ALLINA HEALTH SYSTEM

Consolidated Financial Statements

December 31, 2013 and 2012

(With Independent Auditors' Report Thereon)

ALLINA HEALTH SYSTEM

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KPMG LLP
4200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402

Independent Auditors' Report

The Board of Directors
Allina Health System:

We have audited the accompanying consolidated financial statements of Allina Health System (the System), which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Allina Health System as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Minneapolis, Minnesota
March 11, 2014

ALLINA HEALTH SYSTEM

Consolidated Balance Sheets

December 31, 2013 and 2012

(Dollars in thousands)

Assets		**2013**	**2012**
Current assets:			
Cash and cash equivalents	$	132,704	147,405
Short-term investments		315,058	341,033
Patient accounts receivable, less allowances for uncollectible accounts of $84,088 in 2013 and $59,398 in 2012		405,095	385,761
Inventories		53,146	53,088
Other current assets		75,126	60,469
		981,129	987,756
Investments		1,123,312	955,921
Investments with limited uses		152,555	131,539
Land, buildings, and equipment, net		1,050,770	956,776
Other assets		225,597	176,732
Total assets	$	3,533,363	3,208,724
Liabilities and Net Assets			
Current liabilities:			
Accounts payable and accrued expenses	$	420,116	391,905
Other current liabilities		117,138	118,766
		537,254	510,671
Long-term debt		614,806	634,722
Other liabilities		369,909	426,093
Total liabilities		1,521,969	1,571,486
Net assets:			
Unrestricted		1,857,436	1,501,921
Temporarily restricted		98,925	89,536
Permanently restricted		55,033	45,781
Total net assets		2,011,394	1,637,238
Total liabilities and net assets	$	3,533,363	3,208,724

See accompanying notes to consolidated financial statements.

ALLINA HEALTH SYSTEM

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2013 and 2012

(Dollars in thousands)

		2013	2012
Revenues:			
Patient service revenue net of contractual adjustments	$	3,291,537	3,173,116
Provision for bad debts		(90,581)	(76,201)
Net patient service revenue		3,200,956	3,096,915
Other operating revenue		219,609	181,458
Total revenues		3,420,565	3,278,373
Expenses:			
Salaries and benefits		2,096,786	2,038,575
Supplies and services		758,210	721,793
Depreciation and amortization		138,145	132,564
Financing costs		24,591	25,989
State assessments and taxes		75,787	70,852
Utilities and maintenance		71,179	63,323
Other operating expenses		122,428	97,243
Total expenses		3,287,126	3,150,339
Operating income		133,439	128,034
Nonoperating gains (losses):			
Investment return		92,983	88,713
Gains (losses) on interest rate swap agreements		25,634	(13,029)
Contributions received in acquisitions		76,611	—
Other		(2,210)	(3,237)
Excess of revenues over expenses		326,457	200,481

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ALLINA HEALTH SYSTEM

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2013 and 2012

(Dollars in thousands)

		2013	2012
Unrestricted net assets:			
Excess of revenues over expenses	$	326,457	200,481
Net assets released from restrictions for capital purposes		18,469	7,260
Amortization of unrealized loss on interest rate swap agreement		874	874
Other		9,715	565
Increase in unrestricted net assets		355,515	209,180
Temporarily restricted net assets:			
Contributions		18,982	27,312
Contributions received in acquisitions		12,188	—
Investment return		9,280	7,621
Net assets released from restrictions		(30,255)	(15,856)
Other		(806)	95
Increase in temporarily restricted net assets		9,389	19,172
Permanently restricted net assets:			
Contributions for endowment funds		209	760
Contributions for endowment funds received in acquisitions		9,537	—
Investment return		106	80
Other		(600)	(1,215)
Increase (decrease) in permanently restricted net assets		9,252	(375)
Increase in net assets		374,156	227,977
Net assets at beginning of year		1,637,238	1,409,261
Net assets at end of year	$	2,011,394	1,637,238

See accompanying notes to consolidated financial statements.

ALLINA HEALTH SYSTEM

Consolidated Statements of Cash Flows

Years ended December 31, 2013 and 2012

(Dollars in thousands)

		2013	2012
Operating activities:			
Increase in net assets	$	374,156	227,977
Adjustments to reconcile increase in net assets to net cash and cash equivalents provided by operating activities:			
Depreciation and amortization		138,145	132,564
Provision for bad debts		90,581	76,201
Goodwill impairment		1,341	1,848
Loss (gain) on sale of land, buildings, and equipment		778	(595)
Unrealized gain on interest rate swaps		(39,260)	(738)
Realized and unrealized gains on investments, net		(83,668)	(79,070)
Restricted contributions		(19,191)	(28,072)
Contributions of cash for long-lived assets		(1,393)	(2,327)
Contributions received in acquisitions		(98,336)	—
Earnings on joint ventures		(15,342)	(11,840)
Pension plan expenses		10,819	69,294
Pension plan contributions		(52,916)	(46,000)
Changes in assets and liabilities net of acquisition:			
Change in accounts receivable and other current assets		(111,684)	(87,853)
Change in accounts payable and other current liabilities		8,378	(9,066)
Change in other assets and liabilities		(37,816)	(9,425)
Net cash and cash equivalents provided by operating activities		164,592	232,898
Investing activities:			
Proceeds from sales of land, buildings, and equipment		57,839	2,122
Purchases of land, buildings, and equipment		(213,603)	(210,312)
Contributions of cash for long-lived assets		1,393	2,327
Cash received in acquisitions		2,399	—
(Purchases) sales of investments classified as trading		(13,239)	(43,425)
Sales (purchases) of investments with limited uses		16,629	9,497
Draws on construction funds		—	3,917
Distributions received from joint ventures		11,776	12,820
Contributions to joint ventures		(4,160)	(4,935)
Net cash and cash equivalents used in investing activities		(140,966)	(227,989)
Financing activities:			
Restricted contributions, net		19,191	28,072
Change in pledges receivable		1,128	(22)
Change in outstanding checks payable		(8,065)	18,785
Draw on Line of Credit		19,965	—
Principal payments of long-term debt		(70,546)	(28,587)
Net cash and cash equivalents (used in) provided by financing activities		(38,327)	18,248
(Decrease) increase in cash and cash equivalents		(14,701)	23,157
Cash and cash equivalents at beginning of year		147,405	124,248
Cash and cash equivalents at end of year	$	132,704	147,405
Schedule of noncash financing activities:			
Capitalized lease	$	—	336

See accompanying notes to consolidated financial statements.

(1) Organization and Basis of Presentation

Allina Health System (the System) is a not-for-profit corporation whose consolidated financial statements include the accounts of its owned subsidiaries and controlled affiliates.

The System consists of five hospitals located in the Minneapolis and Saint Paul metropolitan area, six hospitals located outside the metropolitan area, physician clinics employing approximately 1,260 providers, various other health care-related entities, and seven foundations supporting health-related services.

In June 2013, the System acquired Courage Center, and became the sole owner (note 19).

In September 2013, the System acquired the remaining 75% interest of its joint venture in Regina Medical Center, and became the sole owner (note 19).

All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements.

(2) Summary of Significant Accounting Policies

(a) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes. Although estimates are considered to be fairly stated at the time the estimates are made, actual results could differ from those estimates.

(b) Cash and Cash Equivalents

Cash and cash equivalents include bank deposits and short-term investments with an original maturity of three months or less from the date of purchase that have not otherwise been classified as long-term assets due to a designation for long-term purposes.

(c) Pledges Receivable

Pledges are recorded in the period that the pledges are made and represent unconditional promises to give. Pledges that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. A discount on each pledge is computed using the risk-free interest rate available at the time the pledge was made for the duration of the pledge. An allowance for uncollectible pledges receivable is determined based on a review of estimated collectibility and historical experience.

(d) Derivative Financial Instruments

The System uses interest rate swaps as part of its risk-management strategy to manage exposure to fluctuations in interest rates and to manage the overall cost of its debt. Interest rate swaps are used to hedge identified and approved exposures. Interest rate swaps are recognized as either assets or

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liabilities in accordance with the netting provisions in the counterparty agreement and are measured at fair value.

The System accounts for its interest rate swaps in accordance with Accounting Standards Codification (ASC) Topic 815, *Derivatives and Hedging*, which requires entities to recognize all derivative instruments as either assets or liabilities in the consolidated balance sheets at their respective fair values.

For interest rate swaps that are not designated as cash flow hedges, gains or losses resulting from changes in the fair values of the interest rate swaps are reported as nonoperating gains or losses. Any differences between interest received and paid under nonhedged swap agreements are reported with the change in fair value of the swaps as nonoperating gains or losses.

For interest rate swaps that are designated and qualify as cash flow hedges, the effective portion of the gains or losses resulting from changes in the fair value is reported as a component of unrestricted net assets. The ineffective portion, if any, is reported in excess of revenues over expenses in the current period. If hedging relationships cease to be highly effective, gains or losses on the interest rate swaps would be reported in excess of revenues over expenses and accumulated losses would be amortized into excess of revenues over expenses over the remaining life of the debt. Any differences between interest received and paid under the interest rate swap designated as a cash flow hedge is recorded as a component of interest expense. As of December 31, 2013, the System does not have any swaps designated as cash flow hedges.

(e) Inventories

Inventories include drugs and supplies and are recorded at the lower of cost or market on a first-in, first-out (FIFO) basis.

(f) Bond Issue Costs

Costs of bond issuance are deferred and amortized on a straight-line basis over the shorter of the term of the related indebtedness or related liquidity facility.

(g) Investments in Unconsolidated Entities

Investments in entities in which the System has the ability to exercise significant influence over operating and financial policies but does not have operational control are recorded under the equity method of accounting and included in other assets in the consolidated balance sheets. The System's share of net earnings or losses of the entities is included in other operating revenue (note 8).

(h) Investments with Limited Uses

Investments with limited uses are reported at fair value and include assets held by trustees for repayment of long-term debt, assets in escrow for capital projects, assets held for self-insured professional and general liability claims, and donor-restricted funds.

(Continued)

(Dollars in thousands)

(i) Land, Buildings, and Equipment

Land, buildings, and equipment are carried at cost and depreciated using the straight-line method over their estimated useful lives. Interest cost, net of related interest income, incurred during the period for construction of capital assets is capitalized as a component of the cost of acquiring those assets and totaled $744 and $925 for 2013 and 2012, respectively.

The following useful lives are used in computing depreciation:

Land improvements	5–25 years
Buildings	25–40 years
Building additions and improvements	10–20 years
Equipment	2–15 years

(j) Deferred Income Taxes

The System's taxable subsidiaries record deferred income taxes due to temporary differences between financial reporting and tax reporting for certain assets and liabilities. The System accounts for income taxes under the asset-and-liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

Effective January 1, 2008, the System adopted FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109,* which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. This guidance is now included within Accounting Standards Codification (ASC) topic 740, *Income Taxes* (ASC 740). ASC 740 prescribes a more-likely than-not recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken. Under ASC 740, tax positions will be evaluated for recognition, derecognition, and measurement using consistent criteria and will provide more information about the uncertainty in income tax assets and liabilities. The System recorded no assets or liabilities in 2013 and 2012 for uncertain tax positions. The System has not recorded any reserves, or related accruals for interest and penalties for uncertain income tax positions.

(k) Professional and General Liability Claims

The System is insured for professional and general liability claims in excess of self-insured retention limits with an external insurance carrier.

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(l) Temporarily and Permanently Restricted Net Assets

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

(m) Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the System are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. Gifts are reported as either temporarily or permanently restricted if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets in the consolidated statements of operations and changes in net assets. In the absence of a donor specification that restricts income and gains on temporarily restricted gifts, such income and gains are reported as income of unrestricted net assets. In order to protect permanently restricted gifts from a loss of purchasing power, the System uses a spending-rate policy to determine the portion of investment return that can be used to support operations of the current period.

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

(n) Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients and third-party payers for services provided, including estimated retroactive adjustments due to audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as such revenue is no longer subject to such audits, reviews, and investigations.

The provisions for bad debts and charity care are based upon management’s assessment of historical and expected net collections considering historical business and economic conditions, trends in health care coverage, and other collection indicators. After satisfaction of amounts due from insurance, the System follows established guidelines for placing certain past-due patient balances with collection agencies, subject to the terms of certain restrictions on collection efforts as determined by the System.

(o) Other Revenue

Other revenue includes income from investments in unconsolidated entities, rental income, pharmacy and ancillary sales, and grant revenue. Grant revenue includes Meaningful Use-Health Information

Technology for Economic and Clinical Health Act Stimulus Grants of $23,515 and $20,443 for 2013 and 2012, respectively.

(p) Excess of Revenues over Expenses

Excess of revenues over expenses includes operating income and nonoperating gains and losses. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments not classified as trading securities and interest rate swaps designated as cash flow hedges, and changes in liability relating to defined–benefit plans not marked-to-market.

(q) Investment Securities

The System classifies its investments as trading or available-for-sale. The available-for-sale investments include those held whose uses are limited. All other investments are classified as trading. Trading and available-for-sale investments, including bond funds and construction funds, are recorded at fair value. Investments in alternative investments are recorded at net asset value as a practical expedient to fair value. Unrealized gains and losses on trading securities are included in excess of revenues over expenses. Unrealized gains and losses on available-for-sale investments are excluded from excess of revenues over expenses and are reported as a separate component of other changes in unrestricted net assets.

(r) Fair Value Measurements

The System utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. The System determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. When considering market participant assumptions in fair value measurements, the System follows the fair value hierarchy, as outlined in the fair value measurements and disclosures accounting guidance, which distinguishes between observable and unobservable inputs.

(3) Net Patient Service Revenue

The System has agreements with third-party payers who provide payments for health care services at amounts different from established rates. Payment arrangements include prospectively determined rates per discharge, discounted charges, and per diem payments. Other payments are received in the form of pay for performance, shared savings, care management, or medical home management per patient fees.

The System utilizes a process to identify and appeal certain settlements by Medicare and other third-party payers. Additional reimbursement is recorded in the year the appeal is successful. During 2013 and 2012, successful appeals, cost report settlements, and other adjustments to prior year estimates, including the rural floor budget neutrality adjustment and settlements related to revised Supplemental Security Income ratios for 2006 through 2011, resulted in an increase in net patient service revenue of $16,648 and $50,003, respectively. The System recognizes significant amounts of patient service revenue at the time services are rendered even though it does not assess the patient’s ability to pay. For uninsured patients who do not qualify for charity care, the System recognizes revenue on the basis of discounted rates. On the basis of historical experience, a significant portion of the System's patients will be unable or unwilling to pay for the services provided. Thus, the System records a significant provision for bad debts related to uninsured patients and self-pay balances of insured patients who are unable or unwilling to pay for the services provided. The System also records a provision for bad debts related to self-pay balances of insured patients. Patient service revenue net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period by major payer is as follows:

(Dollars in thousands)

	2013	**2012**
Medicare and Medicaid	38%	38%
Managed care	57	57
Commercial and other	2	3
Self-pay	3	2
	100%	100%

The System grants credit without collateral to its patients, most of whom are residents in the communities that it serves and are insured under third-party payer agreements. The System reduces its patient accounts receivable by an allowance for doubtful accounts. Deductibles and coinsurance are classified as either third-party or self-pay receivables on the basis of which party has the primary remaining financial responsibility, while the total gross revenue remains classified based on the primary payer at the time of service. In evaluating the collectibility of accounts receivable, the System analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. The System used a consistent methodology to estimate the allowance and provision for bad debts in the years 2013 and 2012. For receivables associated with self-pay patients after satisfaction of amounts due from insurance, the System follows established guidelines for charging off certain past-due patient balances against the allowance for doubtful accounts. The System has not changed its charity care or uninsured discount policies during the years 2013 or 2012. The System does not maintain an allowance for doubtful accounts from third-party payers, nor did it have significant write-offs from third-party payers. The mix of net patient accounts receivable by major payer as of December 31 consists of the following:

	2013	**2012**
Medicare and Medicaid	35%	34%
Managed care	42	40
Self-pay	12	14
Commercial and other	11	12
	100%	100%

Two managed care payers accounted for approximately 36% and 35% of net patient service revenue in 2013 and 2012, respectively. Amounts due from these two managed care payers accounted for approximately 25% and 25% of net patient accounts receivable at December 31, 2013 and 2012, respectively.

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(4) Community Benefits

The System has adopted the Catholic Health Association/VHA Inc. (CHA/VHA) definition for community benefits provided in the service areas of the System. The major components are defined below.

(a) Cost of Providing Charity Care

The System provides medical care without charge or at reduced cost to residents of the communities that it serves through the provision of charity care. Policies have been established to identify charity care cases that meet certain guidelines for a patient's ability to pay for services. The cost of providing charity care is measured by applying a cost-to-charge ratio to the charges identified as charity care.

(b) Costs in Excess of Medicaid Payments

The System provides services to public program enrollees (Medicaid). Such public programs typically reimburse at amounts less than cost.

(c) Medicaid Surcharge

The System is a participant in the Medicaid Surcharge program. The current program includes a 1.56% surcharge on a hospital's net patient service revenue (excluding Medicare revenue). Reported amounts are net of any disproportionate share adjustments.

(d) MinnesotaCare Tax

The System also participates in the funding of medical care for the uninsured through a MinnesotaCare tax of 2% on certain net patient service revenue. Patients who are unable to get insurance through their employer are eligible to participate in MinnesotaCare.

(e) Community Benefit Services

In the furtherance of its charitable purpose, the System provides a wide variety of community health improvement programs and activities to the various communities that it serves in response to specific needs within those communities. Examples are programs and activities designed to improve the quality of life and build healthier communities. Community services activities include social service programs, health screenings, in-home caregiver services, support counseling for patients and families, crisis intervention, health enhancement and wellness programs, classes on specific conditions, and telephone information services. The System provides these services through programs such as Heart Safe Communities, the Backyard Initiative, Free Bikes 4 Kidz, Neighborhood Health Connection, and Health Powered Kids, all of which focus on partnering with the community to improve health through building social connections and increasing healthy, active living.

(f) Subsidized Health Services

The System provides necessary health care services, which include 24-hour emergency services to the community, burn units, outpatient hospice and palliative care services, and behavioral health services. These clinical services are provided despite financial losses so significant that negative margins remain after removing the effects of charity care, Medicaid shortfalls, and bad debt. These services are provided because they meet an identified community need and, if no longer offered, would either be unavailable in the area or fall to the responsibility of government or another not-for-profit organization to provide.

(g) Education and Workforce Development

The System provides education and training programs and financial assistance for providers, health care students, and other health professionals.

(h) Research

The System participates in clinical and community health research that is shared with the health care community, including clinical research related to integrative medicine and cancer interventions as well as community health research related to care model innovations and population health.

(i) Cash and In-Kind Donations

The System donates funds and in-kind services to individuals and or the community at large and other not-for-profit organizations. Examples are the donation of space for use by community groups, event sponsorships, donation of food, equipment and supplies, and grants.

(j) Community Building

The System engages in community activities that address root causes of health problems such as poverty, homelessness, and environmental issues. The System recognizes that good health is dependent on societal, community, and family environments as well as individual choices, and is affected by much more than the provision of health care services. The System participates in community-building activities including economic development work through Chambers of Commerce, workforce development through career days and mentoring programs, public safety efforts such as National Night Out celebrations, and community health improvement work through participation on local community coalitions.

(k) Other Community Benefit Cost

The System allocates staff time to manage community benefit reporting, assess community benefit programs and needs, and develop and implement programs and activities in response to those needs.

The System contributes additional resources to the communities in which it provides services. The major components are defined below:

Costs in Excess of Medicare Payments – The System provides services to public program enrollees (Medicare). Such public programs typically reimburse at amounts less than cost.

Other Care Provided without Compensation (Bad Debt) – The System provides medical care in which charges are uncollected beyond what is provided under the definition of charity care.

(Dollars in thousands)

Discounts Offered to Uninsured Patients – The hospitals in the System provide a discount on billed charges for medically necessary care delivered to patients who are uninsured and ineligible for government programs or otherwise medically indigent. The unbilled portion of uninsured care is excluded from net patient service revenue.

Taxes and Fees – The System pays property taxes to local and state government used in funding civil and education services to the community.

The following is an estimate of the community benefits provided by the System:

		2013	2012
Cost of providing charity care (charges forgone of $74,083 and $80,384, respectively)	$	29,500	30,400
Costs in excess of Medicaid payments		53,900	53,400
Medicaid surcharge		23,100	21,600
MinnesotaCare tax		42,800	41,100
Community services		8,600	9,000
Subsidized health services		2,600	2,500
Education and workforce development		23,800	23,100
Research		15,800	10,500
Cash and in-kind donations		3,000	3,500
Community building		400	700
Other community benefit cost		5,100	4,400
Total cost of community benefit (as defined by CHA/VHA guidelines)		208,600	200,200
Costs in excess of Medicare payments		189,500	156,900
Other care provided without compensation (bad debt)		90,500	76,200
Discounts offered to uninsured patients		46,500	39,200
Taxes and fees		6,300	5,600
Total value of community contributions	$	541,400	478,100

(Dollars in thousands)

(5) Cash and Cash Equivalents and Investments

As of December 31, cash and cash equivalents and investments, including those with limited uses, consist of the following:

	2013	2012
Cash and cash equivalents	$ 132,704	147,405
Money market collective fund and short-term fixed income	165,233	66,414
Fixed income	665,229	564,324
Equity securities	369,187	205,080
Investments accounted for at net asset value	391,276	592,675
	$ 1,723,629	1,575,898

Certain investments are held for the following limited uses as of December 31:

	2013	2012
By trustee for repayment of long-term debt	$ 2,193	2,765
By trustee for swap collateralization	—	13,640
In escrow for capital projects	26	25
Donor-restricted funds	139,525	105,004
Self-insured professional and general liability claims	10,811	10,105
	$ 152,555	131,539

Total investment return consists of the following:

	2013	2012
Investment earnings in unrestricted net assets:		
Interest and dividend income (net of expense of $1,125 and $932 for 2013 and 2012, respectively)	$ 17,512	16,181
Realized gains on investments	88,915	2,731
Unrealized (losses) gains on investments	(13,444)	69,801
	92,983	88,713
Investment earnings in restricted net assets:		
Interest and dividend income	1,189	1,163
Realized gains on investments	7,866	422
Unrealized gains on investments	331	6,116
	9,386	7,701
	$ 102,369	96,414

(Continued)

(Dollars in thousands)

Total investment return is reported in the consolidated statements of operations and changes in net assets as follows:

		2013	2012
Nonoperating gains	$	92,983	88,713
Changes in restricted net assets		9,386	7,701
	$	102,369	96,414

(6) Other Current Assets

Other current assets as of December 31 consist of the following:

		2013	2012
Pledges and notes receivable	$	5,598	8,732
Prepaid expenses		10,475	9,194
Other miscellaneous receivables		59,053	42,543
	$	75,126	60,469

(7) Land, Buildings, and Equipment

Land, buildings, and equipment as of December 31 consist of the following:

		2013	2012
Land and land improvements	$	94,497	79,475
Buildings		1,264,600	1,146,387
Equipment		1,366,368	1,292,383
		2,725,465	2,518,245
Less accumulated depreciation and amortization		1,727,334	1,639,216
		998,131	879,029
Construction in progress		52,639	77,747
	$	1,050,770	956,776

(Dollars in thousands)

(8) Other Assets

Other assets as of December 31 consist of the following:

		2013	2012
Cash surrender value of insurance policies	$	4,461	4,116
Pledges and notes receivable, less current portion		18,853	16,065
Investment in unconsolidated entities		52,380	46,717
Deferred bond issuance costs, net		4,133	4,542
Deferred compensation		120,426	98,690
Other		25,344	6,602
	$	225,597	176,732

The following table represents the System's investment in and share of net earnings of unconsolidated entities recorded under the equity method of accounting as of and for the years ended December 31:

	Percentage ownership		Equity investment 2013	Equity investment 2012	Share of net earnings 2013	Share of net earnings 2012
St. Francis Regional Medical Center	33.33%	$	30,283	25,930	4,353	4,275
Other entities	16% – 50%		22,097	20,787	10,989	7,565
		$	52,380	46,717	15,342	11,840

The following table reflects summarized financial information for St. Francis Regional Medical Center as of and for the years ended December 31:

		2013	2012
Total assets	$	165,590	162,854
Total liabilities		74,296	75,428
Total net assets		91,294	87,426
Total revenue		120,928	120,719
Total operating expenses		112,365	111,113
Total investment return and other nonoperating		3,753	3,169
Excess of revenues over expenses		12,316	12,775

(Dollars in thousands)

(9) Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses as of December 31 consist of the following:

		2013	2012
Outstanding checks	$	54,137	62,202
Trade accounts payable		57,492	43,063
Accrued payroll, taxes, and vacation		171,431	161,526
Other		137,056	125,114
	$	420,116	391,905

(10) Other Current Liabilities

Other current liabilities as of December 31 consist of the following:

		2013	2012
Current portion of estimated reserves for professional and general liability claims	$	12,762	12,981
Current portion of estimated reserves for workers' compensation claims		13,138	13,217
Employee health plan claims incurred but not reported		14,094	17,218
Defined–contribution retirement plan		35,800	34,519
Due to third-party payers		1,976	1,762
Current portion of long-term debt		39,368	39,069
	$	117,138	118,766

(11) Long-Term Debt

Long-term debt as of December 31 consists of the following:

		2013	2012
Fixed Rate Revenue Bonds, Series 2009A-1 (Allina Health System), annual interest rate from 4.50% to 5.25%	$	108,015	109,515
Fixed Rate Revenue Bonds, Series 2009A-2 (Allina Health System), annual interest rate from 3.25% to 5.50%		71,145	71,430
Variable Rate Revenue Bonds, Series 2009B&C (Allina Health System), Variable Rate Demand Notes, average annual interest rate of 0.08% during 2013; 0.04% at December 31, 2013		164,525	164,525

(Continued)

(Dollars in thousands)

		2013	2012
Fixed Rate Revenue Bonds, Series 2007A (Allina Health System), annual interest rate from 4.50% to 5.50%	$	111,565	117,550
Variable Rate Revenue Bonds, Series 2007C (Allina Health System), Variable Rate Demand Notes, average annual interest rate of 0.09% during 2013; 0.05% at December 31, 2013		121,950	122,625
Variable Rate Revenue Bonds, Series 1998A (Allina Health System) Periodic Auction Reset, average annual interest rate of 0.12% during 2013; 0.08% at December 31, 2013		18,875	24,925
Variable Rate Health Care System Revenue Bonds, Series 1993B (HealthSpan) Periodic Auction Reset, average annual interest rate of 0.15% in 2013; 0.09% at December 31, 2013		26,100	27,400
Variable Rate Demand Hospital Revenue Bonds, Series 1985 (Health Central), average annual interest rate of 0.11% during 2013; 0.06% at December 31, 2013		3,400	5,700
Fixed–Rate Health Facilities Revenue Bonds, Series 1994A		—	9,990
Variable Rate Taxable Bonds, Series 1994B (WestHealth)		—	10,400
Line of Credit		19,965	—
Capitalized leases		4,622	5,208
Other		201	221
		650,363	669,489
Unamortized portion of original issue premium		3,811	4,302
Current portion		(39,368)	(39,069)
	$	614,806	634,722

Certain divisions of the System are members of the Allina Obligated Group (Obligated Group), which is subject to the terms and conditions of the Master Trust Indenture dated October 1, 1998, as amended, between the System and Wells Fargo Bank Minnesota, National Association, and is jointly and severally liable for any debts and/or other obligations of each Obligated Group member and the Obligated Group as a whole. The Obligated Group members include the hospitals, nonhospital specialty care services, and certain physician clinics. The System also operates several wholly owned direct and indirect subsidiaries outside of the Obligated Group, including clinics and foundations.

In June 2011, through an acquisition, the System assumed a fixed–rate mortgage payable, the fixed–rate Revenue Bonds, Series 1994A, issued by the City of Plymouth, on behalf of WestHealth and the variable rate WestHealth Taxable Bonds, Series 1994B, issued pursuant to an Indenture of Trust. The mortgage payable had a balloon payment due in August 2012, and was fully repaid in May 2012. The 1994A and

1994B Bonds were paid in full on January 15, 2013, and are classified as current portion long-term debt at December 31, 2012. The 1994B Bonds were secured through a bank under a Standby Bond Purchase Agreement (the Agreement), which terminated on January 15, 2013 with payment of the bonds. Under the Agreement, the bank had committed to purchase bonds if put and not remarketed. There were no draws over the life of the agreement.

In November 2009, the City of Minneapolis and the Housing and Redevelopment Authority of the City of Saint Paul, on behalf of the System, issued fixed–rate Revenue Bonds, Series 2009A-1 and 2009A-2, in the aggregate principal amount of $113,415 and $71,830, respectively. In addition, Variable Rate Revenue Bonds, Series 2009B&C, were issued in the aggregate amount of $164,525. The 2009A-1 Bonds are secured by the Obligated Group's pledged revenue and were used to acquire, construct, and renovate certain of the System's facilities and refinance and legally defease, in part, the 2007B Bonds. The 2009A-2 Bonds are secured by the Obligated Group's pledged revenue and were used to redeem, in part, the Series 1998A Variable Rate Revenue Bonds at a redemption price of 93%. The 2009B&C Bonds are secured by the Obligated Group's pledged revenue and were used to refinance and legally defease the remaining portion of the Series 2007B Variable Rate Revenue Bonds not refinanced through the issuance of the 2009A-1 Bonds.

The Series 2009B&C Bonds are secured by letters of credit issued by two banks. Repayment of draws against the letters is secured by term credit agreements with the banks in the amount of $114,525, which expires on January 5, 2017, and $50,000, which expires on January 4, 2015. If the bonds were put and not remarketed, the banks would be required to purchase the bonds. Draws under the term credit agreements to repay the banks for the purchase of the bonds are payable in an amount equal to the principal payments necessary to repay the draws over five years in equal quarterly installments, beginning 367 days after the draw, based on the bank's base rate plus 2.00%.

Payment of principal and interest on the Series 2007A, Series 1998A, and Series 1993B Bonds is insured. Interest rates on the variable rate Series 1998A and Series 1993B Bonds are determined by auction. If an auction fails, interest rates payable to the existing bondholders are determined by a formula incorporated in the bond documents for these two series of bonds.

The Series 1985 Bonds are secured by a letter of credit issued by a bank. Repayment of draws against the letter is secured by a term credit agreement with the bank in the aggregate amount of $3,400, which expires on January 4, 2015. If the bonds were put and not remarketed, the bank would be required to purchase the bonds. Draws under the term credit agreement to repay the bank for the purchase of the bonds are payable in an amount equal to the principal payments necessary to repay the draws over five years in equal quarterly installments, beginning 367 days after the draw, based on the bank's base rate plus 2.00%.

On June 18, 2008, the System completed a conversion of the Series 2007C Bonds from auction rate securities to variable rate demand bonds. This conversion included the insurer's consent to remove the insurance and for a bank to support the bonds with a direct pay letter of credit. Repayment of draws against the letter is secured by a term credit agreement with the bank in the aggregate amount of $121,950, which expires on January 4, 2015. If the bonds were put and not remarketed, the bank would be required to purchase the bonds. Draws under the term credit agreement to repay the bank for the purchase of the bonds

(Continued)

(Dollars in thousands)

are payable in an amount equal to the principal payments necessary to repay the draws over five years, beginning 367 days after the draw, based on the bank's base rate plus 2.00%.

In September 2013, through an acquisition, the System assumed the fixed rate Revenue Bonds, Series 2010, issued by the City of Hastings, on behalf of Regina Medical Center. In December 2013, the System utilized its line of credit with a bank in the amount of $19,965 to pay off the Series 2010 Bond, which was classified in current portion long-term debt at December 31, 2013.

Aggregate annual maturities of long-term debt and mandatory sinking fund requirements, as stated under the actual debt terms, for each of the five years following December 31, 2013, are as follows:

2014	$	39,368
2015		20,193
2016		21,373
2017		21,864
2018		23,113
Thereafter		524,452

Aggregate principal payments of long-term debt based on the variable rate demand notes being put back to the System and a corresponding draw being made on underlying liquidity facilities, for each of the five years following December 31, 2013, are as follows:

2014	$	39,368
2015		77,423
2016		79,383
2017		80,134
2018		81,168
Thereafter		292,887

The System uses interest rate swaps as a part of its risk management strategy to manage exposure to fluctuations in interest rates and to manage the overall cost of its debt. Four of the five interest rate swaps are used to hedge identified debt, or interest rate exposures, and are not used for speculative purposes. One of the interest rate swaps was established for speculative purposes and is not tied directly to outstanding debt. Interest rate swaps are recognized as either other long-term assets or other long-term liabilities in accordance with the netting provisions in the counterparty agreement and are measured at fair value.

(Dollars in thousands)

As of December 31, 2013, the System had no collateral posted. As of December 31, 2012, the System posted collateral of $13,640, related to two of the System's swaps due to changes in interest rates. The following table provides details regarding the System's fair value of the derivative instruments at December 31, 2013, none of which are designated as cash flow hedging instruments:

Fixed payer interest rate swaps

Swap	Balance sheet location	Fair value	Notional amount outstanding	Rate paid	Rate received	Average rate received in 2013	Counterparty
2009BC	Other liabilities	$ 7,195	41,131	3.74%	% of LIBOR	0.47%	Wells Fargo
2009BC	Other liabilities	21,407	123,394	3.73	% of LIBOR	0.47	JP Morgan
2007C	Other liabilities	17,924	121,950	3.58	% of LIBOR	0.37	UBS
2001	Other liabilities	12,461	50,000	5.17	SIFMA	0.09	Goldman Sachs
1998A	Other liabilities	2,589	19,375	4.44	SIFMA	0.09	Goldman Sachs
Total		$ 61,576	355,850				

The following table provides details regarding the System's fair value of the derivative instruments at December 31, 2012, none of which are designated as cash flow hedging instruments:

Fixed payer interest rate swaps

Swap	Balance sheet location	Fair value	Notional amount outstanding	Rate paid	Rate received	Average rate received in 2012	Counterparty
2009BC	Other liabilities	$ 11,848	41,131	3.74%	% of LIBOR	0.50%	Wells Fargo
2009BC	Other liabilities	35,455	123,394	3.73	% of LIBOR	0.50	JP Morgan
2007C	Other liabilities	29,846	122,625	3.58	% of LIBOR	0.40	UBS
2001	Other liabilities	19,721	50,000	5.17	SIFMA	0.16	Goldman Sachs
1998A	Other liabilities	3,966	23,475	4.44	SIFMA	0.16	Goldman Sachs
Total		$ 100,836	360,625				

(Dollars in thousands)

The following table provides details regarding the gains (losses) from the System derivative instruments in the consolidated statements of operations and changes in net assets, none of which are currently designated as hedging instruments. The 1998A swap was designated as a hedging instrument until December 31, 2008.

	Amount of gain (loss) on change in fair value recognized as nonoperating: gains (losses) on interest rate swap agreements		Amount of loss reclassified from unrestricted net assets into revenues over expenses as nonoperating: gains (losses) on interest rate swap agreements		Amount of interest paid to counterparty recognized as nonoperating: gains (losses) on interest rate swap agreements		Total	
	2013	2012	2013	2012	2013	2012	2013	2012
2009BC	$ 18,701	1,310	—	—	(5,363)	(5,352)	13,338	(4,042)
2007C	11,922	290	—	—	(3,917)	(3,923)	8,005	(3,633)
2001	7,260	(949)	—	—	(2,526)	(2,518)	4,734	(3,467)
1998A	1,377	87	(874)	(874)	(946)	(1,100)	(443)	(1,887)
	$ 39,260	738	(874)	(874)	(12,752)	(12,893)	25,634	(13,029)

The System records the swaps' liability at fair value, which requires nonperformance risk (i.e., credit risk), to be included in the valuation. Nonperformance risk is defined as the risk that the obligation will not be fulfilled and affects the value at which the liability is transferred. This nonperformance risk is determined by adjusting the discounting rate by a credit spread as of the reporting date. The addition of the credit spread to the discounting rate reduces the reported liability. Because of market volatility, the fair value reported liability of the swaps is approximately $1,916 and $8,665 less as of December 31, 2013 and 2012, respectively, than the mark-to-market valuations (note 14).

The estimated fair value of long-term debt was $676,238 and $708,909 as of December 31, 2013 and 2012, respectively. Interest rates that are currently available to the System for issuance of debt with similar terms and remaining maturities are used to estimate the fair value of fixed–rate debt through the use of discounted cash flow analyses. The fair value measurement was done using Level 2 criteria (note 14). The carrying amount of variable rate bonds and other notes payable approximates fair value.

Interest paid, net of amounts capitalized, was $16,467 and $16,947 during 2013 and 2012, respectively.

The System has a Revolving Credit Agreement with Wells Fargo Bank through June 29, 2014, which consists of a line of credit of $26,000. The interest rate on the line of credit is the Reserve Adjusted London Interbank Offered Rate (LIBOR) plus 0.7%, and is secured by a note under the 1998 Master Trust Indenture. The unused line fee for the revolving line of credit is 0.175% per annum. In December 2013, the System had a draw of $19,965 on the line of credit to pay off the Regina Medical Center 2010 Series Bond, which was classified in current portion long-term debt at December 31, 2013. The System also had insurance-related letters of credit applied against the line of credit in the amount of $4,036 and $3,150 at December 31, 2013 and 2012, respectively.

(Dollars in thousands)

(12) Other Liabilities

Other liabilities as of December 31 consist of the following:

		2013	2012
Estimated reserves for professional and general liability claims, less current portion	$	57,462	59,937
Estimated reserves for workers' compensation claims, less current portion		27,660	30,115
Net pension and postretirement liability		12,500	59,257
Interest rate swaps payable		61,576	100,836
Deferred compensation		147,212	125,212
Leasehold incentive allowance		20,910	16,750
Financing obligation		25,624	25,624
Other		16,965	8,362
	$	369,909	426,093

(13) Restricted Net Assets

Temporarily restricted net assets have been restricted by donors for the following purposes as of December 31:

		2013	2012
Capital	$	11,032	18,300
Charity and indigent care		4,454	4,132
Education and research		19,761	16,572
Patient care		18,405	17,997
Other		45,273	32,535
	$	98,925	89,536

Income on the following permanently restricted net assets is restricted for the following purposes as of December 31:

		2013	2012
Capital	$	128	77
Charity and indigent care		1,806	1,806
Education and research		18,371	18,020
Patient care		12,710	11,772
Other		22,018	14,106
	$	55,033	45,781

(Continued)

(14) Fair Value Measurements

The System's investments include money market, fixed income, and equity securities, which are carried at fair value based on quoted market prices and are classified as trading securities. Investment securities are exposed to various risks, such as interest rate, credit, and overall market volatility. In addition, the System invests in limited partnerships that hold interests in hedge funds, private equity, emerging markets, debt, and commodities, which are accounted for at net asset value as a practical expedient to fair value, and the System recognizes the increase or decrease in the partnerships' net asset value in nonoperating gains (losses). The System generally has liquidity ranging from 30 to 90 days in these funds. Certain of the underlying partnerships may hold some securities without readily determinable fair values.

For all financial instruments other than investments, derivatives, and long-term debt (note 11), the carrying value is a reasonable estimate of fair value because of the short-term nature of the financial instruments.

Realized gains and losses on investments, interest, dividends, and declines in investment value determined to be other than temporary are recorded as nonoperating gains (losses) unless the investment return is restricted by donor or law. Changes in unrealized gains and losses that are considered temporary are recorded as nonoperating gains (losses) for investments classified as trading and as other changes in unrestricted net assets for investments classified as other-than-trading. Investment return restricted by donor or law is recorded as changes in restricted net assets.

The System determines the fair value of its financial instruments based on the fair value hierarchy established in ASC Topic 820, *Fair Value Measurement*, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

> Level 1 Inputs: quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
>
> Level 2 Inputs: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly through corroboration with observable market data.
>
> Level 3 Inputs: unobservable inputs for the asset or liability, that is, inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing an asset or liability (including risk assumptions) developed based on the best information available in the circumstances.

Inputs and valuation techniques for significant other observable and significant unobservable inputs are as follows:

For Level 2 and Level 3 cash equivalents and fixed income assets that rely on significant other observable inputs and significant unobservable inputs, the System employs multiple third-party information providers to help determine the fair value of the assets. Level 2 and Level 3 securities in separately managed accounts are held at Bank of New York Mellon (BNYMellon), who acts as Trustee and Custodian for the assets. As Custodian, BNYMellon uses multiple pricing services to value the assets. The investment managers utilize their own pricing services and valuation processes. Any significant discrepancies between

(Dollars in thousands)

Custodian and investment manager values are reconciled on a monthly basis by the managers and BNYMellon. The System also employs an investment consultant who researches significant pricing differences between the manager and custodian on a security-by-security basis. The consultant will notify the Custodian of any significant pricing issues.

For Level 2 and Level 3 funds of hedge funds, limited partnership assets, and commingled monthly valued funds, the System utilizes net asset value per share or its equivalent to determine the fair value of the assets. For Level 2, the System has the ability to redeem its investment with the investee at net asset value per share (or its equivalent) at the measurement date.

The System's financial assets and liabilities that are measured at fair value on a recurring basis were recorded using the fair value hierarchy at December 31, 2013 as follows:

		Fair value measurements using		
	Total	**Level 1**	**Level 2**	**Level 3**
Cash and cash equivalents:				
Cash	$ 28,797	28,797	—	—
Money market funds	103,907	103,907	—	—
Total cash and cash equivalents	132,704	132,704	—	—
Short-term and long-term investments – trading securities:				
Short-term fixed income	121,404	121,218	186	—
Money market collective fund	3,365	—	3,365	—
Total short-term fixed income and money market	124,769	121,218	3,551	—
Equity:				
Financials	14,006	14,006	—	—
Consumer	6,007	6,007	—	—
Industrials	10,084	10,084	—	—
Technology	7,100	7,100	—	—
Healthcare	2,505	2,505	—	—
International equity mutual funds	222,882	222,882	—	—
Other equity	78,030	78,030	—	—
Total equity	340,614	340,614	—	—

(Dollars in thousands)

	Total	Fair value measurements using Level 1	Level 2	Level 3
Fixed income:				
U.S. Treasury securities	$ 158,206	158,206	—	—
U.S. Agency securities	128,227	—	128,227	—
Corporate bonds	116,217	—	116,217	—
Mortgage, commercial, and asset-backed securities	91,826	—	91,826	—
Sovereigns	3,781	—	3,781	—
Term loan/private placement	35,891	—	35,690	201
Other	77,845	63,306	14,539	—
Total fixed income	611,993	221,512	390,280	201
Investments accounted for at net asset value:				
Global bonds fund	55,536	—	55,536	—
Global equity fund	65,869	—	65,869	—
Emerging markets equity fund	29,834	—	29,834	—
Equity long/short hedge funds	48,975	—	48,975	—
Opportunistic fixed income hedge funds	74,456	—	74,456	—
Fund of hedge funds	4,328	—	2,069	2,259
Private equity funds	8,638	—	—	8,638
Emerging market debt fund	53,367	—	53,367	—
Commodities	19,991	—	19,991	—
Total investments accounted for at net asset value	360,994	—	350,097	10,897
Total investments – trading securities	1,438,370	683,344	743,928	11,098
Investments with limited uses – trading securities:				
Short-term fixed income	15,657	15,647	10	—
Money market collective fund	21,186	—	21,186	—
Equity	28,573	28,573	—	—
Fixed income	43,485	15,974	27,494	17
Investments accounted for at net asset value	30,282	—	29,368	914
Restricted foundation trusts (fixed income)	9,751	—	9,751	—
Total investments with limited uses – trading securities	148,934	60,194	87,809	931

(Continued)

(Dollars in thousands)

			Fair value measurements using		
		Total	**Level 1**	**Level 2**	**Level 3**
Investments with limited uses – available-for-sale securities:					
Money market fund	$	2,163	2,163	—	—
U.S. agency securities		1,458	—	1,458	—
Total investments with limited uses – available-for-sale securities		3,621	2,163	1,458	—
Total investments with limited uses		152,555	62,357	89,267	931
Total	$	1,723,629	878,405	833,195	12,029
Liabilities:					
Interest rate swaps	$	61,576	—	61,576	—

		Fair value measurements, Level 3			
		Total	**Term loan**	**Hedge funds**	**Private equity**
Balance, December 31, 2012	$	3,867	—	3,867	—
Total realized and unrealized losses included in excess of revenues over expenses		1,730	2	240	1,488
Purchases		10,029	217	—	9,812
Sales		(3,597)	(1)	(1,659)	(1,937)
Balance, December 31, 2013	$	12,029	218	2,448	9,363

There were no significant transfers in or out of Level 1 or Level 2 securities during the years ended December 31, 2012 and 2013.

(Dollars in thousands)

The System's financial assets and liabilities that are measured at fair value on a recurring basis were recorded using the fair value hierarchy at December 31, 2012 as follows:

		Fair value measurements using		
	Total	**Level 1**	**Level 2**	**Level 3**
Cash and cash equivalents:				
Cash	$ 38,403	38,403	—	—
Money market funds	109,002	109,002	—	—
Total cash and cash equivalents	147,405	147,405	—	—
Short-term and long-term investments – trading securities:				
Short-term fixed income	37,491	37,491	—	—
Money market collective fund	2,137	—	2,137	—
Total short-term fixed income and money market	39,628	37,491	2,137	—
Equity:				
Financials	10,556	10,556	—	—
Consumer	4,381	4,381	—	—
Industrials	8,672	8,672	—	—
Technology	2,796	2,796	—	—
Healthcare	751	751	—	—
International equity mutual funds	156,705	156,705	—	—
Other equity	5,639	5,639	—	—
Total equity	189,500	189,500	—	—
Fixed income:				
U.S. Treasury securities	114,219	114,219	—	—
U.S. Agency securities	96,399	—	96,399	—
Corporate bonds	126,707	—	126,707	—
Mortgage, commercial, and				—
asset-backed securities	99,581	—	99,581	—
Sovereigns	5,831	—	5,831	—
Term loan/private placements	26,274	—	26,274	—
Other	51,165	43,839	7,326	—
Total fixed income	520,176	158,058	362,118	—
Investments accounted for at net asset value:				
TIPS fund	30,956	—	30,956	—
Global bonds fund	42,665	—	42,665	—
Global equity fund	51,660	—	51,660	—

(Dollars in thousands)

	Total	Fair value measurements using Level 1	Level 2	Level 3
Emerging markets equity fund	$ 23,556	—	23,556	—
Equity long/short fund of hedge funds	180,638	—	180,638	—
Multistrategy fund of hedge funds	183,230	—	179,657	3,573
Commodities	34,945	—	34,945	—
Total investments accounted for at net asset value	547,650	—	544,077	3,573
Total investments – trading securities	1,296,954	385,049	908,332	3,573
Investments with limited uses – trading securities:				
Short-term fixed income	22,970	22,970	—	—
Money market collective fund	1,654	—	1,654	—
Equity	15,580	15,580	—	—
Fixed income	39,720	12,134	27,586	—
Investments accounted for at net asset value	45,025	—	44,731	294
Restricted foundation trusts	4,428	—	4,428	—
Total investments with limited uses – trading securities	129,377	50,684	78,399	294
Investments with limited uses – available-for-sale securities:				
Money market fund	2,162	2,162	—	—
Total investments with limited uses – available-for-sale securities	2,162	2,162	—	—
Total investments with limited uses	131,539	52,846	78,399	294
Total	$ 1,575,898	585,300	986,731	3,867
Liabilities:				
Interest rate swaps	$ 100,836	—	100,836	—

(Dollars in thousands)

	Fair value measurements, Level 3		
	Total	Term loan	Hedge funds
Balance, December 31, 2011	$ 6,546	191	6,355
Total realized and unrealized losses included in excess of revenues over expenses	(274)	(5)	(269)
Purchases	—	—	—
Sales	(2,405)	(186)	(2,219)
Balance, December 31, 2012	$ 3,867	—	3,867

Level 3 pricing is based on net asset value or ownership values provided by hedge fund managers who obtain the net asset value or ownership values from the underlying managers in which they invest.

Fair value measurements of investments in certain entities that calculate net asset value per share (or its equivalent), including restricted and unrestricted assets, as of December 31, 2013 are as follows:

	Net asset value	Unfunded commitments	Redemption frequency (if currently eligible)	Redemption notice period
Global bonds fund	$ 60,195	—	Monthly	15 days
Global equity fund	71,394	—	45 days	15 days
Emerging markets equity fund	32,337	—	Daily	5 days
Equity long/short hedge funds	53,083	—	Monthly/ quarterly	30-90 days
Opportunistic fixed income hedge funds	80,702	—	Quarterly	45-90 days
Fund of hedge funds	4,691	—	Quarterly	90 days
Private equity funds	9,363	29,296	10 years	NA
Emerging market debt fund	57,843	—	Daily	Same day
Commodities	21,668	—	Monthly	30 days
Total	$ 391,276	29,296		

Global bond fund includes fixed- and floating-rate debt securities of governments and government-related entities, as well as derivatives. The net asset value of the fund has been estimated using the net asset value per share of the investment. The fund provides full disclosure of the underlying holdings.

Global equity fund is an investment in a fund that invests in global equities. The net asset value of the fund has been estimated using the net asset value per share of the investment. The fund provides full disclosure of the underlying holdings.

Emerging markets equity fund is an investment in a fund that invests in emerging market equities. The net asset value of the fund has been estimated using the net asset value per share of the investment. The fund provides full disclosure of the underlying holdings.

Emerging market debt fund is an investment in a fund that invests in emerging market debt. The net asset value of the fund has been estimated using the net asset value per share of the investment. The fund provides full disclosure of the underlying holdings.

Commodities include investments in a partnership that invests in long-only equities and commodity derivatives that are traded on public exchanges. The net asset value of the investments in this category has been estimated by the ownership interest in the partnership. The fund provides full disclosure of the underlying holdings and ownership interest.

Equity long/short hedge funds include investments in hedge funds that invest both long and short in U.S. and global common stocks through a hedge funds structure. The value of the investments in this category has been estimated using the net asset value per share of the investments.

Fund of hedge funds include investments in fund of hedge funds that pursue multiple strategies to diversify risks and reduce volatility. The value of the investments in this category has been estimated using the net asset value per share of the investments. The fund of hedge funds were liquidated over the course of 2013 with the exception of one fund of hedge funds investment, which as of December 31, 2013 has a value of $2,448 and one of the hedge fund of funds audit holdback is also included in this category. The fund is currently in liquidation and is making quarterly redemptions to shareholders. Since June 30, 2009, over 99% of the funds have been distributed.

Opportunistic fixed income hedge funds include investments in strategic fixed income and distressed debt hedge fund managers. These managers have the ability to invest across the capital structure and around the globe. The value of the investments in this category has been estimated using the net asset value per share of the investment.

Private equity funds include a limited partnership investment that focuses on health care services and information technology companies as well as a limited partnership that invests in distressed and opportunistic real estate investments. The fair value of the portfolio companies is determined using valuation techniques and procedures in accordance with recommendations by the American Institute of Certified Public Accountants (AICPA) for valuing private companies.

(Dollars in thousands)

The System's deferred compensation investments recorded as other assets that are measured at fair value on a recurring basis were recorded using the fair value hierarchy at December 31, 2013 as follows:

		Fair value measurements using		
	Total	**Level 1**	**Level 2**	**Level 3**
Assets:				
Mutual funds:				
Large cap domestic equity	$ 35,981	35,981	—	—
Mid cap domestic equity	8,034	8,034	—	—
Small cap domestic equity	7,326	7,326	—	—
International equity	17,640	17,640	—	—
Fixed income	25,473	25,473	—	—
Balanced	7,826	7,826	—	—
Life cycle	1,313	1,313	—	—
Money market	2,653	2,653	—	—
Other	2,769	2,769	—	—
Total mutual funds	109,015	109,015	—	—
Guaranteed investment contracts	11,411	—	—	11,411
Total assets	$ 120,426	109,015	—	11,411

	Fair value measurements, Level 3
Balance, December 31, 2012	$ 10,248
Total interest income	232
Purchases	3,619
Sales	(2,688)
Balance, December 31, 2013	$ 11,411

(Dollars in thousands)

The System's deferred compensation investments recorded as other assets that are measured at fair value on a recurring basis were recorded using the fair value hierarchy at December 31, 2012 as follows:

			Fair value measurements using		
		Total	**Level 1**	**Level 2**	**Level 3**
Assets:					
Mutual funds:					
Large cap domestic equity	$	29,010	29,010	—	—
Mid cap domestic equity		6,342	6,342	—	—
Small cap domestic equity		5,716	5,716	—	—
International equity		13,751	13,751	—	—
Fixed income		22,145	22,145	—	—
Balanced		6,094	6,094	—	—
Life cycle		976	976	—	—
Money market		2,603	2,603	—	—
Other		1,805	1,805	—	—
Total mutual funds		88,442	88,442	—	—
Guaranteed investment contracts		10,248	—	—	10,248
Total assets	$	98,690	88,442	—	10,248

		Fair value measurements, Level 3
Balance, December 31, 2011	$	10,026
Total realized and unrealized losses		219
Purchases		3,424
Sales		(3,421)
Balance, December 31, 2012	$	10,248

(15) Benefit Plans

Defined–Benefit Cash Balance Plan

On December 31, 2008, the System froze a defined–benefit cash-balance pension plan (the Plan), covering a large number of noncontract employees. In 2013, the System received approval from the Internal Revenue Service to fully terminate the Plan effective as of December 31, 2012. In November 2013, the System fully distributed the plan assets to participants.

(Dollars in thousands)

The actual asset allocation as of December 31, 2012 was as follows:

	2012
Global equity	2%
Fixed income (debt securities)	82
Diversified funds of hedge funds	—
Real assets	2
Cash	14
	100%

The following table summarizes certain information for the Plan:

	2013	2012
Projected benefit obligation at beginning of year	$ 498,821	444,834
Service cost – benefits earned during the year	—	442
Interest cost on the accumulated benefit obligation	11,826	20,078
Actuarial loss	3,043	58,844
Benefits paid from plan assets	(513,690)	(25,377)
Projected benefit obligation at end of year	—	498,821
Change in plan assets:		
Fair value of plan assets at beginning of year	460,925	430,233
Actual return on plan assets	765	10,070
Contributions from the System	52,000	46,000
Benefits paid from plan assets	(513,690)	(25,378)
Fair value of plan assets at end of year	—	460,925
Deficit	—	(37,896)
Net amount recognized	$ —	(37,896)
Accumulated benefit obligation at end of year	$ —	498,200

The projected benefit obligation (PBO) at December 31, 2012 was the present value of the future benefit payments accrued to date and included expected future salary increases. The PBO present value was determined by using a discount rate that was developed using a yield curve composed of hypothetical zero-coupon bond rates.

As of December 31, 2012, the net amount recognized of $37,896 is reported in the consolidated balance sheets as a noncurrent other liability.

(Dollars in thousands)

The Plan assets measured at fair value on a recurring basis were recorded using the fair value hierarchy at December 31, 2012 as follows:

		Fair value measurements using		
	Total	**Level 1**	**Level 2**	**Level 3**
Investments:				
Money market collective fund	$ 65,842	65,842	—	—
Equity:				
International equity mutual funds	9,600	9,600	—	—
Total equity	9,600	9,600	—	—
Fixed income:				
U.S. agency securities	213,429	103,313	110,116	—
Corporate bonds	41,524	—	41,524	—
Mortgage, commercial, and asset-backed securities	22,872	—	22,872	—
Term loan/private placements	8,174	—	8,174	—
Sovereigns	23,140	22,124	1,016	—
Other	3,058	—	2,448	610
Total fixed income	312,197	125,437	186,150	610
Investments accounted for at net asset value:				
TIPS fund	4,950	—	4,950	—
Corporate bonds	61,621	—	61,621	—
Funds of hedge funds	1,682	—	—	1,682
Commodities	5,033	—	5,033	—
Total investments accounted for at net asset value	73,286	—	71,604	1,682
Total investments	$ 460,925	200,879	257,754	2,292

	Fair value measurements, Level 3		
	Total	**Other-GIC**	**Hedge funds**
Balance, December 31, 2011	$ 3,410	589	2,821
Total realized and unrealized losses included in excess of revenues over expenses	(16)	21	(37)
Purchases	—	—	—
Sales	(1,102)	—	(1,102)
Balance, December 31, 2012	$ 2,292	610	1,682

(Dollars in thousands)

The above information was determined using a measurement date of December 31 and the following assumptions:

	2012
Weighted average discount rate	3.00%
Rate of increase in future compensation levels	4.50

Net periodic pension cost consists of the following components:

		2013	2012
Service cost – benefits earned during the year	$	—	442
Interest cost on the accumulated benefit obligation		11,826	20,078
Expected return on plan assets		(11,090)	(13,018)
Net periodic pension cost		736	7,502
Mark-to-market adjustment		14,133	61,792
Total pension expense	$	14,869	69,294

The net periodic pension cost was determined using the following assumptions:

	2012
Weighted average discount rate	4.70%
Weighted average expected return on plan assets	3.00
Rate of increase in future compensation levels	4.50

The System is making contributions pursuant to provisions of a collective bargaining agreement. The assets for these active participants were spun out of the Plan on January 2, 2013 and into a newly created stand-alone defined benefit pension plan, known as the Allina Health Pension Plan for Collectively Bargained Employees (the new plan). This plan holds assets of $8,927 and has a projected benefit obligation of $8,806 using a discount rate of 4.29% as of December 31, 2013. The System made contributions of $416 and recorded a total pension gain of $449 in 2013. The funded balance of $121 as of December 31, 2013 is reported in the consolidated balance sheet as a noncurrent other asset.

The Defined Benefit Pension Plan of Courage Center was assumed in June 2013 with the acquisition of Courage Center. This plan, which was frozen in 2009, holds assets of $23,621 and has a projected benefit obligation of $26,585 using a discount rate of 5.0% as of December 31, 2013. The System made contributions of $500 in 2013 and recorded a total pension gain of $3,601 in 2013. The unfunded balance of $2,964 as of December 31, 2013 is reported in the consolidated balance sheet as a noncurrent other liability.

(Dollars in thousands)

Multi-employer Plans

Contributions to the union-sponsored multi-employer plans are made in accordance with collective bargaining agreements. The risks of participation in these multi-employer plans are different from single-employer plans in the following aspects: a) assets contributed to the multi-employer plan by one employer may be used to provide benefits to employees of other participating employers; b) if a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers; and c) if the System chooses to stop participating in some of its multi-employer plans and if the plan is underfunded, the System may be required to pay those plans an amount based on the underfunded status of the plan, referred to as the withdrawal liability. The System's participation in these plans for the year ended December 31, 2013 is outlined in the table below. The "EIN/Pension Plan Number" column provides the Employee Identification Number (EIN) and the three-digit plan number, if applicable. Unless otherwise noted, the most recent Pension Protection Act (PPA) zone status available in 2013 and 2012 is for the plan's year-end at December 31, 2012 and 2011, respectively. The zone status is based on information that the System received from the plan and is certified by the plan's actuary. Among other factors, plans in the red zone are generally less than 65% funded, plans in the yellow zone are less than 80% funded, and plans in the green zone are at least 80% funded. The "FIP/RP Status Pending/Implemented" column indicates plans for which a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented. The last column lists the expiration date(s) of the collective-bargaining agreement(s) to which the plans are subject:

Pension fund	EIN/Pension plan number	Pension protection act zone status 2012	Pension protection act zone status 2011	FIP/RP Status pending/ implemented	Contributions of the System in plan year 2012	Contributions of the System in plan year 2011	Surcharge imposed	Expiration date of collective bargaining agreement
Twin City Hospitals Minnesota Nurses Association Pension Plan	41-6184922-001	Yellow	Yellow	Implemented	$ 31,651	24,331	No	May 31, 2016
Other funds					3,945	3,655		
Total contributions					$ 35,596	27,986		

Total amounts expensed under the union-sponsored multi-employer plans were $40,591 and $36,029 for 2013 and 2012, respectively.

The System contributes more than 5% of the total contributions to all of the plans in which it participated for the plan years 2012 and 2011. The System is required to make minimum contributions each year and will make contributions of $35,961 in 2014.

The funding improvement plan for the Twin City Hospitals Minnesota Nurses Association Pension Plan requires no contribution or benefit changes from the currently bargained amounts to achieve the funding improvement plan goals.

At the date the System's consolidated financial statements were issued, Forms 5500 were not available for the plan year ended in 2013.

Defined–Contribution Plans

Certain employees of the System are eligible to participate in defined–contribution plans, whereby 50% of the employees' initial 4% of salary contributions is matched. The defined–contribution plans were enhanced effective January 1, 2009 to provide an additional annual nonelective employer contribution for eligible employees as a replacement to the contribution made to the frozen pension plan. The additional contribution is given as a percent of pay, ranging from 3.0% to 4.5%, based on years of vesting service. Contributions are made during the year following the calendar year-end. The contribution payable to employees is recorded in other current liabilities. Total amounts expensed under defined–contribution plans were $54,508 and $52,594 for 2013 and 2012, respectively.

Postretirement Welfare Benefits

The System provides postretirement welfare benefits to certain employees. Postretirement welfare cost was $2,313 and $2,234 for 2013 and 2012, respectively. As of December 31, 2013 and 2012, accumulated postretirement benefit obligation was $9,632 and $21,631, respectively, and accrued postretirement benefit cost was $9,362 and $21,361, respectively. A discount rate of 3.5%, a rate of return on plan assets of 5.0%, and a medical plan trend rate of 7.0% in 2013, decreasing to 5.0% in 2020 and thereafter, have been assumed.

(16) Self-Insurance Reserves

The System insures its general and professional liability exposures under claims-made policies. Under these policies, the System has self-insured deductible amounts. Claim payments required in excess of certain occurrence and annual aggregate amounts are covered under umbrella policies. An insurance trust has been established, which covers specific claims periods. Actuarially determined amounts are contributed to pay for the estimated cost of claims. The System also self-insures workers' compensation exposures. If claims-made policies presently in force are not renewed or replaced with equivalent insurance, claims asserted after the end of the policy term will be uninsured.

The System has a fixed–rate surety bond in the amount of $45,314 at December 31, 2013 and 2012. The surety bond was obtained in connection with the System's self-insured workers' compensation program at a rate of 0.37% per annum.

The System also has unused letters of credit totaling $4,036 through February 28, 2015. The letters of credit were obtained in connection with the System's self-insured automobile and construction programs at a fee of 0.65% per annum.

(Continued)

The System has made provisions for estimated professional and general liability and workers' compensation claims that have been retained by the System because of deductible provisions of various policies or because of unasserted claims and other uninsured exposures. Reserves of $111,022 and $116,250 as of December 31, 2013 and 2012, respectively, have been recorded based on undiscounted historical data.

Under the comprehensive welfare benefit plan, the System has made provisions for claims reported but not paid and claims incurred but not reported of $14,094 and $17,218 as of December 31, 2013 and 2012, respectively. Management of the plan believes the provisions are adequate to cover claims incurred.

(17) Taxes

The System has been determined to qualify as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code. The System has also been determined to be exempt from federal and state income tax on related income under Section 501(a) of the Internal Revenue Code and Minnesota Statute Section 290.05, Subdivision 2. Certain of the System's subsidiaries and affiliates qualify as tax-exempt organizations, while others are taxable. The System and its subsidiaries paid taxes of $1,944 and $942 in 2013 and 2012, respectively.

As of December 31, 2013 and 2012, the taxable subsidiaries of the System's continuing operations had a gross deferred tax asset of $79,644 and $78,049, respectively, resulting from net operating loss carryforwards, employee compensation and benefits accruals, provision for bad debts, and limitation of charitable contributions, offset by valuation allowances of $78,946 and $77,137, respectively, and a gross deferred tax liability of $697 and $912, respectively, primarily attributable to depreciation and a change in accounting method of a taxable subsidiary. The valuation allowance increased by $1,809 and $1,391 during 2013 and 2012, respectively.

As of December 31, 2013, the continuing operations of the System and its subsidiaries had net operating loss carryforwards of $151,002 for income tax purposes, which expire in various years through 2033.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement and tax return methods of accounting. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

The System has analyzed income tax positions taken for filing with the Internal Revenue Service and all state jurisdictions where it operates. The System believes that income tax filing positions will be sustained upon examination and does not anticipate any adjustments that would result in a material adverse effect on the System's consolidated financial statements.

(18) Commitments and Contingencies

The System has various noncancelable operating occupancy lease agreements and other operating lease agreements for computer, medical, communication, and other equipment. The terms of certain of the lease agreements contain lease escalation clauses, allow for renewal of the leases, and require the System to pay operating costs in addition to minimum base rent. Base rent expense for operating leases totaled $27,584 and $23,011 for the years ended December 31, 2013 and 2012, respectively.

(Dollars in thousands)

Aggregate future minimum lease payments required under operating lease agreements in effect on December 31, 2013 are as follows:

2014	$	23,102
2015		21,134
2016		19,233
2017		16,930
2018		15,349
Thereafter		62,178
	$	157,926

The System has incurred financing obligations relating to space lease agreements in a medical office building and a clinic. Under the guidance in ASC Topic 840, *Leases*, the System is considered the owner of the buildings. As of December 31, 2013 and 2012, the cost of the buildings and the related financing obligation are included in the accompanying consolidated balance sheets in property and equipment, net, and in other liabilities, respectively.

Future payments related to the financing transactions, which will be recorded as interest expense, are as follows:

2014	$	1,175
2015		1,188
2016		1,202
2017		745
2018		716

Approximately 43% of employees are represented by various collective bargaining arrangements, of whom approximately 12% are represented by arrangements that are pending or expire within one year.

Laws and regulations governing the Medicare program are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The System believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that would have a material effect on its consolidated financial statements. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare program.

The System is subject to various legal proceedings and claims that are incidental to its normal business activities. With respect to these actions, established reserves are fairly stated, though actual results could vary from the estimates and assumptions that were used.

(Continued)

(Dollars in thousands)

(19) Acquisitions

On June 1, 2013, the System acquired and became the sole owner of Courage Center and the Courage Foundation to create a unique model of care that will make a difference in the communities the System serves. Courage Center provides rehabilitation services and was integrated with an existing service line of the System. The Courage Foundation also was integrated into an existing foundation of the System. The results of Courage Center's operations, including total revenues of $16,809, have been included in the consolidated financial statements since the acquisition date.

On September 1, 2013, the System acquired and became the sole owner of Regina Medical Center and the Regina Foundation. Through the acquisition, the System will increase the healthcare services provided in the Regina Medical Center service area. Prior to becoming the sole owner of Regina Medical Center, the System had been a 25% member. Regina Medical Center is a hospital located outside the metropolitan area. The results of Regina Medical Center's operations, including total revenues of $18,186, have been included in the consolidated financial statements since the acquisition date.

There was no consideration transferred for the acquisitions, resulting in the System recording an inherent contribution received for the net assets acquired. The following table summarizes the recognized amounts of estimated fair value of the assets acquired and liabilities assumed at the respective acquisition dates.

		Total	Courage Center and Courage Foundation	Regina Medical Center and Regina Foundation
Current and other long-term assets	$	103,677	68,367	35,310
Property and equipment		67,334	28,411	38,923
Liabilities		(34,675)	(28,148)	(6,527)
Long-term debt		(31,475)	—	(31,475)
Previously held equity interest		(6,525)	—	(6,525)
Total identifiable net assets acquired	$	98,336	68,630	29,706
Unrestricted nonoperating contribution received in acquisition	$	76,611	49,503	27,108
Restricted contribution received in acquisition		21,725	19,127	2,598
Total contribution received in acquisition	$	98,336	68,630	29,706

(Dollars in thousands)

(20) Functional Expenses

The System provides health care services to residents within its geographic location. Expenses related to providing these services included in the consolidated statements of operations and changes in net assets are as follows:

		2013	2012
Healthcare services	$	2,781,237	2,652,270
General and administrative		505,889	498,069
	$	3,287,126	3,150,339

(21) Subsequent Events

The System has evaluated subsequent events from the consolidated balance sheet date through March 11, 2014, the date at which the consolidated financial statements were issued, and determined there are no other items to disclose.

KPMG LLP
4200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402

Independent Auditors' Report

The Board of Directors
Allina Health System:

We have audited the consolidated financial statements of Allina Health System as of and for the years ended December 31, 2013 and 2012, and have issued our report thereon dated March 11, 2014, which contained an unmodified opinion on those consolidated financial statements. Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information is presented for the purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Minneapolis, Minnesota
March 11, 2014

ALLINA HEALTH SYSTEM

Consolidating Balance Sheet

December 31, 2013

(Dollars in thousands)

Assets		Obligated Group	Other Nonobligated	Eliminations	Allina Health System
Current assets:					
Cash and cash equivalents	$	120,135	12,569	—	132,704
Short-term investments		314,560	498	—	315,058
Patient accounts receivable, less allowance for uncollectible accounts and charity care of $84,088		382,578	22,517	—	405,095
Inventories		52,893	253	—	53,146
Other current assets		81,027	(5,901)	—	75,126
		951,193	29,936	—	981,129
Investments		1,061,438	61,874	—	1,123,312
Investments with limited uses		20,076	132,479	—	152,555
Beneficial interests in net assets of Allina Foundations		200,273	—	(200,273)	—
Land, buildings, and equipment, net		1,034,283	16,487	—	1,050,770
Other assets		169,610	55,987	—	225,597
Total assets	$	3,436,873	296,763	(200,273)	3,533,363
Liabilities and Net Assets					
Current liabilities:					
Accounts payable and accrued expenses	$	407,418	12,698	—	420,116
Other current liabilities		117,138	—	—	117,138
		524,556	12,698	—	537,254
Long-term debt		614,806	—	—	614,806
Other liabilities		311,421	58,488	—	369,909
Total liabilities		1,450,783	71,186	—	1,521,969
Net assets:					
Unrestricted		1,778,176	79,260	—	1,857,436
Temporarily restricted		152,881	93,840	(147,796)	98,925
Permanently restricted		55,033	52,477	(52,477)	55,033
Total net assets		1,986,090	225,577	(200,273)	2,011,394
Total liabilities and net assets	$	3,436,873	296,763	(200,273)	3,533,363

See accompanying independent auditors' report.

ALLINA HEALTH SYSTEM

Consolidating Statement of Operations and Changes in Net Assets

Year ended December 31, 2013

(Dollars in thousands)

	Obligated Group	Other Nonobligated	Eliminations	Allina Health System
Revenues:				
Patient service revenue net of contractual adjustments	$ 3,131,065	160,472	—	3,291,537
Provision for bad debts	(85,520)	(5,061)	—	(90,581)
Net patient service revenue	3,045,545	155,411	—	3,200,956
Other operating revenue	198,594	33,467	(12,452)	219,609
Total revenues	3,244,139	188,878	(12,452)	3,420,565
Expenses:				
Salaries and benefits	1,996,164	100,622	—	2,096,786
Supplies and services	702,668	55,542	—	758,210
Depreciation and amortization	130,000	8,145	—	138,145
Financing costs	22,475	2,116	—	24,591
Services provided (to) by related divisions	(9,571)	22,023	(12,452)	—
State assessments and taxes	71,752	4,035	—	75,787
Utilities and maintenance	68,032	3,147	—	71,179
Other operating expenses	108,361	14,067	—	122,428
Total expenses	3,089,881	209,697	(12,452)	3,287,126
Operating income (loss)	154,258	(20,819)	—	133,439
Nonoperating gains (losses):				
Investment return	87,460	5,523	—	92,983
Gains on interest rate swap agreements	25,634	—	—	25,634
Contributions received in acquisitions	10,958	65,653	—	76,611
Other	(1,525)	(685)	—	(2,210)
Excess of revenues over expenses	276,785	49,672	—	326,457

(Continued)

ALLINA HEALTH SYSTEM

Consolidating Statement of Operations and Changes in Net Assets

Year ended December 31, 2013

(Dollars in thousands)

	Obligated Group	Other Nonobligated	Eliminations	Allina Health System
Unrestricted net assets:				
Excess of revenues over expenses	$ 276,785	49,672	—	326,457
Net assets released from restrictions for capital purposes	1,355	17,114	—	18,469
Transfer net assets released to Obligated Group	35,783	(35,783)	—	—
Amortization of unrealized loss on interest rate swap agreement	874	—	—	874
Net asset transfer to Obligated Group, net	70,605	(70,605)	—	—
Capital contributions to nonobligated group affiliates, net	(14,681)	14,681	—	—
Other	13,661	(3,946)	—	9,715
Increase (decrease) in unrestricted net assets	384,382	(28,867)	—	355,515
Temporarily restricted net assets:				
Contributions	1,355	17,627	—	18,982
Contributions received in acquisitions	404	11,784	—	12,188
Investment gain	255	9,025	—	9,280
Net assets released from restrictions	(1,355)	(28,900)	—	(30,255)
Change in beneficial interests in net assets of Allina Foundations	35,035	—	(35,035)	—
Other	703	(1,509)	—	(806)
Increase in temporarily restricted net assets	36,397	8,027	(35,035)	9,389
Permanently restricted net assets:				
Contributions for endowment funds	28	181	—	209
Contributions for endowment funds received in acquisitions	—	9,537	—	9,537
Investment gain	72	34	—	106
Change in beneficial interests in net assets of Allina Foundations	8,552	—	(8,552)	—
Other	600	(1,200)	—	(600)
Increase in permanently restricted net assets	9,252	8,552	(8,552)	9,252
Increase (decrease) in net assets	430,031	(12,288)	(43,587)	374,156
Net assets at beginning of year	1,556,059	237,865	(156,686)	1,637,238
Net assets at end of year	$ 1,986,090	225,577	(200,273)	2,011,394

See accompanying independent auditors' report.

ALLINA HEALTH SYSTEM

Consolidating Balance Sheet

December 31, 2012

(Dollars in thousands)

Assets		Obligated Group	Other Nonobligated	Eliminations	Allina Health System
Current assets:					
Cash and cash equivalents	$	143,384	4,021	—	147,405
Short-term investments		339,989	1,044	—	341,033
Patient accounts receivable, less allowance for uncollectible accounts and charity care of $59,398		359,831	25,930	—	385,761
Inventories		52,945	143	—	53,088
Other current assets		49,851	10,618	—	60,469
		946,000	41,756	—	987,756
Investments		925,837	30,084	—	955,921
Investments with limited uses		30,953	100,586	—	131,539
Beneficial interests in net assets of Allina Foundations		156,686	—	(156,686)	—
Land, buildings, and equipment, net		859,443	97,333	—	956,776
Other assets		132,177	44,555	—	176,732
Total assets	$	3,051,096	314,314	(156,686)	3,208,724
Liabilities and Net Assets					
Current liabilities:					
Accounts payable and accrued expenses	$	376,910	14,995	—	391,905
Other current liabilities		98,376	20,390	—	118,766
		475,286	35,385	—	510,671
Long-term debt		634,722	—	—	634,722
Other liabilities		385,029	41,064	—	426,093
Total liabilities		1,495,037	76,449	—	1,571,486
Net assets:					
Unrestricted		1,393,794	108,127	—	1,501,921
Temporarily restricted		116,484	85,813	(112,761)	89,536
Permanently restricted		45,781	43,925	(43,925)	45,781
Total net assets		1,556,059	237,865	(156,686)	1,637,238
Total liabilities and net assets	$	3,051,096	314,314	(156,686)	3,208,724

See accompanying independent auditors' report.

ALLINA HEALTH SYSTEM

Consolidating Statement of Operations and Changes in Net Assets

Year ended December 31, 2012

(Dollars in thousands)

	Obligated Group	Other Nonobligated	Eliminations	Allina Health System
Revenues:				
Patient service revenue net of contractual adjustments	$ 3,027,363	145,753	—	3,173,116
Provision for bad debts	(72,339)	(3,862)	—	(76,201)
Net patient service revenue	2,955,024	141,891	—	3,096,915
Other operating revenue	164,189	28,883	(11,614)	181,458
Total revenues	3,119,213	170,774	(11,614)	3,278,373
Expenses:				
Salaries and benefits	1,947,419	91,156	—	2,038,575
Supplies and services	672,456	49,337	—	721,793
Depreciation and amortization	124,988	7,576	—	132,564
Financing costs	22,946	3,043	—	25,989
Services provided (to) by related divisions	(7,169)	18,783	(11,614)	—
State assessments and taxes	66,594	4,258	—	70,852
Utilities and maintenance	59,130	4,193	—	63,323
Other operating expenses	86,479	10,764	—	97,243
Total expenses	2,972,843	189,110	(11,614)	3,150,339
Operating income (loss)	146,370	(18,336)	—	128,034
Nonoperating gains (losses):				
Investment return	86,079	2,634	—	88,713
Losses on interest rate swap agreements	(13,029)	—	—	(13,029)
Other	(2,118)	(1,119)	—	(3,237)
Excess (deficiency) of revenues over expenses	217,302	(16,821)	—	200,481

(Continued)

ALLINA HEALTH SYSTEM

Consolidating Statement of Operations and Changes in Net Assets

Year ended December 31, 2012

(Dollars in thousands)

	Obligated Group	Other Nonobligated	Eliminations	Allina Health System
Unrestricted net assets:				
Excess (deficiency) of revenues over expenses	$ 217,302	(16,821)	—	200,481
Net assets released from restrictions for capital purposes	2,327	4,933	—	7,260
Transfer net assets released to Obligated Group	5,105	(5,105)	—	—
Amortization of unrealized loss on interest rate swap agreement	874	—	—	874
Capital contributions to nonobligated group affiliates, net	(35,175)	35,175	—	—
Other	(190)	755	—	565
Increase in unrestricted net assets	190,243	18,937	—	209,180
Temporarily restricted net assets:				
Contributions	2,327	24,985	—	27,312
Investment gain	268	7,353	—	7,621
Net assets released from restrictions	(2,339)	(13,517)	—	(15,856)
Change in beneficial interests in net assets of Allina Foundations	22,830	—	(22,830)	—
Other	(548)	643	—	95
Increase in temporarily restricted net assets	22,538	19,464	(22,830)	19,172
Permanently restricted net assets:				
Contributions for endowment funds	39	721	—	760
Investment gain	65	15	—	80
Change in beneficial interests in net assets of Allina Foundations	(479)	—	479	—
Other	—	(1,215)	—	(1,215)
Decrease in permanently restricted net assets	(375)	(479)	479	(375)
Increase in net assets	212,406	37,922	(22,351)	227,977
Net assets at beginning of year	1,343,653	199,943	(134,335)	1,409,261
Net assets at end of year	$ 1,556,059	237,865	(156,686)	1,637,238

See accompanying independent auditors' report.