaudited pro forma results for the year ended August 31, 2010, as if the affiliation had occurred on September 1, 2009:

| | |
|---------------------------------|--------------|
| Total operating revenue | \$ 1,697,320 |
| Operating income | 110,737 |
| Excess of revenue over expenses | 116,482 |

The pro forma information provided should not be construed to be indicative of Northwestern Memorial's results of operations had the affiliation been consummated on September 1, 2009, and is not intended to project Northwestern Memorial's results of operations for any future period.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

2. Affiliation Agreement with Lake Forest Hospital (continued)

As part of this affiliation, Northwestern Memorial committed to various capital projects, including the recent expansion project at NLFH's Grayslake facility and a plan to refurbish or replace existing inpatient and outpatient facilities on the Lake Forest campus within ten years from the affiliation date.

3. Investments and Other Financial Instruments

The composition of investments and cash and cash equivalents at August 31 is as follows:

| | 2011 | 2010 |
|--|---------------------|--------------------|
| | | As Adjusted |
| | | <i>(Note 1)</i> |
| Measured at fair value: | | |
| Cash and short-term investments | \$ 235,892 | \$ 194,338 |
| Equity securities | 43,510 | 33,510 |
| Mutual funds | 608,099 | 593,246 |
| Common collective trusts | 192,900 | 176,159 |
| Commingled funds | 212,726 | 215,761 |
| 103-12 entities | 131,546 | 112,412 |
| Corporate bonds | 37,403 | 34,209 |
| U.S. government and agency issues | – | 690 |
| Foreign government issues | 573 | 446 |
| | 1,462,649 | 1,360,771 |
| Accounted for under the equity method: | | |
| Alternative investments | 1,092,151 | 869,709 |
| | \$ 2,554,800 | \$ 2,230,480 |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

3. Investments and Other Financial Instruments (continued)

Investments and other financial instruments consist of the following:

| | <u>2011</u> | <u>2010</u> |
|--|---------------------|---------------------|
| | As Adjusted | |
| | <i>(Note 1)</i> | |
| Assets limited as to use: | | |
| Trustee-held funds | \$ 7,247 | \$ 6,203 |
| Self-insurance programs | 498,099 | 493,309 |
| Board-designated funds | 130,617 | 136,901 |
| Total assets limited as to use | <u>635,963</u> | 636,413 |
| Donor-restricted funds | 215,594 | 195,619 |
| Unrestricted, undesignated funds | 1,486,744 | 1,241,217 |
| Total investments | <u>2,338,301</u> | 2,073,249 |
| Other financial instruments: | | |
| Cash and cash equivalents and short-term investments | 216,499 | 157,231 |
| | <u>\$ 2,554,800</u> | <u>\$ 2,230,480</u> |

The composition and presentation of investment returns are as follows for the years ended August 31:

| | <u>2011</u> | <u>2010</u> |
|---|--------------------|-------------------|
| | As Adjusted | |
| | <i>(Note 1)</i> | |
| Interest and dividend income | \$ 40,682 | \$ 20,232 |
| Investment expenses | (3,988) | (4,276) |
| Realized gains on investments, net | 64,604 | 32,814 |
| Net increase in unrealized investment gains | 151,922 | 99,663 |
| | <u>\$ 253,220</u> | <u>\$ 148,433</u> |
| Reported as: | | |
| Nonoperating investment return | \$ 237,074 | \$ 137,770 |
| Temporarily restricted: | | |
| Investment return | 16,146 | 10,663 |
| | <u>\$ 253,220</u> | <u>\$ 148,433</u> |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

3. Investments and Other Financial Instruments (continued)

Northwestern Memorial's alternative investments include absolute return hedge funds, equity long/short hedge funds, real estate, natural resources, and private equity limited partnerships (LPs).

Absolute return hedge funds include funds with the ability to opportunistically allocate capital among several strategies. The funds typically diversify across strategies in an effort to deliver consistently positive returns regardless of the movement within global markets. These funds generally exhibit relatively low volatility and are generally redeemable quarterly with a 60-day notice period. Equity long/short hedge funds include hedge funds that invest both long and short in U.S. and international equities. These funds typically focus on diversifying or hedging across particular sectors, regions, or market capitalizations and are generally redeemable quarterly with a 60-day notice period.

Real estate includes LPs that invest in land and buildings and seek to improve property level operations by increasing lease rates, recapitalizing properties, rehabilitating aging/distressed properties, and repositioning properties to attract higher quality tenants. Real estate LPs typically use moderate leverage. Natural resources include a diverse set of LPs that invest in oil and natural gas-related companies, commodity-oriented companies, and timberland. Private equity includes LPs formed to make equity and debt investments in operating companies that are not publicly traded. These LPs typically seek to influence decision making within the operating companies. Investment strategies in this category may include venture capital, buyouts, and distressed debt. These three categories of investments can never be redeemed with the funds. Distributions from each fund will be received as the underlying assets of the fund are expected to be liquidated periodically over the lives of the LPs, which generally run 10 to 12 years.

Of the total amount reported of alternative investments at August 31, 2011, \$618,699 cannot be redeemed for at least one year from the balance sheet date. In addition, \$475,000 is subject to lockup provisions that expire within one year of the balance sheet date.

At August 31, 2011, Northwestern Memorial had commitments to fund an additional \$216,958 to alternative investment entities, which is expected to occur over the next 12 years.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

4. Fair Value Measurements

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and other current liabilities, and short-term borrowings are reasonable estimates of their fair values due to the short-term nature of these financial instruments. The fair value of pledges receivable is based on discounted cash flow analysis and approximated the carrying value at August 31, 2011 and 2010. The fair value of beneficial interests in trusts is based on the present value of expected future cash flows to be received from the trusts (discounted using a risk-free rate of return) or the percentage of the fair value of the trusts' assets, as appropriate, based on each trust arrangement. The estimated fair value of the long-term debt portfolio, including the current portion, based on quoted market prices for the same or similar issues, was \$874,400 and \$893,961 at August 31, 2011 and 2010, respectively. The fair value is based on quoted market prices for the same or similar issues and includes a consideration of third-party credit enhancements, but for which there was no impact to the estimated fair value at August 31, 2011 and 2010.

The methodologies used to determine fair value of assets and liabilities reflect market participant objectives and are based on the applications of a three-level valuation hierarchy that prioritizes observable market inputs over unobservable inputs. The three levels are defined as follows:

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 – Inputs to the valuation methodology are unobservable but reflect the assumptions market participants would use in pricing the asset or liability.

There were no significant transfers into or out of Level 2 or Level 1 that took place between September 1, 2010 and August 31, 2011.

A financial instrument's categorization within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

4. Fair Value Measurements (continued)

The following table presents the financial instruments measured at fair value on a recurring basis as of August 31, 2011:

| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
|--|----------------|----------------|----------------|--------------|
| Assets | | | | |
| Cash and cash equivalents | \$ 131,311 | \$ – | \$ – | \$ 131,311 |
| Investments: | | | | |
| Short-term investments: | | | | |
| Currency and certificates of deposit | 12,174 | – | – | 12,174 |
| Fixed income | – | 73,014 | – | 73,014 |
| Total short-term investments | 12,174 | 73,014 | – | 85,188 |
| Mutual funds: | | | | |
| Fixed income | 376,590 | – | – | 376,590 |
| International equities | 68,748 | – | – | 68,748 |
| U.S. equities | 162,761 | – | – | 162,761 |
| Total mutual funds | 608,099 | – | – | 608,099 |
| Common collective trusts: | | | | |
| International equities | – | 40,065 | – | 40,065 |
| U.S. equities | – | 152,835 | – | 152,835 |
| Total common collective trusts | – | 192,900 | – | 192,900 |
| Commingled funds: | | | | |
| International equities | – | 74,106 | – | 74,106 |
| Natural resources | – | 22,439 | – | 22,439 |
| U.S. equities | – | 116,181 | – | 116,181 |
| Total commingled funds | – | 212,726 | – | 212,726 |
| Bonds: | | | | |
| Corporate bonds | – | 37,403 | – | 37,403 |
| Foreign government issues | – | 573 | – | 573 |
| Total bonds | – | 37,976 | – | 37,976 |
| Equity securities | 43,461 | 49 | – | 43,510 |
| 103-12 entities – international equities | – | 131,546 | – | 131,546 |
| Cash equivalents in investment accounts | 19,393 | – | – | 19,393 |
| Total investments | 683,127 | 648,211 | – | 1,331,338 |
| Beneficial interests in trusts | – | 12,010 | – | 12,010 |
| Total assets | \$ 814,438 | \$ 660,221 | \$ – | \$ 1,474,659 |
| Liabilities | | | | |
| Interest rate swaps | \$ – | \$ 73,845 | \$ – | \$ 73,845 |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

4. Fair Value Measurements (continued)

The following table presents the financial instruments measured at fair value on a recurring basis as of August 31, 2010:

| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
|--|-------------------|-------------------|----------------|---------------------|
| Assets | | | | |
| Cash and cash equivalents | \$ 72,345 | \$ – | \$ – | \$ 72,345 |
| Investments: | | | | |
| Short-term investments: | | | | |
| Currency and certificates of deposit | 73,540 | – | – | 73,540 |
| Fixed income | – | 11,346 | – | 11,346 |
| Total short-term investments | 73,540 | 11,346 | – | 84,886 |
| Mutual funds: | | | | |
| Fixed income | 387,601 | – | – | 387,601 |
| International equities | 85,846 | – | – | 85,846 |
| U.S. equities | 119,799 | – | – | 119,799 |
| Total mutual funds | 593,246 | – | – | 593,246 |
| Common collective trusts: | | | | |
| International equities | – | 39,686 | – | 39,686 |
| U.S. equities | – | 136,473 | – | 136,473 |
| Total common collective trusts | – | 176,159 | – | 176,159 |
| Commingled funds: | | | | |
| International equities | – | 77,891 | – | 77,891 |
| Natural resources | – | 20,305 | – | 20,305 |
| U.S. equities | – | 117,565 | – | 117,565 |
| Total commingled funds | – | 215,761 | – | 215,761 |
| Bonds: | | | | |
| Corporate bonds | – | 34,209 | – | 34,209 |
| U.S. government and agency issues | 690 | – | – | 690 |
| Foreign government issues | – | 446 | – | 446 |
| Total bonds | 690 | 34,655 | – | 35,345 |
| Equity securities | 33,459 | 51 | – | 33,510 |
| 103-12 entities – international equities | – | 112,412 | – | 112,412 |
| Cash equivalents in investment accounts | 37,107 | – | – | 37,107 |
| Total investments | 738,042 | 550,384 | – | 1,288,426 |
| Beneficial interests in trusts | – | 10,962 | – | 10,962 |
| Total assets | <u>\$ 810,387</u> | <u>\$ 561,346</u> | <u>\$ –</u> | <u>\$ 1,371,733</u> |
| Liabilities | | | | |
| Interest rate swaps | \$ – | \$ 78,247 | \$ – | \$ 78,247 |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

4. Fair Value Measurements (continued)

The fair value of Level 1 investments is based on quoted market prices and is valued on a daily basis. The fair value of Level 2 investments is based on a combination of quoted market prices of similar securities and matrix pricing provided by third-party pricing services of similar quality and maturity securities. The fair value of interest rate swaps is based on generally accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative and quoted prices from dealer counterparties and other independent market sources. The valuation incorporates observable interest rates and yield curves for the full term of the swaps. The valuation is also adjusted to incorporate nonperformance risk for NMH or the respective counterparty. The adjustment is based on the credit spread for entities with similar credit characteristics as NMH or market-related data for the respective counterparty. Northwestern Memorial pays fixed rates ranging from 3.3% to 3.9% and receives cash flows based on rates equal to 63% of London Interbank Offered Rate (LIBOR) plus 28 basis points.

A reconciliation of the fair value of assets to the consolidated balance sheets at August 31, 2011 and 2010, is as follows:

| | 2011 | 2010 |
|---|---------------------|---------------------------------------|
| | | As Adjusted <i>(Note 1)</i> |
| Short-term investments measured at fair value | \$ 85,188 | \$ 84,886 |
| Investments, including assets limited as to use measured at fair value | 1,246,150 | 1,203,540 |
| Total investments at fair value | 1,331,338 | 1,288,426 |
| Alternative investments accounted for under equity method included in investments, including assets limited as to use | 1,092,151 | 869,709 |
| Total investments | \$ 2,423,489 | \$ 2,158,135 |
| Other long-term assets: | | |
| Beneficial interests in trusts at fair value | \$ 12,010 | \$ 10,962 |
| Other long-term assets, net | 86,485 | 57,599 |
| Total other long-term assets | \$ 98,495 | \$ 68,561 |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(In Thousands)

4. Fair Value Measurements (continued)

Northwestern Memorial's investments are exposed to various kinds and levels of risk. Equity securities and equity mutual funds expose Northwestern Memorial to market risk, performance risk, and liquidity risk. Market risk is the risk associated with major movements of the equity markets. Performance risk is that risk associated with a company's operating performance. Fixed income securities and fixed income mutual funds expose Northwestern Memorial to interest rate risk, credit risk, and liquidity risk. As interest rates change, the value of many fixed income securities is affected, including those with fixed interest rates. Credit risk is the risk that the obligor of the security will not fulfill its obligations. Liquidity risk is affected by the willingness of market participants to buy and sell particular securities. Liquidity risk tends to be higher for equities related to small capitalization companies and certain alternative investments. Due to the volatility in the capital markets, there is a reasonable possibility of subsequent changes in fair value, resulting in additional gains and losses in the near term.

5. Self-Insurance Liabilities

NMH and NMPG retain certain levels of professional and general liability risks. NMH also retains certain levels of workers' compensation risks. For those risks, the NMH has established trust funds to pay claims and related costs.

NMIC provides coverage, on a claims-made basis, in excess of the amounts retained by NMH and NMPG for professional and general liability claims occurring and reported between October 1, 2002 and November 1, 2004. NMIC is fully reinsured for these risks.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(In Thousands)

5. Self-Insurance Liabilities (continued)

Effective November 1, 2004, NMIC provides, on a claims-made basis, professional and general liability coverage to NMH and professional liability coverage to Northwestern Medical Faculty Foundation, Inc. (NMFF) under a joint insurance program. NMFF is an unconsolidated, not-for-profit, multi-specialty group practice, which serves as the clinical faculty practice plan arm of FSM and is one of the faculty components of the academic medical center. NMIC also provides, on a claims-made basis, professional liability coverage to NMPG and excess general liability coverage to otherwise commercially insured NMHC subsidiaries. NMIC charges a premium for the risk it covers under its indemnity policies. Under the terms of a Mutual Funding Agreement, NMFF and NMH are required to maintain cash and investments or make deposits at NMIC sufficient to pay actuarially determined tail insurance premiums to NMIC upon any cancellation, nonrenewal, or other termination for any reason of NMIC's ongoing joint insurance coverage of both NMH and NMFF. Total NMFF deposits to NMIC, which are reported as due to insureds in the accompanying consolidated balance sheets, amounted to \$45,303 and \$29,702 at August 31, 2011 and 2010, respectively.

NLFH retains certain levels of professional and general liability risks for occurrences on or after January 1, 2003. Prior to June 1, 2011, NLFH purchased commercial insurance for risks in excess of its self-insured retention levels. Effective June 1, 2011, NMIC provides professional and general liability coverage to NLFH in excess of its self-insured retention levels. NMIC is fully reinsured for these risks. NLFH purchased tail coverage for claims incurred but not reported as of December 31, 2002.

Northwestern Memorial's self-insurance liability and related amount recoverable from reinsurers are reported in the accompanying consolidated balance sheets at present value based on a discount rate of 3.0% and 4.0% as of August 31, 2011 and 2010, respectively. The undiscounted gross liabilities for the self-insured programs were \$549,206 and \$549,856 at August 31, 2011 and 2010, respectively. The estimated undiscounted amounts recoverable from reinsurers were \$96,907 and \$105,002 at August 31, 2011 and 2010, respectively. Provisions for the professional and general liability risks are based on an actuarial estimate of losses using actual loss data adjusted for industry trends and current conditions and on an evaluation of claims by Northwestern Memorial's legal counsel. The provision for estimated self-insured claims includes estimates of ultimate costs for both reported claims and claims incurred but not reported.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

5. Self-Insurance Liabilities (continued)

NMH purchased tail coverage for risks in excess of its self-insured retentions following the expiration of the claims-made professional and general liability program covering the period from October 1, 1999 to October 1, 2002. In conjunction with this transaction, NMH recorded a deferred gain that is being amortized based on the estimated runoff period. The balance of the deferred gain was \$4,582 and \$6,625 at August 31, 2011 and 2010, respectively.

In the opinion of management, based in part on the advice of outside legal counsel, adequate provision has been made at August 31, 2011, for all claims incurred to date. Management further believes that the ultimate disposition of these claims will not have a material adverse effect on the financial position of Northwestern Memorial.

6. Employee Benefits Obligations

Northwestern Memorial's noncontributory defined-benefit pension plans (the Plans) cover substantially all of Northwestern Memorial's employees.

The following table summarizes the change in the projected benefit obligation:

| | <u>2011</u> | <u>2010</u> |
|--|-------------------|-------------------|
| Projected benefit obligation, beginning of year | \$ 492,296 | \$ 332,680 |
| Adjustment for Northwestern Lake Forest Hospital | – | 80,820 |
| Service cost | 22,620 | 17,390 |
| Interest cost | 25,391 | 23,146 |
| Net actuarial (gain) loss | (4,642) | 51,690 |
| Benefits paid | (19,650) | (13,430) |
| Projected benefit obligation, end of year | <u>\$ 516,015</u> | <u>\$ 492,296</u> |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

6. Employee Benefits Obligations (continued)

The following table summarizes the change in the Plans' assets:

| | <u>2011</u> | <u>2010</u> |
|---|-------------------|-------------------|
| Plan assets at fair value, beginning of year | \$ 520,424 | \$ 366,657 |
| Adjustment for Northwestern Lake Forest Hospital | – | 53,020 |
| Actual return on the Plans' assets, net of expenses | 63,457 | 31,051 |
| Employer contribution | 5,000 | 83,126 |
| Benefits paid | (19,650) | (13,430) |
| Plan assets at fair value, end of year | <u>\$ 569,231</u> | <u>\$ 520,424</u> |

The following table sets forth the Plans' funded status, as well as recognized amounts in the consolidated balance sheets as of August 31:

| | <u>2011</u> | <u>2010</u> |
|--|------------------|------------------|
| Plan assets at fair value | \$ 569,231 | \$ 520,424 |
| Projected benefit obligation | (516,015) | (492,296) |
| Funded status recognized as prepaid pension cost | <u>\$ 53,216</u> | <u>\$ 28,128</u> |

The accumulated benefit obligation of the Plans is \$480,742 and \$450,839 as of August 31, 2011 and 2010, respectively.

Included in unrestricted net assets are the Plans' amounts that have not yet been recognized in net periodic pension cost at August 31 as follows:

| | <u>2011</u> | <u>2010</u> |
|---------------------------------|---------------------|---------------------|
| Unrecognized prior service cost | \$ (648) | \$ (773) |
| Unrecognized actuarial loss | (124,158) | (165,494) |
| | <u>\$ (124,806)</u> | <u>\$ (166,267)</u> |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

6. Employee Benefits Obligations (continued)

Changes in the Plans' assets and benefit obligations recognized in unrestricted net assets during 2011 and 2010 include the following:

| | <u>2011</u> | <u>2010</u> |
|---|------------------|--------------------|
| Current year actuarial gain (loss) | \$ 29,835 | \$ (49,030) |
| Recognized actuarial loss | 11,501 | 7,614 |
| Current year amortization of prior service cost | 125 | 125 |
| | <u>\$ 41,461</u> | <u>\$ (41,291)</u> |

The Plans' prior service cost and actuarial loss included in unrestricted net assets expected to be recognized in net periodic pension cost during 2012 are \$125 and \$7,315, respectively.

Net periodic pension cost included in operating results for the years ended August 31 is comprised of the following:

| | <u>2011</u> | <u>2010</u> |
|---|------------------|------------------|
| Service cost of benefits earned during the year | \$ 22,620 | \$ 18,190 |
| Interest cost of projected benefit obligation | 25,391 | 23,146 |
| Expected return on the Plans' assets | (38,265) | (29,198) |
| Recognized actuarial loss | 11,501 | 7,614 |
| Amortization of prior service costs | 125 | 125 |
| Net periodic pension cost | <u>\$ 21,372</u> | <u>\$ 19,877</u> |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

6. Employee Benefits Obligations (continued)

The following table sets forth the weighted-average assumptions used to determine the projected benefit obligation and benefit cost as of August 31:

| | <u>2011</u> | <u>2010</u> |
|--|--------------|-------------|
| Used to determine projected benefit obligation | | |
| Discount rate | 5.25% | 5.25% |
| Rate of compensation increase | 3.50 | 3.50 |
| | <u>2011</u> | <u>2010</u> |
| Used to determine benefit cost | | |
| Discount rate | 5.25% | 6.25% |
| Expected long-term rate of return on the Plans' assets | 7.50 | 7.50 |
| Rate of compensation increase | 3.50 | 3.50 |

The expected long-term rate of return on assets is determined based on a capital market asset model, which assumes that future returns are based on long-term, historical performance as adjusted for contemporary dividend yields. The adjusted historical returns were weighted by the current long-term asset allocation targets and reduced by 100 basis points to produce a more normal risk premium. Northwestern Memorial's investment advisor assisted with the analysis.

The Plans' asset allocation and investment strategies are designed to earn returns on plan assets consistent with a reasonable and prudent level of risk. Investments are diversified across classes, sectors, and manager style to minimize the risk of loss. Northwestern Memorial uses investment managers specializing in each asset category and, where appropriate, provides the investment manager with specific guidelines that include allowable and/or prohibited investment types. Northwestern Memorial regularly monitors manager performance and compliance with investment guidelines.

The target allocation of the Plans' assets as of August 31 is as follows:

| | <u>2011</u> | <u>2010</u> |
|---------------------------|-------------|-------------|
| Cash and cash equivalents | –% | –% |
| Equity securities | 42 | 43 |
| Alternative investments | 44 | 42 |
| Fixed income | 14 | 15 |
| | <u>100%</u> | <u>100%</u> |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

6. Employee Benefits Obligations (continued)

The following table presents the Plans' financial instruments as of August 31, 2011, measured at fair value on a recurring basis by the valuation hierarchy described in Note 4:

| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
|--|----------------|----------------|----------------|--------------|
| 103-12 investment entities: | | | | |
| International equities | \$ – | \$ 42,949 | \$ – | \$ 42,949 |
| Private equity | – | – | 2,223 | 2,223 |
| Total 103-12 investment entities | – | 42,949 | 2,223 | 45,172 |
| Common collective trusts: | | | | |
| Fixed income | – | 5,782 | – | 5,782 |
| International equities | – | 23,659 | – | 23,659 |
| Private equity | – | – | 3,593 | 3,593 |
| U.S. equities | – | 44,081 | – | 44,081 |
| Total common collective trusts | – | 73,522 | 3,593 | 77,115 |
| Corporate debt: | | | | |
| Corporate debt instruments – other | – | 2,922 | – | 2,922 |
| Corporate debt instruments – preferred | – | 6,903 | – | 6,903 |
| Total corporate debt | – | 9,825 | – | 9,825 |
| Equity securities: | | | | |
| U.S. equities | 12,641 | 15 | – | 12,656 |
| Hedge funds and other: | | | | |
| Absolute return hedge fund | – | – | 65,649 | 65,649 |
| Equity long/short hedge fund | – | – | 66,573 | 66,573 |
| Fixed income | – | 1,551 | – | 1,551 |
| Natural resources | – | – | 10,591 | 10,591 |
| Total hedge funds and other | – | 1,551 | 142,813 | 144,364 |
| Interest in limited partnerships: | | | | |
| Natural resources | – | – | 17,009 | 17,009 |
| Private equity | – | 25,247 | 71,825 | 97,072 |
| Real estate | – | – | 18,857 | 18,857 |
| Total interest in limited partnerships | – | 25,247 | 107,691 | 132,938 |
| Mutual funds: | | | | |
| Fixed income | 66,592 | – | – | 66,592 |
| International equities | 23,739 | – | – | 23,739 |
| U.S. equities | 56,830 | – | – | 56,830 |
| Total mutual funds | 147,161 | – | – | 147,161 |
| Grand total | \$ 159,802 | \$ 153,109 | \$ 256,320 | \$ 569,231 |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

6. Employee Benefits Obligations (continued)

The following table presents the Plans' financial instruments as of August 31, 2010, measured at fair value on a recurring basis by the valuation hierarchy described in Note 4:

| | Level 1 | Level 2 | Level 3 | Total |
|--|------------|------------|------------|------------|
| 103-12 investment entities: | | | | |
| International equities | \$ – | \$ 32,855 | \$ – | \$ 32,855 |
| Private equity | – | – | 2,237 | 2,237 |
| Total 103-12 investment entities | – | 32,855 | 2,237 | 35,092 |
| Common collective trusts: | | | | |
| Fixed income | – | 22,334 | – | 22,334 |
| International equities | – | 19,407 | – | 19,407 |
| Private equity | – | – | 3,802 | 3,802 |
| U.S. equities | – | 46,786 | – | 46,786 |
| Total common collective trusts | – | 88,527 | 3,802 | 92,329 |
| Corporate debt: | | | | |
| Corporate debt instruments – other | – | 2,891 | – | 2,891 |
| Corporate debt instruments – preferred | – | 8,579 | – | 8,579 |
| Total corporate debt | – | 11,470 | – | 11,470 |
| Equity securities: | | | | |
| U.S. equities | 10,457 | 13 | – | 10,470 |
| Hedge funds and other: | | | | |
| Absolute return hedge fund | – | – | 46,591 | 46,591 |
| 46,6,Equity long/short hedge fund | – | – | 71,242 | 71,242 |
| Fixed income | – | 437 | – | 437 |
| Natural resources | – | – | 3,542 | 3,542 |
| Total hedge funds and other | – | 437 | 121,375 | 121,812 |
| Interest in limited partnerships: | | | | |
| Natural resources | – | – | 13,902 | 13,902 |
| Private equity | – | 10,300 | 57,048 | 67,348 |
| Real estate | – | – | 13,924 | 13,924 |
| Total interest in limited partnerships | – | 10,300 | 84,874 | 95,174 |
| Mutual funds: | | | | |
| Fixed income | 69,279 | – | – | 69,279 |
| International equities | 43,974 | – | – | 43,974 |
| U.S. equities | 40,824 | – | – | 40,824 |
| Total mutual funds | 154,077 | – | – | 154,077 |
| Grand total | \$ 164,534 | \$ 143,602 | \$ 212,288 | \$ 520,424 |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

6. Employee Benefits Obligations (continued)

Fair value methodologies for Level 1 and Level 2 are consistent with the inputs described in Note 4. Fair value for Level 3 is estimated using a practical expedient. The practical expedient used is the NAV per share, or its equivalent. Valuations provided by the respective investment's management consider variables such as the financial performance of underlying investments, recent sales prices of underlying investments, and other pertinent information. In addition, actual market exchanges at period end provide additional observable market inputs of the exit price. There is inherent uncertainty in such valuations, and the estimated fair values may differ from the values that would have been used had a ready market for the securities existed. Most of the alternative investments also have liquidity restrictions and can be divested only at specified times based on terms in the partnership agreements. The financial statements of the limited partnerships are audited annually, generally as of December 31.

NAV is calculated monthly by the investment's management for all of Northwestern Memorial's alternative investments, other than LPs, whose NAV is calculated on a quarterly basis.

Investments held by limited partnerships consist of marketable securities as well as securities that do not have readily determinable fair values. The fair values of the securities held by limited partnerships that do not have readily determinable fair values are determined by the general partner taking into consideration, among other things, the cost of the securities, prices of recent significant placements of securities of the same issuer, and subsequent developments concerning the companies to which the securities relate.

Equity securities include funds of publicly traded common stocks of both U.S. and international corporations. The long-term return of public equities is consistent with the Plans' return assumptions. Alternative investments are consistent with the types and strategies described in Notes 3 and 4. Fixed income includes a mutual fund and a commingled fund with portfolios of fixed income securities. These funds invest primarily in U.S. government and agency obligations, mortgages, and investment-grade corporate debt and may invest opportunistically in non-U.S. and high-yield debt instruments.

Of the total amount of reported alternative investments in the Plans at August 31, 2011, \$135,458 cannot be redeemed for at least one year from the balance sheet date.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

6. Employee Benefits Obligations (continued)

The table below sets forth a summary of changes in the fair value of the Plans' Level 3 assets for the period from September 1, 2009 to August 31, 2011:

| | 103-12 Investment Entities | Common Collective Trusts | Hedge Funds and Other | Interest in Limited Partnerships | Total |
|---|---|---|----------------------------------|---|-------------------|
| Value at September 1, 2009 | \$ 1,958 | \$ 3,620 | \$ 75,467 | \$ 73,760 | \$ 154,805 |
| Gain (loss) realized on assets sold during the period | 34 | 277 | (2,775) | 6,485 | 4,021 |
| Change in unrealized gain (loss) related to holdings at August 31, 2011 | 298 | 117 | 11,660 | (6,525) | 5,550 |
| Purchases at cost | 32 | 43 | 52,897 | 18,943 | 71,915 |
| Sales at cost | (85) | (255) | (15,874) | (7,789) | (24,003) |
| Value at August 31, 2010 | 2,237 | 3,802 | 121,375 | 84,874 | 212,288 |
| Gain (loss) realized on assets sold during the period | 239 | 642 | (2,219) | 6,333 | 4,995 |
| Change in unrealized gain (loss) related to holdings at August 31, 2011 | (119) | (697) | 11,310 | 4,514 | 15,008 |
| Purchases at cost | 51 | 165 | 24,400 | 21,742 | 46,358 |
| Sales at cost | (185) | (319) | (12,053) | (9,772) | (22,329) |
| Value at August 31, 2011 | \$ 2,223 | \$ 3,593 | \$ 142,813 | \$ 107,691 | \$ 256,320 |

The Plans' assets are managed solely in the interest of the Plans' participants and their beneficiaries. The assets are invested with the investment objective of funding the accumulated and projected retirement benefit obligations of the Plans consistent with the Plans' long-term rate-of-return assumption. A time horizon of greater than five years is assumed, and therefore, interim volatility in returns is regarded with appropriate perspective.

Northwestern Memorial has no current plans to contribute to the Plans during the year ending August 31, 2012.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

6. Employee Benefits Obligations (continued)

Benefit payments, which reflect future service, as appropriate, are expected to be paid as follows:

| | |
|------------------------|-----------|
| Year ending August 31: | |
| 2012 | \$ 18,298 |
| 2013 | 19,802 |
| 2014 | 21,307 |
| 2015 | 25,287 |
| 2016 | 27,748 |
| 2017-2021 | 172,043 |

Northwestern Memorial also maintains defined-contribution plans covering substantially all of its full-time and part-time employees. Contributions are limited to 80% of each covered employee's salary and a matching portion of 50% of the first 6% of the employee's contribution per pay period, with an annual maximum of \$7.35 per employee. In addition, these plans have been amended to include a non-elective provision for those employees hired after December 26, 2010, who are not participants in the defined benefit plans. This provision provides for employer contributions of 1% to 2% of each employee's salary provided they are employed as of December 31 of the plan year and have one thousand hours of service in the plan year. Employer contributions related to these plans included in employee benefits expense in the accompanying consolidated statements of operations and changes in net assets totaled \$10,862 and \$8,616 in 2011 and 2010, respectively.

NMHC also maintains other noncontributory postretirement benefit plans (the Noncontributory Plans) for certain executive employees.

Included in unrestricted net assets are the following Noncontributory Plans amounts that have not yet been recognized in net periodic pension cost at August 31:

| | <u>2011</u> | <u>2010</u> |
|-----------------------------|-------------------|-------------------|
| Unrecognized actuarial loss | <u>\$ (3,376)</u> | <u>\$ (2,080)</u> |
| | <u>\$ (3,376)</u> | <u>\$ (2,080)</u> |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

6. Employee Benefits Obligations (continued)

Changes in the Noncontributory Plans' assets and benefit obligations recognized in unrestricted net assets during 2011 and 2010 include the following:

| | <u>2011</u> | <u>2010</u> |
|------------------------------------|-------------------|---------------|
| Current year actuarial loss | \$ (2,811) | \$ (1,355) |
| Recognized actuarial net loss | 1,515 | 1,852 |
| Amortization of prior service cost | - | 34 |
| | <u>\$ (1,296)</u> | <u>\$ 531</u> |

As of August 31, 2011 and 2010, the Noncontributory Plans' unfunded projected benefit obligation amounted to \$18,814 and \$15,917, respectively, and is included in other long-term liabilities in the accompanying consolidated balance sheets. The weighted-average discount rate utilized in determining the actuarial present value was 5.25% in 2011 and 2010. The Noncontributory Plans' actuarial loss included in unrestricted net assets expected to be recognized in net periodic pension cost during 2012 is \$2,850.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

7. Long-Term Debt

Long-term debt consists of the following at August 31:

| | <u>2011</u> | <u>2010</u> |
|---|-------------------|-------------------|
| Revenue Bonds, Series 2009A, payable in annual installments through August 15, 2039 (fixed coupon rates range from 5.00% to 6.00%) | \$ 353,470 | \$ 361,665 |
| Revenue Bonds, Series 2009B, payable in annual installments through August 15, 2039 (fixed coupon rates range from 5.00% to 6.00%) | 96,100 | 98,545 |
| Variable-Rate Demand Revenue Bonds, Series 2008A, payable in annual installments through August 15, 2038 (weighted-average interest rate was 0.18% in 2011 and 0.21% in 2010) | 78,775 | 78,775 |
| Variable-Rate Demand Revenue Bonds, Series 2007A, payable in annual installments through August 15, 2042 (weighted-average interest rate was 0.21% in 2011 and 0.23% in 2010) | 211,600 | 212,600 |
| Revenue Bonds, Series 2003 (Lake Forest Hospital), payable in annual installments through July 1, 2033 (fixed coupon rates range from 4.50% to 6.00%) | 26,250 | 26,600 |
| Variable-Rate Demand Revenue Bonds, Series 2002C, payable in annual installments beginning August 15, 2026 through August 15, 2032 (weighted-average interest rate was 0.18% in 2011 and 0.21% in 2010) | 33,000 | 33,000 |
| Revenue Bonds, Series 2002A (Lake Forest Hospital), payable in annual installments through July 1, 2029 (fixed coupon rates range from 5.75% to 6.25%) | 42,050 | 43,200 |
| | <u>841,245</u> | <u>854,385</u> |
| Less: | | |
| Unamortized discount, net | 6,181 | 5,206 |
| Current maturities | 13,710 | 13,140 |
| | <u>\$ 821,354</u> | <u>\$ 836,039</u> |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(In Thousands)

7. Long-Term Debt (continued)

As of the date of the affiliation, NLFH had outstanding a private placement long-term loan of \$2,680. On February 25, 2010, this loan was repaid.

In addition, as of the date of the affiliation, NLFH had two outstanding bond series: Revenue Bonds, Series 2002A (Lake Forest Hospital) and Revenue Bonds, Series 2003 (Lake Forest Hospital) (see Note 2). These bond series had a fair value of \$45,119 and \$27,011, including bond premiums of \$719 and \$161, respectively, at the affiliation date. These premiums are included in unamortized discount, net, above.

NMH currently has a line of credit available for operations in the amount of \$120,000, which expires in May 2013. Under this committed line of credit, NMH has the option to borrow at various rates expressed as an adjustment to the LIBOR, prime rate or other bank-offered rates. At August 31, 2011 and 2010, no amount was borrowed under the available line of credit.

NMH has standby bond purchase agreements (SBPAs) with multiple banks for all of its variable-rate demand revenue bonds (VRDBs) to provide liquidity support in the event of a failed remarketing as follows:

| | <u>Par Value</u> | <u>Expiration Date</u> |
|--------------|------------------|------------------------|
| Series 2008A | \$ 78,775 | May 2013 |
| Series 2002C | 33,000 | May 2013 |
| Series 2007A | 211,600 | December 2014 |

The SBPAs require NMH to maintain reporting, financial, and other covenants. If an SBPA is not renewed or replaced prior to its expiration, or if some portion or all of the related VRDBs are not successfully remarketed (failed remarketing) during the term of the SBPAs, the related VRDBs convert to a term loan at the earlier of the expiration date of the related SBPA or after 90 consecutive days of failed remarketing. Principal payments on the term loan would then be payable over a three-year term. The first principal payment on any term loan associated with the Series 2002C or Series 2008A Bonds would be due a year and a day from the next fiscal quarter end. The first principal payment on any term loan associated with the Series 2007A Bonds would be due a year and a day from the most recent fiscal year-end.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

7. Long-Term Debt (continued)

Scheduled principal repayments for the next five years, assuming remarketing of variable-rate demand revenue bonds, on long-term debt are as follows:

| | |
|------------------------|-----------|
| Year ending August 31: | |
| 2012 | \$ 13,710 |
| 2013 | 14,500 |
| 2014 | 15,220 |
| 2015 | 15,985 |
| 2016 | 16,785 |

The restrictions under the respective debt agreements require the Obligated Group to maintain reporting, financial, and other covenants. At August 31, 2011, the Obligated Group was in compliance with these provisions.

Northwestern Memorial paid interest of \$41,418 in 2011 and \$39,634 in 2010 (which includes \$10,639 and \$10,532, respectively, for net swap payments included in other operating expense in the accompanying consolidated statements of operations and changes in net assets). Northwestern Memorial capitalized interest of \$3,299 and \$1,145 in 2011 and 2010, respectively.

8. Derivatives

Northwestern Memorial's only derivative financial instruments are interest rate swaps, which NMH maintains on its variable-rate demand revenue bonds for the sole purpose of risk management. These bonds expose NMH to variability in interest payments due to changes in interest rates. Management believes that it is prudent to limit the variability of its interest payments. To meet this objective and to take advantage of low interest rates, NMH entered into various interest rate swap agreements to manage fluctuations in cash flows resulting from interest rate risk. These swaps limit the variable-rate cash flow exposure on the variable-rate demand revenue bonds to synthetically fixed cash flows. By using interest rate swaps to manage the risk of changes in interest rates, NMH exposes itself to credit risk and market risk. Credit risk is the risk that a counterparty will fail to perform under the terms of a derivative contract. When the fair value of a swap is positive, the counterparty owes NMH, which creates credit risk for NMH. NMH minimizes the credit risk in its swap contracts by entering into transactions that require the counterparty to post collateral for the benefit of NMH based on the credit rating of the counterparty and the fair value of the swap contract. The aggregate fair value of the swaps on

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

8. Derivatives (continued)

the consolidated balance sheets as of August 31, 2011 and 2010, reflects a reduction of \$6,858 and \$7,295, respectively, for nonperformance risk. 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. Management also mitigates risk through periodic reviews of their swap positions in the context of their total blended cost of capital.

The following is a summary of the outstanding positions under existing interest rate swap agreements at August 31, 2011 and 2010:

| <u>Notional Amount</u> | | <u>Maturity</u> | <u>Rate Paid</u> | <u>Rate Received</u> |
|------------------------|-------------|-----------------|------------------|-----------------------|
| <u>2011</u> | <u>2010</u> | | | |
| \$ 35,250 | \$ 35,250 | May 2035 | 3.310% | 63% of LIBOR + 28 bps |
| 35,250 | 35,250 | May 2035 | 3.310 | 63% of LIBOR + 28 bps |
| 43,200 | 43,200 | May 2035 | 3.313 | 63% of LIBOR + 28 bps |
| 105,800 | 106,300 | August 2042 | 3.889 | 63% of LIBOR + 28 bps |
| 105,800 | 106,300 | August 2042 | 3.889 | 63% of LIBOR + 28 bps |

The fair value of derivative instruments at August 31 is as follows:

| | <u>Balance Sheet</u> | <u>Liabilities</u> | |
|---|----------------------|--------------------|-------------|
| | <u>Location</u> | <u>2011</u> | <u>2010</u> |
| Interest rate contracts not designated as hedging instruments | Interest rate swaps | \$ 73,845 | \$ 78,247 |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

8. Derivatives (continued)

The effects of derivative instruments on the consolidated statements of operations and changes in net assets for 2011 and 2010 are as follows:

| Interest Rate Contracts | Location of Gain (Loss) Recognized in Excess of Revenue Over Expenses on Derivatives | Amount of Gain (Loss) Recognized in Excess of Revenue Over Expenses on Derivatives | |
|--|---|---|-------------|
| | | 2011 | 2010 |
| Derivatives not designated as hedging instruments | Nonoperating – change in fair value of interest rate swaps | \$ 4,527 | \$ (31,806) |
| | Operating expense – other | (10,639) | (10,532) |

NMH's derivative instruments contain provisions that require NMH's debt to maintain an investment-grade credit rating from certain major credit rating agencies. If NMH's debt were to fall below investment grade, it would be in violation of these provisions, and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing collateralization on derivative instruments in net liability positions. NMH has posted collateral of \$1,172 and \$0 as of August 31, 2011 and 2010, respectively. If the credit risk-related contingent features underlying these agreements were triggered to the fullest extent on August 31, 2011, NMH would be required to post \$80,703 of collateral to its counterparties.

9. Income Tax Status

NMHC, NMH, NLFH, the Foundation, HFI, and NMPG are qualified under the Internal Revenue Code (the Code) as tax-exempt organizations and are exempt from tax on income related to their tax-exempt purposes under Section 501(a) of the Code. Accordingly, no income taxes are provided for the majority of the income in the accompanying consolidated financial statements for these corporations. NMHC, NMH, NLFH, HFI, and the Foundation had unrelated business income (UBI) generated primarily through limited partnerships within the investment portfolio and the sale of certain services that are not directly related to patient care. NMHC, NMH, NLFH, HFI, and the Foundation have unused net operating loss carryforwards available to offset the UBI tax. The net operating loss carryforwards expire through 2029. The deferred tax

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

9. Income Tax Status (continued)

assets associated with these net operating loss carryforwards of \$5,395 and \$5,162 at August 31, 2011 and 2010, respectively, are offset by valuation allowances on the consolidated balance sheets of \$5,395 and \$5,162, respectively.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax asset will not be realized. The ultimate realization of deferred tax assets is dependent on the generation of future taxable income during the periods in which those temporary differences become deductible.

NMIC is incorporated under the laws of the Cayman Islands. The Cayman Islands government imposes no tax on income or capital gains, and NMIC has received an undertaking from the Cayman Islands government exempting it from future income and capital gains taxes until March 25, 2023. However, NMIC is subject to U.S. federal corporate taxation to the extent that it generates net income which is effectively connected with a U.S. trade or business. NMIC is not engaged in any such trade or business in the U.S. In addition, distributions that NMH receives from NMIC are treated as dividends and, as such, are not taxable to NMH. Therefore, no income tax provision has been recorded related to NMIC and its operations.

Interest and penalties on income taxes, when incurred, are included in operating expenses.

10. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at August 31, 2011 and 2010:

| | 2011 | 2010 |
|-------------------------------------|-------------------|--------------------|
| | | As Adjusted |
| | | <i>(Note 1)</i> |
| Healthcare services: | | |
| Purchase of property and equipment | \$ 16,313 | \$ 13,650 |
| Operating expenses and charity care | 74,251 | 64,752 |
| Research, education and other | 49,824 | 46,098 |
| | \$ 140,388 | \$ 124,500 |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

10. Temporarily and Permanently Restricted Net Assets (continued)

Net assets were released from donor restrictions by incurring expenditures for the following purposes:

| | <u>2011</u> | <u>2010</u> |
|-------------------------------------|------------------|------------------|
| Healthcare services: | | |
| Purchase of property and equipment | \$ 380 | \$ 4,088 |
| Operating expenses and charity care | 10,493 | 9,233 |
| Research, education and other | 11,625 | 12,240 |
| | <u>\$ 22,498</u> | <u>\$ 25,561</u> |

Permanently restricted net assets at August 31, 2011 and 2010, are summarized below, the income from which is expendable to support:

| | <u>2011</u> | <u>2010</u> |
|-------------------------------------|-------------------|-------------------|
| Healthcare services: | | |
| Purchase of property and equipment | \$ 15,408 | \$ 628 |
| Operating expenses and charity care | 78,828 | 73,001 |
| Research, education and other | 32,093 | 32,274 |
| | <u>\$ 126,329</u> | <u>\$ 105,903</u> |

Northwestern Memorial's endowment consists of individual donor-restricted funds established for a variety of purposes. Net assets associated with endowment funds are classified and reported based on the donor-imposed restrictions.

Northwestern Memorial has interpreted the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA), as adopted by the State of Illinois, as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Northwestern Memorial classifies as permanently restricted net assets the original value of gifts donated to the permanent endowment, the original value of subsequent gifts to the permanent endowment, and accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the donor intent or, where silent,

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(In Thousands)

10. Temporarily and Permanently Restricted Net Assets (continued)

standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, Northwestern Memorial considers the following factors in making a determination to appropriate or accumulate donor-restricted funds:

- The duration and preservation of the fund
- The purposes of Northwestern Memorial and the endowment fund
- General economic conditions
- The possible effects of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of Northwestern Memorial
- The investment policies of Northwestern Memorial

Northwestern Memorial has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that must be held in perpetuity or for a donor-specified period. Under this policy, the endowment assets are invested in a manner that is intended to produce a real return, net of inflation and investment management costs, of at least 6% over the long term. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate-of-return objectives, Northwestern Memorial relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). Northwestern Memorial targets a diversified asset allocation that places an emphasis on equity-based and alternative investments to achieve its long-term objective within prudent risk constraints.

Northwestern Memorial has a policy of appropriating for distribution each year no more than 4% of the endowment fund balance at the midpoint of the preceding fiscal year. In establishing this policy, Northwestern Memorial considered the long-term expected return on its endowment with the objective to maintain the purchasing power of the endowment assets.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

10. Temporarily and Permanently Restricted Net Assets (continued)

The changes in endowment net assets for the years ended August 31, 2011 and 2010, are summarized below:

| | Temporarily Restricted | Permanently Restricted | Total |
|---|-----------------------------------|-----------------------------------|-------------------|
| Endowment net assets, September 1, 2009 | \$ 31,784 | \$ 79,495 | \$ 111,279 |
| Contributions | 6,859 | 5,187 | 12,046 |
| Contribution of Northwestern Lake Forest Hospital | 307 | 20,982 | 21,289 |
| Change in value of trusts | (148) | 667 | 519 |
| Investment return (as adjusted – Note 1) | 8,103 | – | 8,103 |
| Appropriation for expenditure | (3,876) | – | (3,876) |
| Other | 377 | (428) | (51) |
| Endowment net assets, August 31, 2010 (as adjusted – Note 1) | 43,406 | 105,903 | 149,309 |
| Contributions | 1,573 | 19,683 | 21,256 |
| Change in value of trusts | 44 | 993 | 1,037 |
| Investment return | 12,968 | – | 12,968 |
| Appropriation for expenditure | (5,035) | – | (5,035) |
| Other | (123) | (250) | (373) |
| Endowment net assets, August 31, 2011 | \$ 52,833 | \$ 126,329 | \$ 179,162 |

11. Pledges Receivable

As of August 31, 2011, donor-restricted pledges are expected to be realized as follows:

| | |
|-----------------------------|------------------|
| Less than one year | \$ 13,470 |
| One to five years | 25,789 |
| Thereafter | 3,604 |
| Total pledges receivable | 42,863 |
| Less discount and allowance | (3,696) |
| Net pledges receivable | <u>\$ 39,167</u> |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

12. Net Patient Service Revenue

Northwestern Memorial provides care to patients under payment arrangements with Medicare, Medicaid, Blue Cross, other managed care programs, and other third-party payors. Services provided under those arrangements are paid at predetermined rates and/or reimbursable costs, as defined. Reported costs and/or services provided under certain of the arrangements are subject to retroactive audit and adjustment. Changes in Medicare and Medicaid programs and reduction of funding levels could have an adverse effect on Northwestern Memorial.

Provision has been made in the accompanying consolidated financial statements for contractual adjustments, which represent the difference between the standard charges for services and the actual or estimated payment.

The mix of net patient service revenue from patients and third-party payors was as follows:

| | <u>2011</u> | <u>2010</u> |
|--------------------------|-------------|-------------|
| Medicare | 23% | 22% |
| Medicaid | 6 | 6 |
| Blue Cross | 38 | 37 |
| Other managed care | 30 | 31 |
| Other third-party payors | 2 | 3 |
| Patients | 1 | 1 |
| | <u>100%</u> | <u>100%</u> |

Net patient service revenue increased by \$7,366 in 2011 and \$5,532 in 2010 as a result of changes in estimates due to final cost report settlements and the disposition of other payor audits.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(In Thousands)

12. Net Patient Service Revenue (continued)

Northwestern Memorial grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix by payor source of patient accounts receivable, before deducting estimated uncollectibles, at August 31, 2011 and 2010, was as follows:

| | 2011 | 2010 |
|--------------------------|-------------|-------------|
| Medicare | 16% | 15% |
| Medicaid | 15 | 13 |
| Blue Cross | 23 | 19 |
| Other managed care | 29 | 30 |
| Other third-party payors | 10 | 13 |
| Patients | 7 | 10 |
| | 100% | 100% |

13. Functional Expenses

Northwestern Memorial provides general healthcare services primarily to residents within its geographic location and supports research and education programs. For the years ended August 31, 2011 and 2010, expenses related to providing these services were as follows:

| | 2011 | 2010 |
|------------------------------------|---------------------|--------------|
| Healthcare services | \$ 1,288,060 | \$ 1,136,570 |
| Research and education | 64,471 | 61,141 |
| Fund-raising | 5,842 | 6,208 |
| General, administrative, and other | 266,078 | 284,362 |
| | \$ 1,624,451 | \$ 1,488,281 |

The research and education costs include \$3,448 and \$3,402 of expenses supported by federal, state, and corporate grants and \$8,178 and \$6,848 of expenses supported by other donor-restricted funds in 2011 and 2010, respectively.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

14. Illinois Hospital Assessment Program

In December 2008, the Illinois Hospital Assessment Program (HAP) was approved by the Federal Centers for Medicare and Medicaid Services for the period July 1, 2008 through June 30, 2013. The accompanying consolidated statements of operations and changes in net assets therefore include 12 months of HAP for NMH and NLFH for the year ended August 31, 2011, and 12 months of HAP for NMH and 7 months of HAP for NLFH for the year ended August 31, 2010. Under HAP, the state receives additional federal Medicaid funds for the state's healthcare system, administered by the Illinois Department of Healthcare and Family Services. HAP includes both a payment to NMH and NLFH from the state and an assessment (the provider tax) against NMH and NLFH, which is paid to the state in the same year. Included in the accompanying consolidated statements of operations and changes in net assets for the years ended August 31, 2011 and 2010, respectively, are \$58,255 and \$57,398 of net patient service revenue and \$41,395 and \$39,330 of assessment.

15. Commitments and Contingencies

Consistent with its mission, Northwestern Memorial from time to time provides academic, program, and other support to other not-for-profit entities. The present value of the total remaining commitments related to this support are \$64,318 and \$69,290 at August 31, 2011 and 2010, respectively, which are reported as grants and academic support payable in the accompanying consolidated balance sheet.

As of August 31, 2011, approximately 15% of Northwestern Memorial employees were represented by a collective bargaining agreement. This collective bargaining agreement does not expire within one year.

Certain Northwestern Memorial buildings are located on land leased from Northwestern University under various lease agreements. The principal lease requires annual payments of \$314 through 2074. At August 31, 2011, minimum future rental payments under other noncancelable operating leases, which consist primarily of leases for office space and equipment, some of which include renewal options, are as follows:

| | |
|------------------------|----------|
| Year ending August 31: | |
| 2012 | \$ 9,983 |
| 2013 | 8,459 |
| 2014 | 6,728 |
| 2015 | 5,720 |
| 2016 | 5,331 |
| Thereafter | 18,522 |

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

15. Commitments and Contingencies (continued)

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is a reasonable possibility that recorded amounts will change by a material amount in the near term. During the last few years, as a result of nationwide investigations by governmental agencies, various healthcare organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and potential exclusion from the Medicare and Medicaid programs. In addition, an increasing number of the operations or practices of not-for-profit healthcare providers has been challenged or questioned to determine if they are consistent with the regulatory requirements for nonprofit tax-exempt organizations. These challenges are broader than concerns about compliance with federal and state statutes and regulations of core business practices of the healthcare organizations. Areas that have come under examination have included pricing practices, billing and collection practices, charitable care, community benefit, executive compensation, exemption of property from real property taxation, and others. Northwestern Memorial expects that the level of review and audit to which it and other healthcare providers are subject will increase. There can be no assurance that regulatory authorities will not challenge Northwestern Memorial's compliance with these laws and regulations, and it is not possible to determine the effect, if any, such claims or penalties would have on Northwestern Memorial.

In August 2011, the Illinois Department of Revenue (the Department) denied property tax exemption applications submitted by NMH and two other unaffiliated hospitals. The NMH denial related to its application for an exemption for the Prentice Women's Hospital pavilion (Prentice pavilion) for the 2007 tax year. The Prentice pavilion is located on property that was previously the site of NMH's Wesley pavilion and that has been exempt from tax for decades.

Although the Department did not explain its reasoning, NMH believes the denials were based on the Department's interpretation of the plurality opinion in the March 2010 Illinois Supreme Court decision affirming the denial of a property tax exemption for Provena Covenant Medical Center (Provena), a 199-bed community hospital located in central Illinois. The Provena case did not establish a formula to determine the charitable use of real property. Annually, Northwestern Memorial provides free and discounted care to the uninsured and the underinsured, unreimbursed care under government-sponsored indigent healthcare programs, clinical services, financial support and certain intellectual property to federally qualified health centers, community hospitals and other community-based health organizations, as well as financial support for

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(In Thousands)

15. Commitments and Contingencies (continued)

education and clinical research, all as reported to the Illinois Attorney General in Northwestern Memorial's Annual Non Profit Hospital Community Benefits Plan Report (Report). In its Report for the year ended August 31, 2010, Northwestern Memorial reported total community benefits of \$276,681, including charity care of \$38,200 from NMH.

In October 2011, NMH filed with the Department a Protest and Application for Hearing with respect to the denial of its 2007 application. NMH requested that the Department vacate the denial as moot on the ground, among others, that any attempt to impose tax on the Prentice pavilion for 2007 is precluded by the listing of that property as exempt in the "warrant" book containing official assessment records. NMH has also requested a hearing with the Department concerning its entitlement to an exemption if the Department declines to vacate and dismiss on mootness grounds. NMH has not received any proposed assessments or tax bill for the Prentice pavilion for 2007.

NMH has also filed property tax exemption applications for the Prentice pavilion for the 2009 and 2010 tax years that remain pending in the Department. Nevertheless, in October 2011, NMH received from the Cook County Assessor's Office (the Assessor) notices of intent to list omitted assessments for the Prentice pavilion for 2008, 2009, and 2010, and the Assessor has issued proposed assessments for the Prentice pavilion for 2011. NMH has not received any tax bills for the Prentice pavilion for 2008 through 2011.

NMH will vigorously contest both the denial of its exemption application and the assessments for the Prentice pavilion.

NMH has filed an omitted assessment complaint with the Assessor challenging the putative assessments for 2008 through 2010 on the ground, among others, that any effort to impose tax on the property is precluded by it being listed as exempt in the warrant book containing official assessment records. NMH has also filed an assessment complaint with the Assessor challenging the proposed assessment for 2011 on the ground, among others, that the property is exempt from taxation.

These complaints and related legal proceedings may result in the voiding of the assessments for 2008 through 2011. Voiding of the assessments would mean that no tax was owed. If the assessments are not voided and tax bills are issued for 2008, 2009, 2010, and 2011 that are predicated on the full amount of the Assessor's current assessments, the property tax could be as much as approximately \$22,000; \$14,000; \$15,000; and \$15,000, respectively.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued) (In Thousands)

15. Commitments and Contingencies (continued)

In October 2011, Illinois Governor Pat Quinn announced a hold on additional hospital property tax exemption rulings by the Department. The Governor has asked his staff and the director of the Department to work together with the Illinois Hospital Association, legislators, and the Illinois Attorney General's Office to develop recommendations for legislation addressing the hospital property tax exemption issue by March 2012.

At this time, management is unable to determine what effects, if any, the Provena decision and its interpretation by the Department and assessment officials, the denial of property tax exemption for the Prentice pavilion for the 2007 tax year, the purported assessments for the Prentice pavilion for 2008 through 2011, or the legislative initiative will have on Northwestern Memorial's consolidated financial statements.

On December 3, 2008, NMHC and Northwestern University received a letter from Senator Charles Grassley. The letter requested responses to certain questions and the production of information relating to allegations received regarding the implantation of a certain medical device used in patients at NMH. Northwestern Memorial has cooperated with the inquiry. At this time, management is unable to determine what effects, if any, this request and the investigation of the matters addressed therein may have on the consolidated financial statements.

On February 8, 2010, NMH and NMHC were served as defendants with a lawsuit filed by a former NMH clinical coordinator alleging that employees were not compensated for all time worked. The former employee seeks to represent a class of all NMH hourly employees in over 20 different job classifications. Northwestern Memorial denies any liability with respect to these claims and expects to vigorously defend itself in this case. The case is currently pending in the U.S. District Court for the Northern District of Illinois. At this time, management is unable to determine what effects, if any, this matter may have on the consolidated financial statements.

Northwestern Memorial is a defendant in other various lawsuits arising in the ordinary course of business. Although the outcome of these lawsuits cannot be predicted with certainty, management believes the ultimate disposition of such matters will not have a material effect on Northwestern Memorial's financial condition or operations.

Northwestern Memorial HealthCare and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(In Thousands)

16. Non-Disclosure Agreement with Elmhurst Memorial Healthcare

NMHC and Elmhurst Memorial Healthcare, the corporate parent of Elmhurst Memorial Hospital, have executed a non-disclosure agreement that provides for a period of exclusive discussions regarding a potential affiliation. Northwestern Memorial cannot predict whether these discussions will result in an agreement between the two organizations. Any definitive agreement would be subject to both parties' governing bodies and applicable regulatory approvals.

17. Subsequent Events

Northwestern Memorial evaluated events and transactions occurring subsequent to August 31, 2011 through November 18, 2011, the date of issuance of the consolidated financial statements. During this period, there were no subsequent events requiring recognition in the consolidated financial statements that have not been recorded. In addition, there were no unrecognized subsequent events requiring disclosure, except as previously disclosed.

Other Financial Information

Northwestern Memorial HealthCare and Subsidiaries

Schedule of Community Benefits – Unaudited (In Thousands)

Years Ended August 31, 2011 and 2010

Northwestern Memorial’s unreimbursed cost of providing care to the uninsured and the underinsured; provision for uncollectible accounts (excluding non-patient related provisions); unreimbursed cost of government-sponsored indigent healthcare programs; cost of providing other community services, grants, or awards; and unreimbursed cost to support education and clinical research for the years ended August 31 were as follows:

| | 2011 | 2010 |
|---|-------------------|-------------|
| Unreimbursed cost of charity care | \$ 52,369 | \$ 43,987 |
| Provision for uncollectible accounts | 33,196 | 29,782 |
| Government-sponsored indigent healthcare | 123,752 | 117,153 |
| Total cost of uncompensated care | 209,317 | 190,922 |
| Unreimbursed research and education costs | 61,625 | 71,457 |
| Other community benefits | 18,647 | 14,302 |
| | \$ 289,589 | \$ 276,681 |

These unreimbursed amounts are calculated based on the instructions for the Illinois Attorney General’s Annual Non Profit Hospital Community Benefits Plan Report. The amounts listed for 2011 are management’s estimates and may change when the Medicare Cost Report is filed and the Community Benefits Plan Report is finalized.

Northwestern Memorial provides care to patients regardless of their ability to pay. Northwestern Memorial developed a Free and Discounted Care Policy (the Policy) for both the uninsured and the underinsured. Under the Policy, patients are offered discounts of up to 100% of charges on a sliding scale, which is based on income as a percentage of the Federal Poverty Level guidelines (up to 600%). The Policy also contains provisions that are responsive to those patients subject to catastrophic healthcare expenses and uninsured patients not covered by the provisions above. Since Northwestern Memorial does not pursue collection of these amounts, they are not reported as net patient service revenue.

The unreimbursed cost of government-sponsored indigent healthcare includes the unreimbursed costs for both Medicaid and Medicare. The unreimbursed cost for 2011 and 2010 is reduced by \$16,860 and \$18,068, respectively, of net reimbursement NMH received under the Illinois Hospital Assessment Program (see Note 14).

Northwestern Memorial HealthCare and Subsidiaries

Schedule of Community Benefits – Unaudited (continued)

(In Thousands)

Northwestern Memorial is also involved in numerous community benefit activities. Those activities are wide-ranging and include providing language services, health and wellness education, health screenings, CPR classes, speakers, health fairs, health promotion and disease prevention programs, support groups, and other social services. Those activities are provided free of charge or at a fee that is below the cost of providing them.

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