KAISER FOUNDATION HEALTH PLAN, INC. AND SUBSIDIARIES AND KAISER FOUNDATION HOSPITALS AND SUBSIDIARIES

Combined Financial Statements and
Credit Group Financial Information

December 31, 2012 and 2011

(With Independent Auditors' Reports Thereon)

KAISER FOUNDATION HEALTH PLAN, INC. AND SUBSIDIARIES AND KAISER FOUNDATION HOSPITALS AND SUBSIDIARIES

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KPMG LLP
Suite 1400
55 Second Street
San Francisco, CA 94105

Independent Auditors' Report

The Boards of Directors
Kaiser Foundation Health Plan, Inc.
and Kaiser Foundation Hospitals:

We have audited the accompanying combined financial statements of Kaiser Foundation Health Plan, Inc. and Subsidiaries (Health Plans) and Kaiser Foundation Hospitals and Subsidiaries (Hospitals), both of which are under common management and governance and comprise the combined balance sheets as of December 31, 2012 and 2011, and the related combined statements of operations and changes in net worth and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these combined 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 combined 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 combined 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 combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the combined 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 combined 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 combined 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 combined financial statements referred to above present fairly in all material respects, the combined financial position of Health Plans and Hospitals as of December 31, 2012 and 2011, 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

San Francisco, California
March 8, 2013

KAISER FOUNDATION HEALTH PLAN, INC. AND SUBSIDIARIES AND KAISER FOUNDATION HOSPITALS AND SUBSIDIARIES

Combined Balance Sheets

December 31, 2012 and December 31, 2011

(In millions)

Assets	2012	2011
Current assets:		
Cash and cash equivalents	$ 258	$ 195
Short-term investments	6,267	5,876
Securities lending collateral	1,323	1,364
Broker receivables	779	1,157
Accounts receivable - net	1,485	1,460
Inventories and other current assets	1,185	864
Total current assets	11,297	10,916
Long-term investments	19,470	15,831
Land, buildings, equipment, and software - net	21,615	19,753
Other long-term assets	431	199
Total assets	$ 52,813	$ 46,699
Liabilities and Net Worth		
Current liabilities:		
Accounts payable and accrued expenses	$ 2,663	$ 2,311
Medical claims payable	1,320	1,295
Due to associated medical groups	752	785
Payroll and related charges	1,419	1,455
Securities lending payable	1,323	1,364
Broker payables	1,180	1,458
Long-term debt subject to short-term remarketing arrangements - net	1,480	1,757
Other current debt	456	15
Other current liabilities	1,687	1,659
Total current liabilities	12,280	12,099
Long-term debt	5,752	3,939
Physicians' retirement plan liability	4,590	3,819
Pension and other retirement liabilities	13,749	12,258
Other long-term liabilities	2,158	2,089
Total liabilities	38,529	34,204
Net worth	14,284	12,495
Total liabilities and net worth	$ 52,813	$ 46,699

See accompanying notes to combined financial statements.

KAISER FOUNDATION HEALTH PLAN, INC. AND SUBSIDIARIES AND KAISER FOUNDATION HOSPITALS AND SUBSIDIARIES

Combined Statements of Operations and Changes in Net Worth

Twelve months ended December 31, 2012 and 2011

(In millions)

	2012		2011	
Revenues:				
Members' dues	$ 34,736	68.6%	$ 32,977	68.9%
Medicare	12,396	24.5	11,376	23.8
Copays, deductibles, fees, and other	3,499	6.9	3,517	7.3
Total operating revenues	50,631	100.0	47,870	100.0
Expenses:				
Medical services	24,657	48.7	22,989	48.0
Hospital services	13,797	27.3	13,225	27.6
Outpatient pharmacy and optical services	5,212	10.3	5,060	10.6
Other benefit costs	3,170	6.2	3,017	6.3
Total medical and hospital services	46,836	92.5	44,291	92.5
Health Plan administration	2,124	4.2	1,992	4.2
Total operating expenses	48,960	96.7	46,283	96.7
Operating income	1,671	3.3	1,587	3.3
Other income and expense:				
Investment income - net	1,060	2.1	534	1.1
Interest expense	(135)	(0.3)	(108)	(0.2)
Total other income and expense	925	1.8	426	0.9
Net income	2,596	5.1%	2,013	4.2%
Pension and other retirement liability charges	(1,482)		(2,018)	
Change in net unrealized gains on investments	610		(419)	
Change in restricted donations	16		—	
Change in noncontrolling interest	49		31	
Change in net worth	1,789		(393)	
Net worth at beginning of year	12,495		12,888	
Net worth at end of year	$ 14,284		$ 12,495	

See accompanying notes to combined financial statements.

KAISER FOUNDATION HEALTH PLAN, INC. AND SUBSIDIARIES AND KAISER FOUNDATION HOSPITALS AND SUBSIDIARIES

Combined Statements of Cash Flows

Twelve months ended December 31, 2012 and 2011

(In millions)

	2012	2011
Cash flows from operating activities:		
Net income	$ 2,596	$ 2,013
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation and amortization	1,677	1,627
Gain recognized on investments - net	(723)	(462)
Loss on land, buildings, equipment, and software - net	11	21
Loss (gain) on extinguishment of debt	2	(5)
Changes in assets and liabilities:		
Accounts receivable - net	(25)	(384)
Due from associated medical groups	—	4
Other assets	(336)	(24)
Accounts payable and accrued expenses	242	197
Medical claims payable	25	74
Due to associated medical groups	(30)	134
Payroll and related charges	(36)	105
Pension and other retirement liabilities	482	952
Other liabilities	178	210
Net cash provided from operating activities	4,063	4,462
Cash flows from investing activities:		
Additions to land, buildings, equipment, and software	(3,460)	(3,230)
Proceeds from sales of land, buildings, and equipment	14	3
Proceeds from investments	44,409	45,994
Investment purchases	(47,106)	(47,502)
Decrease (increase) in securities lending collateral	41	(221)
Broker receivables / payables and other - net	(231)	35
Physicians' retirement plan liability	324	249
Net cash used in investing activities	(6,009)	(4,672)
Cash flows from financing activities:		
Issuance of debt	2,300	552
Prepayment and repayment of debt	(315)	(580)
Increase (decrease) in securities lending payable	(41)	221
Change in restricted donations	16	—
Increase in noncontrolling interest	49	31
Net cash provided from (used in) financing activities	2,009	224
Net change in cash and cash equivalents	63	14
Cash and cash equivalents at beginning of year	195	181
Cash and cash equivalents at end of year	$ 258	$ 195
Supplemental cash flows disclosure:		
Cash paid for interest - net of capitalized amounts	$ 124	$ 124

See accompanying notes to combined financial statements.

(1) Description of Business

The accompanying combined financial statements include Kaiser Foundation Health Plan, Inc. and Subsidiaries (Health Plans) and Kaiser Foundation Hospitals and Subsidiaries (Hospitals). Health Plans and Hospitals are primarily not-for-profit corporations whose capital is available for charitable, educational, research, and related purposes. Health Plans are primarily health maintenance organizations and are generally exempt from federal and state income taxes. Membership at December 31, 2012 and 2011 was 9.1 million and 8.9 million, respectively. At both December 31, 2012 and 2011, the percentage of enrolled membership in California was approximately 77%. The principal operating subsidiary of Kaiser Foundation Hospitals is Kaiser Hospital Asset Management, Inc. (KHAM). The principal operating subsidiaries of Kaiser Foundation Health Plan, Inc. (Health Plan, Inc.) are:

Kaiser Foundation Health Plan of Colorado
Kaiser Foundation Health Plan of Georgia, Inc.
Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc.
Kaiser Foundation Health Plan of the Northwest
Kaiser Foundation Health Plan of Ohio
Kaiser Health Plan Asset Management, Inc. (KHPAM)

Independent Medical Groups (Medical Groups) cooperate with Health Plans and Hospitals in conducting the Kaiser Permanente Medical Care Program. Health Plans contract with Hospitals and the Medical Groups to provide or arrange hospital and medical services for members. Hospitals also contract with the Medical Groups for certain professional services. Contract payments to the Medical Groups represent a substantial portion of the expenses for medical services reported in the combined financial statements. Payments from Health Plans and Hospitals constitute substantially all of the revenues for the Medical Groups. Because the Medical Groups are independent and not controlled by Health Plans and Hospitals, their operations are not included in the combined financial statements.

At December 31, 2012 and 2011, the percentages of Health Plans' and Hospitals' total labor force covered under collective bargaining agreements were approximately 68% and 67%, respectively. At December 31, 2012, less than 1% of the workforce was covered under collective bargaining agreements that are scheduled to expire within one year. At December 31, 2012, approximately 3% of the workforce is working under temporarily extended contract terms.

Health Plans and Hospitals strive to improve the health and welfare of the communities they serve through their Direct Community Benefit Investment (DCBI) programs. DCBI expenditures provide funding for community benefit programs that serve communities through research, community-based health partnerships, direct health coverage for low-income families, and collaboration with community clinics, health departments, and public hospitals.

For the year ended December 31, 2012, DCBI expenditures (at cost, net of approximately $880 million of DCBI related revenue) were estimated at $2.0 billion, representing 3.9% of operating revenue. In comparison, for the year ended December 31, 2011, DCBI expenditures (at cost, net of $920 million of

DCBI related revenue) were $1.8 billion, representing 3.8% of operating revenue. The calculation of DCBI expenditures is based on Health Plans' and Hospitals' direct and indirect costs and the services provided by Health Plans and Hospitals under DCBI programs.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The financial statements of Health Plans and Hospitals are presented on a combined basis due to the operational interdependence of these organizations and because their governing boards and management are substantially the same. These combined financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). All material intercompany balances and transactions have been eliminated. Management has evaluated subsequent events through March 8, 2013, which is the date that these combined financial statements were issued.

(b) Cash and Cash Equivalents

Cash and cash equivalents include interest-bearing deposits purchased with an original or remaining maturity of three months or less. Cash and investments that are restricted per contractual or regulatory requirements are classified as long-term investments and excluded from cash and cash equivalents.

(c) Investments

Investments include equity, U.S. Treasury, government agencies, money market funds, and other marketable debt securities and are reported at fair value. Investments are categorized as current assets if they are intended to be available to satisfy current liabilities. Alternative investments are reported under the equity method. Certain investments are illiquid and are valued based on the most current information available. Other-than-temporary impairment and recognized gains and losses, which are recorded on the specific identification basis, and interest, dividend income, and income from equity method alternative investments are included in investment income - net. Health Plans and Hospitals have designated a portion of their investments for the physicians' retirement plan liability related to defined retirement benefits provided for physicians associated with certain Medical Groups. These investments are unrestricted assets of Health Plans and Hospitals. A portion of investment income that represents the expected return on the investments designated for the physicians' retirement plan has been recorded as a reduction in the provision for physicians' retirement plan benefits and is excluded from investment income - net, as described in the *Physicians' Retirement Plan* note.

Investments are regularly reviewed for impairment and a charge is recognized when the fair value is below cost basis and is judged to be other-than-temporary. In its review of assets for impairment that is deemed other-than-temporary, management generally follows the following guidelines:

- Substantially all investments are managed by outside investment managers who do not need Health Plans' or Hospitals' management preapproval for sales, therefore substantially all declines in value below cost are recognized as impairment that is other-than-temporary.
- For other securities, losses are recognized for known matters, such as bankruptcies, regardless of ownership period, and investments that have been continuously below book value for an extended period of time are evaluated for impairment that is other-than-temporary.

All other unrealized losses and all unrealized gains on investments are included as other changes in net worth.

Interest income is calculated under the effective interest method and included in investment income - net. Dividends are included in investment income - net on the ex-dividend date, which immediately follows the record date.

Health Plans' and Hospitals' investment transactions are recorded on a trade date basis.

Health Plans enters into purchase and sale To Be Announced (TBA) commitments of mortgage-backed securities within certain fixed-income investment portfolios, which are considered securities in themselves. Health Plans enters into transactions to sell TBA purchase commitments to third parties at current market values and concurrently acquires other purchase commitments for similar securities at later dates. Open TBA sale commitments represent a liability as Health Plans is obligated to deliver securities on contractual settlement dates. TBA commitments are marked to fair value on a recurring basis. The changes in the fair value of TBA commitments are included in changes in net worth.

(d) Securities Lending Collateral and Payable

Health Plans and Hospitals enter into securities lending agreements whereby certain securities from their portfolios are loaned to other institutions. Securities lent under such agreements remain in the portfolios of Health Plans and Hospitals. Health Plans and Hospitals receive a fee from the borrower under these agreements, which is recognized ratably over the period that the securities are lent. Collateral, primarily cash, is required at a rate of 102% of the fair value of securities lent and is carried as securities lending collateral. The obligation of Health Plans and Hospitals to return the cash collateral is carried as securities lending payable. The fair value of securities lending collateral is determined using level 1 or 2 inputs as appropriate, as defined in the *Fair Value Estimates* note. The fair value of the loaned securities is monitored on a daily basis, with additional collateral obtained or refunded as the fair value of the loaned securities fluctuates.

(e) Broker Receivables and Payables

Broker receivables and payables represent current amounts for unsettled securities sales or purchases.

(f) Land, Buildings, Equipment, and Software

Land, buildings, equipment, and software are stated at cost less accumulated depreciation and amortization. Interest is capitalized on facilities construction and internally developed software work in progress and is added to the cost of the underlying asset. Software, which includes internal and external costs incurred in developing or obtaining computer software for internal use, is capitalized. Qualifying costs incurred during the application development stage are capitalized and depreciation begins when the project is substantially complete and ready for its intended use. Software is amortized on a straight-line basis over periods generally ranging from 3 to 7 years. Buildings and equipment are depreciated on a straight-line basis over the estimated useful lives of the various classes of assets, generally ranging from 3 to 33 years.

Management evaluates alternatives for delivering services that may affect the current and future utilization of existing and planned assets and could result in an adjustment to the carrying values of such land, buildings, equipment, and software in the future. Management evaluates and records impairment losses, where applicable, based on expected utilization, projected cash flows, and recoverable values.

Maintenance and repairs are expensed as incurred. Major improvements that increase the estimated useful life of an asset are capitalized. Upon the sale or retirement of assets, recorded cost and related accumulated depreciation are removed from the accounts, and any gain or loss on disposal is reflected in operations.

Management estimates the fair value of asset retirement obligations that are conditional on a future event if the amount can be reasonably estimated. Estimates are developed through the identification of applicable legal requirements, identification of specific conditions requiring incremental cost at time of asset disposal, estimation of costs to remediate conditions, and estimation of remaining useful lives or date of asset disposal.

(g) Medical Claims Payable

The cost of health care services is recognized in the period in which services are provided. Medical claims payable consists of unpaid health care expenses, which include an estimate of the cost of services provided to Health Plans' members by third-party providers that have been incurred but not reported. The estimate for incurred but not reported claims is based on actuarial projections of costs using historical paid claims and other relevant data. Estimates are monitored and reviewed and, as settlements are made or estimates are revised, adjustments are reflected in current operations. Such estimates are subject to the impact of changes in the regulatory environment and economic conditions. Given the inherent variability of such estimates, the actual liability could differ

significantly from the amounts provided. While the ultimate amount of paid claims is dependent on future developments, management is of the opinion that the reserves for claims are adequate to cover such claims.

(h) Due to Associated Medical Groups

Due to associated medical groups consists primarily of unpaid medical expenses owed to the Medical Groups for medical services provided to members under medical services agreements with Health Plans. The cost of medical services is recognized by Health Plans in the period in which services are provided and is reflected as a component of medical and hospital services expenses.

(i) Self-Insured Risks

Costs associated with self-insured risks, primarily for professional, general, and workers' compensation liabilities, are charged to operations based upon actual and estimated claims. The portion estimated to be paid during the next year is included in current liabilities. The estimate for incurred but not reported self-insured claims is based on actuarial projections of costs using historical claims and other relevant data. Estimates are monitored and reviewed and, as settlements are made or estimates are revised, adjustments are reflected in current operations. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts provided. While the ultimate payments for self-insured claims are dependent on future developments, management is of the opinion that the reserve for self-insured risks is adequate. Insurance coverage, in excess of the per occurrence self-insured retention, has been secured with insurers or reinsurers for specified amounts for professional, general, and workers' compensation liabilities. Decisions relating to the limit and scope of the self-insured layer and the amounts of excess insurance purchased are reviewed each year, subject to management's analysis of actuarial loss projections and the price and availability of acceptable commercial insurance.

(j) Premium Deficiency Reserves

Premium deficiency reserves and the related expense are recognized when it is probable that expected future health care and maintenance costs under a group of existing contracts will exceed anticipated future premiums and reinsurance recoveries over the contract period. If applicable, premium deficiency reserves extending beyond one year are shown as a long-term liability. Expected investment income and interest expense are included in the calculation of premium deficiency reserves, as appropriate. The level at which contracts are grouped for evaluation purposes is generally by geographic region. The methods for making such estimates and for establishing the resulting reserves are reviewed and updated, and any resulting adjustments are reflected in current operations. At December 31, 2012 and 2011, premium deficiency reserves were $49 million and $34 million, respectively. Given the inherent variability of such estimates, the actual liability could differ significantly from the calculated amount.

(k) Derivative Financial Instruments

Derivative financial instruments are utilized primarily to manage the interest costs and the risk associated with changing interest rates. Health Plans and Hospitals enter into interest rate swaps with investment or commercial banks with significant experience with such instruments. In addition, certain investments include derivative products. The changes in the fair value of the derivative instruments are included in investment income - net and settlement costs are recorded as interest expense or investment income - net.

Derivative financial instruments are also utilized to manage the risk of holding equity investments, primarily to hedge downside volatility risk. Heath Plans and Hospitals enter into derivatives such as put-spread collars with similar investment or commercial banks noted above. The changes in fair value for these derivatives are included in investment income - net.

Derivative financial instruments are utilized by Health Plans' and Hospitals' investment portfolio managers. These instruments include futures, forwards, options, and swaps. The changes in fair value for these derivative financial instruments are included in investment income - net.

(l) Revenue Recognition

Members' dues revenue includes premiums from employer groups and individuals. Members' dues revenue is recognized over the period in which the members are entitled to health care services.

The majority of Health Plans' and Hospitals' Medicare revenue is received from the Medicare Advantage Program (Part C). Revenues for Part C include capitated payments, which vary based on health status, demographic status, and other factors. Medicare revenues also include accruals for estimates resulting from changes in health risk factor scores. Such accruals are recognized when the amounts become determinable and collection is reasonably assured. Part C revenue is finalized after all data is submitted to Medicare and the final settlement is made after the end of the year.

In addition, Medicare benefits include a voluntary prescription drug benefit (Part D). Revenues for Part D include capitated payments made from Medicare adjusted for health risk factor scores. Revenues also include amounts to reflect a portion of the health care costs for low-income Medicare beneficiaries and a risk-sharing arrangement to limit the exposure to unexpected expenses. Related accruals are recognized monthly based on cumulative experience and membership data. Part D revenue is finalized after all data is submitted to Medicare and the final settlement is made after the end of the year.

Medicare Part C and D revenue is subject to governmental audits and potential payment adjustments. The Centers for Medicare & Medicaid Services ("CMS") performs coding audits to validate the supporting documentation maintained by Health Plans and its care providers.

Certain Medicare revenues are paid under cost reimbursement plans based on pre-established rates, and the final settlement is made after the end of the year. Estimates of final settlements of the cost reports are recorded by the Health Plans.

Estimates of retrospective adjustments resulting from coding audits, cost reports, and other contractual adjustments are recorded in the time period in which members are entitled to health care services. Actual retrospective adjustments may differ from initial estimates.

The Health Information Technology for Economic and Clinical Health Act, part of the American Recovery and Reinvestment Act of 2009, created an incentive program, beginning in 2011, to promote the "meaningful use" of Electronic Health Records (EHR). To qualify, Medicare providers must attest to CMS that they are using certified EHR in a "meaningful" way by meeting objectives at established thresholds, as defined by CMS. Meaningful use revenues are recognized as grant revenue. Grant revenue is recognized when there is reasonable assurance that the grant will be received and that the organization will comply with the conditions attached to the grant. For the years ended December 31, 2012 and 2011, meaningful use revenues were $180 million and $236 million, respectively, and were recognized in copays, deductibles, fees, and other revenue. The amount recognized is based on management's best estimate and is subject to audit and potential retrospective adjustments.

Health Plans estimates accrued retrospective premium adjustments for certain group health insurance contracts based on claims experience and the provisions of the contract. Health Plans records accrued retrospective premiums as an adjustment to members' dues. For the years ended December 31, 2012 and 2011, the amount of net premiums written by Health Plans subject to the retrospective rating feature were $340 million and $540 million, respectively. During 2012 and 2011, revenue derived under these contracts was 1.0% and 1.6%, respectively, of total members' dues. During 2012 and 2011, retrospective dues adjustments were $(8) million and $(12) million, respectively.

Premiums collected in advance are deferred and recorded as dues collected in advance or Medicare payments received in advance. Revenue is adjusted to reflect estimates of collectability, including retrospective membership adjustment trends and economic conditions. Revenue and related receivables are exclusive of charity care. A portion of revenues derived under contracts with the United States Office of Personnel Management is subject to audit and potential retrospective adjustments.

Patient services revenue is included in copays, deductibles, fees, and other revenue and is recognized as services are rendered. Bad debt expense related to patient services revenue is calculated based on historical bad debt experience and recorded as an offset to patient services revenue (net of contractual allowances and discounts) in the statement of operations.

(m) Pension and Other Postretirement Benefits

Health Plans' and Hospitals' defined benefit pension and other postretirement benefit plans are actuarially evaluated and involve various assumptions. Critical assumptions include the discount rate and the expected rate of return on plan assets (for pension), and the rate of increase for health care costs (for postretirement benefit plans other than pension), which are important elements of expense and/or liability measurement. Other assumptions involve demographic factors such as retirement age, mortality, turnover, and the rate of compensation increases. Health Plans and Hospitals evaluate assumptions annually or when significant plan amendments occur and modify them as appropriate. Pension and other postretirement costs are allocated over the service period of the employees in the plans.

Health Plans and Hospitals use a discount rate to determine the present value of the future benefit obligations. The discount rate is established based on rates available for high-quality fixed-income debt securities at the measurement date whose maturity dates match the expected cash flows of the retirement plans.

Differences between actual and expected plan experience and changes in actuarial assumptions, in excess of a 10% corridor around the larger of plan assets or plan liabilities, are recognized into benefits expense over the expected average future service of active participants. Prior service costs and credits arise from plan amendments and are amortized into postretirement benefits expense over the expected average future service to full eligibility of active participants.

(n) Donations and Grants Made or Received

Donations and grants made are recognized at fair value in the period in which a commitment is made, provided the payment of the donation or grant is probable and the amount is determinable. Donations or grants received, including research grants, are recognized at fair value in the period the donation or grant was committed unconditionally by the grantor or in the period the donation or grant requirements are met, if later.

(o) Inventory

Inventories, consisting primarily of pharmaceuticals and supplies, are carried at the lower of cost (generally first-in, first-out or weighted average price) or market.

(p) Use of Estimates

The preparation of the combined financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts. Allowance for uncollectible accounts receivable; estimated fair value of investments; Medicare revenue accruals; Medicare reserves; incurred but not reported medical claims; physicians' retirement plan liabilities; pension and other retirement liabilities; premium deficiency reserves; self-insured professional liabilities; self-insured general and workers' compensation liabilities; land, buildings, equipment, and software impairment and useful lives; and investment impairment represent significant estimates. Actual results could differ materially from those estimates. With respect to employee benefit plans, as occurs from time to time, negotiations with labor partners may result in changes to compensation and benefits. These changes are reflected in the financial statements as appropriate when agreements are finalized.

(q) Reclassifications

Certain reclassifications have been made in the financial statements to conform 2011 information to the 2012 presentation.

(r) Recently Issued Accounting Standards

During 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-07 *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities* (a consensus of the FASB Emerging Issues Task Force). This guidance was adopted by Health Plans and Hospitals in 2012 and did not have a significant effect on the combined financial statements.

During 2011, the FASB issued ASU No. 2011-04 *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*. This guidance was adopted by Health Plans and Hospitals in 2012 and did not have a significant effect on the combined financial statements.

During 2011, the FASB issued ASU No. 2011-06 *Other Expenses (Topic 720) Fees Paid to the Federal Government by Health Insurers* (a consensus of the FASB Emerging Issues Task Force). This guidance will be adopted by Health Plans and Hospitals in 2014. Management is evaluating the effect of this guidance on the combined financial statements.

(3) Fair Value Estimates

The carrying amounts reported in the balance sheets for cash and cash equivalents, securities lending collateral, broker receivables, accounts receivable - net, accounts payable and accrued expenses, medical claims payable, due to associated medical groups, payroll and related charges, securities lending payable, and broker payables approximate fair value.

Investments, other than alternative investments, as discussed in the *Investments* note, are reported at fair value. The fair values of investments are based on quoted market prices, if available, or estimated using quoted market prices for similar investments. If listed prices or quotes are not available, fair value is based upon other observable inputs or models that primarily use market-based or independently sourced market parameters as inputs. In addition to market information, models also incorporate transaction details such as maturity. Fair value adjustments, including credit, liquidity, and other factors, are included, as appropriate, to arrive at a fair value measurement. Certain investments are illiquid and are valued based on the most current information available, which may be less current than the date of these financial statements.

The carrying value of alternative investments, which include absolute return and private equity, is reported under the equity method, which management believes to approximate fair value. The fair values of alternative investments have been estimated by management based on all available data, including information provided by fund managers or the general partners. The underlying securities within absolute return investments are typically valued using quoted prices for identical or similar instruments within active and inactive markets. The underlying holdings within private equity investments are valued based on recent transactions, operating results, and industry and other general market conditions.

Health Plans and Hospitals utilize a three-level valuation hierarchy for fair value measurements. An instrument's categorization within the hierarchy is based upon the lowest level of input that is significant to the fair value measurement. For instruments classified in level 1 of the hierarchy, valuation inputs are quoted prices for identical instruments in active markets at the measurement date. For instruments classified in level 2 of the hierarchy, valuation inputs are directly observable but do not qualify as level 1 inputs. Examples of level 2 inputs include: quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in inactive markets; other observable inputs such as interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates; and market-correlated inputs that are derived principally from or corroborated by observable market data. For instruments classified in level 3 of the hierarchy, valuation inputs are unobservable inputs for the instrument. Level 3 inputs incorporate assumptions about the factors that market participants would use in pricing the instrument.

The fair value of long-term debt is based on level 2 inputs for debt with similar risk, terms, and remaining maturities. At December 31, 2012 and 2011, the carrying amount of long-term debt totaled $7.6 billion and $5.7 billion, respectively. At December 31, 2012 and 2011, the estimated fair value of long-term debt was approximately $7.9 billion and $5.8 billion, respectively.

At December 31, 2012 and 2011, Health Plans and Hospitals held derivative financial instruments including interest rate swaps, as well as futures, swaps, and forwards held within investment portfolios. The estimated fair values of derivative instruments were determined using level 2 inputs, including available market information and valuation methodologies, primarily discounted cash flows. Additional description and the fair market value of derivative instruments are contained in the *Derivative Instruments* note.

(4) Investments

At December 31, 2012, the estimated fair value of investments by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
Investments:				
Current:				
Equity:				
U.S. large capitalization	$ 14	$ —	$ —	$ 14
Debt securities issued by the U.S. and U.S. government corporations and agencies	—	2,275	—	2,275
Debt securities issued by U.S. states and political subdivisions of states	—	148	—	148
Foreign government debt securities	—	19	—	19
Corporate debt securities	—	2,244	—	2,244
Residential mortgage-backed securities, including Fannie Mae and Freddie Mac	—	649	—	649
Commercial mortgage-backed securities	—	317	—	317
Other asset-backed securities	—	283	—	283
Short-term investment funds	—	318	—	318
Total	$ 14	$ 6,253	$ —	$ 6,267

At December 31, 2012, the estimated fair value of investments by level was as follows (in millions) (continued):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
Investments:				
Noncurrent:				
Equity:				
U.S. large capitalization	$ 2,029	$ 6	$ —	$ 2,035
U.S. small-medium capitalization	875	7	—	882
International developed markets	1,302	589	17	1,908
Global developed markets	464	996	1	1,461
Emerging markets	349	296	—	645
Debt securities issued by the U.S. and U.S. government corporations and agencies	—	1,286	—	1,286
Debt securities issued by U.S. states and political subdivisions of states	—	206	—	206
Emerging market debt securities	—	1,000	—	1,000
Foreign government debt securities	—	468	5	473
Corporate debt securities	—	2,856	4	2,860
Residential mortgage-backed securities, including Fannie Mae and Freddie Mac	—	1,518	—	1,518
Commercial mortgage-backed securities	—	183	14	197
Other asset-backed securities	—	386	—	386
Short-term investment funds	—	692	—	692
Other	10	312	2	324
Alternative investments:				
Absolute return	—	1,427	1,205	2,632
Private equity	—	—	965	965
Total	$ 5,029	$ 12,228	$ 2,213	$ 19,470

At December 31, 2011, the estimated fair value of investments by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
Investments:				
Current:				
Equity:				
U.S. large capitalization	$ 21	$ —	$ —	$ 21
Debt securities issued by the U.S. and U.S. government corporations and agencies	—	1,646	—	1,646
Debt securities issued by U.S. states and political subdivisions of states	—	191	—	191
Foreign government debt securities	—	30	—	30
Corporate debt securities	—	2,220	—	2,220
Residential mortgage-backed securities, including Fannie Mae and Freddie Mac	—	790	—	790
Commercial mortgage-backed securities	—	278	—	278
Other asset-backed securities	—	281	—	281
Short-term investment funds	—	419	—	419
Total	$ 21	$ 5,855	$ —	$ 5,876

At December 31, 2011, the estimated fair value of investments by level was as follows (in millions) (continued):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
Investments:				
Noncurrent:				
Equity:				
U.S. large capitalization	$ 1,747	$ —	$ —	$ 1,747
U.S. small-medium capitalization	1,114	—	—	1,114
International developed markets	803	375	8	1,186
Global developed markets	175	779	—	954
Emerging markets	90	215	—	305
Debt securities issued by the U.S. and U.S. government corporations and agencies	—	1,417	—	1,417
Debt securities issued by U.S. states and political subdivisions of states	—	183	—	183
Emerging market debt securities	—	681	—	681
Foreign government debt securities	—	337	—	337
Corporate debt securities	—	2,395	—	2,395
Residential mortgage-backed securities, including Fannie Mae and Freddie Mac	—	1,747	—	1,747
Commercial mortgage-backed securities	—	225	16	241
Other asset-backed securities	—	340	1	341
Short-term investment funds	—	822	—	822
Other	6	85	3	94
Alternative investments:				
Absolute return	—	952	697	1,649
Private equity	—	—	618	618
Total	$ 3,935	$ 10,553	$ 1,343	$ 15,831

At December 31, 2012, debt and equity securities available-for-sale were as follows (in millions):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Equity:				
U.S. large capitalization	$ 1,684	$ 365	$ —	$ 2,049
U.S. small-medium capitalization	722	160	—	882
International developed markets	1,576	339	(7)	1,908
Global developed markets	1,120	341	—	1,461
Emerging markets	569	76	—	645
Debt securities issued by the U.S. and U.S. government corporations and agencies	3,520	41	—	3,561
Debt securities issued by U.S. states and political subdivisions of states	306	48	—	354
Emerging market debt securities	929	71	—	1,000
Foreign government debt securities	441	51	—	492
Corporate debt securities	4,754	350	—	5,104
Residential mortgage-backed securities, including Fannie Mae and Freddie Mac	2,103	64	—	2,167
Commercial mortgage-backed securities	490	24	—	514
Other asset-backed securities	662	7	—	669
Short-term investment funds	1,010	—	—	1,010
Other	299	25	—	324
Total	$ 20,185	$ 1,962	$ (7)	$ 22,140

At December 31, 2011, debt and equity securities available-for-sale were as follows (in millions):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Equity:				
U.S. large capitalization	$ 1,470	$ 298	$ —	$ 1,768
U.S. small-medium capitalization	879	235	—	1,114
International developed markets	1,069	118	(1)	1,186
Global developed markets	809	145	—	954
Emerging markets	293	12	—	305
Debt securities issued by the U.S. and U.S. government corporations and agencies	3,000	63	—	3,063
Debt securities issued by U.S. states and political subdivisions of states	341	33	—	374
Emerging market debt securities	662	21	(2)	681
Foreign government debt securities	345	22	—	367
Corporate debt securities	4,347	268	—	4,615
Residential mortgage-backed securities, including Fannie Mae and Freddie Mac	2,441	96	—	2,537
Commercial mortgage-backed securities	499	20	—	519
Other asset-backed securities	615	7	—	622
Short-term investment funds	1,230	11	—	1,241
Other	95	—	(1)	94
Total	$ 18,095	$ 1,349	$ (4)	$ 19,440

At December 31, available-for-sale debt securities by contractual maturity and asset-backed debt securities were as follows (in millions):

	2012		2011	
	Amortized cost	Fair value	Amortized cost	Fair value
Due in one year or less	$ 1,971	$ 1,991	$ 2,004	$ 2,022
Due after one year through five years	5,859	6,006	5,116	5,222
Due after five years through ten years	1,352	1,447	1,116	1,172
Due after ten years	2,076	2,401	1,784	2,019
Residential mortgage-backed securities, including Fannie Mae and Freddie Mac	2,104	2,167	2,441	2,537
Commercial mortgage-backed securities	490	514	499	519
Other asset-backed securities	662	669	615	622
Total	$ 14,514	$ 15,195	$ 13,575	$ 14,113

For the year ended December 31, 2012, the reconciliation of investments with fair value measurements using significant unobservable inputs (level 3) was as follows (in millions):

	Equity securities	Debt securities	Alternative investments	Total
Beginning balance	$ 8	$ 20	$ 1,315	$ 1,343
Transfers out of level 3	—	(1)	—	(1)
Total net gains:				
Realized	—	1	146	147
Unrealized	—	1	(1)	—
Purchases	16	9	796	821
Sales	(6)	—	(84)	(90)
Settlements	—	(5)	(2)	(7)
Ending balance	$ 18	$ 25	$ 2,170	$ 2,213
Total realized and unrealized year-to-date net gains related to assets held at December 31, 2012	$ —	$ 2	$ 145	$ 147

For the year ended December 31, 2011, the reconciliation of investments with fair value measurements using significant unobservable inputs (level 3) was as follows (in millions):

	Equity securities	Debt securities	Alternative investments	Total
Beginning balance	$ 2	$ 25	$ 677	$ 704
Transfers into level 3	10	—	2	12
Total net gains:				
Realized	—	1	91	92
Unrealized	—	(1)	1	—
Purchases	5	2	756	763
Sales	(9)	—	(204)	(213)
Settlements	—	(7)	(8)	(15)
Ending balance	$ 8	$ 20	$ 1,315	$ 1,343
Total realized and unrealized year-to-date net gains related to assets held at December 31, 2011	$ —	$ 1	$ 90	$ 91

Transfers between fair value input levels, if any, are recorded at the end of the reporting period. During the years ended December 31, 2012 and 2011, there were no transfers between assets with inputs with quoted prices in active markets for identical assets (level 1) and assets with inputs with significant other observable inputs (level 2).

Noncurrent investments include specific funds held in trust accounts related to collateral requirements for certain reinsurance agreements. At December 31, 2012 and 2011, the values of these funds were $31 million and $25 million, respectively.

Absolute return investments use advanced investment strategies, including derivatives, to generate positive long-term risk adjusted returns. Private equity investments consist of funds that make direct investments in private companies. Management meets with alternative investment fund managers periodically to assess portfolio performance and reporting and exercises oversight over fund managers. At December 31, 2012, Hospitals had original commitments related to alternative investments of $2.0 billion, of which $1.1 billion was invested, leaving $875 million of remaining commitments. At December 31, 2011, Hospitals had original commitments related to alternative investments of $1.5 billion, of which $635 million was invested, leaving $833 million of remaining commitments.

For the years ended December 31, investment income - net was comprised of the following (in millions):

	2012	2011
Other-than-temporary impairment	$ (258)	$ (686)
Recognized gains	922	1,177
Recognized losses	(152)	(277)
Income from equity method alternative investments	203	105
Interest, dividends, and other income - net	631	469
Derivative income (loss)	16	(3)
Total investment income - net	1,362	785
Less investment income included in operating income	(302)	(251)
Investment income - net	$ 1,060	$ 534

For the years ended December 31, 2012 and 2011, Health Plans and Hospitals recorded impairment of certain investments in accordance with the policy described in the note *Summary of Significant Accounting Policies - Investments*. During 2012 and 2011, there was no impairment of alternative investments.

Absolute return and private equity investments include redemption restrictions. Absolute return investments require 10 to 90 day written notice of intent to withdraw and are often subject to the approval and capital requirements of the fund manager. Absolute return investments of $150 million are subject to a 24 month lock-up period. Private equity agreements do not include provisions for redemption. Distributions will be received as the underlying investments of the funds are liquidated, which is expected over the next 11 years.

(5) Derivative Instruments

(a) Interest Rate Swaps

At December 31, 2012 and 2011, Health Plans and Hospitals had 11 agreements to manage interest rate fluctuations (Interest Rate Swaps) with a total notional amount of $1.2 billion for each year. At December 31, 2012 and 2011, the fair values of these agreements were $(301) million and $(303) million, respectively, and were recorded in other long-term liabilities. For the years ended December 31, 2012 and 2011, Health Plans and Hospitals recorded approximately $37 million and $35 million in interest expense relating to the Interest Rate Swaps, respectively. For the years ended December 31, 2012 and 2011, net changes in market values totaled $2 million and $(146) million, respectively, and were recorded in investment income - net.

(b) Derivatives Held in Investment Portfolios

At December 31, 2012 and 2011, Health Plans' and Hospitals' portfolio managers held $(10) million and $9 million, respectively, of futures, forwards, options, and swaps to attempt to protect investments against volatility. For the years ended December 31, 2012 and 2011, net changes in

market values totaled $(27) million and $55 million, respectively, and were recorded in investment income - net. For the years ended December 31, 2012 and 2011, gains resulting from derivative settlements totaled $41 million and $87 million, respectively, and were recorded in investment income - net.

(c) Information on Derivative Gain (Loss) and Fair Value

Information on Derivative Gain (Loss) Mark-to-Market Valuation Recognized in Income

(In millions)

Derivatives not designated as hedging instruments	Statement of operations category	Gain (loss) recognized in income on derivatives for years ended December 31, 2012	2011
Interest rate swaps - related to debt	Investment income - net	$ 2	$ (146)
Interest rate swaps - other	Investment income - net	2	(1)
Options, rights, and warrants	Investment income - net	1	(1)
Futures and forwards	Investment income - net	(30)	57
		$ (25)	$ (91)

Information on Derivative Settlement Costs Recognized in Income

(In millions)

Derivatives not designated as hedging instruments	Statement of operations category	Gain (loss) recognized in income on derivatives for years ended December 31, 2012	2011
Interest rate swaps - related to debt	Interest expense	$ (37)	$ (35)
Interest rate swaps - other	Investment income - net	5	(6)
Futures and forwards	Investment income - net	44	92
Options, rights, and warrants	Investment income - net	(8)	1
		$ 4	$ 52

Information on Fair Value of Derivative Instruments – Assets

(In millions)

Derivatives not designated as hedging instruments	Balance sheet category	Fair value at December 31, 2012	Fair value at December 31, 2011
Interest rate swaps - other	Other long-term investments	$ 2	$ —
Futures and forwards	Other long-term investments	47	27
Options, rights, and warrants	Other long-term investments	2	1
		$ 51	$ 28

Information on Fair Value of Derivative Instruments – Liabilities

(In millions)

Derivatives not designated as hedging instruments	Balance sheet category	Fair value at December 31, 2012	Fair value at December 31, 2011
Interest rate swaps - related to debt	Other long-term liabilities	$ 301	$ 303
Interest rate swaps - other	Other long-term liabilities	2	1
Futures and forwards	Other long-term liabilities	58	16
Options, rights, and warrants	Other long-term liabilities	1	2
		$ 362	$ 322

These derivatives contain reciprocal provisions whereby if Health Plans' and Hospitals' or the counterparties' credit rating was to decline to certain levels, provisions would be triggered requiring Health Plans and Hospitals or the counterparties to provide certain collateral. At December 31, 2012 and 2011, no collateral was required to be posted by either Health Plans and Hospitals or the counterparties.

(6) Accounts Receivable - net

At December 31, accounts receivable - net were as follows (in millions):

	2012	2011
Patient services	$ 316	$ 324
Members' dues	593	546
Medicare	403	396
Other	297	334
	1,609	1,600
Allowances for bad debt	(124)	(140)
Total	$ 1,485	$ 1,460

(7) Inventories and Other Current Assets

At December 31, inventories and other current assets were as follows (in millions):

	2012	2011
Inventories – net	$ 766	$ 648
Prepaid expenses	407	202
Other	12	14
Total	$ 1,185	$ 864

(8) Land, Buildings, Equipment, and Software - net

At December 31, land, buildings, equipment, and software - net were as follows (in millions):

	2012	2011
Land	$ 1,646	$ 1,562
Buildings and improvements	24,754	22,180
Furniture, equipment, and software	8,644	8,333
Construction and software development in progress	3,535	3,462
	38,579	35,537
Accumulated depreciation and amortization	(16,964)	(15,784)
Total	$ 21,615	$ 19,753

Health Plans and Hospitals capitalize interest costs on borrowings incurred during the construction, upgrade, or development of qualifying assets. Capitalized interest is added to the cost of the underlying assets and is depreciated or amortized over the useful lives of the assets. During 2012 and 2011, Health Plans and Hospitals capitalized $94 million and $71 million of interest in connection with various capital projects, respectively.

Asset retirement obligations relate primarily to the following: leased building restoration, building materials containing asbestos, leaded wall shielding, storage tanks (above ground and below ground), chillers or cooling tower chemicals, mercury in large fixed-components, and hard drives requiring data wiping prior to disposal. At December 31, 2012 and 2011, the liability for asset retirement obligations was $83 million and $80 million, respectively. During 2012 and 2011, amortization and other adjustments of the associated assets totaled $5 million and $3 million, respectively. At December 31, 2012 and 2011, the unamortized asset related to this retirement obligation was $17 million and $16 million, respectively.

(9) Medical Claims Payable

For the years ended December 31, activity in the liability for medical claims payable was as follows (in millions):

	2012	2011
Balances at January 1	$ 1,295	$ 1,221
Incurred related to:		
Current year	6,926	6,622
Prior years	(109)	(138)
Total incurred	6,817	6,484
Paid related to:		
Current year	5,831	5,558
Prior years	961	852
Total paid	6,792	6,410
Balances at December 31	$ 1,320	$ 1,295

Amounts incurred related to prior years vary from previously estimated liabilities as the claims are ultimately adjudicated and paid. Liabilities are reviewed and revised as information regarding actual claims payments becomes known. Negative amounts reported for incurred related to prior years result from claims being adjudicated and paid for amounts less than originally estimated.

(10) Other Liabilities

At December 31, other current liabilities were as follows (in millions):

	2012	2011
Self-insured risks	$ 397	$ 350
Dues collected in advance	510	449
Medicare liabilities	80	162
Postretirement benefits	99	83
Physicians' retirement plan liability	134	124
TBA commitments	160	255
Other	307	236
Total	$ 1,687	$ 1,659

At December 31, other long-term liabilities were as follows (in millions):

	2012	2011
Self-insured risks	$ 1,288	$ 1,249
Other	870	840
Total	$ 2,158	$ 2,089

(11) Debt

At December 31, long-term debt was as follows (in millions):

	2012	2011
Tax-exempt and taxable revenue bonds:		
0.10% to 3.90% variable rate due through 2052	$ 3,731	$ 3,555
3.25% to 5.38% fixed rate due through 2045	3,955	2,154
Others at various rates due through 2026	2	2
Total	$ 7,688	$ 5,711
Other current debt:		
Commercial paper	$ 100	$ —
Current portion of long-term debt	356	15
Long-term debt subject to short-term remarketing arrangements - net	1,480	1,757
Long-term debt classified as a long-term liability	5,752	3,939
Total	$ 7,688	$ 5,711

During 2012, Hospitals issued $1.0 billion of taxable bonds and $1.0 billion of tax-exempt revenue bonds, of which $908 million was tax-exempt fixed-rate debt and $100 million was tax-exempt variable rate debt. Additionally, during 2012, Hospitals remarketed $200 million of put bonds and the transaction was accounted for as an extinguishment and reoffering. During 2012, Hospitals retired $15 million of bonds that matured in 2012 and refunded $100 million of fixed-rate bonds using taxable commercial paper proceeds.

During 2011, Hospitals remarketed $347 million of put bonds and the transaction was accounted for as an extinguishment and reoffering. Additionally, during 2011 Hospitals issued $205 million of tax-exempt revenue bonds that mature in 2031 and retired $205 million of fixed-rate bonds. Hospitals retired $14 million of bonds that matured in 2011 and paid $14 million to extinguish $19 million of variable rate bonds during the year.

At December 31, 2012 and 2011, at the holder's option, repurchase of variable rate demand bonds totaling $3.6 billion and $3.5 billion may be required at earlier than stated maturity, respectively. These bonds may be remarketed rather than repurchased. To date, all such bonds have been remarketed. Health Plans and Hospitals have provided self liquidity for the variable rate demand bonds with put options. Additionally, at December 31, 2012 and 2011, management had the ability to finance the acquisition of up to $1.5 billion of any unremarketed bonds that are put, using available credit facilities. At December 31, 2012 and 2011, $1.5 billion and $1.8 billion of these variable rate demand bonds were classified in current liabilities, respectively. These amounts were net of $1.5 billion of available long-term credit facilities.

Variable rates for these bonds are determined by market rates for similar obligations. At December 31, 2012 and 2011, $79 million and $34 million of the above tax-exempt fixed-rate revenue bonds represented a net unamortized premium balance, respectively.

Scheduled principal payments for each of the next five years and thereafter considering obligations subject to short-term remarketing as due according to their long-term amortization schedule were as follows (in millions):

2013	$	456
2014		158
2015		30
2016		121
2017		18
Thereafter		6,826
Total	$	7,609

At December 31, 2012, Hospitals had certain bonds that require mandatory tender by the holder on a date certain as follows: $75 million in 2014, $205 million in 2016, and $275 million in 2017. Hospitals intends to remarket these bonds until final maturity of the bonds.

Credit Facility

Hospitals' credit facility of $1.5 billion terminates in August 2016. Various interest rate options are available under this facility. Any revolving borrowings mature on the termination date. Hospitals pays facility fees, which range from 0.065% to 0.125% per annum, depending upon Hospitals' long-term senior unsecured debt rating. At December 31, 2012, the facility fee was at an annual rate of 0.08%. At December 31, 2012 and 2011, no amounts were outstanding under this credit facility.

Hospitals' revolving credit facility contains financial covenants. Under the terms of this facility, Hospitals is required to maintain minimum debt service coverage, as defined. Hospitals is also required to maintain a ratio of total debt to capital, as defined.

Taxable Commercial Paper Program

Hospitals maintains a commercial paper program providing for the issuance of up to $1.5 billion in aggregate maturity value of short-term indebtedness. The commercial paper is issued in denominations of $100,000 and will bear such interest rates, if interest-bearing, or will be sold at such discount from their face amounts, as agreed upon by Hospitals and the dealer acting in connection with the commercial paper program. The commercial paper may be issued with varying maturities up to a maximum of 270 days from the date of issuance. At December 31, 2012 and 2011, $100 million and $0 of commercial paper was outstanding under this program and is included within other current debt, respectively.

(12) Pension Plans

(a) Defined Benefit Plan

Health Plans and Hospitals have a defined benefit pension plan (Plan) covering substantially all their employees. Benefits are based on age at retirement, years of credited service, and average compensation for a specified period prior to retirement. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future.

For financial reporting purposes, the projected unit credit method is used. At December 31, 2012 and 2011, substantially all pension fund assets were held in a group trust. At December 31, 2012 and 2011, the trust's assets are invested in fixed-income and equity securities, with approximately 11% and 9% of trust assets, net of liabilities, invested in alternative investments.

At December 31, the funded status of the plan was as follows (in millions):

	2012	2011
Change in projected benefit obligation (PBO):		
Benefit obligation at beginning of year	$ 10,692	$ 8,558
Service cost	819	679
Interest cost	548	480
Plan amendments	1	(29)
Net actuarial loss	2,100	1,234
Benefits paid	(288)	(230)
Benefit obligation at end of year	$ 13,872	$ 10,692
Accumulated benefit obligation at end of year	$ 10,348	$ 7,978
Change in Health Plans' and Hospitals' share of trust assets:		
Fair value of plan assets at beginning of year	$ 5,452	$ 4,779
Actual return on plan assets	782	208
Contributions	1,383	695
Benefits paid	(288)	(230)
Fair value of plan assets at end of year	$ 7,329	$ 5,452
Funded status	$ (6,543)	$ (5,240)
Amounts recognized in the balance sheet consist of:		
Other long-term assets	$ —	$ —
Current liabilities	—	—
Pension and other retirement liabilities	(6,543)	(5,240)
	$ (6,543)	$ (5,240)
Amounts recognized in net worth:		
Net actuarial loss	$ 5,727	$ 4,227
Prior service cost	35	49
	$ 5,762	$ 4,276

The measurement date used to determine pension valuations was December 31.

For the years ended December 31, pension expense was as follows (in millions):

	2012	2011
Service cost	$ 819	$ 679
Interest cost	548	480
Expected return on plan assets	(461)	(401)
Amortization of net actuarial loss	279	169
Amortization of prior service cost	15	17
Net pension expense	1,200	944
Other changes in plan assets and PBO recognized in net worth:		
Net actuarial loss	1,779	1,426
Prior service cost (credit)	1	(29)
Amortization of net actuarial loss	(279)	(169)
Amortization of prior service cost	(15)	(17)
Total recognized in net worth	1,486	1,211
Total recognized in net periodic benefit cost and net worth	$ 2,686	$ 2,155

During 2013, $377 million and $15 million in estimated net actuarial loss and prior service cost, respectively, will be amortized from net worth into net pension expense.

Actuarial assumptions used were as follows:

	2012	2011
Weighted average discount rate at January 1 for calculating pension expense	5.10%	5.60%
Weighted average discount rate for calculating December 31 PBO	4.35%	5.10%
Weighted average salary scale for calculating pension expense and December 31 PBO	4.60%	4.60%
Expected long-term rate of return on plan assets for calculating pension expense	7.75%	7.75%

During 2013, management expects to contribute approximately $852 million to its pension plan.

The following benefit payments, which reflect expected future service, are expected to be paid (in millions):

2013	$	394
2014		438
2015		482
2016		533
2017		579
2018 - 2022		3,390

Explanation of Investment Strategies and Policies

A total return investment approach is employed for the defined benefit pension plan whereby the plan invests in a mix of equity, fixed-income, and alternative asset classes to maximize the long-term return of plan assets for a prudent level of risk. The intent of this strategy is to minimize plan expenses by outperforming plan liabilities over the long run. Risk tolerance is established through consideration of plan liabilities, plan funded status, and corporate financial condition. The investment portfolio will consist over time of a varying but diversified blend of equity, fixed-income, and alternative investments. Diversification includes such factors as geographic location, equity capitalization size and style, placement in the capital structure, and security type. Investment risk is measured and monitored on an ongoing basis through annual liability measurements, periodic asset/liability studies, and quarterly investment portfolio reviews. The Plan's investment policy has restrictions relating to credit quality, industry/sector concentration, duration, concentration of ownership, and use of derivatives.

Capital Market Assumption Methodology

To determine the long-term rate of return assumption for plan assets, management incorporates historical relationships among the various asset classes and subclasses to be accessed over the investment horizon. Management's intent is to maximize portfolio efficiency. This will be accomplished by seeking the highest returns prudently available among the available asset classes. Overall portfolio volatility is managed through diversification among asset classes. Current market factors such as inflation and interest rates are evaluated before long-term capital market assumptions are determined. From time to time, management reviews its long-term investment strategy and reconciles that strategy with the long-term liabilities of the pension plan. This asset-liability study produces a range of expected returns over medium and long-term time periods. Those intermediate and long-term investment projections form the basis for the expected long-term rate of return on assets.

At December 31, 2012, the estimated fair value of total pension trust assets - net by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
Assets:				
Cash and cash equivalents	$ 69	$ 367	$ —	$ 436
Broker receivables	—	689	—	689
Securities lending collateral	—	1,496	—	1,496
Equity:				
U.S. large capitalization	1,962	348	—	2,310
U.S. small-medium capitalization	747	—	—	747
International developed markets	2,567	675	—	3,242
Global developed markets	650	340	2	992
Emerging markets	518	786	—	1,304
Debt securities issued by the U.S. and U.S. government corporations and agencies	—	1,586	—	1,586
Debt securities issued by U.S. states and political subdivisions of states	—	160	—	160
Foreign government debt securities	—	351	1	352
Corporate debt securities	—	3,001	1	3,002
Residential mortgage-backed securities, including Fannie Mae and Freddie Mac	—	762	—	762
Commercial mortgage-backed securities	—	135	—	135
Emerging market debt securities	—	353	—	353
Other	1	700	—	701
Alternative investments:				
Absolute return	—	658	716	1,374
Private equity	—	—	624	624
Total assets	6,514	12,407	1,344	20,265
Liabilities:				
Broker payables	—	951	—	951
Securities lending payable	—	1,496	—	1,496
Other liabilities	33	329	—	362
Total liabilities	33	2,776	—	2,809
Fair value of pension trust assets - net	$ 6,481	$ 9,631	$ 1,344	$ 17,456

At December 31, 2012, Health Plans' and Hospitals' share of pension trust assets was 42.0%, or $7.3 billion. The remaining share of pension trust assets is for Medical Groups and a related party associated with Medical Groups.

At December 31, 2011, the estimated fair value of total pension trust assets - net by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
Assets:				
Cash and cash equivalents	$ 3	$ 610	$ —	$ 613
Broker receivables	—	1,315	—	1,315
Securities lending collateral	—	1,442	—	1,442
Equity:				
U.S. large capitalization	1,784	299	—	2,083
U.S. small-medium capitalization	895	—	—	895
International developed markets	1,527	577	—	2,104
Global developed markets	343	326	—	669
Emerging markets	217	449	—	666
Debt securities issued by the U.S. and U.S. government corporations and agencies	—	1,601	—	1,601
Debt securities issued by U.S. states and political subdivisions of states	—	140	—	140
Foreign government debt securities	—	154	—	154
Corporate debt securities	—	2,587	—	2,587
Residential mortgage-backed securities, including Fannie Mae and Freddie Mac	—	781	—	781
Commercial mortgage-backed securities	—	225	—	225
Emerging market debt securities	—	112	—	112
Other	—	529	—	529
Alternative investments:				
Absolute return	—	494	420	914
Private equity	—	—	299	299
Total assets	4,769	11,641	719	17,129
Liabilities:				
Broker payables	—	1,413	—	1,413
Securities lending payable	—	1,442	—	1,442
Other liabilities	—	427	—	427
Total liabilities	—	3,282	—	3,282
Fair value of pension trust assets - net	$ 4,769	$ 8,359	$ 719	$ 13,847

At December 31, 2011, Health Plans' and Hospitals' share of pension trust assets was 39.4%, or $5.5 billion. The remaining share of pension trust assets is for Medical Groups and a related party associated with Medical Groups.

For the year ended December 31, 2012, the reconciliation of assets with fair value measurements using significant unobservable inputs (level 3) was as follows (in millions):

	Equity securities	Debt securities	Alternative investments	Total
Beginning balance	$ —	$ —	$ 719	$ 719
Transfers into level 3	—	—	—	—
Changes related to actual return on plan assets	1	—	76	77
Purchases, sales, and settlements - net	1	2	545	548
Ending balance	$ 2	$ 2	$ 1,340	$ 1,344
Total year-to-date net gains related to assets held at December 31, 2012	$ 1	$ —	$ 76	$ 77

For the year ended December 31, 2011, the reconciliation of assets with fair value measurements using significant unobservable inputs (level 3) was as follows (in millions):

	Equity securities	Debt securities	Alternative investments	Total
Beginning balance	$ —	$ —	$ 91	$ 91
Transfers into level 3	—	—	162	162
Changes related to actual return on plan assets	—	—	15	15
Purchases, sales, and settlements - net	—	—	451	451
Ending balance	$ —	$ —	$ 719	$ 719
Total year-to-date net gains related to assets held at December 31, 2011	$ —	$ —	$ 15	$ 15

During the years ended December 31, 2012 and 2011, there were no significant transfers of assets with inputs with quoted prices in active markets for identical assets (level 1) and assets with inputs with significant other observable inputs (level 2).

The target asset allocation and expected long-term rate of return on assets ("ELTRA") for calculating pension expense were as follows:

	2012 and 2011 Target Range	2012 and 2011 ELTRA
Cash and cash equivalents	0%-3%	3.00%
Equity securities	45%-55%	9.35%
Debt securities	30%-45%	5.75%
Alternative investments	10%-20%	8.00%
Total	100%	7.75%

Alternative investments, which include absolute return and private equity, held in the pension trust are reported at net asset value as a practical expedient for fair value. Absolute return investments use advanced investment strategies, including derivatives, to generate positive long-term risk adjusted returns. Private equity investments consist of funds that make direct investments in private companies. At December 31, 2012, the trust had original commitments related to alternative investments of $1.3 billion, of which $598 million was invested, leaving $730 million of remaining commitments. At December 31, 2011, the trust had original commitments related to alternative investments of $1.0 billion, of which $297 million was invested, leaving $721 million of remaining commitments.

Absolute return and private equity investments include redemption restrictions. Absolute return investments require 10 to 90 day written notice of intent to withdraw and are often subject to the approval and capital requirements of the fund manager. Absolute return investments of $100 million are subject to a 24 month lock-up period. Private equity agreements do not include provisions for redemption. Distributions will be received as the underlying investments of the funds are liquidated, which is expected over the next 11 years.

(b) Defined Contribution Plans

Health Plans and Hospitals have defined contribution plans for eligible employees. Employer contributions and costs are based on a percentage of covered employees' eligible compensation. During 2012 and 2011, there were no required employee contributions. For the years ended December 31, 2012 and 2011, plan expense, primarily employer contributions, was $220 million and $204 million, respectively.

(c) Multi-Employer Plans

Health Plans and Hospitals participate in a number of multi-employer defined benefit pension plans under the terms of collective bargaining agreements that cover some union-represented employees. Some risks of participating in these multi-employer plans that differ from single-employer plans include:

- Assets contributed to the multi-employer plan by one employer may be used to provide benefits to employees of other participating employers.
- If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
- Employers that choose to stop participating in a multi-employer plan may be required to pay the plan an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

Health Plans' and Hospitals' participation in these plans for the annual period ended December 31, 2012 is outlined in the table below. The "EIN/PN" column provides the Employee Identification Number (EIN) and the three-digit plan number (PN), if applicable. Unless otherwise noted, the most recent Pension Protection Act (PPA) zone status available in 2012 and 2011 is for the plan's year-end in 2011 and 2010, respectively. The zone status is based on information that Health Plans and Hospitals obtained from publicly available information provided by the United States Department of Labor. Among other factors, plans in the red zone are generally less than 65% funded, plans in the yellow zone are between 65% and 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 "Health Plans' and Hospitals' Contributions to Plan Exceeded More Than 5% of Total Contributions" columns represent those plans where Health Plans and Hospitals were listed in the plans' Forms 5500 as providing more than 5 percent of the total contributions for the plan years listed. The last column lists the expiration dates of the collective bargaining agreements to which the plans are subject. There have been no significant changes that affect the comparability of 2012 and 2011 employer expense.

Pension Fund	EIN-PN	Pension Protection Act Zone Status 2012	Pension Protection Act Zone Status 2011	FIP/RP Status Pending / Implemented	(in millions) Health Plans' and Hospitals' Contributions December 31, 2012	(in millions) Health Plans' and Hospitals' Contributions December 31, 2011	Surcharge Imposed	Health Plans' and Hospitals' Contributions to Plan Exceeded More Than 5% of Total Contributions [1] 2011	Health Plans' and Hospitals' Contributions to Plan Exceeded More Than 5% of Total Contributions [1] 2010	Expiration Date of Collective Bargaining Agreement
IUOE Stationary Engineers Local 39 Pension Fund [2]	946118939 -001	Green	Green	N/A	$ 9	$ 8	No	Yes	Yes	9/17/2015
Southern California United Food and Commercial Workers Unions and Drug Employers Pension Fund [2]	516029925 -001	Red	Green	Pending	3	3	No	Yes	Yes	2/1/2014
Oregon Retail Employees Pension Trust [2]	936074377 -001	Red	Red	Implemented	3	3	Yes	Yes	Yes	9/30/2015
Other	Various	Green			20	13		No	No	Various
Other	Various	Yellow			1	0		No	No	Various
Other	Various	Red			0	8		No	No	Various
Total Expense					$ 36	$ 35				

(1) At the date the financial statements were issued, Forms 5500 were not available for plan years ended during 2012.

(2) Plan fiscal year end is December 31.

(13) Postretirement Benefits Other than Pensions

(a) Defined Benefit Plan

Certain employees may become eligible for postretirement health care and life insurance benefits while working for Health Plans and Hospitals. Benefits available to retirees, through both affiliated and unaffiliated provider networks, vary by employee group. Postretirement health care benefits available to retirees include subsidized Medicare premiums, medical and prescription drug benefits, dental benefits, and vision benefits.

During 2012, various Health Plan and Hospital postretirement and health care and life insurance benefit plans were modified for certain union-represented employees. Under the terms of these agreements, Health Plans' and Hospitals' retiree medical cost in future periods for affected participants will be based on a fixed maximum amount of employer funding toward the costs for retiree medical coverage. These agreements have been accounted for as negative plan amendments and resulted in a reduction in liability for postretirement benefits other than pension of $1.9 billion. On June 30, 2012, Health Plans' and Hospitals' postretirement health care and life insurance liability was remeasured as a result of many of these agreements, and actuarial assumptions were updated, leading to different assumptions for discount rate and health care trend rates for the six months ended June 30, 2012 versus the six months ended December 31, 2012.

At December 31, the accrued liability for postretirement benefits was as follows (in millions):

	2012	2011
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 7,101	$ 6,033
Service cost	345	315
Interest cost	340	359
Plan amendments	(1,945)	42
Benefits paid or provided	(85)	(90)
Net actuarial loss	1,549	442
Benefit obligation at end of year	$ 7,305	$ 7,101
Change in plan assets:		
Fair value of plan assets at beginning of year	$ —	$ —
Contributions	85	90
Benefits paid or provided	(85)	(90)
Fair value of plan assets at end of year	$ —	$ —
Funded status	$ (7,305)	$ (7,101)
Amounts recognized in the balance sheet consist of:		
Noncurrent assets	$ —	$ —
Current liabilities	(99)	(83)
Pension and other retirement liabilities	(7,206)	(7,018)
	$ (7,305)	$ (7,101)
Amounts recognized in net worth:		
Net actuarial loss	$ 4,123	$ 2,749
Prior service cost (credit)	(1,807)	22
Transition obligation	—	6
	$ 2,316	$ 2,777

The measurement date used to determine postretirement benefits valuations was December 31.

For the years ended December 31, postretirement benefits expense was as follows (in millions):

	2012	2011
Service cost	$ 345	$ 315
Interest cost	340	359
Amortization of prior service cost (credit)	(113)	2
Amortization of net actuarial loss	175	109
Amortization of transition obligation	3	7
Postretirement benefits expense	750	792
Other changes in plan assets and benefit obligations recognized in net worth for the years ended December 31:		
Amortization of transition obligation	(3)	(7)
Reduction in transition obligation due to plan amendment	(3)	—
Prior service cost (credit)	(1,942)	42
Amortization of prior service credit (cost)	113	(2)
Net actuarial loss	1,549	442
Amortization of net actuarial loss	(175)	(109)
Total recognized in net worth	(461)	366
Total recognized in net periodic benefit cost and net worth	$ 289	$ 1,158

During 2013, $222 million, $(217) million, and $0 million in estimated net actuarial loss, prior service credit, and transition obligation, respectively, will be amortized from net worth into postretirement benefits expense.

The unrecognized transition obligation represents the excess of the benefit obligation at January 1, 1993 over amounts previously accrued for this liability. Health Plans and Hospitals have elected to recognize the liability for the transition obligation over a twenty-year period.

During 2012 and 2011, the employer contributions and benefits paid or provided were $85 million and $90 million, respectively. During 2012 and 2011, there were no participant contributions from active employees.

Actuarial assumptions used were as follows:

	2012	2011
Weighted average discount rate for calculating postretirement benefits expense from January 1 to June 30	5.25%	6.00%
Weighted average discount rate for calculating postretirement benefits expense from July 1 to December 31	4.90%	6.00%
Weighted average discount rate for calculating December 31 accumulated postretirement benefit obligation	4.60%	5.25%

For the six months ended June 30, 2012, the assumed health care cost trend rates used to determine postretirement benefits expense were as follows:

	Basic and supplemental medical Pre-65/Post-65	Prescription drug Pre-65/Post-65	Medicare Part D	Dental	Medicare Part B premium	Medicare Part C
Initial trend rate - 2012	7.50% / 7.00%	7.50% / 7.50%	11.50%	5.00%	7.00%	1.00%
Ultimate trend rate	5.00% / 5.00%	5.00% / 5.00%	5.00%	5.00%	5.00%	5.00%
First year at ultimate trend rate	2017 / 2017	2022 / 2022	2019	2011	2017	2019

The following were the assumed health care cost trend rates used to determine the December 31, 2012 benefit obligation and postretirement benefits expense for the six months ended December 31, 2012:

	Basic medical Pre-65/Post-65	Prescription drug Pre-65/Post-65	Medicare Part D	Dental	Medicare Part A&B	Medicare Part C	Supplemental medical
Initial trend rate - 2012	7.50% / 6.75%	6.50% / 6.50%	8.10%	4.50%	6.25%	1.00%	7.50%
Initial trend rate - 2013	7.50% / 6.75%	6.50% / 6.50%	6.70%	4.50%	6.25%	4.00%	7.50%
Ultimate trend rate	4.50% / 4.50%	4.50% / 4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
First year at ultimate trend rate	2026 / 2022	2025 / 2025	2025	2012	2020	2026	2026

A 1% increase in the health care medical trend rate would increase the benefit obligation by $1.3 billion and the service cost plus interest by $139 million. A decrease of 1% in the health care medical trend rate would decrease the benefit obligation by $1.0 billion and the service cost plus interest by $106 million.

The following benefit payments, which reflect expected future service, are expected to be paid or provided (in millions):

2013	$	99
2014		116
2015		141
2016		166
2017		195
2018 - 2022		1,479

(b) Multi-Employer Plans

Health Plans and Hospitals participate in multi-employer union-administered retiree medical health and welfare plans that provide benefits to some union employees. Benefits for retirees under these plans are negotiated as part of the collective bargaining process. For the years ended December 31, 2012 and 2011, Health Plans' and Hospitals' employer expense for both current and retiree benefits was $64 million and $58 million, respectively.

(14) Physicians' Retirement Plan

Kaiser Foundation Health Plan, Inc. provides defined retirement benefits for physicians associated with certain Medical Groups. Benefits are determined based on the length of service and level of compensation of each participant. The plan is unfunded and is not subject to the Employee Retirement Income Security Act.

At December 31, the accrued liability for physicians' retirement plan was as follows (in millions):

	2012	2011
Physicians' retirement plan liability at January 1	$ 3,943	$ 3,253
Service cost	207	160
Interest cost	199	185
Net actuarial loss	497	459
Benefits paid	(122)	(114)
Physicians' retirement plan liability at December 31	$ 4,724	$ 3,943
Accumulated benefit obligation at end of year	$ 3,626	$ 2,899
Change in plan assets:		
Fair value of plan assets at the beginning of year	$ —	$ —
Actual return on plan assets	—	—
Company contributions	122	114
Benefits paid	(122)	(114)
Fair value of plan assets at end of year	$ —	$ —
Funded status	$ (4,724)	$ (3,943)
Amounts recognized in the balance sheet consist of:		
Other long-term assets	$ —	$ —
Current liabilities	(134)	(124)
Noncurrent liability	(4,590)	(3,819)
	$ (4,724)	$ (3,943)
Amounts recognized in net worth:		
Net actuarial loss	$ 1,477	$ 1,020

The measurement date used to determine physicians' retirement valuation was December 31.

A portion of the investments of Health Plans has been designated by management for the liabilities of the physicians' retirement plan. These investments are not held in trust or otherwise legally segregated and are not restricted even though it has been intended that these assets be used to pay the obligations of the physicians' retirement plan.

For purposes of the physicians' retirement plan expense, the expected return on assets is the portion of investment income that represents the expected return on the investments designated for the physicians' retirement plan. This amount is recorded as a reduction in the expense for the physicians' retirement plan

and is excluded from investment income - net, as described below and in the *Summary of Significant Accounting Policies - Investments* note.

For the years ended December 31, physicians' retirement plan provision was as follows (in millions):

	2012	2011
Service cost	$ 207	$ 160
Interest cost	199	185
Amortization of net actuarial loss	40	18
Total benefit expense	446	363
Expected return on assets - investment income included in operating expenses	(302)	(251)
Net benefit expense	144	112
Other changes in projected benefit obligations recognized in net worth		
Net actuarial loss	497	459
Amortization of net actuarial loss	(40)	(18)
Total recognized in net worth	457	441
Total recognized in net periodic benefit cost and net worth	$ 601	$ 553

During 2013, $62 million in estimated net loss will be amortized from net worth into net benefit expense.

Actuarial assumptions used were as follows:

	2012	2011
Weighted average discount rate at January 1 for calculating benefit expense	5.10%	5.70%
Weighted average discount rate for calculating December 31 benefit obligation	4.45%	5.10%
Weighted average salary scale for calculating pension expense and December 31 benefit obligation	4.90%	4.90%
Expected long-term rate of return on designated investments for calculating benefit expense	7.75%	7.75%

The following benefit payments, which reflect expected future service, are expected to be paid (in millions):

2013	$	134
2014		148
2015		166
2016		183
2017		198
2018 - 2022		1,207

(15) Commitments and Contingencies

(a) Operating Leases

Health Plans and Hospitals lease primarily office space, medical facilities, and equipment under various operating leases that expire through 2048. Certain leases contain rent escalation clauses and renewal options for additional periods.

At December 31 2012, minimum commitments under noncancelable operating leases extending beyond one year were as follows (in millions):

2013	$	295
2014		271
2015		209
2016		148
2017		108
Thereafter		310
Total	$	1,341

Minimum payments have not been reduced by minimum sublease rentals of $5 million due in the future under noncancelable subleases.

For the years ended December 31, 2012 and 2011, total operating lease expense for all operating leases was $432 million and $449 million, respectively.

(b) Purchase Commitments

Health Plans and Hospitals have entered into long-term agreements that require certain minimum purchases of goods and services. These commitments are at levels that are consistent with normal business requirements. Health Plans has committed to directing most of its purchasing volume for selected products through an outside agency and has committed to at least $1 billion in purchasing per annum through March 31, 2014. During 2012 and 2011, Health Plans' total purchases through this outside agency exceeded $1 billion. Should the $1 billion level not be achieved, financial

penalties would be assessed at an established percentage of any shortfalls. In addition, should the purchasing volume for certain product categories be redirected from the outside agency, a financial penalty would be assessed at an established percentage. In management's judgment, there is a remote probability of material financial penalties under this contract.

At December 31, 2012, minimum purchase commitments, excluding contracts that count towards the $1 billion per annum commitment noted above, extending beyond one year were as follows (in millions):

2013	$	210
2014		156
2015		74
2016		29
2017		64
Thereafter		3
Total	$	536

During 2012 and 2011, Health Plans' and Hospitals' total purchases under these contracts with minimum purchase commitments were $385 million and $256 million, respectively.

(c) Surety Instruments and Standby Letters of Credit

In the normal course of business, Health Plans and Hospitals contract to perform certain financial obligations that require a guarantee from a third party. This guarantee creates a contingent liability to the entity that provides that guarantee. At December 31, 2012 and 2011, Health Plans and Hospitals had entered into surety instruments and standby letters of credit that totaled $88 million and $80 million, respectively.

Health Plan, Inc. and Hospitals also guarantee payment of workers' compensation liabilities of certain Medical Groups under self-insurance programs. The majority of such liabilities are recorded as other long-term liabilities of Health Plan, Inc., as payment is provided for under the applicable medical service agreements. In addition to amounts accrued, at December 31, 2012 and 2011, pursuant to such guarantees, Health Plan, Inc. and Hospitals are contingently liable for approximately $160 million and $130 million of certain Medical Groups' self-insured workers' compensation liabilities, respectively.

(d) Hospital Seismic Safety Act

In 1994, the California legislature enacted Senate Bill 1953, which requires that California hospitals evaluate and upgrade acute care facilities to meet the requirements of the Hospital Seismic Safety Act of 1983. Hospitals has applied for and has been granted or believes it will be granted certain extensions to the seismic compliance deadlines under Senate Bills 449, 1661, or 90 through January 1, 2015 or January 1, 2020. Management believes that it is probable that certain planned replacement

facilities will be timely completed with extensions by January 1, 2015 or January 1, 2020, as applicable. At this time, management believes the possibility of a material impact on the operations of Health Plans and Hospitals from failure to comply with California hospital seismic safety law is remote.

Because of a highly competitive construction market, complexities of state and local planning, zoning and regulatory requirements, construction risks, and other factors, schedules for upgrading certain facilities are regularly reviewed and revised to be consistent with Hospitals' strategy and changes in legislation. A material impact on the operations of Health Plans and Hospitals could occur if an acute care facility were required to close due to failure to upgrade or conduct a planned closure in accordance with the deadlines set forth by the current legislation.

(e) Regulatory

Health Plans are required to periodically file financial statements with regulatory agencies in accordance with statutory accounting and reporting practices. Health Plans must comply with the various states' minimum regulatory net worth requirements generally under the regulation of the California Department of Managed Health Care and various state departments of insurance. Such requirements are generally based on tangible net equity or risk-based capital, and for California are calculated on the basis of combined net worth of Health Plans and Hospitals. At December 31, 2012 and 2011, the regulatory net worth, so defined, exceeded the aggregate regulatory minimum requirements by approximately $13 billion and $11 billion, respectively.

Health Plans' regulated subsidiaries maintain investments in various states where they are licensed. At both December 31, 2012 and 2011, $5 million in securities were held to satisfy various state regulatory requirements.

Health Plans and Hospitals are subject to regulation by certain state and federal agencies. Regulatory activity, whether initiated by the government or by voluntary disclosure by Health Plans and/or Hospitals, may result in changes to business practices and also may result in fines, taxes, penalties, or other sanctions. Where appropriate, reserves have been established for such sanctions. The outcome of legal and regulatory matters is inherently uncertain, however, and it is possible that one or more of the legal or regulatory matters currently pending or threatened could have a material adverse effect.

(f) Litigation

Health Plans and Hospitals are involved in various legal proceedings arising, for the most part, in the ordinary course of business operations. Such litigation proceedings include professional liability, administrative litigation, employment litigation, breach of contract, and other commercial and tort litigation, consistent with the health care industry. In addition, Health Plans indemnify the Medical Groups against various claims, including professional liability claims.

In the opinion of management, based upon current facts and circumstances, the resolution of these matters is not expected to have a material adverse effect on the combined financial position or combined results of operations of Health Plans and Hospitals. Where appropriate, reserves have been established. The outcome of litigation and other legal and regulatory matters is inherently uncertain, however, and it is possible that one or more of the legal or regulatory matters currently pending or threatened could have a material adverse effect.

(16) Subsequent Event

Health Plans and Hospitals are implementing a new claims system. In January 2013, Health Plans and Hospitals revised the implementation plan and selected new software and a software provider. Management determined that the carrying value of development work to date is not fully recoverable and therefore approximately $75 million in capitalized software and $1 million in hardware were expensed in January 2013.

KPMG LLP
Suite 1400
55 Second Street
San Francisco, CA 94105

Independent Auditors' Report on Credit Group Financial Information

The Boards of Directors
Kaiser Foundation Health Plan, Inc.
and Kaiser Foundation Hospitals:

We have audited the combined financial statements of Kaiser Foundation Health Plan, Inc. and Subsidiaries (Health Plans) and Kaiser Foundation Hospitals and Subsidiaries (Hospitals) both of which are under common management and governance, as of and for the years ended December 31, 2012 and 2011, and have issued our report thereon dated March 8, 2013 which contained an unmodified opinion on those combined financial statements. Our audits were performed for the purpose of forming an opinion on the combined financial statements of Health Plans and Hospitals as a whole. The supplementary information included in pages 52 through 54 is presented for the purposes of additional analysis and is not a required part of the combined 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 combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined 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 combined financial statements as a whole.

KPMG LLP

San Francisco, California
March 8, 2013

KAISER FOUNDATION HEALTH PLAN, INC.,
KAISER HEALTH PLAN ASSET MANAGEMENT, INC.,
KAISER FOUNDATION HOSPITALS AND
KAISER HOSPITALS ASSET MANAGEMENT, INC.
(CREDIT GROUP)[1]

Combined Balance Sheets

December 31, 2012 and December 31, 2011

(In millions)

Assets	**2012**	**2011**
Current assets:		
Cash and cash equivalents	$ 133	$ 96
Short-term investments	4,011	3,815
Securities lending collateral	1,323	1,364
Broker receivables	765	1,148
Accounts receivable - net	1,144	1,167
Due from affiliated organizations	1,053	867
Inventories and other current assets	1,051	730
Total current assets	9,480	9,187
Long-term investments	18,746	15,219
Land, buildings, equipment, and software - net	19,828	18,175
Investments in subsidiaries	814	673
Other long-term assets, including noncurrent portion of due from affiliated organizations	1,469	1,078
Total assets	$ 50,337	$ 44,332
Liabilities and Net Worth		
Current liabilities:		
Accounts payable and accrued expenses	$ 2,341	$ 1,952
Medical claims payable	1,119	1,103
Due to associated medical groups	660	664
Payroll and related charges	1,200	1,276
Securities lending payable	1,323	1,364
Broker payables	1,136	1,406
Long-term debt subject to short-term remarketing arrangements - net	1,480	1,757
Other current debt	456	15
Other current liabilities	1,327	1,326
Total current liabilities	11,042	10,863
Long-term debt, including noncurrent portion of due to affiliated organizations	7,067	5,255
Physicians' retirement plan liability	4,590	3,819
Pension and other retirement liabilities	11,514	10,150
Other long-term liabilities	1,840	1,750
Total liabilities	36,053	31,837
Net worth	14,284	12,495
Total liabilities and net worth	$ 50,337	$ 44,332

[1] Entities which are obligated to make payments under various debt and guarantee agreements.

See accompanying independent auditors' report on credit group financial information.

KAISER FOUNDATION HEALTH PLAN, INC.,
KAISER HEALTH PLAN ASSET MANAGEMENT, INC.,
KAISER FOUNDATION HOSPITALS AND
KAISER HOSPITALS ASSET MANAGEMENT, INC.
(CREDIT GROUP)[1]

Combined Statements of Operations and Changes in Net Worth

Twelve months ended December 31, 2012 and 2011

(In millions)

	2012	2011
Revenues:		
Members' dues	$ 27,050	$ 25,432
Contract revenue from Health Plans	1,647	1,645
Medicare	10,333	9,583
Copays, deductibles, fees, and other	2,948	2,995
Total operating revenues	41,978	39,655
Expenses:		
Medical services	18,960	17,696
Hospital services	13,661	13,038
Outpatient pharmacy and optical services	3,852	3,765
Other benefit costs	2,312	2,180
Total medical and hospital services	38,785	36,679
Health Plan administration	1,380	1,287
Total operating expenses	40,165	37,966
Income before equity in net income of subsidiaries	1,813	1,689
Equity in net income of subsidiaries	(66)	(44)
Operating income	1,747	1,645
Other income and expense:		
Investment income - net	1,013	499
Interest expense	(164)	(131)
Total other income and expense	849	368
Net income	2,596	2,013
Pension and other retirement liability charges	(1,482)	(2,018)
Change in net unrealized gains on investments	610	(419)
Change in restricted donations	16	—
Change in noncontrolling interest	49	31
Change in net worth	1,789	(393)
Net worth at beginning of year	12,495	12,888
Net worth at end of year	$ 14,284	$ 12,495

[1] Entities which are obligated to make payments under various debt and guarantee agreements.

See accompanying independent auditors' report on credit group financial information.

KAISER FOUNDATION HEALTH PLAN, INC.,
KAISER HEALTH PLAN ASSET MANAGEMENT, INC.,
KAISER FOUNDATION HOSPITALS AND
KAISER HOSPITALS ASSET MANAGEMENT, INC.
(CREDIT GROUP)[1]

Combined Statements of Cash Flows

Twelve months ended December 31, 2012 and 2011

(In millions)

	2012	2011
Cash flows from operating activities:		
Net income	$ 2,596	$ 2,013
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation and amortization	1,513	1,481
Gain recognized on investments - net	(715)	(462)
Loss (gain) on land, buildings, equipment, and software - net	7	20
Loss (gain) on extinguishment of debt	2	(5)
Changes in assets and liabilities:		
Accounts receivable - net	23	(337)
Due to associated medical groups	—	4
Investments in subsidiaries	(141)	445
Due from affiliated organizations	(143)	(552)
Other assets	(342)	(5)
Accounts payable and accrued expenses	270	188
Medical claims payable	16	42
Due to associated medical groups	(4)	133
Payroll and related charges	(76)	102
Pension and other retirement liabilities	352	475
Other liabilities	95	150
Net cash provided from operating activities	3,453	3,692
Cash flows from investing activities:		
Additions to land, buildings, equipment, and software	(3,074)	(3,058)
Proceeds from sales of land, buildings, and equipment	14	3
Proceeds from investments	42,797	44,165
Investment purchases	(45,195)	(45,211)
Decrease (increase) in securities lending collateral	41	(221)
Broker receivables / payables and other - net	3	59
Physicians' retirement plan liability	324	249
Increase in long-term affiliated receivable	(334)	(100)
Net cash used in investing activities	(5,424)	(4,114)
Cash flows from financing activities:		
Issuance of debt	2,300	552
Prepayment and repayment of debt	(315)	(374)
Increase (decrease) in long-term affiliated debt	(1)	39
Increase (decrease) in securities lending payable	(41)	221
Change in restricted donations	16	—
Increase in noncontrolling interest	49	31
Net cash provided from financing activities	2,008	469
Net change in cash and cash equivalents	37	47
Cash and cash equivalents at beginning of year	96	49
Cash and cash equivalents at end of year	$ 133	$ 96
Supplemental cash flows disclosure:		
Cash paid for interest - net of capitalized amounts	$ 122	$ 113

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